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# Superintendent of Insurance v. Bankers Life and Casualty Co.: Supreme Court Expansion of Rule 10b-5

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section 16(b) is in order.<sup>48</sup> Such is the suggestion of the Court.<sup>49</sup> The amendment could clearly state what standard is to be used to carry out the statutory purpose. There would also be a clear expression of congressional intent in situations similar to *Reliance Electric*, giving the Congress an opportunity to impose liability for such profits or affirm the position of the Supreme Court.

Dudley W. Murrey

### ***Superintendent of Insurance v. Bankers Life and Casualty Co.*: Supreme Court Expansion of Rule 10b-5**

Bankers Life and Casualty Company, one of the respondents and owner of Manhattan Casualty Company, agreed to sell all of Manhattan's stock to Begole for \$5,000,000. Begole, conspiring with Bourne and others, conceived a plan to purchase Manhattan's stock with Manhattan's own assets. The conspirators arranged through Garvin, Bantel, a note brokerage firm, to have a \$5,000,000 check issued to them by Irving Trust Company, although they had no funds on deposit with the bank at the time. Manhattan then sold its treasury bonds to realize the \$5,000,000 necessary to cover the check.<sup>1</sup> Irving Trust then issued a second \$5,000,000 check to Manhattan, which Manhattan in turn negotiated to Belgian American Trust, through Sweeney as president of Manhattan (Sweeney having been installed in that office by the conspirators). Belgian American gave Manhattan a certificate of deposit in return. Sweeney endorsed the certificate of deposit to New England Note, which was controlled by Bourne. Bourne endorsed the certificate of deposit to Belgian American Banking in return for a \$5,000,000 loan to New England Note. The proceeds of this note were sent to Irving Trust to cover the second check. As a result, Manhattan was left with neither assets nor treasury bonds, Begole with all of Manhattan's stock, and Belgian American Banking with a \$5,000,000 deposit. The Superintendent of Insurance of the State of New York, representing Manhattan as receiver, alleged a fraud in the sale of Manhattan's treasury

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<sup>48</sup> It has been suggested that there is the possibility of liability for the profits realized on the trading of inside information (as is the case here) under rule 10b-5 of the Securities and Exchange Commission. 2 A. BROMBERG, *SECURITIES LAW: FRAUD*, § 12.4 (1971); Lowenfels, *supra* note 12, at 61. There is the possibility of problems of proof inherent in the use of rule 10b-5 which will limit the effectiveness of this rule in the regulation of the profits gained under a plan such as Emerson used. As the Court admits, there are situations where no use of inside information is made while an honest profit is realized. In such a case there would be no point of application for rule 10b-5, which is based on the fraudulent use of material inside information. However, *Reliance Electric* does join in that trend of judicial thought that would narrow the applicability of § 16(b), while broadening that of rule 10b-5. Profits retained as in Emerson's transaction may now be reached most effectively through rule 10b-5, although only where there are fraudulent dealings.

<sup>49</sup> 404 U.S. at 425.

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<sup>1</sup> Manhattan sold its United States Treasury Bonds for \$4,854,552.67. The amount from the sale of the bonds plus the necessary cash to total \$5,000,000 was then credited to Manhattan's account at Irving Trust and the \$5,000,000 Irving Trust check was charged against it.

bonds<sup>2</sup> in violation of certain provisions of the Securities Act of 1933<sup>3</sup> and the Securities Exchange Act of 1934.<sup>4</sup> The federal district court dismissed the action for failure to state a federal cause of action.<sup>5</sup> The Second Circuit affirmed.<sup>6</sup> *Held, reversed and remanded*: Securities Exchange Act section 10(b) and rule 10b-5 must be read flexibly, not technically and restrictively; therefore, this scheme of financing the sale of securities may be classified as a fraud in connection with the sale of securities, since the corporation must be protected against deceptive devices which deprive the corporation of compensation for the sale of its securities. *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1972).

