

3-1-1986

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Stock Market Manipulation and Corporate Control Transactions*

NORMAN S. POSER**

The definition of manipulation has recently become a live issue in the context of mergers, tender offers, and going private transactions. In responding to allegations of manipulative management tactics, courts have sometimes stretched the concept of manipulation in order to find a violation of section 14(e) or section 10(b) of the Securities and Exchange Act of 1934. In the recent case of Schreiber v. Burlington Northern, Inc., the Supreme Court held that there can be no manipulation without misrepresentation or nondisclosure. The author shows that this is consistent with the antimanipulative provisions of the Exchange Act. He also explores the nature of the deception and the intent that is needed to prove manipulation.

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** Professor of Law, Brooklyn Law School. I thank my research assistant, Melissa M. Johnson, for her invaluable assistance in bringing this Article to the point at which it could be published; and my previous research assistants, Carol Mayer and Jacqueline Shaevitz, for assisting with the underlying research. I also thank my colleague Professor Arthur Pinto for his comments and suggestions. I am solely responsible, however, for the views expressed in this Article. Finally, I thank Brooklyn Law School for its assistance with a Summer Research Stipend.

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I. INTRODUCTION

It may seem surprising that, more than fifty years after the inception of federal securities regulation, the meaning of so basic a concept as manipulation should require clarification. The eradication of manipulation was, after all, one of the main purposes of the Securities Exchange Act of 1934 ("Exchange Act"),¹ and Congress designed several of its provisions to accomplish this result.² Yet the Act nowhere defines the term "manipulation" or "manipulative."

For many years, the absence of a definition did not seem to create major interpretive problems.³ By and large, courts, regulators, and commentators agreed on what was meant by manipulation.⁴ In recent years, however, the question of the meaning and scope of manipulation has become a subject of sharp controversy. The issue has usually arisen in the context of mergers;⁵ tender offers;⁶ going private transactions;⁷ and, more generally, other situations involving possible shifts in or reinforcement of corporate control.⁸ Transactions of these kinds

1. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1982) [hereinafter cited as Exchange Act]; see Exchange Act § 2, 15 U.S.C. § 78b.

2. See Exchange Act § 9, 15 U.S.C. § 78i; Exchange Act § 10(b), 15 U.S.C. § 78j(b); Exchange Act § 13(e), 15 U.S.C. § 78m(e); Exchange Act § 14(e), 15 U.S.C. § 78n(e); Exchange Act § 15(c)(1), 15 U.S.C. § 78o(c)(1); Exchange Act § 15(c)(2), 15 U.S.C. § 78o(c)(2).

3. It does not appear that a single article dealing with stock market manipulation appeared in any major law review between 1952 and 1981.

4. According to a 1934 study, manipulation means "planned effort by an individual or group of individuals to make the market price of a security behave in some manner in which it would not behave if left to adjust itself to uncontrolled or uninspired supply and demand." TWENTIETH CENTURY FUND, *THE SECURITY MARKETS* 444 (A. Bernheim & M. Schneider eds. 1935) [hereinafter cited as TWENTIETH CENTURY FUND].

5. See, e.g., *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975).

6. See, e.g., *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970). For a definition of the term "tender offer," see *infra* note 174.

7. See, e.g., *Shivers v. Amerco*, 670 F.2d 826 (9th Cir. 1982). A "going private" transaction is typically one in which controlling persons of a publicly owned company convert the company into a privately owned one. See SEC Rule 13e-3, 17 C.F.R. § 240.13e-3 (1985).

8. See, e.g., *Nash v. Farmers New World Life Ins. Co.*, 570 F.2d 558 (6th Cir.), *cert. denied*, 439 U.S. 822 (1978) (claim by minority shareholders that the acquisition of 95% of the outstanding shares by a controlling shareholder by means of a tender offer was manipulative because it "destroyed the market" for the corporation's shares).

are referred to collectively in this Article as "corporate control transactions."

In several recently decided cases, a shareholder of a company that was the target of a hostile tender offer,⁹ or the tender offeror itself,¹⁰ has challenged the defensive tactics used by the target company's management, claiming that these tactics constitute manipulative activities prohibited by section 10(b) or 14(e). The question raised in several of these cases has been: whether fully and accurately disclosed actions can constitute manipulation? Or, put another way: is deception an essential element of manipulation?

Schreiber v. Burlington Northern, Inc.,¹¹ decided by the Supreme Court of the United States near the end of its 1984 Term, provides an answer to this question. In *Schreiber*, the Court held that "manipulative" conduct under section 14(e)¹² of the Exchange Act¹³ necessarily includes a misrepresentation or nondisclosure. The decision makes clear that if the management of a target company fully and accurately discloses its actions to deter or defeat a hostile tender offer, then its actions are not illegal under section 14(e).¹⁴ Furthermore, the Court held that it is not within the province of the federal courts to rule on the fairness of the actions of participants in tender offers. So long as these activities are disclosed, it is for the market to determine whether a tender offer will be successful, subject to applicable requirements of

9. See, e.g., *Panther v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), cert. denied, 454 U.S. 1092 (1981).

10. See, e.g., *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

11. 105 S. Ct. 2458 (1985).

12. Exchange Act, 15 U.S.C. § 78n(e).

13. *Id.*

14. Section 14(e) forbids not only "manipulative," but also "fraudulent" or "deceptive" acts or practices, in connection with any tender offer; in *Schreiber*, the Supreme Court held that all three words connote deception. "All three species of misconduct . . . are directed at failures to disclose." *Schreiber*, 105 S. Ct. at 2462. See *infra* text accompanying notes 64-70.

The *Schreiber* case itself did not involve management's defensive tactics against a hostile tender offer, but rather allegedly collusive arrangements between a tender offeror and management of a target company, to the detriment of the target's shareholders. See *infra* text accompanying notes 41-46. The full text of section 14(e) is as follows:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

Exchange Act, 15 U.S.C. § 78n(e).

state corporate law.¹⁵

Schreiber thus has an important potential impact on contested tender offers. The decision, however, has even broader implications. In *Schreiber*, the Court took the occasion to reaffirm its earlier statements in *Ernst & Ernst v. Hochfelder*¹⁶ and *Santa Fe Industries, Inc. v. Green*¹⁷ that the term "manipulative" as used in section 10(b)¹⁸ of the Exchange Act, which, as implemented by Securities Exchange Commission Rule 10b-5 ("Rule 10b-5"),¹⁹ outlaws manipulative conduct in connection with any purchase or sale of a security,²⁰ should likewise be interpreted to require misrepresentation or other deceptive conduct.²¹

Nonetheless, *Schreiber* deals with only one aspect of manipulation—the requirement that there be deception. Even there, the decision does not concern itself with the nature of the requisite deception. Furthermore, the *Schreiber* Court did not deal with the question of the intent or purpose that is necessary to prove a case of manipulation, let alone provide a comprehensive definition of the term "manipulative." These are matters that this Article will address.

This Article does not, however, purport to be a general article on

15. *Schreiber*, 105 S. Ct. at 2444. On the question of the application of state corporate law in tender offer situations, see *infra* text accompanying notes 24-26 and note 77.

16. 425 U.S. 185 (1976).

17. 430 U.S. 462 (1977).

18. Exchange Act, 15 U.S.C. § 78j(b).

19. 17 C.F.R. § 240.10b-5 (1985).

20. The full text of section 10(b) is as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails, or of any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Exchange Act, 15 U.S.C. § 78j(b). The full text of Rule 10b-5 is as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in 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.

17 C.F.R. § 240.10b-5 (1985).

21. *Schreiber*, 105 S. Ct. at 2462.

the subject of stock market manipulation. That subject is comprehensively covered by Professor Loss in his incomparable treatise,²² and in addition there are several law review articles which, although now quite old, provide excellent discussions of the antimanipulative provisions of the Exchange Act.²³ The purpose of this Article is rather to study the application of the antimanipulative provisions of the Exchange Act to corporate control transactions, in order to understand the concept of manipulation in this important modern context. To do this, however, it is necessary not only to revisit briefly the legislative history of the Exchange Act and its more recent annex, the Williams Act, but also to look at what the term "manipulation" meant before 1934.

One of the premises of this Article is that the concept of manipulation derives not only from the common law but also from practices that were common in the securities markets of the nineteenth and early twentieth centuries, and that the undefined word "manipulative" that appears in sections 10(b) and 14(e) of the Exchange Act is informed by these practices. Only against the background of actual conduct in the pre-1934 securities markets can one properly understand the antimanipulative provisions of the Exchange Act. It is clear from this background that a corporate control transaction is manipulative if deception is used as an integral part of a scheme, one of whose objects is to affect the market price of a security. If the elements of deception and manipulative intent are present, the fact that the ultimate goal of the scheme is to achieve or maintain corporate control does not prevent the transaction from being manipulative.

Immediately following this introduction, Part II will examine *Schreiber* and its background. Part III will explore the meaning of "manipulation" under the common law and, more broadly, as the financial community prior to 1934 understood the term. Part IV will discuss the antimanipulative provisions of the Exchange Act and their legislative history. Finally, Part V presents an analysis of the issues of deception and intent in light of recent federal court decisions in corporate control situations.

II. THE *SCHREIBER* DECISION AND ITS BACKGROUND

To a large degree, the use of the antimanipulative provisions of

22. 3 L. LOSS, *SECURITIES REGULATION* 1529-70 (2d ed. 1961).

23. See Berle, *Stock Market Manipulation*, 38 COLUM. L. REV. 393 (1938); Note, *Manipulation of the Stock Markets Under the Securities Laws*, 99 U. PA. L. REV. 651 (1951); Note, *Regulation of Stock Market Manipulation*, 56 YALE L.J. 509 (1947); Comment, *Market Manipulation and the Securities Exchange Act*, 46 YALE L.J. 624 (1937).

the federal securities laws as a basis for challenging management's defensive tactics is a direct result of the inadequacy of state corporate law, as interpreted by the courts, to protect the interests of shareholders.²⁴ In several cases involving a contest for corporate control, the principal thrust of the plaintiff's claim has been that actions by members of management were designed to further their own interests, for the purpose of retaining control of the corporation, or of benefiting themselves in other ways, in violation of their fiduciary duty to the corporation and its shareholders.²⁵ Traditionally such charges are within the province of state law. Plaintiffs in these cases, however, have not generally fared well. The judicially created "business judgment rule," which holds that a court will not review actions of directors on behalf of the corporation if these actions can be supported by a rational business purpose, has often foreclosed relief under state corporate law. To overcome the business judgment rule, the person challenging the transaction has the burden of proving that the directors acted solely or primarily for the purpose of retaining control.²⁶

Faced with the difficulty of successfully challenging directors' actions under state law, plaintiffs in situations of this kind have turned to the federal securities laws. If the target company, however, has complied with the disclosure and substantive requirements of the Williams Act (the sections of the Exchange Act, adopted in 1968 and amended in 1970, which regulate tender offers, corporate repurchases, and certain related matters)²⁷ and has not engaged in any other deceptive conduct, then the only provisions of federal law that might be the basis for a lawsuit are the prohibitions against stock price manipulation contained in sections 9(a), 10(b), and 14(e) of the Exchange

24. For a general critique of the corporate law of Delaware, see Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974).

25. In *Panter v. Marshall Field & Co.*, a divided panel of the Seventh Circuit Court of Appeals held that under the law of Illinois, plaintiffs, who were shareholders of Marshall Field & Co., failed to provide the evidence of self-dealing, fraud, overreaching, or other bad conduct necessary to show a breach of the directors' fiduciary duties when they employed defensive tactics to fend off possible takeovers. 686 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). The majority relied heavily on the "business judgment rule" and attached particular significance to the fact that Marshall Field had a majority of independent directors. *Id.* at 295-99. See *infra* text accompanying note 26; see also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

26. See *Gearhart Indus., Inc. v. Smith Int'l, Inc.*, 741 F.2d 707 (5th Cir. 1984); *Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Johnson v. Trueblood*, 629 F.2d 287 (3d Cir.), *cert. denied*, 450 U.S. 999 (1981); *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

27. Exchange Act § 13(d), 15 U.S.C. § 78m(d); Exchange Act § 13(e), 15 U.S.C. § 78m(e); Exchange Act § 14(d), 15 U.S.C. § 78n(d); Exchange Act § 14(e), 15 U.S.C. § 78n(e); Exchange Act § 14(f), 15 U.S.C. § 78n(f).

Act.²⁸

Charging management of a company that is defending itself from a hostile tender offer with manipulation is a plausible litigation strategy. Because manipulation is usually considered to involve an "artificial" influence on the market price of a stock,²⁹ any action which may affect the outcome of a tender offer might conceivably be manipulative, as it is likely to have an impact on the price of the target company's stock.³⁰ Indeed, the crucial importance of the market price of the target company's stock in a contested tender offer creates a strong inducement to employ manipulative acts.³¹

In 1981, in *Mobil Corp. v. Marathon Oil Co.*,³² the Sixth Circuit Court of Appeals held that a target company's defensive tactic against a takeover was a "manipulative act or practice," in violation of section 14(e), although the action taken was fully disclosed and did not contain any element of deception. A company whose shares were the subject of a tender offer had given options to a third company to purchase the target company's most valuable asset and newly issued shares of the target. The options were exercisable in the event of a change of control of the target not approved by its management. The court held that these "lock-up options," though fully disclosed and nondeceptive, were manipulative because they "artificially and significantly discouraged competitive bidding" for the target company's stock.³³

Mobil touched off a spirited controversy in the law reviews on the

28. See *infra* text accompanying notes 177-241, 245-46, 256-66.

29. "So long as the investor's motive . . . is not to create an artificial demand for, or supply of, the security, illegal market manipulation is not established." *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 383 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973), *reh'g denied*, 430 U.S. 976 (1976).

30. Manipulation in connection with contests for corporate control is not new. For a description of how in 1881 entrepreneur Jay Gould employed a variety of manipulative devices to drive down the price of the stock of the Manhattan Elevated Railway Company in order to acquire control of the company at a reduced price, see M. JOSEPHSON, *THE ROBBER BARONS* 209-12 (1934).

31. See, e.g., *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970) (Where the target company's management effected both heavy open-market purchases and secret off-market sales on the last day of a tender offer to make the market price of the stock equal or exceed the tender offer price and thus discourage shareholders from tendering their shares, the Second Circuit held that these activities were manipulative and deceptive, in violation of section 9(a)(2) of the Act.). For further discussion of the case, see *infra* text accompanying notes 355-56.

32. 669 F.2d 366 (6th Cir. 1981).

33. *Id.* at 376. Cf. *Biechele v. Cedar Point, Inc.*, 747 F.2d 209, 213-14 (6th Cir. 1984) (distinguishing *Mobil's* "lock-up options" from this case's "add-on agreement," under which a buyer of stock would receive additional compensation from the seller under certain circumstances, and holding the latter not to be a manipulative device).

question of whether deception was an essential element of manipulation under the federal securities laws.³⁴ If it were not, then corporate management's complex and ingenious methods to thwart the plans of potential or actual raiders might be proscribed as manipulative, in violation of section 14(e) and perhaps 10(b). Certainly the "shark repellents,"³⁵ "poison pills,"³⁶ and other devices that management has used to deter or defeat takeover attempts are as artificially discouraging to competitive bidding for corporate control as were the lock-up options used in *Mobil*. No other circuit, however, has followed the Sixth Circuit's broad view of manipulation as articulated in *Mobil*. In addition the Second³⁷ and Eighth Circuits³⁸ have flatly rejected the Sixth Circuit's broad view of manipulation.³⁹ On the other hand, most law review writers who commented on *Mobil* defended the decision, generally on the ground that prohibiting defensive tactics that as a practical matter reduced the choices available to shareholders of a

34. See, e.g., Weiss, *Defense Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation*, 35 VAND. L. REV. 1087 (1982); Note, *Target Defensive Tactics as Manipulative Under Section 14(e)*, 84 COLUM. L. REV. 228 (1984); Note, *Section 14(e) of the Williams Act: Can There Be Manipulation with Full Disclosure or Was the Mobil Court Running on Empty?*, 12 HOFSTRA L. REV. 159 (1983); see also Junewicz, *The Appropriate Limits of Section 14(e) of the Securities Exchange Act of 1934*, 62 TEX. L. REV. 1171 (1984); Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred*, 97 HARV. L. REV. 1964, 1978-83 (1984) [hereinafter Note, *The "Poison Pill" Preferred*].

35. The term "shark repellent" is typically used to refer to "amendments to a potential subject company's certificate of incorporation or by-laws that have been devised to discourage unsolicited approaches from unwanted bidders." See ADVISORY COMM. ON TENDER OFFERS, U.S. SEC. & EXCHANGE COMM'N REPORT OF RECOMMENDATIONS 141 (1983). Under this category fall tactics such as super majority provisions, fair price provisions, and staggered boards. See generally M. LIPTON & E. STEINBERGER, TAKEOVERS AND FREEZEOUTS §§ 6.2-3 (1978) (two volume, current coverage of the area, including examples of relevant documents); Friedenbergh, *Jaws III: The Impropriety of Shark-Repellent Amendments as a Takeover Defense*, 7 DEL. J. CORP. L. 32 (1981) (describing the major types of shark-repellent amendments surviving current legal approaches to the subject, and analyzing advantages of the various provisions); Hochman & Folger, *Deflecting Takeovers: Charter and By-Law Techniques*, 34 BUS. LAW 537 (1979) (discussing defensive provisions within the frameworks of Delaware and New York law).

36. The term "poison pill" refers to an issue of securities that is convertible upon a takeover into securities of the acquiring company, with the result that the acquirer's stock is diluted. See Note, *The "Poison Pill" Preferred*, *supra* note 34; see also *Moran v. Household Int'l, Inc.*, 490 A.2d 1059 (Del. 1985) (where the Supreme Court of Delaware held that the "poison pill" device was acceptable as an anticipatory defense to potential takeover attempts).

37. *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1 (2d Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984); *Buffalo Forge Co. v. Ogden Co.*, 717 F.2d 757 (2d Cir.), *cert. denied*, 464 U.S. 1018 (1983).

38. *Feldbaum v. Avon Prod., Inc.*, 741 F.2d 234 (8th Cir. 1984).

