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ADMINISTRATIVE LAW—FEDERAL SECURITIES EXCHANGE
Stock Purchases by Insiders Possessing Material Information and Misleading Corporate Press Release Violate SEC Rule 10b-5

The Texas Gulf Sulphur Company (hereafter TGS) had been conducting exploratory surveys for mineral deposits in eastern Canada since 1957. On November 12, 1963 visual estimates of an initial drilling on land located near Timmins, Ontario revealed the presence of copper, zinc, and silver. Although the actual value of these deposits was not established to be between 150 and 250 million dollars until several months later, the company’s expert witnesses testified that at the time they had never seen or heard of a comparable initial drill hole. After learning of the drilling results, the president of TGS ordered both the drilling site to be concealed and the exploration group to keep the results confidential in order to facilitate the acquisition of surrounding land, a procedure which the trial court found to be the usual mining practice under the circumstances.

During the period from November 12, 1963 until April 16, 1964 when the results of subsequent operations at Timmins were made known to the public, seven of the defendants who had knowledge of the drillings or of the accompanying land acquisition program purchased TGS stock and calls (options to buy stock at a fixed price at or within a certain time) on the national securities exchanges, without disclosing their knowledge to the public or to the persons from whom they purchased. Among these individuals, some of whom had never purchased TGS stock or calls before, were directors and officers of TGS as well as employees without managerial status in the company. One such employee, a geologist, was said to have recommended TGS stock to friends who as “tippees” then proceeded to purchase shares for themselves during the same period. Moreover, in February, 1964 five of the defendants accepted stock options from the company without disclosing their knowledge of the Timmins discovery to the Stock Option Committee of the Board of Directors.

By Friday, April 10, 1964, the results of a fourth drill hole had established a third dimension to the mineralized zone, thus giving TGS geologists some idea of the extent of the deposit. Shortly after these findings were communicated to TGS offices in New York, the executive vice president drafted a press release designed to quell rumors about the discovery which had appeared in the New York press. The press release which appeared in New York newspapers on Monday, April 12, stated that unauthorized reports had exaggerated the scale of operations, characterized the findings as “prospects,” and indicated that further study would be required before the results would be conclusive. The
release promised that more definite statements would be issued to TGS stockholders and the public. No significant activities in TGS shares resulted from the issuance of the statement.

Meanwhile, an article reporting a 10 million ton ore strike was approved for publication in a Canadian mining journal on April 16. A similar statement was given to the Ontario Minister of Mines for release on the 15th. The statement was not distributed in Canada, however, until the morning of April 16 shortly before a detailed report of a 25 million ton discovery was released to the American press at 10 A.M. During this latter period the secretary of TGS ordered further purchases of TGS stock. On the 16th a director left the press conference after it had ended and called his son-in-law, a stockbroker, who then purchased shares for the family trust and his customers before the news appeared over the Dow Jones broad tape at 10:54 A.M. That day TGS stock closed at 363⁄₄ in comparison to 293⁄₄ on the previous day. One month later, it sold at 583⁄₄.

Shortly thereafter the Securities and Exchange Commission began disciplinary proceedings in a federal district court against the individual defendants and TGS alleging violation of section 10(b) of the Securities Exchange Act of 1934, and rule 10b-5, promulgated thereunder, as grounds for injunctive relief to:

(1) Restrain the individual defendants from (a) making further purchases of TGS stock without disclosing material information which had not been made available to the public, and (b) from disclosing such information to other persons not associated with TGS so that they might act on it;

(2) Compel the individual defendants to offer recission to those persons from whom they had purchased shares;

(3) Compel the individual defendants to make restitution to those persons who had sold shares to outsiders with information which had been disclosed to them by the defendants; and

(4) Restrain the corporate defendant from issuing any further materially false and misleading press releases to the public.¹

Judge Bonsal of the Southern District of New York dismissed the complaint against TGS and ten of the twelve individual defendants who appeared. Relying on expert testimony that "one drill core does not establish an ore body, much less a mine," the Court found that purchases of TGS stock prior to April 9, 1964 were not violative of section 10(b) since drilling results did not constitute material information until that time. Only the two defendants who had purchased stock between the 9th and the morning of the 16th were adjudged to have