### I. SECTION 10(b) AND RULE 10b-5

Section 10(b) and rule 10b-5, adopted by the Securities and Exchange Commission, prohibit fraudulent securities transactions, and a violation of this section or rule has been held by the courts to give a defrauded party to a securities transaction a private civil cause of action.<sup>7</sup> Section 10(b) lays down a sweeping injunction against fraud, leaving it up to the SEC to define that term. The section makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . ."<sup>8</sup>

In accordance with this power to define, the SEC has adopted rule 10b-5, which provides that "[i]t shall be unlawful for any person . . . (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact . . . or (c) [t]o 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."<sup>9</sup>

These provisions constitute an attempt on the part of Congress and the SEC to outlaw fraud in the purchase or sale of securities in the most pervasive language possible. Courts have repeatedly stated that the common-law concept

<sup>2</sup> Manhattan's board of directors was allegedly deceived into authorizing the sale by the misrepresentation that the proceeds would be exchanged for a certificate of deposit of equal value.

<sup>3</sup> Securities Act of 1933, 15 U.S.C. § 77q(a) (1970).

<sup>4</sup> Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970).

<sup>5</sup> *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 300 F. Supp. 1083 (S.D.N.Y. 1969).

<sup>6</sup> *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 430 F.2d 355 (2d Cir. 1970).

<sup>7</sup> The implication of this private civil cause of action based on a violation of § 10(b) originated in the case of *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). See also *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964); *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951). As stated in *Shell v. Hensley*, 430 F.2d 819, 827 (5th Cir. 1970):

When a person who is dealing with a corporation in a securities transaction denies the corporation's directors access to material information known to him, the corporation is disabled from availing itself of an informed judgment on the part of the board regarding the merits of the transaction. In this situation the private right of action recognized under Rule 10b-5 is available as a remedy for the corporate disability.

See Comment, *Private Remedies Available Under Rule 10b-5*, 20 Sw. L.J. 620 (1966).

<sup>8</sup> Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1970).

<sup>9</sup> 17 C.F.R. § 240.10b-5 (Supp. 1972). There must also be some contact with interstate commerce. *Id.*

of fraud has no bearing on the definition of fraud under section 10(b) or rule 10b-5.<sup>10</sup> Consequently, actions under these provisions have been popular with plaintiffs who might have been substantially hampered by the technicalities of common-law fraud. Moreover, actions under section 10(b) and rule 10b-5 are often advantageous to plaintiffs bringing shareholder derivative suits who might have been blocked procedurally by short statutes of limitations, security-for-expense requirements, or other state procedural requirements.<sup>11</sup>

Under the authority of section 10(b), the "catch-all" clause<sup>12</sup> of the Exchange Act, the SEC promulgated rule 10b-5 to render unlawful all fraudulent schemes in connection with the purchase or sale of any security. Since *Kardon v. National Gypsum Co.*<sup>13</sup> the courts have inferred private rights of action for violations of the rule, and have broadly construed section 10(b) and rule 10b-5 to impose few restrictions on the defrauded claimant. Furthermore, the Supreme Court has stated that the securities laws should be construed "not technically or restrictively, but flexibly to effectuate . . . [their] remedial purposes."<sup>14</sup> Public and private corporations,<sup>15</sup> purchasers and sellers,<sup>16</sup> corporate insiders,<sup>17</sup> and corporate outsiders<sup>18</sup> have all been held to fall within the scope of section 10(b) and rule 10b-5. As a result of this vast growth of private rights, certain doctrines have been enunciated by the federal courts which purport to limit the class of plaintiffs who have standing to sue under section 10(b) and rule 10b-5.<sup>19</sup>

## II. JUDICIAL INTERPRETATION OF THE "IN CONNECTION WITH" REQUIREMENT

Every 10(b) and 10b-5 lawsuit must initially overcome an important bar-

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<sup>10</sup> *Berko v. SEC*, 316 F.2d 137 (2d Cir. 1963); *Norris & Hirschberg v. SEC*, 177 F.2d 228 (D.C. Cir. 1948); *Charles Hughes & Co. v. SEC*, 139 F.2d 434 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1944). The Supreme Court, in dealing with the meaning of fraud under the Investment Advisors Act of 1940, stated that it could not find that:

Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit' intended to require proof of intent to injure and actual injury to clients.