39. Even the Sixth Circuit has circumscribed its holding in *Mobil*—the court stated: "This court cautioned that *Mobil* was an unusual case and that its holding was not to be broadened and applied indiscriminately." *Biechele v. Cedar Point, Inc.*, 747 F.2d 209 (6th Cir. 1984).

target company who are confronted with a tender offer was consistent with the overriding legislative purpose of the Williams Act: to give such shareholders the opportunity to decide, in an unpressured atmosphere, whether to tender their shares.⁴⁰

The Supreme Court of the United States has now resolved the issue in favor of a narrow interpretation of the term "manipulation." In *Schreiber*,⁴¹ a wholly owned subsidiary of Burlington Northern, Inc. had made a tender offer in December 1982 for 25.1 million (or fifty-one percent) of the outstanding shares of El Paso Gas Co., at a price of \$24 per share. Despite opposition from El Paso's management, the offer was fully subscribed by its last day, December 30, 1982. The tender offer provided a number of conditions under which Burlington could cancel the offer at any time before it actually paid for the shares.⁴²

On January 10, 1983, Burlington announced that it had made a new, friendly takeover agreement with El Paso's management. Under the new agreement, Burlington rescinded the December tender offer and substituted a new offer under which it would buy not only twenty-one million shares from El Paso shareholders at \$24, but would also buy 4,166,667 newly issued shares from El Paso at the same price. In addition, Burlington agreed to provide "procedural protections" for the remaining El Paso shareholders in the event of a subsequent merger of the two companies,⁴³ and that Burlington would recognize existing "golden parachute" agreements between El Paso and four members of its senior management, which gave these officers long-term employment protection in the event that El Paso should be taken over.⁴⁴

The revised tender offer was substantially oversubscribed, more than forty million shares being tendered by February 8, 1983. As a result, El Paso shareholders who had tendered their shares in the first

40. The Supreme Court, in examining the legislative history of section 14(e), has concluded that "the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer." *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 35 (1977). *Accord* *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975). For the argument that "manipulation" under section 14(e) should be interpreted in accordance with the overriding legislative purpose of the Williams Act, see for example, Weiss, *supra* note 34, at 1095-1100.

41. 105 S. Ct. 2458 (1985).

42. *Schreiber v. Burlington N., Inc.*, 568 F. Supp. 197, 199 (D. Del. 1983), *aff'd*, 731 F.2d 163 (3d Cir. 1984), *aff'd*, 105 S. Ct. 2458 (1985). The complaint alleged that none of the conditions for cancellation of the tender offer ever occurred. Joint Appendix at JA-11, *Schreiber v. Burlington N., Inc.*, 731 F.2d 163 (3d Cir. 1984), *aff'd*, 105 S. Ct. 2458 (1985) (Second Amended Class Action Complaint, ¶ 20).

43. The procedural protections required approval by non-Burlington members of El Paso's board of directors for a merger. *Schreiber*, 105 S. Ct. at 2460 n.1.

44. *Id.* at 2460 n.2.

offer and then had retendered them were able to sell fewer shares at the favorable price of \$24 because they were now part of a larger prorationing pool.⁴⁵

The plaintiff, who was one of these shareholders, brought an action against the two companies and El Paso's board of directors, on behalf of herself and other similarly situated shareholders. She claimed that the withdrawal of the first tender offer and the substitution of the second offer were a "manipulative" distortion of the market for El Paso shares, in violation of section 14(e).⁴⁶

The district court dismissed the suit, on the ground that, because the alleged manipulation did not involve a misrepresentation, it did not violate section 14(e).⁴⁷ The Third Circuit Court of Appeals affirmed the lower court's decision.⁴⁸ In a unanimous opinion⁴⁹ by Chief Justice Burger, the Supreme Court affirmed, holding that "the term 'manipulative' as used in § 14(e) requires misrepresentation or nondisclosure. . . . Without misrepresentation or nondisclosure, § 14(e) has not been violated."⁵⁰

In its opinion, the Court followed its now-familiar procedure⁵¹ of first examining the language of the statute, then reviewing its purpose and legislative history, and finally discussing questions of policy.⁵² As to the statutory language, the Court stated that the plaintiff's reading of the term "manipulative"—to include acts which, although fully disclosed, "artificially" affect the price of the takeover target's stock—conflicted with "the normal meaning of the term."⁵³ In this connec-

45. Under the Williams Act and the rules of the Securities and Exchange Commission, where an offeror makes a tender offer for fewer than all of the outstanding equity securities of a class, and shareholders tender a greater number of shares than the tender offeror is bound to purchase, the tender offeror must purchase a pro rata number of shares of each shareholder who tenders his shares during the life of the tender offer. Exchange Act § 14(d)(6), 15 U.S.C. § 78(n)(6); SEC Rule 14d-8, 17 C.F.R. § 240.14d-8 (1985).

46. Exchange Act, 15 U.S.C. § 78n(e). See *supra* note 14. The plaintiff also alleged that the defendants failed to disclose the "golden parachute" agreements when Burlington made the January tender offer. She claimed that this nondisclosure was a deceptive act forbidden by section 14(e). The court held that, because the only injuries claimed by the plaintiff were related to the cancellation of the first offer, and because the alleged deception occurred in relation to the making of the second offer, there was no causal relationship between the deception and the plaintiff's alleged injuries. *Schreiber*, 105 S. Ct. at 2465.

47. *Schreiber v. Burlington N., Inc.*, 568 F. Supp. 197, 204 (D. Del. 1983).

48. *Schreiber v. Burlington N., Inc.*, 731 F.2d 163 (3d Cir. 1984).

49. Justice Powell took no part in the decision, and Justice O'Connor took no part in the consideration or the decision.

50. *Schreiber*, 105 S. Ct. at 2465.

51. See, e.g., *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

52. "The [Court's] starting point is the language of the statute." *Schreiber*, 105 S. Ct. 2461.

53. *Id.* at 2461-62.

tion, the Court's opinion quoted at some length from *dicta* in its opinions in *Ernst & Ernst v. Hochfelder*⁵⁴ and *Santa Fe Industries v. Green*⁵⁵ in which it had interpreted the term "manipulation" as the term is used in section 10(b).⁵⁶ Because these earlier statements of the Supreme Court's views on manipulation have been the basis for numerous court of appeals and district court decisions during the past decade,⁵⁷ and have now been found by the Court to be equally applicable to section 14(e), they are worth setting forth here.

In *Hochfelder*, a 1976 decision, the Supreme Court held that *scienter*, or "intent to deceive, manipulate or defraud,"⁵⁸ is an essential element of a private cause of action under section 10(b) and Rule 10b-5. In reviewing the language of section 10(b), the Court stated: "Use of the word 'manipulative' is especially significant. It is and was virtually a term of art when used in connection with the securities markets. It connotes intentional or willful conduct *designed to deceive or defraud* investors by controlling or artificially affecting the price of securities."⁵⁹

A year later, in *Santa Fe*, the Court decided that a claim by minority shareholders of unfair treatment by corporate management in setting the compensation that they would receive in a Delaware "squeeze-out" merger did not state a cause of action under section 10(b) and Rule 10b-5, in the absence of deceptive or manipulative conduct.⁶⁰ In discussing the "manipulative" language of section 10(b), the Court said:

The term refers to practices, such as wash sales, matched orders, or rigged prices, *that are intended to mislead investors* by artificially affecting the market activity. . . . Section 10(b)'s general prohibition of practices deemed by the SEC to be "manipulative"—in this technical sense of artificially affecting market activity in order to mislead investors—is fully consistent with the fundamental pur-

54. 425 U.S. 185 (1976).

55. 430 U.S. 462 (1977).

56. *Schreiber*, 105 S. Ct. at 2462.

57. See, e.g., *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 540 (9th Cir. 1984); *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1, 4 (2d Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984); *Dan River v. Icahn*, 701 F.2d 278, 285 (4th Cir. 1983); *Billard v. Rockwell Int'l Corp.*, FED. SEC. L. REP. (CCH) ¶ 98,733 (2d Cir. June 30, 1982); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 287-89 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981); *Radol v. Thomas*, 534 F. Supp. 1302, 1311 (S.D. Ohio 1982), *aff'd*, 722 F.2d 244 (6th Cir. 1985).

58. *Hochfelder*, 425 U.S. at 193.

59. *Id.* at 199 (emphasis subsequently added in *Schreiber*, 105 S. Ct. at 2462).

60. 430 U.S. at 474-77. "A 'squeeze-out' merger occurs when Corporation A, which holds a controlling interest in Corporation B, uses its control to merge B into itself or into a wholly owned subsidiary. The minority shareholders in Corporation B are, in effect, forced to sell their stock." *Schreiber*, 105 S. Ct. at 2460 n.1.

pose of the 1934 Act " 'to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*. . . . ' " . . . Indeed, *nondisclosure is usually essential to the success of a manipulative scheme*. . . . No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices. But we do not think it would have chosen this "term of art" if it had meant to bring within the scope of 10(b) instances of corporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary.⁶¹

Subsequent law review writers, arguing for a broader definition of manipulation that would encompass nondeceptive acts, pointed out that in *Santa Fe* (although not in *Hochfelder*) the Court carefully qualified its narrow characterization of manipulation (that is, manipulation *generally* refers to practices such as wash sales, etc. Nondisclosure is *usually* essential to the success of a manipulative scheme).⁶² In view of the fact, however, that the *Santa Fe* Court was not focusing on the question of the meaning of manipulation, it is understandable that the Court avoided making an unqualified statement as to its definition. In *Schreiber*, the Court based its opinion that misrepresentation or nondisclosure is an essential element of manipulation under section 14(e) on the views that it had expressed in *Santa Fe* with regard to section 10(b). In doing so, the Court ignored the qualifying language that it had used in *Santa Fe*, making it clear that misrepresentation or nondisclosure is *always* required in order to make out a case of manipulation.⁶³

Furthermore, the Court refuted the plaintiff's textual argument, one often made by law review writers as well, that "Congress' use of the disjunctive in section 14(e), which bars 'fraudulent, deceptive, *or* manipulative acts or practices,' also suggests that 'deceptive' acts and 'manipulative' acts are different kinds of behavior."⁶⁴ The Court countered this argument with the statement that "it is a familiar principle of statutory construction that words grouped in a list should be given related meaning."⁶⁵ In the Court's view, the presence of the word "deceptive" in the statute reinforces rather than negates the idea that manipulative conduct is itself deceptive conduct.⁶⁶

61. *Santa Fe*, 430 U.S. at 476-77 (emphasis added) (footnotes omitted).

62. See, e.g., Junewicz, *supra* note 34, at 1183; Weiss, *supra* note 34, at 1097; Note, *Target Defensive Tactics as Manipulative Under Section 14(e)*, *supra* note 34, at 246.

63. *Schreiber*, 105 S. Ct. at 2462-63.

64. Weiss, *supra* note 34, at 1097 (footnote omitted).

65. *Schreiber*, 105 S. Ct. at 2462 (citing *Securities Indus. Ass'n v. Board of Governors*, 104 S. Ct. 3003, 3010 (1984)).

66. *Id.* at 2462-63. All of which demonstrates that Supreme Court Justices have the privilege of selecting the applicable maxim of statutory construction.

The Court also stated that the meaning that it had given to the term "manipulation" in *Hochfelder* and *Santa Fe* was consistent with the use of the term at common law,⁶⁷ and with its "traditional dictionary definition."⁶⁸ Finally, the Court indicated that it saw little significance in the differences between the wording of sections 10(b) and 14(e).⁶⁹ The former speaks of "any manipulative or deceptive device or contrivance," while the latter prohibits "any fraudulent, deceptive, or manipulative acts or practices." The Court pointed out that "[a]ll three species of conduct, *i.e.*, 'fraudulent, deceptive or manipulative,' listed by Congress [in Section 14(e)] are directed at failures to disclose. The use of the term 'manipulative' provides emphasis and guidance to those who must determine which types of acts are reached by the statute"⁷⁰

The Court then turned to the purpose and legislative history of the Williams Act and of section 14(e). The Court's view of the Williams Act is illuminating, particularly in light of the somewhat differing statements as to the purpose of this legislation that the Court has made in previous opinions.⁷¹ First, the Court said that the purpose of the Williams Act "was to preserve a neutral setting in which the contenders [in a tender offer] could fully present their arguments."⁷² Congress intended to ensure that shareholders who were confronted with a tender offer would be provided with adequate information, and

67. See *infra* text accompanying notes 146-66.

68. *Schreiber*, 105 S. Ct. at 2462. The Court quoted this dictionary definition, "manipulation is 'management with use of unfair, scheming, or underhanded methods.'" *Id.* at n.5 (citing WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1376 (1971)). It is not clear how this definition supports the Court's conclusion that manipulation requires deception, because the definition appears to encompass unfair, though fully disclosed, actions.

69. See *infra* text accompanying notes 257-66.

70. *Schreiber*, 105 S. Ct. at 2462.

71. Compare *Piper Aircraft Co. v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 31 (1977) ("[T]he legislation was designed solely to get needed information to the investor . . .") with *Edgar v. MITE Corp.*, 457 U.S. 624, 634 (1982) ("Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice.") (citation omitted). The latter statement has been used as the basis for making the argument that section 14(e) imposes substantive requirements on participants in tender offers. See *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538, 1545 (S.D.N.Y.), *rev'd*, 722 F.2d 1 (2d Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984).

72. *Schreiber*, 105 S. Ct. at 2463. Previous Supreme Court decisions interpreting the Williams Act also have emphasized the neutral stance of the act as between tender offeror and management of the target company. "There is no question that in [adopting the Williams Act], Congress intended to protect investors. . . . But it is also crystal clear that a major aspect of the effort to protect the investor was to avoid favoring either management or the takeover bidder." *Edgar v. MITE Corp.*, 457 U.S. 624, 633 (1982) (citations omitted). See also *Piper Aircraft Corp. v. Chris-Craft Indus.*, 430 U.S. 1, 29-30 (1977) (discussing the Congressional policy of evenhandedness).

"relied primarily on disclosure to implement the purpose of the Williams Act."⁷³ Section 14(e) was designed as a broad antifraud provision, supplementing the more specific disclosure requirements of the statute.⁷⁴ In perhaps the most significant sentence in its opinion, the Court stated:

Nowhere in the legislative history is there the slightest suggestion that § 14(e) serves any purpose other than disclosure, or that the term 'manipulative' should be read as an invitation to the courts to oversee the substantive fairness of tender offers; the quality of any offer is a matter for the marketplace.⁷⁵

Regulation of the fairness of tender offers thus is not a purpose of the Williams Act, even though the concept of "fairness" may involve more than simply the price of the offer (as it does in *Schreiber*), and extend to dealings between the tender offeror and corporate management that involve a breach of management's fiduciary duty to the shareholders. The Court also apparently feared that a broad interpretation of the term "manipulation" would inevitably involve it in "fairness" questions.⁷⁶

In the absence of deceptive acts, the antifraud provisions of the Exchange Act, whether section 14(e) or 10(b), do not concern themselves with protecting investors against unfair treatment, breach of fiduciary duty, or corporate mismanagement. These are matters that

73. *Schreiber*, 105 S. Ct. at 2463.

74. These requirements are contained in section 14(d), Exchange Act, 15 U.S.C. § 78n(d).

75. *Schreiber*, 105 S. Ct. at 2464 (footnote omitted).

76. The Court's holding that the sole purpose of section 14(e) is disclosure raises a question as to the validity of SEC Rules 14e-1, 14e-2, and 14e-3, 17 C.F.R. § 240.14e-1-3 (1985), which are substantive rules adopted by the Commission under section 14(e). See Pitt & Chernow, *Williams Act Rejected as Tool to Ensure Fairness*, Legal Times, June 17, 1985, at 27, col. 1. Rule 14e-1 regulates the length of time that a tender offer must remain open; Rule 14e-2 requires management of a target company to state its position with respect to whether it recommends that shareholders accept or reject a tender offer; and Rule 14e-3 prohibits those having material non-public information concerning a tender offer to trade or to "tip" other persons.

The adoption of substantive rules under the section can, however, be defended on the ground that the section gives the Commission authority to adopt rules not only to define fraudulent, deceptive, or manipulative acts and practices, but also to "prescribe means reasonably designed to prevent" such acts and practices. Exchange Act § 14(e), 15 U.S.C. § 78n(e). In *Schreiber*, the Court said that it disagreed with the plaintiff's argument that this broad rulemaking authority would be pointless if section 14(e) were concerned with disclosure only. By giving the Commission this authority (in the 1970 amendments to the Williams Act), "Congress simply provided a mechanism for defining and guarding against those acts and practices which involve material misrepresentation or nondisclosure . . . without suggesting any change in the meaning of the term 'manipulative' itself." *Schreiber*, 105 S. Ct. at 2464, n.11. For a post-*Schreiber* decision in which the court did not question the continued validity of SEC Rule 14e-1, see *L.P. Acquisition Co. v. Tyson*, FED. SEC. L. REP. (CCH) ¶ 92,271 (6th Cir. Aug. 26, 1985).

are traditionally within the province of state law, and the enactment of the federal statutes, including the Williams Act, was not intended to alter this allocation of federal and state authority.⁷⁷

The Court buttressed its comments on fairness with a policy argument: if judges had the power to decide whether a tender offer was unfair, then uncertainty would be injected into the tender offer process, and it would be impossible to tell, before the close of the offer, whether fully disclosed actions of one side or the other might eventually be judged to be manipulative. Furthermore, "[t]his uncertainty would directly contradict the expressed Congressional desire to give investors full information."⁷⁸

Thus, in the Court's view, disclosure was the sole purpose of the Williams Act, which has "sweeping disclosure requirements and narrow substantive safeguards."⁷⁹ These substantive provisions⁸⁰ were intended only to implement and support the disclosure provisions of the Williams Act.⁸¹ Section 14(e) is simply one of these disclosure provisions, which are intended to give shareholders confronted with a tender offer the opportunity to make an informed decision.⁸²

77. In *Santa Fe*, the Court said: "Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden." 430 U.S. at 479. In *Schreiber*, the district court stated: "The unfairness of a securities transaction, absent deception, . . . is not the primary concern of the federal securities laws; rather, this is a concern of state law." *Schreiber*, 568 F. Supp. at 202 (citing *Santa Fe*, 430 U.S. at 478-80). Nevertheless, it has been suggested that the Supreme Court's earlier decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), in which the Court held that an Illinois tender offer statute was in violation of the Commerce Clause of the Constitution, now raises a question, in view of the *Schreiber* decision, as to whether the states have the power to regulate unfair defensive tactics. Ferrara & Carroll, *Tender Offer Developments: 1985 Midyear Review*, Legal Times, Aug. 5, 1985, at 12, col. 1. There is no suggestion in the *Schreiber* opinion, however, that the Court meant to limit the ability of state legislatures or judges to regulate the fiduciary duties of corporate directors (as opposed to enforcing state anti-takeover statutes), an area in which state corporate law has traditionally governed. Moreover, the fact that the Court cited *Santa Fe* with approval seems to indicate that it did not intend to depart from the view expressed in that decision that "state fiduciary standards" should govern the internal affairs of corporations. *Santa Fe*, 430 U.S. at 479.

78. *Schreiber*, 105 S. Ct. at 2465.