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violated the Act. The issuance of the press release during this latter period, however, was held not to be unlawful because there had been no showing that the corporation or the individual defendants had sought to benefit from the release and because the statement was not shown to be "misleading or deceptive on the basis of the facts then known" to the drafters. On appeal by the SEC and the two defendants who were held to have violated the Act, the parties stipulated to defer the question of remedies to be applied pending a final determination of liability.\(^2\) SEC v. Texas Gulf Co., 401 F.2d 833 (2d Cir. 1968).

An important part of the Securities and Exchange Commission's role as federal watchdog over the national exchanges is the prevention of fraudulent acts and practices. In addition to the specific prohibition of misrepresentation and deception in connection with the use of a prospectus or registration statement\(^4\) and the broad proscription of fraudulent offers and sales of securities in interstate commerce,\(^5\) one of the more flexible administrative weapons available to the SEC is Rule 10b-5\(^6\) promulgated pursuant to the Commission's rulemaking power under section 10(b) of the Securities Exchange Act of 1934.\(^7\) Borrowing from the language of the general fraud provisions in section 17 of the 1933 Act, the rule provides that it shall be unlawful for any person\(^8\) to employ manipulative or deceptive devices in connection with the purchase or sale of any security by means of the mails, interstate commerce, or the facilities of the national securities exchanges. Specifically proscribed are (1) the employment of devices, schemes, or artifices to defraud, (2) the misrepresentation of material facts or the omission of material facts which make statements misleading, or (3) the engaging in practices which operate, or which would operate, as a fraud or deceit on any person.

The Commission's purpose in promulgating the rule in 1942 appears to have been to close a serious "loophole" in the protections against fraud under the 1933 and 1934 Acts.\(^9\) Prior to that time neither the statutes nor the Commission's rules proscribing fraud covered the purchase of securities by persons other than brokers and dealers in the over-the-counter markets.\(^10\) Section 17(a) of the 1933 Act applied only to fraudulent sales.\(^11\) Section 15(c) of the 1934 Act applied to purchases and sales by brokers and dealers but only

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10. 3 L. Loss, Securities Regulation 1424-1428 (2d ed. 1961).
in the over-the-counter market. Consequently, one of the more common situations, in which officers, directors, principal shareholders, or the corporate issuer itself purchased securities on the exchanges without disclosing inside information relevant to the true value of the securities traded, did not in itself give rise to liability under the federal acts. Furthermore, while the defrauded buyer was afforded a civil remedy in connection with transactions effected by the misrepresentations and omissions of the seller, a person who sold securities on the market in transactions which did not involve misleading or defective registration statements and prospectuses, or explicitly prohibited market manipulations, was compelled to turn to state law for relief since the federal acts failed to provide him with a remedy.

In most state courts, however, recovery against corporate insiders was impeded by the limited scope of liability for common law misrepresentation. In accordance with the idea that there could be no tortious liability for nonfeasance, officers and directors who dealt in their corporation’s securities were responsible only for having made outright misrepresentations and half truths or for having actively concealed material facts. By the majority view, insiders were not liable for nondisclosure of facts absent some fiduciary relationship involving an affirmative duty of disclosure. The theory that mere silence should not generally constitute a breach of duty persisted in transactions on the stock exchanges where nondisclosure is the usual practice. Prior to the enactment of the federal securities legislation, however, federal courts attempted to mitigate the common law rule by finding some special duty to speak. The Supreme Court conceded that although the ordinary relations between a director and shareholder do not create a duty of disclosure as to the value of shares before the director’s purchase from the shareholder, “yet there