. . . There has also been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and that, accordingly, the doctrines must be adapted to the merchandise in issue.

*SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-94 (1963).

<sup>11</sup> In actions under rule 10b-5, federal courts do not apply any security-for-expenses requirements but do apply the state statute of limitations. See *McClure v. Borne Chem. Co.*, 292 F.2d 824 (3d Cir. 1961); *Klein v. Spear, Leeds & Kellogg*, 306 F. Supp. 743 (S.D.N.Y. 1969).

<sup>12</sup> See *Hearings on H.R. 7852 and H.R. 8720 Before the Subcomm. on Stock Exchange Regulation of the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934) (testimony of Mr. Thomas G. Corcoran), quoted in A. BROMBERG, *SECURITIES LAW: FRAUD—SEC RULE 10b-5*, § 2.2(332), at 22.4 (1971).

<sup>13</sup> 69 F. Supp. 512 (E.D. Pa. 1946); see note 7 *supra*.

<sup>14</sup> *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

<sup>15</sup> *Schine v. Schine*, 250 F. Supp. 822 (S.D.N.Y. 1966).

<sup>16</sup> *Studebaker Corp. v. Allied Prods. Corp.*, 256 F. Supp. 173 (W.D. Mich. 1966).

<sup>17</sup> *Ruckle v. Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964).

<sup>18</sup> *United States v. Re*, 336 F.2d 306 (2d Cir.), *cert. denied*, 379 U.S. 904 (1964).

<sup>19</sup> Five such limitations are discussed in *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 543-44 (2d Cir. 1967).

rier in the requirement of both section 10(b) and rule 10b-5 that the statement, act, or device must have occurred in connection with the purchase or sale of any security. Litigation over the scope of the "in connection with" requirement has usually arisen in situations involving the standing of the plaintiff to sue under section 10(b) and rule 10b-5. Generally, the "in connection with" requirement has been liberally construed by the courts.<sup>20</sup>

This restriction was first enunciated in *Birnbaum v. Newport Steel Corp.*<sup>21</sup> In *Birnbaum* minority shareholders of Newport brought a derivative suit on behalf of the corporation, and a class action as representatives of all similarly situated shareholders under rule 10b-5. The complaint alleged that the president and controlling stockholder of Newport had sold his controlling interest at a substantial premium while rejecting a merger which would have been highly profitable to Newport shareholders. The plaintiffs contended that such actions constituted fraudulent practices in connection with the purchase or sale of securities within the meaning of section 10(b) and rule 10b-5. Judge Learned Hand, speaking for the Second Circuit, dismissed the action and held that section 10(b) "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller."<sup>22</sup>

In effect, the *Birnbaum* doctrine consists of two elements. First, a plaintiff has no standing to sue unless he has been defrauded in connection with his purchase or sale of securities. Second, corporate wrongdoings are not cognizable under rule 10b-5 unless they are of the type "usually associated with the purchase or sale of securities" rather than fraudulent mismanagement of corporate affairs.<sup>23</sup> As late as 1964, in *O'Neill v. Maytag*,<sup>24</sup> a federal court, in reaffirming the principles in *Birnbaum*, was reluctant to permit relief under rule 10b-5 when the alleged breach of duty resembled a breach of general corporate fiduciary duties more than a deception perpetrated on shareholders.<sup>25</sup>

Following the *O'Neill* decision, a trend toward liberalization of the coverage of the "in connection with" restriction began. The trend resulted in a pro-

<sup>20</sup> See, e.g., *Vine v. Beneficial Fin. Co.*, 252 F. Supp. 212, 214 (S.D.N.Y. 1966).

<sup>21</sup> 193 F.2d 461 (2d Cir. 1952), cert. denied, 343 U.S. 956 (1952).

<sup>22</sup> *Id.* at 464.

<sup>23</sup> *Id.*

<sup>24</sup> 339 F.2d 764 (2d Cir. 1964).