79. *Id.*

80. Exchange Act §§ 14(d)(5)-(7), 15 U.S.C. §§ 78n(d)(5)-(7) (substantive provisions governing the manner of making tender offers). Section 14(d)(5) gives certain withdrawal rights to shareholders who have tendered their shares; section 14(d)(6) deals with prorationing where a tender offeror is not required by the terms of the tender offer to purchase all the shares that have been tendered; and section 14(d)(7) requires a tender offeror to pay the same price for all shares purchased.

81. These provisions "require or prohibit certain acts so that investors will possess additional time within which to take advantage of the disclosed information." *Schreiber*, 105 S. Ct. at 2463 (footnote omitted).

82. The Court reasoned:

In *Schreiber*, the Court made explicit the seminal ruling that it had handed down eight years earlier in *Santa Fe* that the focus of the federal securities laws is on full disclosure—not only is disclosure the “facial and primary concern” of section 14(e), but disclosure is described as “the core of the Act.”⁸³ Thus, the Court asserted that disclosure is the primary purpose not only of section 14(e) and the Williams Act, but also of the federal securities laws generally.⁸⁴ Both *Santa Fe* and *Schreiber* make clear that, even though the principal purpose of the securities laws is protection of investors, conduct that adversely affects investors is not necessarily covered by the securities laws. Such conduct, if nondeceptive, is traditionally the province of state corporate law.⁸⁵

It is this writer's belief that the Court's decision in *Schreiber* is entirely consistent with the intention of Congress in 1934 when it enacted the Exchange Act, and in 1968 when it enacted the Williams Act. Furthermore, *Schreiber* is consistent with the numerous lower court decisions that have rejected claims that a wide variety of defensive tactics against takeovers were manipulative.⁸⁶ The important

Congress' consistent emphasis on disclosure persuades us that it intended takeover contests to be addressed to shareholders. . . . The same Congress that placed such emphasis on shareholder choice would not at the same time have required judges to oversee tender offers for substantive fairness. It is even less likely that a Congress implementing that intention would express it only through the use of a single word placed in the middle of a provision otherwise devoted to disclosure.

Id. at 2465.

83. *Id.* at 2462-63.

84. This, of course, is not exactly a novel thesis. See L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 29-38 (1983) (Professor Loss makes clear that disclosure, not substantive regulation, was the basic philosophy of this New Deal legislation).

85. I am indebted to my colleague Professor Bailey Kuklin for the suggestion that many philosophers of ethics have believed that taking property by deception is a worse offense than taking by force. Cicero observed, “Now wrongdoing originates in one of two ways: either by force or by deception; deception is like a little fox, force like a lion. Both are most uncharacteristic of man, but deception should arouse greater contempt.” CICERO, DE OFFICIIS 22-23 (H. Eiding trans. 1974). Another philosopher commented:

Deception deprives a person of the information he or she needs in order to choose rationally for himself or herself. Deception, like coercion, is a form of manipulating the data on which a person counts, in order to make him do what the deceiver wants him to do. Where it is successful, the deceived becomes in the same manner the unwilling tool.

F. HAYEK, THE CONSTITUTION OF LIBERTY 143-44 (1960).

Limiting the scope of the federal securities laws to the more serious type of wrongdoing is consistent with the notion that these statutes should deal with the more egregious problems, leaving run-of-the-mill offenses to state law.

86. Before *Schreiber*, holdings that nondeceptive conduct was not manipulative were usually based on the Supreme Court's opinion in *Santa Fe*. See *supra* text accompanying notes 60-61.

exception, of course, was *Mobil*, in which the Sixth Circuit Court of Appeals held that a lock-up option designed to deny a successful tender offeror the fruits of its victory was manipulative under section 14(e).⁸⁷ *Schreiber*, however, has now overruled *Mobil*.

Specific defensive tactics against hostile takeovers that have survived challenges that they were manipulative include the purchase of assets from persons likely to favor incumbent management, in exchange for authorized but unissued stock;⁸⁸ the sale of treasury stock to a third party and the grant to the same party of a right of first refusal to buy one of the target company's divisions;⁸⁹ the sale of a substantial asset to a third party in the face of a hostile tender offer;⁹⁰ the grant of an option to a friendly party to purchase sufficient authorized but unissued shares to make it mathematically impossible for a hostile tender offeror to achieve control;⁹¹ and the making of a

87. See *supra* text accompanying notes 32-33.

88. *Oklahoma Publishing Co. v. Standard Metals Corp.*, 541 F. Supp. 1109 (W.D. Okla. 1982). The court said:

These transactions do not rise to the level of violating the federal securities laws simply because the holders of the newly issued stock are favorable to the incumbent management. If Standard Metals has received inadequate consideration for its stock, the defendants may be held liable for mismanagement of corporate assets under the appropriate state law.

Id. at 1113 (citing *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977)).

89. *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413 (S.D.N.Y. 1982). As to the plaintiff's claim that the decision in *Mobil* was controlling, the court stated:

I doubt that decision represents the law in this [the Second] circuit. In my view the reasoning of that decision could unduly interfere with the right of company management to combat a takeover attempt that it believes in good faith to be harmful to its share holders. . . .

But even if the *Mobil* decision represented controlling law, it does not compel an injunction on these facts. The . . . purchase agreement is not merely an option, although defeasible in certain circumstances. It was not set at a bargain price, even though the tender offer price was soon raised above it. The right of first refusal . . . is not an option and is not calculated to effectuate a sale below market value. I conclude that the *Mobil* case is properly distinguished even if it represents the law.

Id. at 422.

90. *Whittaker Corp. v. Edgar*, 535 F. Supp. 933 (N.D. Ill. 1982).

91. *Data Probe Acquisition Corp. v. Datatab, Inc.*, 722 F.2d 1 (2d Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984). The district court, however, had held that this defensive tactic was manipulative under section 14(e). In a lengthy and highly interesting opinion, Judge Sofaer took the position that *Santa Fe* was not controlling in an action under section 14(e), because the purpose of the Williams Act (of which section 14(e) is a part) is not only to provide information to shareholders confronted with a tender offer, but also to prohibit conduct that "unduly impedes the shareholders' exercise of the decision-making prerogative guaranteed to them by Congress." *Data Probe Acquisition Corp. v. Datatab, Inc.*, 568 F. Supp. 1538, 1545 (S.D.N.Y. 1983). Judge Sofaer's decision was reversed by the Second Circuit, in an opinion that explicitly rejected *Mobil* as an "unwarranted extension of the Williams Act," *Data Probe*, 722 F.2d at 5 (citation omitted). See also *Buffalo Forge Co. v. Ogden Corp.*, 717 F.2d 757, 760 (2d Cir.), *cert. denied*, 464 U.S. 1018 (1983).

counter-tender offer for the shares of the tender offeror.⁹² In one leading case, the plaintiff took the position that management's failure to disclose its alleged long-standing policy of perpetuating its control by opposing *any* takeover supplied the nondisclosure necessary to make out a case of manipulation under sections 10(b) and 14(e). The district court, citing *Santa Fe*, concluded that there was no support for this argument.⁹³

Although decided before *Schreiber*, all of these cases seem fully consistent with it. Very few decisions hold that fully disclosed defensive tactics are manipulative under the federal securities laws, and *Schreiber* appears to deprive these decisions of any remaining validity they might have had.⁹⁴ After *Schreiber*, there seems to be little possibility that defensive measures taken by target-company management can be successfully attacked under the federal securities laws, assuming that the tactics are fully and accurately disclosed.

In examining the allegations of the complaint in *Schreiber*, one cannot help being struck by how different they are from the claims that are typically made in a manipulation case. Notably, the complaint does not allege that the defendants intended to affect, or had any financial interest in affecting, the market price of El Paso stock.⁹⁵ The gravamen of the charge appears to be that Burlington's

92. *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982). In language that seems to forecast that of the Supreme Court in *Schreiber*, the district court said: "Section 14(e) is solely a disclosure provision. Congress has not authorized the federal judiciary to scrutinize the substantive fairness of tender offers as long as adequate disclosure is made." *Id.* at 628 (citation omitted).

93. *Panther v. Marshall Field & Co.*, 486 F. Supp. 1168, 1186 (N.D. Ill. 1980), *aff'd*, 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). The court also held that, because the sole purpose of the Williams Act was the protection of investors who are confronted with a tender offer, there could be no violation of section 14(e) unless a tender offer was actually made, or at least announced. *Id.* at 1187-88.

94. *See Joseph E. Seagram & Sons, Inc. v. Abrams*, 510 F. Supp. 860, 861 (S.D.N.Y. 1981) (A tender offeror, Seagram, charged that the directors of the target company, St. Joe Minerals Corporation, had a plan to "sell off its assets and, failing this, to destroy the charter of the company," in order to defeat the tender offer.). According to the district court, the suit was brought under section 14(e), "presumably on the theory that an improper manipulation of the market is in progress by the moves of the St. Joe directors." *Id.* The plaintiff also claimed that the target had purchased shares at a price of \$60 per share in order to defeat a tender offer at a price of \$45 per share and that the directors were determined to keep control, regardless of the company's best interests or the wishes of the shareholders. Judge Pollack granted a temporary restraining order against this "scorched earth" policy, pending a full-scale factual hearing, in the "interests of potential and actual stockholders and investors and the integrity of the market." *Id.* at 862. The opinion does not, however, discuss the issue of manipulation, and it seems to be based at least partly on the state-law grounds of breach of the directors' fiduciary duties.

95. "The main inquiry in all manipulation cases has been toward establishing the purpose for which the more easily proved trading activity was undertaken." Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 526.

“improper termination and withdrawal of the [December] tender offer constituted a willful breach of the tender offer agreements” between the Burlington and the El Paso shareholders.⁹⁶ In fact, the Third Circuit’s opinion in the case stated that the plaintiff’s theory of recovery based on manipulation “seeks to convert an arguable breach of contract into a violation of the Williams Act.”⁹⁷

Given the fact that the plaintiffs in *Schreiber* did not allege that the defendants were attempting to influence the market price of El Paso stock, the Supreme Court might well have decided the case on the grounds that the defendants were not acting with a manipulative intent, and that the creation of an “artificial” market price for the stock would at most be an unintended side effect of the defendants’ actions.⁹⁸ The Supreme Court in *Schreiber*, however, its only decision that is squarely on the subject of manipulation,⁹⁹ leaves open several important questions: What is the nature of the misrepresentation or nondisclosure that is a requisite for manipulation?¹⁰⁰ Does a failure by the defendant to reveal the motives for, or the possible consequences of, his actions provide the necessary nondisclosure? What is the nature of the intent that must be proved? Does the intent requirement differ for different methods of manipulation? These questions will be addressed in Part V of this Article.

96. Joint Appendix at JA-13-14, *Schreiber v. Burlington N., Inc.*, 731 F.2d 163 (3d Cir. 1984), *aff’d*, 105 S. Ct. 2458 (1985) (Second Amended Class Action Complaint, ¶ 25(a)).

97. *Schreiber*, 731 F.2d at 165. There is some authority for saying that courts will examine the overall gravamen of a complaint in order to determine whether it states a cause of action for manipulation. For example, in *Nash v. Farmers’ New World Life Ins. Co.*, minority shareholders claimed that the allegedly unfair terms of a merger constituted manipulation within the meaning of section 10(b). 570 F.2d 558 (6th Cir.), *cert. denied*, 439 U.S. 822 (1978). After citing the “term of art” language in *Santa Fe*, the court said in affirming dismissal of the complaint: “The gravamen of Appellant’s claim is that the merger terms were unfair, not that Defendants manipulated prices.” *Id.* at 562 (footnotes omitted).

98. For a discussion of manipulative intent, see 3 L. LOSS, *SECURITIES REGULATION* 1551-52 (2d ed. 1961). See also Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 512-16 (analyzing methods of market manipulation); Comment, *Market Manipulation and the Securities Exchange Act*, *supra* note 23, at 634 (noting the difficulty of proving even large scale manipulation).

99. The facts of neither *Hochfelder* nor *Santa Fe* involved manipulation. The discussion of manipulation in these two opinions was part of a general discussion of section 10(b). In *Hochfelder*, the Court held that a cause of action under section 10(b) required *scienter*. 425 U.S. 185, 193 (1976). In *Santa Fe*, that deception was an essential element of a violation of section 10(b). 430 U.S. 462, 473-74 (1977). See *supra* text accompanying notes 58-61.

100. The district court in *Schreiber* stated that “deception alone is not manipulation under Section 14(e). The manipulative activity must *artificially affect* the market price *and* do so in a misleading or deceptive manner.” 568 F. Supp. at 202. The Supreme Court did not comment on this question, presumably because it was not necessary to do so in order to decide the case before it.

III. MANIPULATION BEFORE 1934

In 1934, Congress gave the Securities and Exchange Commission ("SEC") authority to prohibit "any manipulative . . . device or contrivance" in connection with the purchase or sale of any security.¹⁰¹ In view of the sparseness of the legislative history that bears on the meaning of the undefined term "manipulative,"¹⁰² it is important to understand what the framers of the Exchange Act meant when they used this term.¹⁰³

As Chief Justice Burger stated in *Schreiber*, the narrow meaning that the Supreme Court gave to the term "manipulative" in that decision is consistent with the common law.¹⁰⁴ As will be seen, however, not all practices that were regarded as manipulative in 1934 were actionable or illegal under the common law.¹⁰⁵ Indeed, one of the purposes of the Exchange Act was to make illegal certain stock-market practices that were then regarded as manipulative but were not illegal. It is therefore relevant also to know what the term meant to the financial community and others before enactment of the federal securities laws. Fortunately, in addition to judicial decisions,¹⁰⁶ there is a rich literature that describes stock market practices that were regarded as manipulative before enactment of the Exchange Act in 1934. These materials include legislative reports,¹⁰⁷ but also more informal materials such as works by financial historians,¹⁰⁸ contemporaneous accounts and memoirs of Wall Street operators,¹⁰⁹ and even

101. Exchange Act § 10(b), 15 U.S.C. § 78j(b).

102. See *infra* text accompanying notes 252-55.

103. Where the meaning of an undefined term in the federal securities laws "had been crystallized by . . . prior judicial interpretation . . . [i]t is . . . reasonable to attach that meaning to the term as used by Congress. . . ." SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

104. *Schreiber*, 105 S. Ct. at 2462. To support this statement, the Court cited Professor Loss's treatise, L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 984-89 (1983), as well as two pre-1934 cases, the English case of *Scott v. Brown, Doering, McNab & Co.*, [1892] 1 Q.B. 724, 724 (C.A.), and *United States v. Brown*, 5 F. Supp. 81, 85 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935). For discussion of the cases, see *infra* text accompanying notes 145, 160-64.

105. See *infra* text accompanying notes 159, 165-67.

106. See, e.g., *People v. Rice*, 221 A.D. 443, 223 N.Y.S. 566 (1927); *Ridgely v. Keene*, 134 A.D. 647, 119 N.Y.S. 451 (1909); *Rex v. DeBerenger*, 3 M. & S. 67, 105 Eng. Rep. (K.B. 1814).

107. See, e.g., REPORT OF THE SENATE COMM. ON BANKING AND CURRENCY, STOCK EXCHANGE PRACTICES, S. REP. NO. 1455, 73d Cong., 2d Sess. (1934).

108. See, e.g., J. BROOKS, ONCE IN GOLCONDA (1969); M. JOSEPHSON, THE ROBBER BARONS (1934).

109. See, e.g., J. DILLON, HIND-SIGHTS, OR LOOKING BACKWARD AT SWINDLES (1911); W. FOWLER, TEN YEARS IN WALL STREET (1870); J. MEDBERY, MEN AND MYSTERIES OF WALL STREET (1878); D. SALMON, CONFESSIONS OF A FORMER CUSTOMERS' MAN (1932); W. VAN ANTWERP, THE STOCK EXCHANGE FROM WITHIN (1913).

popular novels.¹¹⁰

The Exchange Act's prohibition of certain specific manipulative practices in section 9(a),¹¹¹ coupled with the grant of authority to the SEC in section 10(b) to make unlawful new manipulative practices,¹¹² is persuasive evidence that Congress did not intend to limit the definition of manipulation to those practices that were known and regarded as manipulative in 1934.¹¹³ Congress regarded manipulation as a flexible concept that could encompass schemes that might hatch in the future from the fertile and creative brains of dishonest market operators.

Nonetheless, there must be a limit to the flexibility of this concept. Unless the term "manipulation" has a central core of meaning, section 10(b) could be interpreted as giving the SEC the authority to forbid any practice (in connection with the purchase or sale of a security) of which it disapproved.¹¹⁴ There is no evidence that Congress intended to bestow such unlimited discretion on the courts or on the new agency that it set up in 1934 to police the securities markets.

A. *Manipulative Practices*

What, then, did the term "manipulation," as it referred to the stock market, mean in 1934? Beginning at least as early as the middle of the nineteenth century and continuing until the very time that Congress considered the bill that was to become the Exchange Act, the most important market manipulations were the work of groups of speculators known as pools.¹¹⁵ During the nineteenth century, before a substantial portion of the public had become accustomed to invest-

110. See, e.g., E. LEFEVRE, *SAMPSON ROCK OF WALL STREET* (1906); N. RIDGELY, *BY LAW OF MIGHT* (1908); A. TRAIN, *PAPER PROFITS* (1930).

111. See Exchange Act § 9(a)(1)-(5), 15 U.S.C. § 78i(a)(1)-(5).

112. Exchange Act, 15 U.S.C. § 78j(b).

113. Section 10(b) "was described rightly as a 'catchall' clause to enable the Commission to deal with new manipulative [or cunning] devices." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976).

114. In *Schreiber*, the Court expressed concern, for policy reasons, with the idea of giving unfettered discretion to judges to determine which acts are manipulative: "Inviting judges to read the term 'manipulative' with their own sense of what constitutes 'unfair' or 'artificial' conduct would inject uncertainty into the tender offer process." 105 S. Ct. at 2464-65. See *supra* text accompanying notes 75-76.

For an instructive and entertaining debate between Professors H.L.A. Hart and Lon L. Fuller about interpreting words used in statutes, see Fuller, *Positivism and Fidelity to Law—A Reply to Professor Hart*, 71 HARV. L. REV. 630, 661-69 (1958); Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 606-08 (1958).