13. Section 16(b) of the 1934 Act, however, provides that directors, officers, and the owners of more than 10 per cent of any class of stock shall be liable to the corporate issuer for profits realized from any purchase and sale, or any sale and purchase, of their corporation’s securities within any period of less than six months. Securities Exchange Act § 16(b), 48 Stat. 896 (1934), 15 U.S.C. § 78p(b) (1964).
15. Carpenter v. Danforth, 52 Barb. 581, 584 (1861) (officers and directors were held to have an affirmative duty of disclosure to the corporation and to stockholders in dealings undertaken on behalf of the corporation). Cf. Prosser, Law of Torts § 101 (3d ed. 1964) and Restatement of Torts § 551 (1938).
are cases where, by reason of the special facts [unknown to the seller], such a duty exists." The injured party, however, still faced the problem of ascertaining which circumstances constituted "special facts."

Shortly after the promulgation of Rule 10b-5 the Commission indicated that the failure of a corporation and its insiders to disclose information surrounding the actual state of corporate earnings and a plan to liquidate the corporation was violative of the Rule and that rescission of their purchases ought to be made to the seller. Realizing the inadequacy of administrative and criminal sanctions, federal courts quickly recognized that the "existence of a remedy is implicit under general principles of the law." The success of suits brought under Rule 10b-5 in situations where on substantially the same facts the seller failed to recover on a theory of common law deceit indicated that the federal rule would raise fewer obstacles than had the common law with regard to the requirement of materiality, scienter, reliance, and proof of actual damage.

Although critics point to an unwarranted disregard of congressional and administrative intent by the courts, much of the judicial discussion concerns the extent to which the rule incorporates the elements of common law fraud. Although no language touching on scienter, reliance, or causation is included in the statute, section 10(b) has been construed to require at least some showing of a "proper relationship" among the minimum elements necessary for a cause of action under the rule, namely the use of the mails or instrumentalities of interstate commerce, a purchase or sale of a security, and the use of a manipulative or deceptive device.

Early decisions spoke of a duty of insiders to disclose facts "... coming to their knowledge by reason of their position, which would materially affect the judgment of the other party to the transaction." Couched in these terms,

19. Kardon v. Nat'l Gypsum Co., 73 F. Supp. 798, 803 (E.D. Pa. 1947), modified, 83 F. Supp. 613 (E.D. Pa. 1947). See Restatement of Torts § 286 (1934) (a civil cause of action arises under a violation of statute where plaintiff is within the class of persons whom the statute was intended to protect and the interest invaded was one which the statute was intended to protect.).
20. In Speed v. Transamerica Corp. a minority shareholder recovered from a controlling shareholder who had purchased shares at less than true value without disclosing any material facts. 99 F. Supp. 808 (D. Del. 1951), 135 F. Supp. 176 (D. Del. 1955), modified on other grounds, 235 F.2d 369 (3d Cir. 1956). But see Geller v. Transamerica Corp. where under Kentucky law an officer or director was held to be under no obligation to volunteer information. 53 F. Supp. 625, 630 (D. Del. 1943), aff'd per curiam, 151 F.2d 534 (3d Cir. 1945).
the requirement of materiality would seem to be closely associated with the actual, subjective state of the seller's mind and the concept of reliance in common law misrepresentation. Later cases, however, differentiate between the two concepts. Materiality has come to mean that a duty of disclosure will arise only where there exist those significant facts "... about a corporation's business which in reasonable and objective contemplation might affect the value of the corporation's stock or securities and which the insiders should reasonably believe are unknown to the outsider."

This standard coincides with the position that materiality requires that a reasonable man would attach importance to the fact misrepresented while reliance requires that the plaintiff himself have attached importance to the same fact. Consequently, no liability under Rule 10b-5 attaches to transactions where the undisclosed information has only possible rather than probable market consequences, or where the possibility of some corporate action known only to the insider is too remote to have influenced a reasonable investor.

The materiality-reliance dichotomy is significant in situations where there has been no misstatement of fact made and actual reliance becomes a difficult matter of proof since plaintiff knows only of the insider's silence. In cases of the complete nondisclosure of facts relevant to the value of securities traded, liability need not be based on implied representation. In face-to-face transactions not executed on the exchanges, liability has been said to rest on a disjunctive construction of the rule insofar as under the third clause of the rule alone the insider's silence constitutes an "act, practice, or course of business which operates or would operate as a fraud or deceit" on the plaintiff. The affirmative duty to speak arises from the statutory attempt to equalize the bargaining position between the insider and all other investors.