<sup>25</sup> The action was a shareholder's derivative suit for alleged violation of the Securities Exchange Act and the Federal Aviation Act, 49 U.S.C. §§ 1301-1542 (1970), arising out of an air carrier's purchase of its own securities. In a 2-to-1 decision, the Second Circuit held that plaintiff had not stated a claim cognizable under § 10(b) and rule 10b-5 because no deception had been perpetrated by the defendants:

Between principal and agent and among corporate officers, directors, and shareholders, state law has created duties which exist independently of the sale of stock. . . . The question posed by this case is whether it is sufficient for an action under Rule 10b-5 to allege a breach of one of these general fiduciary duties where the breach does not involve deception. We think it is not. At least where the duty allegedly breached is only the general duty existing among corporate officers, directors and shareholders, no cause of action is stated under Rule 10b-5 unless there is an allegation of facts amounting to deception.

339 F.2d at 767-68.

scription of all fraudulent activity in connection with a securities transaction, not only fraudulent activity usually associated with the purchase or sale of securities. The enlargement of the section 10(b) and rule 10b-5 coverage beyond the usual and commonplace fraudulent securities transactions was illustrated in *A.T. Brod & Co. v. Perlow*.<sup>26</sup> In *Brod* a stockbroker brought a 10b-5 action against one of his customers who allegedly intended to pay for ordered securities only if the price went up by the settlement date. The Second Circuit described the district court's restriction of 10b-5 coverage to "fraud usually associated with the sale or purchase of securities" and relating to the investment value of the securities as "much too narrow."<sup>27</sup> The court said that rule 10b-5 was designed to "prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud or present a unique form of deception."<sup>28</sup> The court further stated that "[n]ovel or atypical methods should not provide immunity from the securities laws."<sup>29</sup> Thus, *Brod* represents a departure from *Birnbaum* in that rule 10b-5 was held to include all fraudulent activity rather than merely fraudulent schemes of the type usually associated with securities transactions.<sup>30</sup>

Since *Brod*, the federal courts have continued to expand the scope of section 10(b) and rule 10b-5. Generally, the decisions can be categorized within two areas of corporate misdeeds cognizable under the provisions: "(1) deceptions and misrepresentations; and (2) fraudulent mismanagement of the corporation by its directors when the mismanagement involves a purchase or sale of securities by the corporation."<sup>31</sup>

The "in connection with" clause has usually been construed in a broad manner whenever materially misleading statements or deceptive insider activities have been discovered.<sup>32</sup> In *SEC v. Texas Gulf Sulphur Co.*<sup>33</sup> directors had purchased company stock on the basis of material inside information, and then issued deceptive press releases to the public. The court, in determining whether there had been a 10b-5 violation, concluded that the purpose of the 1934 Act indicated the necessity of a broad interpretation of the rule.<sup>34</sup> The court found that the "in connection with" phrase was intended to cover a device "of a sort that would cause reasonable investors to rely thereon, and in connection therewith, so relying, cause them to purchase or sell the corporation's securities."<sup>35</sup> Moreover, the court reasoned that the scope of the rule must be assessed

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<sup>26</sup> 375 F.2d 393 (2d Cir. 1967).

<sup>27</sup> *Id.* at 396.

<sup>28</sup> *Id.* at 397.

<sup>29</sup> *Id.*

<sup>30</sup> In *Glickman v. Schweickart & Co.*, 242 F. Supp. 670, 674 (S.D.N.Y. 1965), the court similarly held that rule 10b-5 was not limited to misrepresentations relating to the subject matter of the purchase but also included misrepresentations concerning the means of financing the purchase.

<sup>31</sup> See Comment, *S.E.C. Rule 10b-5—"In Connection With the Purchase or Sale of Any Security" Restriction: Need for Analytical Precision*, 5 COLUM. J. LAW & SOC. PROB., No. 2, Aug. 1969, at 28, 32.

<sup>32</sup> *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965); *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964).

<sup>33</sup> 401 F.2d 833 (2d Cir. 1968).

<sup>34</sup> *Id.* at 859-60.