115. "[T]he most important [manipulative] market campaigns . . . are the work of groups organized into syndicates, pools or joint accounts." TWENTIETH CENTURY FUND, *supra* note 4, at 445.

ing in shares of stock¹¹⁶ and before issuers of securities had large capitalizations,¹¹⁷ pool operations usually consisted of struggles between groups of professional speculators who were known either as "bulls" or as "bears."¹¹⁸ Typically, bears would sell a stock short (that is, sell shares that they did not own, borrowing shares in order to make delivery to the buyers) and then try to force down the price of the stock, in order to cover their short positions at a low price. Bulls, on the other hand, would try to "corner" the stock (that is, obtain control over the entire available supply) in order to force the bears to buy stock from the bulls, at prices dictated by the bulls, in order to meet their (the bears') contractual commitments.¹¹⁹

In light of the *Schreiber* decision, it is most interesting to observe that deceit was an essential element of these early manipulative operations of pools or, as they were sometimes called, "rings."¹²⁰ According to an 1870 account:

The ring [of bulls] having been made up, they proceed to buy the stock. *Two requisites are necessary to every successful ring; first secrecy, second, simulation.* . . . Every possible method is taken to deceive those that are outside the ring, and prevent them from supposing that the stock is passing under the control of the party who

116. For much of the nineteenth century, the individual investor of modest means did not participate in the stock market to any appreciable degree. See V. CAROSSO, *INVESTMENT BANKING IN AMERICA* 14-16 (1970). Not until the government's sale of "Liberty Bonds" to finance United States participation in World War I did public investors become an important source of capital. "Whereas bankers had estimated the bond market in 1917 at 350,000 individuals, the number subscribing to the first Liberty Loan was over 4 million and was much larger for the second, third, fourth, and fifth loans—9.4, 18.4, 22.8 and 11.8 million, respectively." U.S. TREASURY, *ANNUAL REPORT* (1918 & 1919), reprinted in V. CAROSSO, *supra*, at 226. For the first time, millions of Americans learned that intangible property could make money for them. For a description of how a major investment banking house promoted the sale of Liberty Bonds, see V. CAROSSO, *supra*, at 227.

117. Before the rise of industrialization in the late nineteenth century, most businesses were small, had few capital needs and, accordingly, issued small numbers of corporate shares. Nevertheless, with the growth of large businesses, particularly the railroads, industry began to issue shares in greater amounts in order to acquire the funds needed for expansion. V. CAROSSO, *supra* note 116, at 29-31. World War I and the ensuing economic boom had a profound effect upon this youthful corporate structure. "Security issues followed one another in rapid succession and, whereas before World War I an issue of one million dollars was considered large, in the middle 20's issues of twenty and twenty-five million dollars were by no means unusual." *United States v. Morgan*, 118 F. Supp. 621, 642 (S.D.N.Y. 1953). Accord R. SOBEL, *THE CURBSTONE BROKERS* 171-72 (1970).

118. A nineteenth century writer gave the following explanation of these terms: "If you are *long*, you are a bull; if *short*, a bear. . . . If a bear finds anything in his peregrinations, whether it be a turkey on the roost or a man in a tree, he lifts his paw and pulls it down. The bull, on the contrary, lowers his head only to give men and things a decided upward tendency." J. MEDBERY, *supra* note 109, at 81.

119. W. FOWLER, *supra* note 109, at 26-32.

120. *Id.* at 28.

are [sic] manipulating it. Sometimes the stock is made to assume a weakness, . . . and all sorts of reports are set afloat to depreciate its value.¹²¹

With the entry of a broader spectrum of the public into the stock market, particularly after the First World War,¹²² and the appearance of publicly held companies with a large number of outstanding shares,¹²³ the objectives of pool operators shifted toward separating public investors, rather than other professional traders, from their money.¹²⁴ Deception was an essential element of the manipulative tactics used by pools during the 1920's and right up to the time of passage of the Exchange Act.¹²⁵

121. *Id.* at 30-32 (emphasis added). Later (the same account continues), after the bears have been induced to take short positions:

[D]ifferent brokers are employed to bid up the price in the market in order to frighten the bears, and at the same time they are notified to deliver the stock which they have borrowed of the ring. . . . Sometimes, instead of buying the stock, the bears 'settle' with the ring by paying them the difference between the market price and the lower price, at which they [sold short]. In that case, the ring find themselves saddled with a large amount of stock, for which there is little demand. And now the problem is to unload. Accordingly, they sell enough stock to 'break' the market 4 or 5 percent downwards. The bears rush in and sell at the lowered price. When the ring have taken a sufficient number of their contracts, they bid the stock up again, and compel the bears again to cover. Every time the stock rises sharply, it has such an appearance of strength . . . that many of the outside bulls are tempted into buying, and sell out at a loss, when the stock declines.

Id. at 31-32.

122. *See supra* notes 116-17.

123. *See supra* note 117. During the 1920's, the annual issues of domestic corporate securities more than tripled. V. CAROSSO, *supra* note 116, at 243-44.

124. In the 1920's, the general public began to participate in stock market speculation for the first time. *See supra* note 116. Because the vast majority of post-war public investors were ignorant of the inner workings of Wall Street, they were prime candidates for manipulation by pool operators. *See J. BROOKS, supra* note 108, at 67-74. Thus, by 1933, the victims of pools were primarily members of the public rather than other professionals. For a discussion of the direct effect of manipulation upon the public, see TWENTIETH CENTURY FUND, *supra* note 4, at 502-03.

125. *See J. BROOKS, supra* note 108, at 65-66, 71; F. PECORA, WALL STREET UNDER OATH *passim* (1968).

The testimony [before the United States Senate Committee on Banking and Currency from January 1933 to July 1934] had brought to light a shocking corruption in our banking system, a widespread repudiation of old fashioned standards of honesty and fair dealing in the creation and sale of securities, and a merciless exploitation of the vicious possibilities of intricate corporate chicanery. The public had been deeply aroused by the spectacle of cynical disregard of fiduciary duty on the part of many of its most respected leaders; of directors, who conveniently subordinated their official obligations to an avid pursuit of personal gain; of great banks, which combined the functions of a bank with those of a stock jobber; of supposedly impartial public markets for the sale of securities, actually operated as private clubs for the individual benefit of their members.

F. PECORA, *supra*, at 283-84.

In a typical manipulative pool, members of the top management of the company whose stock was to be manipulated¹²⁶ and a number of Wall Street operators,¹²⁷ often including the specialist in the stock (that is, the New York Stock Exchange member to whom the Exchange had entrusted the task of making a market in the stock)¹²⁸ would first acquire options from the company that would enable them to buy its stock with a minimal investment. They would then use a number of devices to "create a kind of price mirage which may lure an outsider into the market to his damage."¹²⁹ One such device was to spread false information about the potential earnings or operations of the company.¹³⁰ "Word of mouth rumor-mongering was augmented by the use of fake financial services, tip sheets, bribed financial writers, and bribed customers' men or brokers who, without disclosing their financial interests, would recommend [the stock]."¹³¹ The success of the manipulation could also be promoted "by the spreading of advance notice among persons anxious to get in on the ground floor."¹³²

Where, as was often the case, the stock being manipulated was traded on a stock exchange, the most effective way of inducing members of the public to buy the shares was to falsify the appearance of the market itself by causing transactions to appear on the exchange's ticker tape that did not represent the free play of supply and demand.¹³³ Because all transactions in stocks traded on a stock exchange were promptly reported on the exchange's ticker tape,

126. *Id.* at 270-82; Comment, *Market Manipulation and the Securities Exchange Act*, *supra* note 23, at 626-28.

127. See F. PECORA, *supra* note 125, at 270-82; Comment, *Market Manipulation and the Securities Exchange Act*, *supra* note 23, at 626-28.

128. "The testimony of members of the New York Stock Exchange given before the Senate Committee on Banking and Currency tends to confirm the common knowledge of 'the Street' that collusion with specialists has been a method of price manipulation used by pools." TWENTIETH CENTURY FUND, STOCK MARKET CONTROL 111 (E. Clark, A. Bernheim, J. Dewhurst, M. Schneider eds. (1934)). "[T]he specialist in the manipulated stock is an invaluable ally of the pool." Note, *Manipulation of the Stock Markets Under the Securities Laws*, *supra* note 23, at 662. Accord Comment, *Market Manipulation and the Securities Exchange Act*, *supra* note 23, at 626-28.

129. *United States v. Brown*, 5 F. Supp. 81, 93 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935). See *infra* notes 161-62.

130. See *Harris v. United States*, 48 F.2d 771 (9th Cir. 1931); Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 512.

131. Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 512.

132. *Id.*

133. "The most effective manner of inducing others to purchase is to have a favorable ticker tape record which indicates to prospective purchasers that others consider the security to be underpriced." Comment, *Market Manipulation and the Securities Exchange Act*, *supra* note 23, at 627. A 1930 fictional account of Wall Street operations states: "There was no need to give out any bull tips . . . [The pool operator's] job was to seek directly to influence public

which could be seen by brokers and investors in brokerage offices throughout the country, a skillfully orchestrated campaign of buying and selling shares in order to create bogus prices was a highly effective form of misrepresentation.¹³⁴ As one financial historian has stated: "The point of a pool operation was simplicity itself: it was a way of inducing the Stock Exchange ticker tape to tell a story that was essentially false, and thus to deceive the public."¹³⁵

The crudest way of misrepresenting the market was the "wash sale," in which the manipulator gave an order to sell shares of stock to one broker and an order to buy the same number of shares of the same stock at the same price to another broker.¹³⁶ The transaction that was consequently printed on the ticker tape was a total falsehood because it did not represent any change of beneficial ownership of the security.¹³⁷ Only a shade less deceptive was the "matched order," in which the manipulator traded with a confederate for the purpose of creating an appearance of trading activity or a change of price in the market.¹³⁸

Although the spreading of false information about the company,

sentiment by the best possible kind of publicity—that of the tape." A. TRAIN, *supra* note 110, at 259-60.

134. A pool "is dug by a group of gambling gentlemen. These philanthropists collect a sizable wad of stock at low prices. Then they tell the public that they intend to buy a lot more and shoot the price of the stock sky-high, or, perhaps, even higher than that. The pool now "creates activity" in the stock by buying and selling its shares to one another, or to their friends, at slightly advancing prices.

Old John B. Public excitedly swallows his Adam's apple. While he pop-eyedly absorbs the "information" fed out by the altruistic birds who are preparing to take him for a ride and send him home in a barrel. . . .

Finally the psychic pressure becomes too great, and John makes a flying leap for the bait. . . .

D. SALMON, *supra* note 109, at 124.

135. J. BROOKS, *supra* note 108, at 69.

136. Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 513.

137. Manipulation by falsifying the market is not limited to the securities markets. For example, in July 1985 David Bathurst resigned from his position as chairman of Christie's, the international auction house, after admitting in the course of litigation that he had falsely reported that three Impressionist paintings had been sold at auction for a total of \$5.6 million, whereas only one of these paintings had been sold, for \$2.2 million. The other two paintings had not attracted large enough bids for them to be sold. The "phantom sales" of the two paintings were recorded by several publications that keep track of art prices:

Mr. Bathurst said that he made the false report to help the owner of the paintings because it is more difficult to sell art privately if it does not do well at auction, and to maintain stability in the art market which might have become depressed if the public immediately discovered that only one painting was sold.

Christie's Chairman Admits to False Report, N.Y. Times, July 8, 1985, at C13, col. 4; McGill, *Christie's Chairman Quits in False Sale Case*, N.Y. Times, July 20, 1985, at 1, col. 1.

138. Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 513. *Accord* Comment, *Market Manipulation and the Securities Exchange Act*, *supra* note 23, at 627.

bribery of salesmen and financial writers, wash sales, and matched orders were often used by pool operators, sometimes in combination with each other, an equally commonly used manipulative device appears to have been the effecting of *bona fide* purchases and sales in a manner that was designed to lure the public into the market.¹³⁹ A skillful manipulator could play on the gullibility and greed of the public with incredible effect.¹⁴⁰ An account in a 1930 novel about Wall Street gives a good picture of how it was done:

Shelton [the pool operator] has begun [the manipulation] by bidding up the price on small lots. The floor traders, seeing the stock's apparent buoyancy, had begun to buy in anticipation of a rise, and this had resulted in an increased demand which Shelton had satisfied out of the stock which he himself had just bought. . . . This had in turn naturally checked the buying and, when the price began to sag in consequence, he had repurchased the stock he had just sold a point or two higher up thus creating a new appearance of strength. While the process was in fact simplicity itself, it gave the effect of great activity and widespread buying which could not fail to have an effect upon the susceptible public.¹⁴¹

Lest the reader dismiss this description of a manipulation as mere fictional fantasy, it should be pointed out that a real pool operation in 1933, only a few months before the Exchange Act was enacted, used methods such as these to run the price of a stock up from twenty to ninety within two months. The price then plummeted from ninety to thirty in only four days, when the pool operators withdrew their support for the stock, after disposing of their holdings at a profit.¹⁴² And this situation was in no way exceptional: during 1929 alone, 105 stocks listed on the New York Stock Exchange were the subject of

139. See *United States v. Brown*, 5 F. Supp. 81, 93 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935).

140. A leading authority on security analysis has observed that securities markets are unusual in that price rises often attract buyers, while price declines attract sellers. Referring to "technical analysis" of the market, he has written:

The one principle that applies to nearly all these so-called "technical approaches" is that one should buy *because* a stock or the market has gone up and one should sell *because* it has declined. This is the exact opposite of sound business sense everywhere else, and it is most unlikely that it can lead to lasting success in Wall Street.

B. GRAHAM, *THE INTELLIGENT INVESTOR* x (4th ed. 1973).

It is of course this tendency of investors (or speculators) to "follow the market" by buying or selling in accordance with market trends that makes it possible for manipulators to succeed in their efforts to draw the public in by falsifying the market.

141. A. TRAIN, *supra* note 110, at 146.

142. F. PECORA, *supra* note 125, at 270-82.

pools managed by member firms of the Exchange.¹⁴³

Compared with the crude and direct deception involved in activities such as spreading false publicity, touting, wash sales, or matched orders, manipulation by means of actual purchases and sales was a relatively sophisticated technique. Yet this technique was equally deceptive, even though each purchase or sale effected by the pool operator was an actual market transaction that placed the members of the pool at the risk of the market and was not the product of prearrangement among confederates trading with each other in the market. But while this method was more subtle than that of the cruder manipulative practices, its aim was identical: to give a "false appearance to the market for a security in order to deceive others trading in the market and thus to influence them to buy or sell in accordance with the manipulator's desire."¹⁴⁴ The *Schreiber* Court summed up the essentially deceptive nature of manipulation when it pointed out that *Scott v. Brown, Doering, McNab & Co.*, a nineteenth century seminal English case "which broke new ground in recognizing that manipulation could occur without the dissemination of false statements, nonetheless placed emphasis on the presence of deception. As Lord Lopes stated in that case, 'I can see no substantial distinction between false rumors and false and fictitious acts.'"¹⁴⁵

B. *Manipulation Under the Common Law*

While all of these practices were regarded as manipulative and condemned by many observers of the stock market during the early twentieth century, the American legal system did not proscribe all of them.¹⁴⁶ To be sure, spreading false information in order to influence securities prices was condemned under the common law as fraud.¹⁴⁷

143. Note, *Manipulation of the Stock Markets Under the Securities Laws*, *supra* note 23, at 661.

144. Loomis, *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214, 241 (1959).

145. *Schreiber*, 105 S. Ct. at 2462 n.4 (citing *Scott v. Brown, Doering, McNab & Co.*, [1892] 1 Q.B. 724 (C.A.)).

146. See *infra* text accompanying notes 159, 165-67.

147. It seems to be an established rule of law that any statement of any kind issued by anyone and intended to affect the price of, or to be used in appraising, a security must be accurate; and that the knowing publisher of false information is liable on an action of fraud to anyone who relies on it, or probably, even to anyone who acts to his loss in the open market on a false valuation as a result of such statement.

Berle, *Liability for Stock Market Manipulation*, 31 COLUM. L. REV. 264, 268 (1931). See *Bedford v. Bagshaw*, 4 H. & N. 538 (1859) (where the defendant made false representations to the London Stock Exchange that caused the Exchange to list the company's shares, the plaintiff, a purchaser of these shares in the market, was awarded damages in an action for deceit).

Not only was it grounds for criminal prosecution,¹⁴⁸ but a contract to manipulate by this means was unenforceable,¹⁴⁹ and the manipulators could be held liable to a person who bought at a price affected by the manipulation.¹⁵⁰ In the latter type of action, it was not necessary for the plaintiff to establish that he had relied upon, or had even heard or read, the false information; it was sufficient to prove that the "effect of the statement was to create a false valuation or appraisal by the . . . market, and the buyer relied upon the state of the market."¹⁵¹ A. A. Berle, Jr. wrote in 1931 that in this event "[t]he chain of causation between the statement relied upon and the price adopted by the investor is slightly longer than the ordinary case of deceit, but is no less direct."¹⁵²

In general, the early twentieth century saw an increasing tendency to apply legal sanctions to various forms of manipulation. At least as early as 1909, wash sales were considered to be "illegal and immoral contracts" which the courts would not enforce.¹⁵³ A person found guilty of making a wash sale could be prosecuted under the New York antifraud statute¹⁵⁴ or, if he were a New York Stock Exchange member, expelled from the Exchange.¹⁵⁵ Matched orders, however, were still regarded as enforceable in 1909,¹⁵⁶ but by 1931, as concepts of fraud broadened, they had begun to be regarded as fraudulent "fictitious transactions."¹⁵⁷ Touting of stocks through "fake financial services, . . . bribed financial writers, and [the bribing of]

148. *People v. Federated Radio Corp.*, 244 N.Y. 33 (1926); *People v. Rice*, 221 A.D. 443, 223 N.Y.S. 566 (1927).

149. *Bradley v. Bradley*, 165 N.Y. 183 (1900); *Ridgely v. Keane*, 134 A.D. 647, 119 N.Y.S. 451 (1909).

150. *Ottinger v. Bennett*, 203 N.Y. 554, *adopting the appellate division dissenting opinion of Miller, J.*, 144 A.D. 525, 129 N.Y.S. 819 (1911); *Ridgely v. Keane*, 134 A.D. 647, 119 N.Y.S. 451 (1909); *Bedford v. Bagshaw*, 4 H.& N. 538 (1859). See Berle, *Liability for Stock Market Manipulation*, *supra* note 147, at 268-72. See generally 3 L. LOSS, *SECURITIES REGULATION* 1535-40 (2d ed. 1961) (litigation over manipulation prior to the securities statutes).

151. Berle, *Liability for Stock Market Manipulation*, *supra* note 147, at 269.

152. *Id.* It therefore appears that the "fraud on the market" concept, which has been used in recent years by several federal courts to provide the causative link in private actions for misrepresentation under Rule 10b-5, can trace its lineage to the pre-1934 common law of manipulation. See *infra* note 273 and text accompanying notes 273, 275-79.

153. *Ridgely v. Keane*, 134 A.D. 647, 119 N.Y.S. 451 (1909); REPORT OF THE GOVERNOR'S COMMITTEE ON SPECULATION IN SECURITIES AND COMMODITIES (THE HUGHES REPORT) (1909), reprinted in W. VAN ANTWERP, *supra* note 109, at 421-23.

154. *People v. Rice*, 221 A.D. 443, 223 N.Y.S. 566 (1927). See also *People v. Federated Radio Corp.*, 244 N.Y. 33 (1926) (holding defendants liable under the New York antifraud statute for printing deceptive advertisements designed to sell securities).