Moreover, proof of the plaintiff's reliance alone may not be a true indication that the insider's conduct was the proximate cause of his injury where factors other than the defendant's conduct may have influenced the course of market prices when plaintiff traded in the market. Nevertheless, a violation of a federal securities statute does not give rise to a private remedy absent some causal relationship between the alleged violation and the injury claimed. In common law deceit, reliance is the concept used to establish this causal connec-

tion insofar as the injured party's "justifiable reliance upon the misrepresentations is a substantial factor in determining the course of conduct which results in his loss."\textsuperscript{33} In the case of nondisclosure, although a plaintiff need not prove that he actively relied on the defendant's silence, "the proper test is whether the plaintiff would have been influenced to act differently than he did if the defendant had disclosed to him the undisclosed fact."\textsuperscript{34}

Assuming that the injured seller has relied upon conduct violative of 10b-5, there remains the question as to the extent he should recover against the insider-purchaser whose presence in the market was unknown to him and whose purchases did not involve any of the shares sold by the injured party. Conceivably, this particular seller has relied on the insider's conduct as much as the seller whose shares actually found their way into the insider's hands. To limit the class of potential plaintiffs to those persons whose shares were actually transferred to insiders, an early decision required that there be at least "a semblance of privity between the vendor and purchaser."\textsuperscript{35} Later cases, however, made it clear that the absence of privity of contract is not fatal to the plaintiff's case. Instead, courts have restricted the scope of the insider's duty in terms of reliance. Where a partial disclosure of material facts has been made, a purchaser-plaintiff, for example, need only allege that "... he has purchased the shares from whatever source, relying upon the misleading statements, and that through such purchase has suffered damage."\textsuperscript{36} Indeed, the erosion of privity under 10b-5 has progressed to a point such that only the plaintiff need have engaged in a purchase or sale. Recovery is fully possible against non-trading third parties whose unlawful conduct has caused the injured party to buy or sell.\textsuperscript{37}

That the plaintiff must be at least a buyer or seller in an action for damages seems to be the general rule despite continuing attempts to broaden the scope of section 10(b) to include liability for the fraudulent management of corporate affairs as well as liability for fraudulent practices associated with the purchase or sale of securities.\textsuperscript{38} Plaintiff need not be a seller in actions for injunctive relief on the grounds that such suits largely avoid the issues of proof of loss and causation which are present in claims for damages.\textsuperscript{39} A recent opinion\textsuperscript{40} which has been cited in the Second Circuit as the basis for permitting a

\begin{itemize}
\item 33. Restatement of Torts § 546 (1938). See Prosser \textit{supra} note 15 at § 103.
\item 34. See List v. Fashion Park 340 F.2d 457, 463 (2d Cir. 1964).
\item 38. See, e.g., Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952).
\end{itemize}
non-trading plaintiff to maintain an action for damages\textsuperscript{41} expressly left the question open by refusing to pass on the Commission's argument that plaintiff need only establish that the rule has been violated and that his stock lost value as a result in order to recover.

Although facts amounting to deception must be alleged to make out a prima facie case, the deception need not be restricted in any common law sense.\textsuperscript{42} The absence of any language in the rule requiring intentional conduct, and broad readings of the rule in the Sixth, Seventh, and Ninth Circuits have indicated that proof of scienter or "...knowledge of the falsity or misleading character of a statement and a bad faith intent to mislead or misrepresent are not required to prove violation of the statute upon which a civil remedy for damages will lie."\textsuperscript{43} On the other hand, problems of scienter do arise in actions by defrauded \textit{purchasers} under section 10(b) where unlike sections 11 and 12 of the 1933 Act, nothing in the way of procedural requirements is set forth. Section 12, which expressly provides for actions by defrauded buyers, requires that the plaintiff-buyer sustain the burden of proof that the seller did not reasonably believe his statements to be true.\textsuperscript{44} For this reason the Second and Ninth Circuits, for example, require that the buyer make an averment of scienter in his complaint under section 10(b) lest the buyer's action under that section nullify the limitation made applicable by Congress to section 12.\textsuperscript{45}