<sup>35</sup> *Id.* at 860.

in light of the purposes of the legislation from which it was derived, *i.e.*, "to promote free and open public securities markets and to protect the investing public from suffering inequities in trading."<sup>36</sup>

In *Heit v. Weitzen*<sup>37</sup> the court referred to the principles enunciated in *Texas Gulf Sulphur*, and stated:

There is no necessity for contemporaneous trading in securities by insiders or by the corporation itself. Rule 10b-5 is violated whenever assertions are made . . . in a manner reasonably calculated to influence the investing public . . . if such assertions are [so] false or misleading . . . as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes.<sup>38</sup>

Thus, it appears that any person, including a corporation, may be held to have used a deceptive device in connection with a securities transaction, regardless of his intent, if the device or contrivance is of a sort that may reasonably be relied upon by the investing public.<sup>39</sup>

The second aspect of the "in connection with" litigation involves the question of whether an action for a fiduciary breach can be brought under section 10(b) and rule 10b-5. This question relates to the dictum of *Birnbaum* that action which is merely "fraudulent mismanagement of corporate affairs" is not actionable under the antifraud provisions of the securities laws.<sup>40</sup>

Later case law, exemplified by *O'Neill v. Maytag*,<sup>41</sup> had limited the coverage of rule 10b-5 to situations in which there was an actual deception of the board of directors by officers or other directors. A fiduciary breach, standing alone, without the presence of an actual deception, was not considered a violation of rule 10b-5.<sup>42</sup> *McClure v. Borne Chemical Co.*,<sup>43</sup> on the other hand, articulated the broadest use of the provisions as general remedies for breaches of fiduciary duties. In the Third Circuit's view, section 10(b) "imposes broad fiduciary duties on management vis-à-vis the corporation and its individual stockholders . . . . Section 10(b) provides stockholders with a potent weapon for the enforcement of many fiduciary duties."<sup>44</sup> *McClure's* sweeping interpretation of section 10(b) and rule 10b-5 as a virtually unlimited federal remedy for breaches of fiduciary obligations has not, however, met with unqualified judicial acceptance.

In *Ruckle v. Roto American Corp.*<sup>45</sup> a minority director was allowed to

<sup>36</sup> *Id.* at 858.

<sup>37</sup> 402 F.2d 909 (2d Cir. 1968).

<sup>38</sup> *Id.* at 913, quoting in part from *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860-61 (2d Cir. 1968) (en banc).

<sup>39</sup> See *Heit v. Weitzen*, 402 F.2d 909 (2d Cir. 1968). See also *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965), in which the court stated that fraudulent misrepresentations which induced an investor to defer the sale of securities, resulting in loss, were "in connection with" the sale of securities under § 10(b) and rule 10b-5; *Goodman v. H. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967), in which the fraudulent acts of certain securities brokers, including the false representations that they were buying and selling securities on behalf of plaintiff investors, were held to be "in connection with" the sales and purchases of securities within the meaning of § 10(b) and rule 10b-5.

<sup>40</sup> See note 21 *supra*, and accompanying text.

<sup>41</sup> 339 F.2d 764 (2d Cir. 1964).

<sup>42</sup> See note 23 *supra*, and accompanying text.

<sup>43</sup> 292 F.2d 824 (3d Cir. 1961).

<sup>44</sup> *Id.* at 834.

<sup>45</sup> 339 F.2d 24 (2d Cir. 1964).

bring a derivative action under rule 10b-5 against the majority directors. It was alleged that the board was deceived by the withholding of the latest financial statement, and, as a result of the deception, issued to the president a sufficient number of shares to permit him to maintain his control. The court refused to dismiss the suit, holding that rule 10b-5 is available when a corporation is actually defrauded into issuing securities.<sup>46</sup> In *Schoenbaum v. Firstbrook*<sup>47</sup> the Second Circuit permitted a derivative suit for a company's sale of securities at an inadequate price to persons exercising a controlling influence over it, holding that the directors were guilty of deceiving the stockholders. The court relied on dicta in *Ruckle*, stating that a majority or even the entire board of directors may be held to have defrauded their corporation.