155. J. DILLON, *supra* note 109, at 62.

156. W. VAN ANTWERP, *supra* note 109, at 423.

157. *Harris v. United States*, 48 F.2d 771 (9th Cir. 1931).

brokers" likewise were classed as fraudulent practices.¹⁵⁸

The effecting of actual transactions for the purpose of influencing its price by inducing others to buy or sell a security, though commonly viewed as manipulative, remained legal in the United States until the enactment of the Exchange Act.¹⁵⁹ The 1933 decision of Judge Woolsey in *United States v. Brown*¹⁶⁰ has sometimes been cited for the proposition that manipulation by actual trading was illegal in the United States before 1934, indicating that deception was not a necessary element of manipulation under the common law.¹⁶¹ The language used in Judge Woolsey's opinion, however, treats manipulation as a sophisticated form of deception.¹⁶² Furthermore, the case actually involved wash sales, payments to publicity agents and brokers to tout the stock, and "false and fraudulent representations and statements;"¹⁶³ the Second Circuit Court of Appeals affirmed the lower court's decision on the narrow ground of conventional fraud.¹⁶⁴

Thus, although manipulation by means of actual purchases and sales was commonly recognized as manipulative and deceptive,¹⁶⁵ no

158. Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 512.

159. "In the United States prior to 1934 no case established the illegality of any form of manipulation by actual purchases and sales" Note, *Regulation of Stock Market Manipulation*, *supra* note 23, at 517. In 1931, A. A. Berle, Jr. wrote that under American (as opposed to English) law:

[A] group may purchase with the sole aim of raising the price or may sell with the sole aim of depressing it; and granted that they are not connected with the corporation, or have not in some other way assumed obligations to the market or to investors in that corporation, the law leaves them strictly alone. In theory, apparently, reliance is placed upon the risks involved in the transaction to prevent manipulation of stock prices.

Berle, *supra* note 147, at 272. *Accord* Berle, *supra* note 23, at 406.

160. 5 F. Supp. 81 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935).

161. One writer recently stated that in *Brown* "the culpable conduct consisted of creating a 'controlled market' and artificially raising the quoted price of the stock, not disclosure tainted by misrepresentation or omission." Note, *Target Defensive Tactics as Manipulative Under Section 14(e)*, *supra* note 34, at 248. The quoted statement, that there was no "disclosure tainted by misrepresentation or omission," would be correct only if one does not regard falsification of the appearance of the market as a misrepresentation.

162. "[W]hen two or more persons, by a joint effort, raise the price of a listed stock artificially, they are creating a kind of price mirage which may lure an outsider into the market to his damage. . . . [S]uch a procedure would of itself constitute a fraud on the public. . . ." *Brown*, 5 F. Supp. at 93.

163. *Id.*

164. *United States v. Brown*, 79 F.2d 321, 325-26 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935).

165. [W]here a man or group of men purchases stock, not because they appraised the stock as worth the price, but because thereby they hoped to induce others to appraise it at that price, the scheme partook of the nature of a conspiracy to induce others to act on a false assumption, to the profit of the wrongdoers and to the loss of the outside purchaser.

case prior to 1934 established its illegality.¹⁶⁶ The 1933 and 1934 hearings of the Senate Banking Committee revealed to the American public for the first time that manipulative activities were widespread, that they were practiced by "prominent businessmen and national figures of both political parties,"¹⁶⁷ and that some of these practices were perfectly legal under existing law.

By 1934, when the legislation that became the Exchange Act was being considered by Congress, the term "manipulation" encompassed a variety of stock market practices, all of which involved deception of the investing public for the purpose of influencing the market price of a security for the immediate profit of the manipulators. It is against this background that the antimanipulative provisions of the Exchange Act and legislative history of these provisions need to be understood.

IV. THE ANTIMANIPULATIVE PROVISIONS OF THE EXCHANGE ACT

The Exchange Act deals with the problem of manipulation in two principal ways.¹⁶⁸ First, in sections 9(a)(1) to 9(a)(5),¹⁶⁹ Congress prohibited certain specific practices, including wash sales, matched orders, dissemination of false information, and manipulation through actual trading. Second, in section 10(b),¹⁷⁰ Congress gave the SEC broad authority to prohibit or regulate "new" forms of manipulation that might appear in the future.¹⁷¹

In 1968 Congress enacted additional antimanipulative provisions

Berle, *supra* note 147, at 272-73.

166. See *supra* note 159 and accompanying text.

167. V. CAROSSO, *supra* note 116, at 324-25.

168. "The problem of manipulation was attacked by Congress in a number of ways—by specific prohibitions, by giving the Commission rule-making authority in certain areas, and by a general prohibition against any trading for a manipulative purpose." 3 L. LOSS, *SECURITIES REGULATION* 1542 (2d ed. 1961).

In addition to the provisions that prohibited or that gave the SEC authority to prohibit manipulation, Congress also gave the SEC authority to regulate certain specific practices affecting the trading markets, such as price stabilization, short selling, stop loss orders, and trading in options, which had been used in connection with manipulative schemes but which also appeared to have legitimate functions. See Exchange Act § 9(a)(6), 15 U.S.C. § 78i(a)(6); Exchange Act § 9(b), 15 U.S.C. § 78i(b); Exchange Act § 9(c), 15 U.S.C. § 78i(c); Exchange Act § 10(a), 15 U.S.C. § 78j(a).

169. Exchange Act, 15 U.S.C. § 78i(a)(1)-(5).

170. Exchange Act, 15 U.S.C. § 78j(b).

171. "The section was described rightly as a 'catchall' clause to enable the Commission 'to deal with new manipulative [or cunning] devices.'" *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976) (footnote omitted). Cf. *Loomis*, *supra* note 144, at 241. For the complete text of section 10(b), see *supra* note 20. In addition, subsections 15(c)(1)-(2), Exchange Act, 15 U.S.C. § 78o(c)(1)-(2), forbid manipulation by brokers and dealers in the over-the-counter market and provide rule-making authority to the Securities and Exchange Commission.

as part of the Williams Act.¹⁷² Section 13(e) gives the SEC the authority to adopt rules prohibiting manipulation in connection with corporate repurchases of shares;¹⁷³ and section 14(e) (the provision under consideration in the Schreiber case) prohibits manipulation in connection with tender offers.¹⁷⁴

As will be seen, the meaning of manipulation in these separate provisions is closely interrelated. It should be observed at the outset of this discussion that the remedies provided by the federal securities laws are cumulative, and that a cause of action may be stated under one or more of the general antimanipulative provisions regardless of whether the conduct involved is of the kind proscribed under another, more specific prohibition.¹⁷⁵ For example, an independent cause of action for manipulation can exist under section 10(b) even though one or more of the elements of a section 9(a) violation may be missing.¹⁷⁶

A. Section 9(a)

Sections 9(a)(1) to 9(a)(5) prohibit practices that had been identified as manipulative¹⁷⁷ in the congressional hearings that led to enactment of the statute, but not all of these practices were clearly illegal before 1934.¹⁷⁸ In fact, the purpose of section 9(a)(2) was precisely to make illegal the central activity of the manipulative pools that had flourished prior to 1934, manipulation by means of actual trading.¹⁷⁹

172. See *supra* note 27 and accompanying text.

173. Exchange Act, 15 U.S.C. § 78m(e).

174. Exchange Act, 15 U.S.C. § 78n(e). For the complete text of section 14(e), see *supra* note 14. The term "tender offer" is not defined in the Exchange Act. A leading treatise on the subject defines the term as "simply an invitation to the stockholders of a corporation to tender a sufficient number of shares for purchase and thereby attain actual or effective control." E. ARANOW & H. EINHORN, *PROXY CONTESTS FOR CORPORATE CONTROL* 585 (2d ed. 1968). The question of the meaning of a tender offer has been the subject of a certain amount of litigation. See *Wellman v. Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979), *aff'd on other grounds*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983); L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 582-84 (1983).

175. *Herman & MacLean v. Huddleston*, 459 U.S. 375, *on remand*, 705 F.2d 775 (5th Cir. 1983).

176. *Chemetron Corp. v. Business Funds, Inc.*, 718 F.2d 725 (5th Cir. 1983) (vacating its previous judgment in light of the Supreme Court's decision in *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983)).

177. See *supra* text accompanying notes 115-45. Section 9 is headed "Manipulation of Security Prices" although, curiously, the word "manipulation" or "manipulative" does not appear anywhere in the text of the section.

178. See *supra* text accompanying notes 159, 165-67.

179. A report from the legislative history of the Act states:

[Section 9(a)(2)] makes it unlawful to effect either alone or in concert with others a series of transactions in any registered security, creating actual or apparent active trading in the security or raising or depressing the price thereof, for the purpose of inducing the purchase or sale of the security by others. This provision

Because the stock market practices that were the subject of the hearings occurred largely in connection with trading on the stock exchanges, rather than on the then embryonic over-the-counter market, the prohibitions of section 9(a) were confined to activities "in any security registered on a national securities exchange"—that is, listed securities.¹⁸⁰

Section 9(a)(1) prohibits wash sales and matched orders.¹⁸¹ This "crude" form of manipulative activity, according to a 1934 committee report, "create[s] a misleading appearance of activity with a view to enticing the unwary into the market on the hope of a quick gain."¹⁸² It was regarded as "the most vicious practice of the stock exchanges . . . on a par with the use of loaded dice . . . however, more reprehensible."¹⁸³ For a violation of section 9(a)(1) to occur, the activity must be "for the purpose of creating a false or misleading appearance of active trading in [the] security."¹⁸⁴ Because the only likely purpose of engaging in wash sales or matched orders is to falsify the market, however, this requirement of specific intent has not been an obstacle to imposing liability for this kind of activity.¹⁸⁵

Sections 9(a)(3), (4), and (5)¹⁸⁶ are specialized prohibitions designed to end certain identified manipulative practices of broker-dealers and other persons selling, offering to sell, purchasing, or offering to purchase registered securities. Section 9(a)(3) prohibits such persons from inducing the purchase or sale of a security by distributing information that the price of the security is likely to rise or fall as a result of a manipulation, while section 9(a)(5) prohibits any other person from doing the same thing for a consideration received from any such person.¹⁸⁷ Section 9(a)(4) prohibits such persons from

should perform the wholesome service of outlawing pool operations, as well as every other device used to persuade the public that activity in a security is the reflection of a genuine demand instead of a mirage.

S. REP. NO. 1455, 73d Cong., 2d Sess. 55 (1934). *See supra* text accompanying note 139.

180. Exchange Act, 15 U.S.C. § 78i(a).

181. Exchange Act, 15 U.S.C. § 78i(a)(1).

182. H.R. REP. NO. 1383, 73d Cong., 2d Sess. 10 (1934).

183. 78 CONG. REC. 7717 (1934).

184. Exchange Act, 15 U.S.C. § 78i(a)(1).

185. *See Note, Manipulation of the Stock Markets Under the Securities Laws, supra* note 23, at 662; *Comment, Market Manipulation and the Securities Exchange Act, supra* note 23, at 638.

186. Exchange Act, 15 U.S.C. §§ 78i(a)(3)-(5).

187. It has been argued that sections 9(a)(3) and (5) do not require misrepresentation or nondisclosure, and that therefore deception is not an essential element of manipulation of all the antimanipulative provisions of the Act. Junewicz, *supra* note 34, at 1185. Although it is literally true that a person can violate section 9(a)(3) or (5) by making true statements (that is, that a manipulation is planned or taking place), these two subsections are in a sense derivative as they can be violated by truthful statements only if there is a manipulation.

inducing the purchase or sale of a security by materially false or misleading statements. These provisions of the Exchange Act were aimed at eliminating "tipster sheets" and the like, as well as the "touting" of listed securities.¹⁸⁸ Like section 9(a)(1), they prohibited manipulative abuses that were already illegal under other provisions of federal and state law.¹⁸⁹

Section 9(a)(2), which has been called "the very heart of the act,"¹⁹⁰ makes it unlawful for any person to effect "a series of transactions in any [listed] security . . . creating actual or apparent trading in such security or raising or depressing [its] price . . . , for the purpose of inducing the purchase or sale of such security by others."¹⁹¹ In order to establish a violation of section 9(a)(2), three elements must be shown: that a person (1) effected a series of transactions,¹⁹² which (2) created actual or apparent trading or raised or depressed the price of a registered security, (3) for the purpose of inducing others to buy or sell the security.¹⁹³

The legislative history of the specific-purpose requirement of section 9(a)(2) provides a useful insight into the framers' understanding of the term "manipulation." Because section 9(a)(2) created a new offense unknown to the American common law, and because the line between legitimate and manipulative trading was a thin one, Congress was concerned that the statute clearly define the requisite intent.¹⁹⁴ In the version of the section that was reported out by the House of Representatives, the requisite intent was that "of raising or depressing the price of such security."¹⁹⁵ Similarly, the Senate version required that the trading be "with the specific intent of raising or depressing such price."¹⁹⁶ In explaining these provisions, the legislators emphasized

188. S. REP. NO. 1455, 73d Cong., 2d Sess. 55 (1934).

189. See *supra* text accompanying notes 147-52, 158.

190. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 992 (1983) (footnote omitted).

191. Exchange Act, 15 U.S.C. § 78i(a)(2).

192. A "series" may be as few as three, or possibly two, transactions. 3 L. LOSS, SECURITIES REGULATION 1550 (2d ed. 1961). A bid or offer will suffice as a "transaction," even though no purchase or sale occurs. Note, *Manipulation of the Stock Markets Under the Securities Laws*, *supra* note 23, at 663.

193. See *Spencer Co. v. Agency Rent-A-Car, Inc.*, FED. SEC. L. REP. (CCH) ¶ 98,301 at 91,895 (D. Mass. Sept. 21, 1981), *later op.*, FED. SEC. L. REP. (CCH) ¶ 98,361 (D. Mass. Nov. 17, 1981), *later proc.*, 542 F. Supp. 237 (D. Mass. 1982). The third element of section 9(a)(2), the requisite purpose of inducing others to buy (or sell), is an essential element of the offense. *SEC v. Resch-Cassin & Co.*, 362 F. Supp. 964, 977 (S.D.N.Y. 1973).

194. *Stock Exchange Practices: Hearings on S. 84, 56, 97 Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess. 6507-10 (1934) [hereinafter cited as *Stock Exchange Practices*].

195. H.R. REP. NO. 1383, 73d Cong., 2d Sess. 20 (1934).

196. S. REP. NO. 792, 73d Cong., 2d Sess. 17 (1934).

that extensive trading is bound to cause changes in the market price of a security, but that mere knowledge on the part of a purchaser or seller that his transactions will have this effect is not sufficient to make the transactions manipulative.¹⁹⁷ A representative of the New York Stock Exchange nevertheless complained that under the Senate bill "people will not know whether they are on the verge or on the edge of performing a criminal act. . . . [Because] nobody buys a security with the idea that his purchase is going to leave the market entirely unaffected," every purchase or sale might be interpreted as being for the purpose of raising or depressing the price, "and hence every buyer and seller would be a criminal."¹⁹⁸

The Conference Committee that resolved the differences between the House and Senate bills substituted the more restrictive requirement that the purpose be that of "inducing the purchase or sale of such securities by others." Under the new language, it would no longer be possible to find a person guilty of manipulative activity simply because he knows or should have known that a price movement would be a natural consequence of his purchases or sales.¹⁹⁹ Most important for the purposes of this discussion, it is implicit in the specific intent requirement of section 9(a)(2) that deception is a necessary element of manipulation by trading. Nondeceptive activities might have been brought within the prohibition of the section if it merely required that a purchaser's or seller's purpose be to raise or depress the price of the security. But a person who purchases or sells securities for the purpose of inducing other persons to trade is necessarily deceiving those persons into believing that the manipulator's purchases or sales are a bona fide expression of supply and demand in the market, rather than the creation of a "price mirage."²⁰⁰ Thus section 9(a)(2), which made illegal a hitherto unproscribed type of market activity, was consistent with the view that existed in 1934 and

197. *Id.*; H.R. REP. NO. 1383, 73d Cong., 2d Sess. 20 (1934). "Bringing about a price rise . . . is not unlawful in itself." Op. Gen. Counsel, Sec. Ex. Act Rel. No. 3056 (1941).

198. *Stock Exchange Practices*, *supra* note 194, at 6508, 6510.

199. In the context of criminal law, specific intent requires that the doer of an act intend a consequence that "represent[s] the very purpose for which an act is done (regardless of likelihood or occurrence), or . . . [that is] known to be substantially certain to result (regardless of desire)." R. PERKINS & R. BOYCE, *CASES AND MATERIALS ON CRIMINAL LAW AND PROCEDURE* 417 (5th ed. 1977) (footnote omitted). Similarly, in tort law, the word "intent" means "that the actor desires to cause the consequences of his act, or that he believes that the consequences are substantially certain to result from it." RESTATEMENT (SECOND) OF TORTS § 8A (1965). See Comment, *Market Manipulation and the Securities Exchange Act*, *supra* note 23, at 634.

200. See *United States v. Brown*, 5 F. Supp. 81, 93 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935); *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 383 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973), *reh'g denied*, 430 U.S. 976 (1976).

earlier, that manipulation was a form of deception.²⁰¹

In order to establish the requisite purpose of section 9(a)(2) of inducing others to purchase or sell, the courts have generally required some additional activity by the defendants, other than a series of transactions.²⁰² Such additional activity may include making a secret agreement with other owners of the security to withhold their securities from the market while the defendant makes his purchases;²⁰³ making secret sales off the market, while making purchases on the market;²⁰⁴ or engaging in a distribution of the security in order to use the manipulated after-market to sell the security to the public.²⁰⁵

The SEC has adopted the position that manipulation in violation of section 9(a)(2) is an inherently deceptive practice. Thus, in *Thornton & Co.*,²⁰⁶ where the respondents manipulated the market for a listed stock by both wash sales and actual trading, in violation of sections 9(a)(1) and 9(a)(2), the Commission said:

Purchasers in over-the-counter as well as the Exchange markets are entitled to believe that the Exchange market price which governed the price charged them represents a price established in an independent market free of artificial devices. *To sell securities on the basis of a manipulated price is to sell on the basis of misrepresentation.*²⁰⁷

B. Section 10(b)

Section 10(b), which is by far the best known and most important of the Act's antimanipulative provisions, prohibits any person from using "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of a security, in violation of rules prescribed by the SEC "as necessary or appropriate in the public interest or for the protection of investors."²⁰⁸ Section 10(b) was intended as a "catch-all" provision to enable the SEC "to deal with

201. "[A]ll section 9 devices have the effect of misinforming investors by creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand." *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1361 (N.D. Tex. 1979). See *supra* text accompanying notes 115-45. For further discussion of the *Hundahl* case, see also *infra* text accompanying notes 231-41.