Unlike all private actions, however, administrative and judicial proceedings brought by the SEC under section 21\textsuperscript{46} of the 1934 Act are not hindered by the absence of proof of actual injury to investors \textsuperscript{47} where "the aim of administrative proceedings under Rule 10b-5 is to deter misconduct by insiders, rather than to compensate their victims."\textsuperscript{48} Nor is the SEC limited to obtaining the injunctive relief for defrauded investors which is specifically authorized by statute. Under their broad equitable powers the federal courts may "order an accounting and restitution ... and provide such other equitable relief as might be necessary to protect the public interest and effectuate the statutory purpose."\textsuperscript{49}

Accordingly, the Commission has sought to extend the scope of liability


\textsuperscript{42} O'Neill v. Maytag, 339 F.2d 764, 768 (2d Cir. 1964).


\textsuperscript{47} Berko v. SEC, 316 F.2d 137, 143 (2d Cir. 1963).

\textsuperscript{48} See List v. Fashion Park 340 F.2d 457, 463 (2d Cir. 1964).

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under the rule to reach conduct which is not technically sufficient to sustain a common law action for fraud and deceit. Foreshadowing many of the issues in the instant case the Commission itself has made it clear that silence on the part of any person who trades on the exchange does not preclude liability under the rule regardless of whether or not he is a traditional insider within the meaning of section 16(b) of the 1934 Act.50 Rather, the duty of disclosure has been held to rest upon "the existence of a relationship giving access . . . to information intended to be available only for a corporate purpose . . . and the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing."51

Relying on this rationale, the Court of Appeals in the instant case reversed the dismissal of the complaint against eight of the eleven individual defendants who knew of the facts surrounding the initial operations at Timmins. Accordingly, the trial court's judgment against the two defendants who traded after April 9, 1964 was affirmed. Only one of the defendants who had traded prior to the issuance of the official announcement on April 16 was held not to have purchased his stock on the basis of material inside information surrounding the work at Timmins. The fact that certain defendants were not traditional insiders was of no consequence where these persons were in possession of material inside information which must be disclosed to the investing public before these individuals could trade in the securities of their employer. Their duty to refrain from disclosure by reason of corporate secrecy surrounding the discovery did not justify their silence where the defendants could have stayed out of the market until the corporation itself had revealed the strike to the public.52

Although the possessor of inside information is not always precluded from trading on the basis of his special knowledge, market activity without disclosure is forbidden in those extraordinary situations "which are reasonably certain to have a substantial effect on the market price of the security"53 if the basic facts surrounding the situation are disclosed. The materiality of the information is not diminished by the fact that only the speculative investor would rely on it. Rejecting the trial court's test of whether a conservative trader would have used the defendants' knowledge, Judge Waterman, writing for the Court, concluded that the results of the first drilling were not so remote as to be immaterial if the knowledge of the possibility of the existence of a mine was a fact to which a reasonable, if speculative, investor would have attached importance.54

51. Cady, Roberts and Co., 40 SEC 907, 912 (1961). See Ross v. Licht where the court, pointing to a "relationship giving access," indicated that tippees (outsiders who trade in reliance on information provided them by insiders) violate the rule although the relationship among the defendants is such that liability in any event could be predicated on the aiding and abetting of a violation, 263 F. Supp. 395, 410 (S.D.N.Y. 1967).
52. SEC v. Texas Gulf Sulphur, 401 F.2d 833, 848 (2d Cir. 1968).
53. Id. 830. According to Judge Waterman, the insider must balance "both the indicated probability that the event will occur and the anticipated magnitude of the event in the light of the totality of the company activity," id. at 849.
54. Id. 830.
Consequently, all who traded on the basis of the initial drilling results before April 17, 1964 were held to have engaged in a deceptive practice in violation of section 10(b) and its rule. Likewise, those defendants who disclosed their material knowledge to outsiders in order that they might also trade had violated section 10(b) by their "tipping."\(^5\) Nor was the surrender of stock options by those who had accepted them without disclosing their knowledge of the Timmins discovery a satisfaction of the Commission's claim for their recision where the surrender was made only after proceedings had been commenced against the defendants, and the issuance of injunctions might be necessary to prevent future violations of the rule in this manner.\(^6\)