Thus, the great weight of authority is that a cause of action under section 10(b) and rule 10b-5 is not limited to those frauds usually associated with the purchase or sale of securities, but can be used to police all fraudulent schemes in connection with a securities transaction regardless of how unique or uncommon the fraud or deception might be. Under this expanded concept of coverage, section 10(b) and rule 10b-5 are increasingly available to attack breaches of fiduciary duties involving fraud or deception in connection with securities transactions.

### III. SUPERINTENDENT OF INSURANCE V. BANKERS LIFE & CASUALTY CO.

In considering the scope of the "in connection with" requirement, the Supreme Court, in *Superintendent of Insurance v. Bankers Life & Casualty Co.*,<sup>48</sup> faced a section 10(b) and rule 10b-5 problem for only the second time.<sup>49</sup> The appellants claimed that a majority of the board of directors was deceived by misrepresentations of other members of the board and some of the defendants, and, therefore, believed that the corporation itself would receive the proceeds from the sale of the bonds. On the basis of the fraudulent representations, the board was induced to authorize the sale of the bonds in exchange for a certificate of deposit without value to the corporation.

The respondent, Bankers Life, contended that the opinions in *Texas Gulf Sulphur*<sup>50</sup> and *Heit v. Weitzen*<sup>51</sup> precluded recovery under section 10(b). Specifically, Bankers Life relied on the language in *Texas Gulf Sulphur* which limited the scope of the section to the purpose of the legislation, which the court found to be "to promote free and open public securities markets and to protect the investing public."<sup>52</sup> The court in *Texas Gulf Sulphur* also restricted the scope of the "in connection with" requirement to only that sort of device upon which reasonable investors would rely.<sup>53</sup> Drawing on this

<sup>46</sup> *Id.* at 28.

<sup>47</sup> 405 F.2d 215 (2d Cir. 1968) (en banc).

<sup>48</sup> 404 U.S. 6 (1971).

<sup>49</sup> In its first confrontation with § 10(b) and rule 10b-5, the Supreme Court considered only the scope of the words "purchase or sale" in the context of merger situations. The Court found that a merger involves a purchase and sale, and that § 10b-5 may apply to a proxy solicitation. *SEC v. National Secs., Inc.*, 393 U.S. 453 (1969).

<sup>50</sup> *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc); see notes 33-36 *supra*, and accompanying text.

<sup>51</sup> 402 F.2d 909 (2d Cir. 1968).

<sup>52</sup> *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 858 (2d Cir. 1968) (en banc).

<sup>53</sup> *Id.* at 860.

language, the respondents contended that the fraud in no way affected either the securities markets or the investing public, and, thus, was not actionable under section 10(b).

The Supreme Court found that although one of the purposes of section 10(b) was the "preservation of the integrity of the securities market," the scope of the section was not limited to that purpose. Drawing upon language from the *Capital Gains* case,<sup>54</sup> the Court broadly construed the scope of section 10(b) and rule 10b-5 and the "in connection with" requirement and stated that "Section 10(b) must be read flexibly, not technically and restrictively."<sup>55</sup> In reaching its conclusion, the Court looked through the myriad of lower federal court decisions to the congressionally intended scope of the Securities Exchange Act as enunciated by Congress in 1934. Specifically, the Court drew on two statements from the congressional report: (1) "disregard of trust relationships by those whom the law should regard as fiduciaries are all a single seamless web" along with manipulations, investor's ignorance, and the like;<sup>56</sup> and (2) in the securities field "where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers" in the regulatory agency "have been found practically essential."<sup>57</sup> Under such a flexible reading of section 10(b) the Court found that there was a sale of a security, and since fraud was used in connection with the securities transaction, the action was cognizable under section 10(b). The heart of the case was that "Manhattan suffered an injury as a result of deceptive practices touching on its sale of securities."<sup>58</sup>