202. *Liberty Nat'l Ins. Holding Co. v. Charter Co.*, FED. SEC. L. REP. (CCH) ¶ 98,671 (N.D. Ala. Apr. 27, 1982), *later op.*, FED. SEC. L. REP. (CCH) ¶ 98,797 (N.D. Ala. Aug. 13, 1982), *aff'd*, 734 F.2d 545 (11th Cir. 1984).

203. *Otis & Co. v. SEC*, 106 F.2d 579 (6th Cir. 1939).

204. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 794-97 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970).

205. *SEC v. Resch-Cassin & Co., Inc.*, 362 F. Supp. 964 (S.D.N.Y. 1973).

206. 28 S.E.C. 208 (1948), *aff'd*, 171 F.2d 702 (2d Cir. 1948).

207. *Id.* at 224 (citing *Kidder, Peabody, & Co.*, 18 S.E.C. 559 (1945)) (emphasis added).

208. For the complete text of section 10(b), see *supra* note 20.

new manipulative devices" that did not exist or were not known in 1934.²⁰⁹ Because it was not possible to foresee every manipulative device that might be invented in the future, Congress gave the SEC authority under section 10(b) to adopt rules defining additional manipulative practices.²¹⁰

Section 10(b) is not self-operative but requires that the SEC adopt rules to implement it. As the Sixth Circuit Court of Appeals has stated:

Section 10(b) does not flatly prohibit the use of a manipulative device in the purchase or sale of a security; rather, it prohibits "any manipulative or deceptive device or contrivance in contravention of such rules as the [SEC] may prescribe." Only those manipulative devices prohibited in SEC Regulations are unlawful under the Exchange Act.²¹¹

Several of the rules that the Commission has adopted under section 10(b) do actually define specific practices as being manipulative.²¹² Most of the discussion of the antimanipulative content of section 10(b) centers on Rule 10b-5, however, which the Commission adopted in 1942.²¹³ This rule simply applies, with little change in language, the broad antifraud provisions of section 17(a) of the Securities Act of 1933²¹⁴ to purchases as well as sales of securities.²¹⁵ Because section 10(b) is applicable to "any security," while section 9(a) applies only to securities registered on a national securities exchange,²¹⁶ Rule 10b-5 has been used to proscribe manipulation of an unlisted security that would be a violation of section 9(a) if the

209. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203 (1976). See *Santa Fe Indus. v. Green*, 430 U.S. 462, 477 (1977); see also *Herpich v. Wallace*, 430 F.2d 792, 801 (5th Cir. 1970).

210. Section 10(b) and Rule 10b-5 "are not intended as a specification of particular acts or practices that constitute 'manipulative or deceptive devices or contrivances,' but are instead designed to encompass the infinite variety of devices that are alien to the 'climate of fair dealing.'" *Herpich*, 430 F.2d at 802 (citing *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963)).

211. *Marsh v. Armada Corp.*, 533 F.2d 978, 982 (6th Cir. 1976), *cert. denied*, 430 U.S. 954 (1977).

212. For example, SEC Rule 10b-6 prohibits participants in a distribution of securities from engaging in certain market activities. 17 C.F.R. § 240.10b-6 (1983). See L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 802-03 (1983).

213. For the complete text of Rule 10b-5, see *supra* note 20.

214. Securities Act of 1933, 15 U.S.C. § 77q(a) [hereinafter cited as Securities Act]. The Commission adopted Rule 10b-5 to close a loophole: to afford sellers the same protection that buyers have under section 17(a) of the Securities Act of 1933. The rule's aim is to reach "misleading or deceptive activities, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit." *Herpich*, 430 F.2d at 802 (quoting *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961)).

215. See L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 820-22 (1983).

216. See *supra* text accompanying note 180.

security were a listed security.²¹⁷ That limited though important application of the rule leaves open, however, the central question for this discussion: what are the meaning and scope of the term "manipulation" under section 10(b) and Rule 10b-5?

It seems clear that, because section 10(b) was designed as a "catch-all" that would encompass "new" types of manipulation,²¹⁸ its prohibitions are not limited to the specific practices described in section 9(a).²¹⁹ There is no evidence that Congress's only purpose in enacting section 10(b) was to apply the prohibitions of section 9(a) to over-the-counter securities, or to apply the prohibitions of section 17(a) to fraudulent purchases.²²⁰ At the same time, the question remains: if manipulation under section 10(b) is a broader concept than it is under section 9(a), how much broader is it?²²¹

As stated earlier, the Supreme Court in *Santa Fe*, a case brought under section 10(b), said that manipulation "refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."²²² This definition is restrictive in two ways. First, it defines manipulation in terms of the specific practices prohibited by section 9(a), although it stops short of saying that its scope is limited to those practices. Second, the *Santa Fe* Court's use of the word "mislead" in the final clause of its definition indicates that the Court considered deception to be an essential element of manipulation.²²³ With the

217. *Barrett & Co.*, 9 S.E.C. 310 (1941). Because section 17(a) of the Securities Act applies only to sales of securities, and section 15(c) of the Exchange Act, while applying to purchases as well as sales, is limited to fraudulent acts by brokers and dealers, Rule 10b-5 has also been used against nonbrokers or dealers who engage in fraudulent purchases. See L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 820-22 (1983).

218. L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 821 (1983).

219. *But see* *Hundahl v. United Benefit Ins. Co.*, 465 F. Supp. 1349, 1361 (N.D. Tex. 1979) (where the court said in dictum: "Legislative history supports the . . . view that the manipulative conduct prohibited in Section 10(b) is limited to the devices which Section 9 bars.").

220. "[Congress] did not . . . limit the section in its application to the manipulative and deceptive devices or contrivances known in 1934." *Herpich v. Wallace*, 430 F.2d 792, 801 (5th Cir. 1970).

221. For a discussion of manipulative activities prohibited by section 9(a), see *supra* text accompanying notes 177-207.

222. *Santa Fe*, 430 U.S. at 476. See *supra* text accompanying note 61.

223. Section 10(b)'s general prohibition of practices deemed by the SEC to be "manipulative"—in this technical sense of artificially affecting market activity in order to mislead investors—is fully consistent with the fundamental purpose of the 1934 "Act to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*."

Santa Fe, 430 U.S. at 476-77 (quoting *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972) and *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963)).

notable exception of *Mobil Corp. v. Marathon Oil Co.*,²²⁴ almost all the court decisions dealing with corporate control transactions have followed the teaching of *Santa Fe* that manipulation under section 10(b), although not limited to the section 9(a) prohibitions, is limited to these and similar practices that deceive investors. As Judge Lasker has stated:

This term of art cannot be extended to cover every form of unfair dealing which appears to the lay person to be manipulative. The unifying element in the manipulative devices listed in *Santa Fe* is that they are "used to persuade the public that activity in a security is the reflection of genuine demand instead of a mirage."²²⁵

In *United States v. Charnay*,²²⁶ a case decided shortly before *Santa Fe*, an indictment charged that the defendants, who had made an offer to acquire all the assets of Air West on behalf of Hughes Tool Company, artificially depressed the price of the stock on the American Stock Exchange in order to coerce the company's directors to vote in favor of the offer. According to the indictment, this was done by causing several persons to make substantial sales of Air West stock and at the same time guaranteeing to these sellers by secret understanding a recovery of a minimum amount irrespective of the price obtained on the Exchange.²²⁷ The trial court dismissed the indictment because it did not include an allegation that the defendants' purpose was to induce the purchase or sale of the stock by others. The Ninth Circuit Court of Appeals reversed, holding that there is simply no requirement under Rule 10b-5, as there is under section 9(a)(2), that such a purpose be alleged or proved.²²⁸ It is enough, the court said, that the defendants "purposely sought to depress the market for the stock, and in fact achieved this result, with the object and effect of deceiving the shareholders and directors."²²⁹ Thus the court held that a charge of manipulation by trading under section 10(b) requires that there be deception and an intent to influence the market price of a security, but not necessarily the specific intent required by section 9(a)(2).²³⁰

On the other hand, in *Hundahl v. United Benefit Life Insurance*

224. 669 F.2d 366 (6th Cir. 1981). See *supra* text accompanying notes 32-33.

225. *Billard v. Rockwell Int'l Corp.*, 526 F. Supp. 218, 222 (S.D.N.Y.), *aff'd*, 683 F.2d 51 (2d Cir. 1981) (citation omitted).

226. 537 F.2d 341 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976), *aff'd*, 577 F.2d 81 (9th Cir. 1978). For further discussion of this case, see *infra* text accompanying notes 357-58.

227. *Id.* at 344.

228. See *supra* text accompanying notes 190-205.

229. *Charnay*, 537 F.2d at 350.

230. See *supra* text accompanying notes 190-205.

Co.,²³¹ where the defendants were charged with artificially depressing a stock by means of nondisclosures and misrepresentations, Judge Higginbotham of the Northern District of Texas took a far narrower view of what constitutes manipulation under section 10(b). In that case, Mutual, which owned seventy-one percent of the shares of United, had made an offer to buy the nine percent of the outstanding shares that were owned by the plaintiffs. The plaintiffs claimed that, in order to induce them to sell their shares, Mutual had artificially depressed the price of United shares through use of misleading and grossly conservative accounting reports, improper restriction of dividends, and failure to disclose their actions and the true value of United's assets. These acts, the plaintiffs claimed, were manipulative under section 10(b) and Rule 10b-5.²³²

Judge Higginbotham dismissed the suit. He held that "conduct that interferes with the free market only by depriving it of complete information is not necessarily manipulative."²³³ Judge Higginbotham defined manipulation as "practices in the marketplace which have the effect of either creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand or tampering with the price itself."²³⁴ In the court's view, the scope of manipulation under section 10(b) is closely related to the "section 9 devices," all of which "have the effect of misinforming investors by creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand."²³⁵ While Judge Higginbotham stopped short of holding that manipulation under section 10(b) is limited to the section 9(a) prohibitions, he stated that such a view is suggested by the legislative history of the Exchange Act.²³⁶

The *Hundahl* definition seems to limit manipulation to falsification of the market and to exclude from the definition false statements about a company or its securities that are designed to affect the market's valuation of the securities. In *Hundahl*, the plaintiff argued that section 9(a)(4), which makes it unlawful to make any intentionally false or misleading statement for the purpose of inducing the purchase or sale of a security, seems to prohibit exactly the type of conduct

231. 465 F. Supp. 1349 (N.D. Tex. 1979).

232. *Id.* at 1354.

233. *Id.* at 1360.

234. *Id.*

235. *Id.* at 1361.

236. *Id.* See also *In re Commonwealth Oil/Tesoro Petroleum Sec. Litig.*, 484 F. Supp. 253, 267 (W.D. Tex. 1979) (Higginbotham, J.).

alleged in that case.²³⁷ The court rejected this contention, saying that section 9(a)(4) applies only to persons "intimately involved in the workings of the marketplace—brokers, dealers, and persons who sell, buy, or offer to sell or buy a security registered on a national exchange."²³⁸

The *Hundahl* definition of manipulation seems unduly narrow, and it has not generally been followed by other courts. It is difficult to understand why persons who make false statements about a company for the purpose of buying up the company's shares at a depressed price, as the defendants in *Hundahl* were alleged to have done, should not be considered to be "in the marketplace." In fact, there seems to be no reason why manipulation under section 10(b) should not include the making of false statements about a stock for the purpose of increasing its market value by a person who has pledged shares of the stock as collateral for a loan. Actions of this kind would not violate section 9(a)(4) because the actor is not himself purchasing or offering to purchase the security, but they would have the elements of deception and manipulative intent required for a section 10(b) violation.²³⁹

Furthermore, the language of section 10(b), which covers deceptive or manipulative conduct by "any person," seems to argue against Judge Higginbotham's restriction of the definition to persons intimately involved with the market place.²⁴⁰

It can be seen from *Charnay* and *Hundahl* that the courts have

237. *Hundahl*, 465 F. Supp. at 1361 n.5. The entire text of section 9(a)(4) is as follows:

(a) **Transactions relating to purchase or sale of security**

It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—

....

(4) If a dealer or broker, or other person selling or offering for sale or purchasing or offering to purchase the security, to make, regarding any security registered on a national securities exchange, for the purpose of inducing the purchase or sale of such security, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.

Exchange Act, 15 U.S.C. § 78i(a)(4).

238. *Hundahl*, 465 F. Supp. at 1361.

239. False or misleading statements made in order to "affect the market price of a company's stock to the advantage of the company or its insiders" violate section 10(b) and Rule 10b-5 even though the person who makes the statements does not purchase or sell any securities. *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 293 (S.D.N.Y. 1966), *aff'd in part and rev'd in part*, 401 F.2d 833, 861-63 (2d Cir. 1968), *cert. denied sub nom. Coates v. SEC and Kline v. SEC*, 394 U.S. 976 (1969).

240. It is also significant that persons other than brokers and dealers, such as corporate

not been entirely consistent in defining the scope of manipulation under section 10(b) and Rule 10b-5. Nevertheless, these cases are consistent with the teaching of *Santa Fe* (and of *Schreiber*) that manipulation under section 10(b) is closely restricted by the common law concept of manipulation as an inherently deceptive practice aimed at falsely affecting the public's valuation of a security.²⁴¹

C. *The Williams Act*

The Williams Act²⁴² is designed to regulate tender offers and corporate repurchases of stock.²⁴³ It contains two antimanipulative provisions: section 13(e),²⁴⁴ which gives the SEC authority to regulate "acts and practices [which] are fraudulent, deceptive, or manipulative" in connection with corporate repurchases by issuers that are registered with the Commission under the Exchange Act; and section 14(e),²⁴⁵ which prohibits (1) any material misstatement or omission and (2) "any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer."²⁴⁶ Section 14(e) also gives the SEC rulemaking authority.

Section 13(e) need not detain us for very long. The Commission has used the rulemaking authority that it acquired under this section to regulate "going private" transactions²⁴⁷ and tender offers by issuers.²⁴⁸ In the hearings on the bill that became the Williams Act, SEC chairman Manuel Cohen stated that corporate repurchases may have a significant effect on the market price of the shares. He referred to situations that had occurred "in which repurchases of shares were timed to increase the market price for such shares, while the company was negotiating to acquire other companies in exchange for its

officers, frequently participated in pre-1934 manipulations. See *supra* note 125 and text accompanying note 126.

241. "Indeed, one leading commentator has written that the Securities Exchange Act did not modify the common law concept of manipulation, but incorporated it." *Hundahl*, 465 F. Supp. at 1360 (citing 3 L. LOSS, SECURITIES REGULATION 1530 (2d ed. 1961)). See *supra* text accompanying notes 146-66.

242. See *supra* note 27.

243. For the legislative history of the Williams Act, see generally S. REP. NOS. 510 & 550, 90th Cong., 1st Sess. (1967); H. R. REP. NO. 1711, 90th Cong., 2d Sess. (1968).

244. Exchange Act, 15 U.S.C. § 78m(e).

245. Exchange Act, 15 U.S.C. § 78n(e).

246. *Id.* For the full text of section 14(c), see *supra* note 14.

247. SEC Rule 13e-3, 17 C.F.R. § 240.13e-3 (1985). A going private transaction is the process of "[e]liminating public stock ownership in a corporation with the intention of continuing the corporation's life and business as a closely held company." Kerr, *Going Private: Adopting a Corporate Purpose Standard*, 3 SEC. REG. L.J. 33 (1975).

248. SEC Rule 13e-4, 17 C.F.R. § 240.13e-4 (1985). See *supra* note 174 for definition of the term "tender offer."

stock.”²⁴⁹ In one of these situations, “a repurchase program was actually used . . . to reduce the number of shares deliverable under existing contracts for the acquisition of other companies, or the assets of other companies.”²⁵⁰ While conceding that it already had “substantial authority” under section 10(b) to deal with such activities, the Commission stated that under section 13(e) it would be able to adopt “more specific rules designed to deal with a variety of problems arising out of corporations’ repurchases of their own shares” and “to mitigate undesirable market impact” caused by such activities.²⁵¹

Apart from its discussion of these corporate repurchase situations, the legislative history of the Williams Act offers no guidance as to what the lawmakers meant by the term “manipulative” either in section 13(e)²⁵² or 14(e),²⁵³ or whether the term “manipulative” has a different meaning under the Williams Act than it has under section 10(b). As the *Schreiber* Court states, the legislative history of section

249. *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 27 (1967) [hereinafter referred to as *Hearings*]. See *Complaint in SEC v. Georgia-Pacific Corp.*, FED. SEC. L. REP. (CCH) ¶ 91,680 (S.D.N.Y. Apr. 27, 1966); *Genesco, Inc.*, 1966 Prospectus (May 10, 1966).

250. *Hearings*, *supra* note 249, at 27.

251. *Id.* at 212, 213 app. 1.

252. In *Schreiber*, the Court stated that section 13(e) was enacted as a result of congressional concern “that corporate stock repurchases could be used to distort the market for corporate control.” 105 S. Ct. at 2463 n.8. The Court did not, however, cite any authority for this statement.

253. Several points about the two antimanipulative provisions of the Williams Act may be noted. First, unlike section 10(b), both sections 13(e) and 14(e) proscribe “fraudulent” as well as “deceptive” and “manipulative” conduct. The SEC at one time took the position that the additional word in the statute gave it authority to regulate the fairness of corporate repurchase Programs. Proposed Rule 13e-3A required a good faith belief in the fairness of the terms supported by the informed opinions of two outside experts, while proposed Rule 13e-3B required both fairness of terms and a valid business purpose. Sec. Ex. Act Rel. No. 5567, Feb. 6, 1975, FED. SEC. L. REP. (CCH) ¶ 80,104. The agency, however, has never attempted to regulate the fairness of transactions covered by section 13(e). See SEC Rule 13e-3, 17 C.F.R. § 240.13e-3 (1985). As indicated earlier, *Schreiber* now makes it clear that the Williams Act does not govern the fairness of transactions. See *supra* text accompanying notes 75-76. Second, section 13(e), like section 10(b) but unlike section 14(e), is not operative unless the SEC exercises its rulemaking authority under the section. Third, section 13(e), applies only to companies with securities registered under the Exchange Act, whereas section 14(e) applies to “any tender offer,” regardless of whether the target company has a class of registered securities, and section 10(b) applies to “any security,” whether or not registered on a national exchange. Section 14(e), therefore, unlike the other provisions of the Williams Act, applies to a tender offer for shares of a company that is not required to register with the SEC. *L.P. Acquisition Co. v. Tyson*, FED. SEC. L. REP. (CCH) ¶ 92,271 at 91,878 (6th Cir. Aug. 26, 1985).