As for the defendants who had traded just before and after the official announcement of April 16, liability could not be avoided on the grounds that the news had already been effectively disclosed in the Canadian news media or by the mere issuance of a statement to the American press.\(^7\) Nor did the honest belief of those particular defendants that sufficient disclosure had been made prior to placing their orders preclude liability. An insider's good faith is no defense to an action for equitable relief under 10b-5 since a liberal interpretation of the regulatory provisions indicates that negligent conduct is unlawful. In accordance with previous decisions in the Second Circuit,\(^8\) however, the Court was careful to point out that its holding was consistent with the requirement that some form of scienter "... whether it be termed lack of diligence, constructive fraud, or negligent conduct, remains implicit..." in the rule.\(^9\) Freedom from liability at least requires that the defendants' belief be reasonable under the circumstances.\(^10\)

And, in view of the fact that one of the more significant purposes of the federal securities legislation was the prevention of the circulation of improper information by the issuer itself,\(^11\) the company could not be held to a less rigorous standard of care in the issuance of the press release on April 12, 1964.\(^12\) Rejecting the trial court's reasoning that no cause of action against TGS had

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55. Id. 852.
56. Since the SEC did not appeal the dismissal of the complaint against two defendants whom the trial court held not to be part of "top management" and thus without a duty of disclosure to the Stock Option Committee, the Court of Appeals made no finding as to the scope of liability in regard to the acceptance of the options; id. at 857; see also supra note 24.
57. Adequate disclosure to the investing public, said the majority, meant that the defendants should have at least awaited the announcement's appearance over the "media of widest circulation, the Dow Jones broad tape ..." Id. 854.
58. See discussion accompanying supra note 45. The Court also relies on its discussion of sections 11 and 17 of the 1933 Act in Barnes v. Osajsky, 373 F.2d 269 (2d Cir. 1967).
60. Id. 856.
61. Id. 858-59. See also Judge Friendly's concurring opinion at 868.
62. With respect to the press release Judge Waterman wrote: "Accordingly, we hold that Rule 10b-5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public, e.g. by means of the financial media, ... if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes," id. at 862.
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been established since the press release had not been given out "in connection with the purchase or sale of any security," Judge Waterman pointed out that, unlike other sections of the securities acts, no language within section 10(b) specifically required the defendant's participation as a condition to liability. In Waterman's view, legislative history indicates that the section was intended as a catchall clause to enable the SEC to deal with new forms of manipulative devices.64

That the corporation's liability should not turn on the existence of the specific intent to derive a direct benefit is evidenced by the Court's statement that "... the investing public may be injured as much by one's misleading statement ... caused by negligence as by a misleading statement published intentionally to further a wrongful purpose."65 As in the case of the insider conduct discussed above, however, the corporation's due diligence in seeking out the whole truth and disseminating the same in good faith would preclude liability even though the statement is found to be materially false or misleading.66

Accordingly, the finding of the trial court that the press release was not misleading on the basis of facts known to its drafters at the time it was issued was not sufficient where the proper test was "whether the reasonable investor, in the exercise of due care, would have been misled by it."67 Nor was the finding that the drafters had used "reasonable business judgment under the circumstances" satisfactory where the trial court ought to have determined whether the drafters had exercised due diligence.68 Without having to decide whether the lack of due diligence alone, absent proof of bad faith, would sustain an action for damages against the corporation, the Court reversed the dismissal of the complaint against the company and remanded to the district court. The district court was instructed to determine whether the press release was in fact misleading to a reasonable investor and whether the statement was issued by reason of the corporation's failure to use due diligence under the circumstances. If both issues were resolved affirmatively, the district court might then, in its discretion, enjoin the company from distributing further deceptive information to the public.69