The Court then paid lip service to the *Birnbaum* dictum<sup>59</sup> that section 10(b) was not intended to encompass transactions which comprise no more than internal corporate mismanagement, but, in essence, so restricted this thought that it is meaningless. Again, the Court did not rely on case law but looked instead to the congressional intent. The Court stated that by section 10(b) Congress intended to bar deceptive devices and contrivances in the purchase or sale of securities "whether conducted in the organized markets or face-to-face."<sup>60</sup> By stating that disregard of trust relationships by fiduciaries and manipulation are all a "single seamless web," the Court was essentially combining the concepts of fiduciary breach of duties and securities fraud. The Court further stated that the controlling stockholder owes the corporation a fiduciary obligation—one "designed for the protection of the entire community of interests in the corporation—creditors as well as stockholders."<sup>61</sup> Although

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<sup>54</sup> SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

<sup>55</sup> 404 U.S. at 12.

<sup>56</sup> *Hearings on H.R. 1383*, *supra* note 12, at 6.

<sup>57</sup> *Id.* at 7.

<sup>58</sup> 404 U.S. at 12-13. When a person who is dealing with a corporation in a securities transaction denies the corporation's directors access to material information known to him, the corporation is disabled from availing itself of an informed judgment on the part of its board regarding the merits of the transaction. In this situation the private right of action recognized under rule 10b-5 is available as a remedy for the corporate disability. *Shell v. Hensley*, 430 F.2d 819, 827 (5th Cir. 1970). See also note 7 *supra*, and accompanying text.

<sup>59</sup> See notes 21-25 *supra*, and accompanying text; 404 U.S. at 9.

<sup>60</sup> *Id.* at 12.

<sup>61</sup> *Id.*, citing *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939).

it did not expressly so state, it may be reasonably inferred that the Court was saying that fiduciary breaches of duties were cognizable under section 10(b) if in connection with the purchase or sale of securities. Since the respondent owed Manhattan a fiduciary duty, and breached that fiduciary obligation by virtue of a fraud in connection with a securities transaction, a cause of action existed under section 10(b).

Thus, the Court appears to be making a strong move to open up section 10(b) and rule 10b-5 to include what has traditionally been an area of state law. However, the Court's opinion is cryptic in that the Court in several instances strongly hints that fiduciary breaches are actionable under the section and the rule, but never expressly says whether this result is intended. It appears that it would have been preferable for the Court to make a definite move, and then define within what limits fiduciary breaches in connection with securities transactions may be brought under the provisions.

#### IV. CONCLUSION

The *Bankers Life* decision is noteworthy in historical perspective in that the Court does not retreat from the broad application of section 10(b) and rule 10b-5 previously adopted by lower courts. The opinion is significant in that the Court went back to the congressional intent in enacting the Securities Exchange Act of 1934 to avoid some of the restrictions that the lower courts had placed on the section. The Court broadly construed the "in connection with" requirement and seems to have somewhat weakened the concept that fiduciary breaches are not actionable under the provisions. Thus, it appears that the Court, in moving strongly to open up section 10(b) and rule 10b-5, has adopted a broad interpretation of the provisions that will affect many everyday transactions.

The opinion, however, is far from satisfactory. Although a reasonable analogy supports the inference that the Supreme Court intends that fiduciary breaches of duties in connection with securities transactions are within the proscription of section 10(b) and rule 10b-5, the Court never concretely states its opinion. Rather, the Court hinted strongly that such actions are actionable under the provisions. Further, the Court did not give adequate consideration to the various factors and situations in bringing a suit for a fiduciary breach under the provisions of the section and the rule. Perhaps in an attempt to provide simple rules for judging 10(b) and 10b-5 cases, the Court has been guilty of oversimplification, establishing flexible standards for judging the scope of the provisions while compounding the litigation potentialities by speaking in generalities and failing to set definitive bounds.

On the other hand, the Supreme Court's consideration of this vast problem area, which has heretofore been reviewed by the Court only once, may imply that in the near future additional cases concerning section 10(b) and rule 10b-5 may be heard. In this sense, the decision represents a tempered judicial broadening of section 10(b) and rule 10b-5 which will require further judicial interpretation.

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