Finally, under sections 13(e) and 14(e) the Commission has authority to adopt rules both to define and to “prescribe means designed reasonably to prevent” the proscribed acts; whereas under section 10(b) the Commission has authority to adopt “such rules and regulations as [it]

14(e) is "sparse."²⁵⁴ The few references that are made to the section in the congressional reports speak only of its role in requiring that investors receive "full disclosure of material information" from persons making or opposing tender offers.²⁵⁵ Nowhere in the legislative history is there any discussion of the term "manipulative" or any suggestion that the term might mean something else under section 14(e) than it does under section 10(b).

Practically from the time the Williams Act became effective, the courts have seen no essential difference between the substance of sections 14(e) and 10(b), the principal difference between the two sections being their respective "in connection with" clauses.²⁵⁶ For example, in *Panter v. Marshall Field & Co.*,²⁵⁷ the Seventh Circuit Court of Appeals held that sections 14(e) and 10(b) "are coextensive in their antifraud prohibitions, and differ only in their 'in connection with' language. They are therefore construed *in pari materia* by courts."²⁵⁸ Similarly, in *Golub v. PPD Corp.*,²⁵⁹ the Eighth Circuit Court of Appeals held that "Section 10(b) and Rule 10b-5 and § 14(a)

"may prescribe as necessary or appropriate in the public interest or for the protection of investors." Exchange Act, 15 U.S.C. § 78j(b).

The legislative history of the Williams Act does not indicate any reason for the differences between section 13(e) and 14(e), or for the differences between these sections and section 10(b).

254. *Schreiber*, 105 S. Ct. at 2464. Similarly, "the legislative history of § 10(b) is sparse and there is a 'dearth of evidence' as to the intent of Congress." Poser, *Misuse of Confidential Information Concerning a Tender Offer as a Securities Fraud*, 49 Brooklyn L. Rev. 1265, 1278 (1983) (citing 1 A. BROMBERG, SECURITIES LAW: FRAUD § 2.2 (330), at 22.2 (Supp. 1977)).

255. H.R. REP. NO. 1711, 90th Cong., 2d Sess. 11 (1968); S. REP. NO. 550, 90th Cong., 2d Sess. 11 (1967).

256. Section 10(b) and Rule 10b-5 proscribe manipulative conduct in connection with the "purchase or sale of any security," whereas section 14(e) proscribes manipulative conduct in connection with "any tender offer." The principal effect of this language difference is that a nonpurchaser or seller has standing to sue under section 14(e) but not under section 10(b). See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731-32, 737-38 (1975); *Stull v. Bayard*, 561 F.2d 429, 432 (2d Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978); *Pryor v. United States Steel Corp.*, 591 F. Supp. 942, 954 (S.D.N.Y. 1984). The fact that an early decision, that of Judge Weinfeld in *Applied Digital Data Sys. v. Milgo Elec.*, 425 F. Supp. 1145 (S.D.N.Y. 1977), interpreted section 14(e) broadly, so as to include actions which under principles of common law tort would constitute unlawful interference with a prospective advantage, actually supports the argument that sections 10(b) and 14(e) are substantively identical, because *Milgo* was decided before the Supreme Court had handed down its narrow interpretation of section 10(b) in *Santa Fe*. Judge Weinfeld stated that "14(e) in effect applies Rule 10b-5 to a tender offeror and parties opposing a tender offer." *Id.* at 1153 n.21 (citing *Electronic Specialty Co. v. Int'l Controls Corp.*, 409 F.2d 937, 940-41 (2d Cir. 1969). The Court consequently interpreted section 14(e) consistently with the Second Circuit's holding in *Green v. Santa Fe Indus. Inc.*, 533 F.2d 1283, 1286-87 (2d Cir. 1976) (which the Supreme Court was later to reverse), that section 10(b) and Rule 10b-5 prohibited breaches of fiduciary duty by corporate management).

257. 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981).

258. *Id.* at 282 (citations omitted).

259. 576 F.2d 759 (8th Cir. 1978).

and (e) and Rule 14a-9 are obviously aimed at the same general evils in the field of corporate ownership, management and finance, are in *pari materia* and should be similarly construed."²⁶⁰ Even the Sixth Circuit Court of Appeals, which until the time of the Supreme Court's *Schreiber* decision was the only federal appeals court that had held that nondeceptive acts could come within section 14(e)'s prohibition of "manipulative acts or practices," did not draw a distinction between sections 10(b) and 14(e); its decision in *Mobil Corp v. Marathon Oil Co.*²⁶¹ was based both on an expansive reading of the term "manipulative" and on a finding that that reading was not inconsistent with the Supreme Court's interpretation of section 10(b) in *Hochfelder* and *Santa Fe*.²⁶²

If there were ever any legitimate doubts in the past that the operative language of section 14(e) should be interpreted in the same manner as section 10(b), the *Schreiber* decision has now put those doubts to rest. Neither the differences in the language of the two sections nor the different contexts in which they appear in the statute justifies, in the Supreme Court's eyes, any difference in interpretation. In fact, the Court based its decision squarely on *Santa Fe*, stating that "Congress used the phrase 'manipulative or deceptive' in section 10(b) as well [as in section 14(e)], and we have interpreted 'manipulative' in that context to require misrepresentation."²⁶³ As to the use by Congress in section 14(e) but not in section 10(b) of the word "fraudulent," the Court said: "All three species of misconduct, i.e., 'fraudulent, deceptive or manipulative,' listed by Congress are directed at failures to disclose."²⁶⁴ Thus the numerous decisions that

260. *Id.* at 764. In *Lewis v. McGraw*, 495 F. Supp. 27 (S.D.N.Y. 1979), *aff'd*, 619 F.2d 192 (2d Cir.), *cert. denied*, 449 U.S. 951 (1980), the district court said: "The principles of *Santa Fe Industries* apply to claims under Section 14(e) as well as Section 10(b)." *Id.* at 31 (citations omitted).

261. 669 F.2d 366 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982).

262. To support its holding that there was manipulation, the Sixth Circuit cited the Supreme Court's statement in *Santa Fe*: "'No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.'" *Mobil Oil*, 669 F.2d at 374 (quoting 430 U.S. at 477). The court also cited the qualifying language used in *Santa Fe*, in order to make the point that the Supreme Court had not said "that nondisclosure was the only ground upon which to base a 10(b) claim." *Id.* at 376, citing *Santa Fe*, 430 U.S. at 477-78. The point is that the Sixth Circuit did not attempt to distinguish *Santa Fe* on the grounds that that case was brought under a different section of the Exchange Act than was *Mobil*. See *supra* text accompanying notes 32-33, 60-61.

263. *Schreiber*, 105 S. Ct. at 2462 (citing *Santa Fe*, 430 U.S. at 476-77; *Piper*, 430 U.S. at 43; and *Hochfelder*, 425 U.S. at 199).

264. *Id.* Sections 13(e) and 14(e) were not the first provisions of the Exchange Act to prohibit "fraudulent" acts. Sections 15(c)(1) and 15(c)(2), 15 U.S.C. § 78o(c)(1)-(2), which were adopted in 1936, prohibit fraudulent, as well as deceptive and manipulative, conduct by

discuss the meaning of "manipulation" under section 10(b)²⁶⁵ are equally applicable to situations involving section 14(e).²⁶⁶

V. DECEPTION AND INTENT AS ELEMENTS OF MANIPULATION

The two principal legal issues concerning manipulation are those of deception and intent. As we have seen in the discussion of section 9(a)(2) and its legislative history, the two issues are closely interrelated.²⁶⁷ The *Schreiber* decision makes it clear that manipulation requires deception, but it does not deal with the nature of the deception that is required. Furthermore, there is ample precedent that manipulation under section 10(b) or 14(e) requires at least an intent to influence the price of a security.²⁶⁸ The requisite manipulative intent under these sections of the Exchange Act is more specific than the *scienter* that is required for "deceptive" conduct under section 10(b)²⁶⁹ but perhaps less specific than the requirements of section 9(a).²⁷⁰

The purpose of this part of the Article is to explore further the issues of deception and intent, in the context of asserted manipulation in connection with corporate control transactions.

A. Deception

1. DISTINCTION BETWEEN "DECEPTIVE" AND "MANIPULATIVE" CONDUCT

A question that needs to be asked is why the definition of "manipulative" matters, now that *Schreiber* has established beyond any doubt that misrepresentation or nondisclosure is an essential element of manipulative conduct under section 14(e) and, by extension, under section 10(b). Because sections 10(b) and 14(e) prohibit deceptive as well as manipulative conduct, what does alleging manipulation add to a plaintiff's claim?²⁷¹

brokers and dealers in dealings in the over-the-counter market. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 803 (1983).

265. See *supra* text accompanying notes 222-36.

266. See *supra* text accompanying notes 256-62.

267. See *supra* text accompanying notes 194-201.

268. See *Atchley v. Qonaar Corp.*, 704 F.2d 355 (7th Cir. 1983). In *Chris-Craft Indus. v. Piper Aircraft Corp.*, the court said: "So long as the investor's motive . . . is not to create an artificial demand for, or supply of, the security, illegal market manipulation is not established." 480 F.2d 341, 383 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973), *reh'g denied*, 430 U.S. 976 (1976).

269. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

270. See *United States v. Charnay*, 537 F.2d 341 (9th Cir.), *cert. denied*, 429 U.S. 100 (1976), *aff'd*, 577 F.2d 81 (9th Cir. 1978).

271. An argument some commentators made before the *Schreiber* decision was that, if

Indeed, in many situations, particularly where the allegedly improper conduct consists of false or misleading statements or omissions, an allegation of deception will suffice and alleging manipulation does not add anything to the plaintiff's claim. If the plaintiff is, however, unable to prove that he actually relied on the defendant's deception, the question of whether there was manipulation may be important. In a *manipulation* case based on misleading misstatements or omissions, the causal link between the defendant's misconduct and the plaintiff's harm is provided by the manipulation's effect on the market.²⁷² In a *deception* case based on the defendant's affirmative misstatements, on the other hand, reliance must be pleaded and proved in some jurisdictions, although not in jurisdictions that have adopted the "fraud on the market" theory: namely, that the plaintiff relied on the integrity of the market to reflect the free interplay of supply and demand, and that the defendant's misstatements interfered with the integrity of the market.²⁷³ In a deception case based on omissions of material facts by the defendant, however, the plaintiff need not prove actual reliance if he can show that the omissions were material.²⁷⁴

It may be seen that the "fraud on the market" theory is the first cousin, or possibly an even closer relative, of manipulation.²⁷⁵ Under both concepts, the causal line between the plaintiff's harm and the

deception were a necessary element of manipulation, the term "manipulation" in the statute would be surplusage. The Supreme Court refuted this argument in *Schreiber*. See *supra* text accompanying notes 64-66.

272. "[W]here the success of a fraud does not require an exercise of volition by the plaintiff, but instead requires an exercise of volition by other persons, there need be no showing that the plaintiff himself relied upon the deception. 'What must be shown is that there was deception which misled [other] stockholders and that this was in fact the cause of plaintiff's claimed injury.'" *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 797 (2d Cir. 1969) (citing *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 635 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1968)).

273. Traditionally, a plaintiff in a private action under Rule 10b-5 must demonstrate actual reliance on the defendant's deception. The "fraud on the market" theory does away with this requirement. Although the Supreme Court has not yet addressed the theory, the Second, Fifth, and Ninth Circuits have accepted it in some form. See, e.g., *Panzirer v. Wolf*, 663 F.2d 365 (2d Cir. 1981), *vacated as moot*, 459 U.S. 1027 (1982); *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (en banc); *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976). These courts recognize the difficulty of proving reliance "where the fraud has affected the market and damaged the plaintiff only through its effect on the market. . . . [Therefore, they] do not require direct reliance where the fraud affects the market, on the ground that an investor relies generally on the supposition that the market price is validly set and that no unsuspected fraud has affected the price." *Panzirer*, 663 F.2d at 368.

274. *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972). For the Supreme Court's definition of materiality, see *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

275. See *supra* text accompanying notes 151-52.

defendant's wrongdoing is not actual reliance on the defendant's deceptive acts, but damage to the free market. The "fraud on the market" theory, however, has a number of drawbacks. First, it is still an emerging concept that has not been accepted by some federal circuit courts of appeal, and the Supreme Court has yet to rule on its validity.²⁷⁶ Second, the theory established only a presumption of reliance, which may be rebutted by showing that the material misrepresentation or omission did not substantially contribute to the plaintiff's investment decision.²⁷⁷ Finally, the "fraud on the market" theory has been said to apply only to securities which have "efficient" markets, i.e., those in which "security prices reflect all available public information about the economy, about financial markets, and about the specific company involved."²⁷⁸ For these reasons, it may be prudent or even necessary for a plaintiff to plead manipulation, in situations where he may have difficulty proving that he relied on the defendant's misrepresentations that affected the market, rather than only to plead deception, with its traditional reliance requirement.²⁷⁹

2. DECEPTION AND COERCION

Although a manipulated market is an "artificial" market, the artificiality must come about as a result of deceptive conduct. For example, the very making of a tender offer is not manipulative, although it may create an artificial market, in the sense that the forces of supply and demand cease operating in their normal manner.

In *Billard v. Rockwell International Corp.*,²⁸⁰ Rockwell made a tender offer for the stock of a subsidiary at a price of \$25 per share. The plaintiffs, shareholders of the subsidiary, claimed that the offer

276. See Note, *The Fraud-on-the-Market Theory*, 95 HARV. L. REV. 1143 (1982).

277. *Panzirer v. Wolf*, 663 F.2d 365, 367 (2d Cir. 1981), *vacated as moot*, 459 U.S. 1027 (1982); *Reingold v. Deloitte Haskins & Sells*, FED. SEC. L. REP. (CCH) ¶ 91,880 at 90,380-81 (S.D.N.Y. Dec. 6, 1984).

278. *Reingold*, at 90,381. See H. KRIPKE, *THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE* 100-05 (1979); Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW 1 (1982).

279. It may be argued that any plaintiff who uses the "fraud on the market" theory in a deception case under section 10(b) or 14(e) is really alleging manipulation and should prove all the elements of a manipulation cause of action, including specific intent to affect the price of the security. This, however, would place an unreasonable burden on a plaintiff who purchased in a market affected by deceptive conduct but who is unable to prove that the defendant acted with manipulative intent. See *infra* text accompanying notes 280-304. For example, in *Panzirer v. Wolf*, the plaintiff alleged that she purchased shares in reliance on the integrity of the market, which had been affected by an allegedly false annual report issued by the company. 663 F.2d 365. The court held that her complaint stated a cause of action, even though it contained no allegation that the officers or the auditors of the company acted with manipulative intent. *Id.* at 367.

280. FED. SEC. L. REP. (CCH) ¶ 98,733 (2d Cir. June 30, 1982).

was manipulative under sections 10(b) and 14(e) in that Rockwell had withheld favorable financial data concerning its subsidiary until after the tender offer had been announced, in order to artificially depress the price of its stock. The plaintiffs also asserted that the tender offer "capped" the market at \$25, because Rockwell had announced its intention to follow the tender offer with a merger, under which any non-tendering shareholders would receive the same price of \$25 for their shares.

The Second Circuit Court of Appeals held that these allegations did not state a cause of action for manipulation. The court emphasized the absence of any deception, saying, "Announcement of a genuine tender offer in no way created an artificial impact on market activity. No potential trader is led to believe there is a ready market for shares when none in fact exists and the activity of the offeror is not designed to achieve anything other than the success of the offer."²⁸¹ As to the withholding of financial data, the court said that this information had been disclosed before the earliest date upon which the shareholders could tender their shares under the terms of the tender offer. Moreover, the offer was open for a period of forty days after the disclosure, during which time, under the express terms of the offer, the shareholders were free to withdraw any tendered shares.²⁸² Thus, any "freeze" on the stock price was due to the voluntary informed judgment of the shareholders in deciding to tender their shares at the tender offer price of \$25.

Another interesting challenge to a tender offer occurred in *Radol v. Thomas*,²⁸³ a case that arose out of the same contest for control as in *Mobil*.²⁸⁴ U.S. Steel Company ("Steel") made a "two-tier merger" bid for control of Marathon Oil Co. ("Marathon"). The first step was an all-cash tender offer for thirty million Marathon shares at a price of \$125 per share; while the second step was a merger of Marathon with a wholly owned subsidiary of Steel, under which each outstanding Marathon share that had not been purchased under the tender offer would be exchanged for a twelve and one-half percent twelve-year \$100 face-value note of Steel, which was deemed to be worth \$86 at the time of the merger.²⁸⁵

281. *Id.* at 93,701.

282. *Id.* at 93,700.

283. 556 F. Supp. 586 (S.D. Ohio 1983), *aff'd*, FED. SEC. L. REP. (CCH) ¶ 92,289 (6th Cir. Sept. 13, 1985). See also *Radol v. Thomas*, 534 F. Supp. 1302 (S.D. Ohio 1982) (denying plaintiffs' motion for a preliminary injunction to enjoin the proposed merger).

284. *Mobil Corp. v. Marathon Oil Corp.*, 669 F.2d 366 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982).

285. *Radol*, 556 F. Supp. at 588.

The plaintiffs, Marathon shareholders, contended that the effect of the disparity in value between the two steps of the acquisition was to coerce the shareholders into tendering their shares in the first step.²⁸⁶ The plaintiffs characterized this coercion as a manipulative device within the meaning of sections 10(b) and 14(e) because it "effectively depriv[ed] Marathon shareholders of the option of holding their shares for long-term appreciation and . . . contribute[d] to 'inefficiency in investment decisions.'" ²⁸⁷ The plaintiffs relied on the Sixth Circuit's *Mobil* decision as the basis for their claim of manipulation.²⁸⁸

The district court held that *Mobil* did not control. "The two-tier tender offer and merger at issue here did not 'circumvent the natural forces of market demand' in the manner of the options in *Mobil*. . . . [T]he Court is aware of no case in which . . . a disparity [between the price of the two steps of an acquisition] has been the basis for finding of a violation of § 10(b) or § 14(e)." ²⁸⁹ Furthermore, unlike the lock-up option that was held to be manipulative in *Mobil*, the two-tier offer did not discourage competing offers; this was made clear by the fact that the Mobil Corporation responded with a similar offer of its own. Also, the court in *Mobil* allowed the two-tier arrangement to stand when it struck down the options that Marathon had granted to Steel. Finally, the court buttressed its conclusion that *Santa Fe's* "term of art" definition of "manipulation" did not cover a two-tier acquisition, with the fact that Congress did not outlaw transactions of this kind but instead authorized the SEC to regulate them.²⁹⁰

The distinction between deception and coercion is also made clear in cases involving "greenmail."²⁹¹ The greenmail decisions per-

286. *Id.* at 589-90. In fact, 91.18% of the shares were tendered. See *Radol v. Thomas*, 534 F. Supp. 1302, 1305 (S.D. Ohio 1982).

287. *Radol*, 556 F. Supp. at 590.