The instant case seems to have judicially established on firm ground the holding of Cady, Roberts70 that an insider's silence in connection with purchases on the securities exchanges can be as damning as the utterance of outright falsehoods and half-truths. The majority opinion lays to rest speculation that the

63. See, e.g., sections 12(2) and 17(a) of the 1933 Securities Act, and section 15(c)(1) of the 1934 Securities Act.
64. Id. at 859 citing the testimony of proponents of section 10(b). Hearings Before House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 115 (1934).
65. Id. 860.
66. Id. 862.
67. Id. 863.
68. Id.
69. Id.
rule of Cady, Roberts could be explained away as a special duty to which only brokers and dealers were subject. Consequently, the holding of Goodwin v. Agassiz, a classic common law case in the area which bears a remarkable similarity to the factual situation in the instant case, appears to have been rejected by the Court as no longer applicable to the commercial world. Rather, the conclusion seems to be that the reluctance on the part of some individuals to seek corporate office because of the unavailability of insider profits is not too high a price to pay for the integrity of the market. Admittedly, the ordinary investor's knowledge and judgment is unlikely to be equal to that of the corporate official who is trading in his company's securities. Yet, the requirement of full disclosure seems appropriate where the trader has access to information which he should reasonably know would substantially distort the market risks of other investors. Because so many legitimate fringe benefits are available to corporate employees in the form of stock option programs, retirement plans, etc., the imposition of liability for the misuse of corporate information seems just and proper.

If mere silence can be unlawful, however, trial courts in the future will be faced with the difficult problem of determining which facts ought to have been disclosed. It was the factual problem of ascertaining when a reasonable investor could have believed that the Timmins discovery was more than just a "prospect" which most disturbed the dissenting judges. Likewise, the majority of the Court, with the exception of Judges Friendly and Kaufman, seemed reluctant to deal with the question of whether the corporate press release of April 12 was in fact misleading to a reasonable investor. Indeed, the majority’s reversal of the district court’s holding was greatly facilitated by the trial court’s attempt to limit the insider’s duty to reasonable, but conservative traders. If the district court had refrained from elaborating on the rule of law which had been set fourth in List v. Fashion Park, the majority undoubtedly would have found their job more difficult when compelled to deal with factual considerations alone. Consequently, it can be fairly said that the instant case has greatly enlarged the category of potentially unlawful corporate and insider conduct by means of a broad “reasonable man” standard while at the same time greatly limiting the predictability of the outcome of 10b-5 actions by making factual considerations controlling. Furthermore, the difficulties to be encountered by the courts in ascertaining materiality under the standard are arguably small in comparison with the problem presented to corporate officials who may no longer rely on their own personal notions of what constitutes deceptive information.

73. List v. Fashion Park, 340 F.2d 457, 462 (2d Cir. 1964). See Ruder, supra note 22 at 887 (Professor Ruder saw the district court's fixing of April 9 as the date when the information became material as a reflection of "the court's desire to eliminate liability for certain defendants rather than its firm judgment as to the time at which the facts actually became material." He looked on the opinion as an "exercise in judicial discretion" undertaken for the protection of those defendants whose conduct was not deliberate.).
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As the dissenting opinion correctly points out, however, the nondisclosure of corporate information has not previously given rise to liability under rule 10b-5 unless the defendant has engaged in a securities transaction or has actively induced the injured party to buy or sell. On the basis of precedent, therefore, one might argue that the company ought not to be reprimanded for the issuance of the press release absent some corporate purpose to benefit directly from subsequent market activity. On the other hand, as Judge Friendly observes in his concurring opinion, the fact that one of the more significant purposes of the federal securities legislation was the prevention of the circulation of improper information by the issuer itself should be sufficient to permit the SEC to deal with corporate statements which, like those in the instant case, carry so much potential for harm. Again, as in the case of insider conduct, the Commission is not seeking to compel the company to disclose information which for legitimate business reasons was to be kept secret. Rather, the administrative purpose seems to be only that management use reasonable care in drafting future releases. The exercise of due diligence under the circumstances by insiders and issuers, therefore, will provide some protection although it seems clear that in the market, as in corporate dealings generally, the business judgment rule will not preclude liability where negligence is clearly established.

Moreover, it seems unlikely that the federal courts will retreat from this position to require a higher degree of fault under 10b-5 in view of the liberal interpretation given by the Supreme Court to the federal securities laws in general. By analogy to the language in section 206(2) of the Investment Advisors Act failure to establish an intent to deceive and the lack of good faith should not prevent liability from arising under rule 10b-5 at least in proceedings brought by the Commission. In considering section 206, Justice Goldberg cautioned that the 1940 Act was to be construed "like other securities legislation 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purposes." In situations involving nondisclosure, the defendant's intent should not be material, said Justice Goldberg, because...

it is the practice itself . . . with its potential for abuse, which 'operates as a fraud or deceit' within the meaning of the Act when relevant information is suppressed. . . . Failure to disclose material facts must be deemed fraud or deceit within its intended meaning, for, as the experience of the 1920's and 1930's amply reveals, the darkness and ignorance of commercial secrecy are the conditions upon which predatory practices best thrive.

74. SEC v. Texas Gulf Sulphur 401 F.2d 833, 868 (2d Cir. 1968).
75. Id. 863.
79. Id. at 200. Cf. SEC v. Van Horn which construes the language of section 17 of
With Justice Goldberg's remarks in mind, therefore, the Court of Appeals' holding in the instant case seems proper (despite the closeness of the decision as to the company in terms of factual considerations) when viewed in the light of the Commission's broad obligation to seek out any fraudulent practice which would impair the maintenance of fair and honest markets. And, even if the courts were to limit civil liability for damages under the rule to conduct which falls just short of the activities in the instant case, the deterrent purposes of actions brought by the SEC under section 10(b) more than justify the reasoning of the majority in an area where an ounce of prevention is truly worth a pound of cure.

GERALD TONER

CONSTITUTIONAL LAW—1866 CIVIL RIGHTS ACT HELD CONSTITUTIONAL UNDER THE THIRTEENTH AMENDMENT

The Alfred H. Mayer Company refused to sell a new home to Joseph Lee Jones solely because Jones was a Negro. The home was constructed as part of the Paddock Woods housing development near St. Louis, Missouri, a housing development that will ultimately be a suburban community of approximately one thousand people. Because he was denied the right to purchase the property solely on the basis of his race, Jones brought an action in a federal district court against the developers for damages and injunctive relief. He based his complaint upon 42 U.S.C. section 1982, asserting that this provision prohibits private discrimination in the sale of real property. Alternatively, he argued that defendant's action violated the equal protection clause of the fourteenth amendment since the state was actively involved in the housing development. The defendants moved for a dismissal on the grounds that 42 U.S.C. section 1982 was enacted pursuant to the fourteenth amendment, and therefore is applicable only where there is action by the state; and that the facts alleged did not constitute such state action. The district court, holding for the defendants, the 1933 Act as to not require proof of scienter in an action under that section, 371 F.2d 181, 185 (7th Cir. 1966).

1. 42 U.S.C. § 1982 (1965) provides:
   All citizens of the United States shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property.
   Plaintiffs also claimed that defendants violated other federal statutes, acts, and orders, but these claims were not determinative in the final disposition of the case.

2. The defendants, acting in corporate form, were licensed by the state and were protected by state zoning, banking, and lending laws. Approval by a county building commissioner was required, and other state and county regulations and services were involved. Also, the plaintiffs claimed that the defendants themselves fell under the meaning of the equal protection clause since they exercised the power of municipal government by providing and maintaining streets, recreation facilities, garbage collection, and other such services.