288. *Id.*

289. *Id.*

290. *Id.* See SEC Rule 13e-3, 17 C.F.R. § 240.13e-3 (1985). See also *Martin Marietta Corp. v. Bendix Corp.*, 549 F. Supp. 623 (D. Md. 1982) (where the district court held that a "front-end-loaded" two-tiered acquisition—one in which the first step of the acquisition offered more favorable terms to shareholders than the second step—was not manipulative, in violation of section 14(e)). Bendix had challenged Martin Marietta's two-tier offer under the statute, on the grounds of its allegedly coercive nature, in that it placed pressure on shareholders to tender their stock under the terms of the first step. The court said that even if this fully disclosed two-tier acquisition "is in fact 'coercive,' it would only be because its two-tier structure is revealed all too well." *Martin Marietta*, 549 F. Supp. at 630.

291. See *Heine v. The Signal Cos.*, FED. SEC. L. REP. (CCH) ¶ 95,898 (S.D.N.Y. Mar. 4, 1977). The SEC has studied the effects of "greenmail":

Since January, 1979 about five and one-half billion dollars has been paid by firms to repurchase blocks of common stock from individual shareholders (or to a particular group of shareholders). These payments represent an aggregate

haps demonstrate more clearly than any others that coercive or even extortionate practices are not the concern of the federal securities laws, if unaccompanied by deception. In *Dan River, Inc. v. Icahn*,²⁹² Icahn ("Icahn") and companies which he controlled, acquired more than five percent ownership of the common stock of Dan River. In its statement of beneficial ownership filed with the SEC under section 13(d), Icahn stated that it intended to gain control of the company and then to merge it with another already controlled company or to sell Dan River's assets so as to generate cash for additional business combinations. Icahn also stated that, "given an acceptable offer, it would be willing to abandon the takeover plans and sell its Dan River shares."²⁹³

Dan River alleged that this " 'buy-me-out-or-face-a-takeover' ultimatum is a manipulative and deceptive scheme."²⁹⁴ In holding in favor of the defendant, the court stated that the plaintiff's threatened actions did not amount to "intentional or willful conduct designed to deceive or defraud investors by artificially affecting the price of securities," the definition of manipulation set forth in *Ernst & Ernst v. Hochfelder*.²⁹⁵ Conceding that Icahn had presented management with a difficult choice, the court observed that so does any party who contemplates a takeover attempt. "Were Icahn's conduct to be held unlawful, we would be left with the peculiar result that the tender offeror who openly informs the investment community that a buy-out is a distinct possibility is damned while the tender offeror who conceals the same information proceeds unimpugned."²⁹⁶ By analogy,

premium above market price of over one billion dollars. Many of these large premium payments clearly were made by target management to reduce the threat of losing control of the firm through a tender offer or proxy fight. . . . The term 'Greenmail' is commonly used to describe these payoffs, reflecting the widespread perception that this practice, or the process leading to it, is counter to the best interests of target shareholders.

The Impact of Targeted Share Repurchases (Greenmail) on Stock Prices, Study by the Office of the Chief Economist of the Securities and Exchange Commission, FED. SEC. L. REP. (CCH) ¶ 83,713 at 87,173-74 (Sept. 11, 1984) (footnote omitted) [hereinafter cited as *Impact of Greenmail*]; see also *Norlin Corp. v. Rooney, Pace, Inc.*, 744 F.2d 255 (2d Cir. 1984) (court construing the business judgment rule in diversity case held it unlawful for directors to try to defeat takeover attempt by voting shares they controlled); Note, *Greenmail: Targeted Stock Repurchases and the Management-Entrenchment Hypothesis*, 98 HARV. L. REV. 1045, 1054, 1060 (1985) (arguing that although evidence indicates that greenmail harms shareholders, a plaintiff will not succeed under federal securities laws unless he can prove that the target's directors either misrepresented the company's situation or failed to disclose material information).

292. 701 F.2d 278 (4th Cir. 1983).

293. *Id.* at 281.

294. *Id.* at 282.

295. *Id.* at 285 (citing *Hochfelder*, 425 U.S. 185, 199 (1976)). See *supra* text accompanying notes 58-59.

296. *Hochfelder*, 701 F.2d at 285.

the coercive frankness of the highwayman who gives his victim the choice of "your money or your life" could not be considered fraudulent. Greenmail, although it has been widely criticized, does not violate section 10(b) or 14(e).²⁹⁷

Other attempts to gain control of a company by means of substantial purchases of its stock have been held nonmanipulative. For example, in *Spencer Cos. v. Agency Rent-A-Car, Inc.*,²⁹⁸ a target company claimed that the defendant manipulated its stock, in violation of section 9(a)(2), by buying 36.2% of the outstanding shares. The district court held that the complaint did not make out a violation of the statute because there was no allegation that the defendant's purpose was to induce others to buy.²⁹⁹ The plaintiff did allege, however, that the defendant's purpose was to induce *the plaintiff* to buy the stock held by the defendants at the higher market price. The court said that allegation did not state a cause of action under section 9(a)(2) because the plaintiff

would [not] in any way be deceived into buying the stock because of the high market price or apparent demand for the stock. Instead, plaintiff alleges that defendants' plan [is] to 'extort' it to purchase the shares. . . . Such a purpose is not what § 9(a)(2) seeks to prohibit. Plaintiff is fully aware of the actions taken by defendants with respect to its stock and their effect on the stock price.³⁰⁰

If the defendant coerces but does not deceive the plaintiff, it does not matter whether he has created an artificial market for the security—it is not manipulation, although there may be a state cause of action based on unfair conduct or breach of fiduciary duty.³⁰¹ This is

297. In 1983, the SEC's Tender Offer Advisory Committee proposed that Congress should take legislative action against greenmail. As a result, the Commission proposed legislation in 1984 that would restrict corporate repurchases from shareholders above the market price. The Commission, however, later withdrew its support for this and other antigreenmail bills that had been introduced in Congress, and no such legislation has thus far been enacted. S. 2782, 98th Cong., 2d Sess. (1984); S. 2777, 98th Cong. 2d Sess. (1984); H.R. 5693, 98th Cong., 2d Sess. (1984); Sec. Ex. Act Rel. No. 34-21079 (June 21, 1984). See also *Impact of Greenmail*, *supra* note 291 (supporting Commission's position for requiring vote on these transactions in light of the overall impact of greenmail on the wealth on nonparticipating shareholders); Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities—An Update*, 40 BUS. LAW. 1403, 1413-14 (1985) (stating that the credibility of the greenmail threat is directly related to the increasing availability of junk bond takeover financing and the ability to launch two-tier offers).

298. FED. SEC. L. REP. (CCH) ¶ 98,301, at 91,895 (D. Mass. Sept. 21, 1981), *later op.*, FED. SEC. L. REP. (CCH) ¶ 98,361 (D. Mass. Nov. 17, 1981), *later proc.*, 542 F. Supp. 237 (D. Mass. 1982).

299. *Id.* at 91,896.

300. *Id.* (citation omitted). See also *Polinsky v. MCA Inc.*, 680 F.2d 1286 (9th Cir. 1982).

301. This, of course, is one of the lessons of *Schreiber* and *Santa Fe*. See *supra* note 77.

true no matter how unfair the defendant's activities may be, and regardless of whether these activities affect the price of the security.

Perhaps the most extreme example of an intentional impact on the market that is not considered to be manipulation in the absence of deception, is the alleged "destruction" of the market by a controlling shareholder in order to acquire the minority's shares at a reduced price. In *Shivers v. Amerco*,³⁰² the individual defendants were members of a family that owned ninety-four percent of Amerco stock. The remaining shares were freely traded among the minority shareholders, most of whom were employees of the company, at a normal trading range of 120% to 130% of book value. Amerco had an informal policy of repurchasing minority shareholders' stock at book value whenever a shareholder requested it to do so.

Minority shareholders brought an action alleging that the defendants had decided to destroy the market for Amerco stock so that they could buy up the minority shareholdings at a low price. In order to accomplish this, the defendants allegedly used their control to effect a 100 - 1 reverse stock split and also caused the company to announce that it would no longer repurchase shares for book value but would pay only fifty percent of book value. The plaintiffs claimed that these actions " 'prevented free and honest balancing of investment supply with investment demand' and therefore constituted manipulation of stock prices."³⁰³ The Ninth Circuit Court of Appeals found for the defendants, saying that it doubted that the complaint stated a cause of action under Rule 10b-5, because the nature of the reverse stock split and the surrounding facts were fully disclosed, and "[p]laintiffs have not alleged that defendants misled investors by artificially depressing the price of Amerco stock."³⁰⁴

3. THE NATURE OF THE REQUIRED DECEPTION

It is clear that the deception required for manipulative conduct need not be verbal. Falsification of the market may be accomplished by acts, such as fictitious or even real trading, instead of by words.³⁰⁵ Furthermore, non-verbal deception can even be used to falsify the

302. 670 F.2d 826 (9th Cir. 1982).

303. *Id.* at 829 (citing *United States v. Charnay*, 537 F.2d 341, 349 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976), *aff'd on remand after prior appeal*, 577 F.2d 81 (9th Cir. 1978)).

304. *Id.* (citing *Santa Fe Indus. v. Green*, 430 U.S. 462, 476-77 (1977)). The court did not actually reach the merits of the case, but affirmed the district court's dismissal of the suit on the ground that the plaintiffs lacked standing to sue. *Id.* at 829-31. Another decision holding that "destruction" of the market is not manipulation is *Nash v. Farmers New World Life Ins. Co.*, 570 F.2d 558 (6th Cir.), *cert. denied*, 439 U.S. 822 (1978).

305. *See supra* text accompanying notes 133-45.

public's valuation of a security.³⁰⁶

What is more questionable is what must be the subject of the deception. There is authority for the proposition that deception as to the actor's motives³⁰⁷ or as to the likely effects of his actions³⁰⁸ is not sufficient to establish a section 10(b) violation. Nevertheless, the decisions raise considerable doubt as to whether this is in fact the case.

In *Alabama Farm Bureau Mutual Casualty Co. v. American Fidelity Life Insurance Co.*,³⁰⁹ a shareholder brought a derivative suit against a company that had repurchased about twenty percent of its outstanding shares in the open market, claiming inter alia that the purchases were part of a scheme by members of management to perpetuate their control of the company "by manipulating the market in [the company's] Shares and artificially inflating the market price of

306. *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964). In one forward-looking early decision, the New York Court of Appeals held that a misrepresentation concerning the financial situation of a company that was calculated to induce purchases of its securities was an actionable fraud, even though the misrepresentation was effected by acts rather than by words. The defendant was a corporate director who had agreed to declare a dividend out of the company's capital, in violation of the New Jersey's dividend statute (2 N.J. Comp. St., Corporations §30 (West 1911)). The director then caused the dividend declaration to receive widespread publicity. The plaintiff, who was not a shareholder at the time the dividend was declared, purchased shares in reliance on the implied representation that the company had sufficient surplus to legally declare the dividend. The court held in favor of the plaintiff, adopting the opinion of the dissenting judge in the Appellate Division, which stated that a fraudulent representation may be effected by conduct, and that "the representation need not be made directly to the party injured by it." *Ottinger v. Bennett*, 144 A.D. 525, 533, 203 N.Y. 554 (1911).

307. In the wake of *Santa Fe*, courts have consistently held that since a shareholder cannot recover under 10b-5 for a breach of fiduciary duty, neither can he "bootstrap" such a claim into a federal securities action by alleging that the disclosure philosophy of the statute obligates defendants to reveal either the culpability of their activities, or their impure motives for entering the allegedly improper transaction.

Panther v. Marshall Field & Co., 646 F.2d 271, 288 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981) (citations omitted). See also R. JENNINGS & H. MARSH, *SECURITIES REGULATION* 1028 (5th ed. 1982). (Courts have found the true motives of the management "in engaging in the transaction not in the context of total nondisclosure, but in connection with a proxy statement which revealed all of the facts relating to the proposed transactions" not to be material.) (footnote omitted).

308. Any tender offer or acquisition by a company of its own stock obviously would reduce the number of outstanding shares and increase the proportionate control and earnings of all shareholders who retained their stock. . . . It is not a violation of any securities law to fail to disclose a result that is obvious even to a person with only an elementary understanding of the stock market. . . . Nor is it necessarily a violation of the securities law to have a plan to make a stock acquisition with such a result, unless the plan includes practices that are intended to mislead or to defraud investors.

Vaughn v. Teledyne, Inc., 628 F.2d 1214, 1220 (9th Cir. 1980) (citations omitted).

309. 606 F.2d 602 (5th Cir. 1979), *reh'g denied*, 610 F.2d 818 (5th Cir.), *cert. denied*, 449 U.S. 820 (1980).

the Shares . . . in order to discourage other shareholders or nonshareholders from purchasing Shares or attempting to gain control of' [the company]."³¹⁰

Although the company adequately disclosed the size and scope of the repurchase plan, a divided Fifth Circuit Court of Appeals nevertheless upheld the complaint against a motion to dismiss. The court conceded that Rule 10b-5 does not require the defendants to disclose either their motives or "to characterize the various effects of the transaction as favorable or unfavorable or to evaluate its overall effect."³¹¹ Furthermore, it is not necessary to disclose the obvious: that stock purchases will tend to increase the stock's price or avert a price decline. Nevertheless, "it is necessary for the impact of a transaction to be described factually to the extent that such information would be significant to a reasonable, disinterested director . . . or shareholder."³¹² Here, the defendant omitted to disclose the "inflationary effect" that the purchases would have on the market price of the company's outstanding shares. "[R]ead as a whole, the complaint . . . asserts a scheme artificially to manipulate the market and artificially (that is beyond the operation of normal market factors) to inflate prices."³¹³

All of this is far from clear. If the directors of a company that announces a repurchase plan are not required to state the obvious (that the purchases are likely to raise the price of the stock), why are they required to disclose the expected "inflationary effect" of the repurchases? Furthermore, if directors are not required to disclose their motives, why are they required to disclose that the repurchases are part of a scheme artificially to manipulate the market?³¹⁴ While the *Alabama Farm* opinion is consistent with the prevailing view, now confirmed by *Schreiber*, that misrepresentation or nondisclosure is required for manipulation, it seems to water down that requirement to such an extent that it becomes almost meaningless.³¹⁵

310. *Id.* at 611.

311. *Id.* (citing *Golub v. PPD Corp.*, 576 F.2d 759, 765 (8th Cir. 1978)).

312. *Id.* (citations omitted).

313. *Id.*

314. There is also an obvious circularity to the reasoning that the failure to disclose a scheme to manipulate provides the deception necessary to make out a manipulative scheme. Under this logic, if the defendant had disclosed a scheme to manipulate, there would be no manipulation, because there would be no nondisclosure, and therefore no deception. The paradox is reminiscent of the puzzle about a man who is about to be executed. He is told that he may make one statement, and that he will be shot if it is a true statement and hanged if it is a false one. The question is: what statement should he make to prevent his execution altogether? The answer is: "I am going to be hanged."

315. See *supra* notes 49-50.

The most persuasive basis for the view that nondisclosure of motive furnishes the necessary deception in a manipulation case, however, is provided by a series of decisions involving the reduction or elimination of dividend payments for allegedly manipulative purposes. In these cases, a controlling person caused, or threatened to cause, the company's directors to reduce dividends for the alleged purpose of acquiring shares from non-controlling shareholders at a reduced price.

In *Cochran v. Channing Corp.*,³¹⁶ a relatively early Rule 10b-5 case, the complaint alleged that Channing, which controlled the board of directors of Agricultural Insurance Company, had facilitated its secret program for buying up the company's shares by reducing its quarterly dividend, and

that because of the dividend reduction and lack of information as to Channing's program of purchases, plaintiff . . . sold some 500 shares . . . which he would not otherwise have sold, at a price reflecting the depressing effect of the dividend reduction, and a price below what he . . . could have obtained later after disclosure of Channing's purchasing program. . . .³¹⁷

In holding that the complaint stated a cause of action under section 10(b) and subsections (1) and (3) of Rule 10b-5,³¹⁸ the court stated:

One who causes a reduction of dividend in order more cheaply to purchase the shares of a corporation is most certainly employing a device to defraud and is engaging in a course of business which operates as a fraud upon the seller of those securities. . . . In the instant case defendants not only failed to disclose a material fact (the true reason for the cut in the dividend rate) but were themselves responsible for its very existence.³¹⁹

A few years later, in *Mutual Shares Corp. v. Genesco, Inc.*,³²⁰ the Second Circuit Court of Appeals followed *Cochran*, upholding the Rule 10b-5 complaint filed by shareholders of S.H. Kress and Company, which alleged that Genesco had "manipulated the market price of Kress stock, in part by keeping the Kress dividends to a minimum, in order to acquire shares of Kress's minority stockholders at less than the true value," and which requested injunctive relief.³²¹ The court did not dispense with the need for deception, but stated that

316. 211 F. Supp. 239 (S.D.N.Y. 1962).

317. *Id.* at 242.

318. See *supra* note 20 for the texts of section 10(b) and Rule 10b-5.

319. *Cochran*, 211 F. Supp. at 243.

320. 384 F.2d 540 (2d Cir. 1967).

321. *Id.* at 542. The Second Circuit stated that the fact that the plaintiffs themselves had not sold their shares did not foreclose injunctive relief, because "[t]he complaint alleges a manipulative scheme which is still continuing." *Id.* at 546.

"[t]he alleged deceit was defendants' silence as to their true fraudulent intentions and the actual value of Kress's real estate."³²²

Cochran and *Mutual Shares* were decided before *Santa Fe* and, of course, long before *Schreiber*. While they are consistent with these two Supreme Court decisions insofar as requiring deception as an element of manipulation, it is less than clear that the type of deception involved in the dividend-reduction cases would meet the more stringent requirements that the Court has since imposed. In *Santa Fe*, for example, the Court defined manipulation as "practices . . . that are intended to mislead investors by artificially affecting market activity."³²³ Traditionally, the deception involved in a manipulative scheme related either to the company or to the market itself.³²⁴ In *Cochran* and *Mutual Shares*, however, the deception related principally to the defendant's motives for buying the stock.³²⁵ It is therefore possible that the validity of these decisions has not survived *Santa Fe*'s and *Schreiber*'s narrow interpretation of the statute.

Where, however, the threat of a dividend reduction is used to coerce shareholders into selling their shares, there is no cause of action for manipulation. This is consistent with the greenmail cases,³²⁶ where coercion unaccompanied by misrepresentation or nondisclosure has been held not to violate the antimanipulative provisions of the Act. In *Marsh v. Armada Corp.*,³²⁷ a tender offeror announced to shareholders of the target company that, in the event the takeover was successful, dividends would cease. After the tender offer was successfully completed, dividends were eliminated. The Sixth Circuit Court of Appeals posed the issue in this way: "[W]hether manipulation of the market price of the stock by eliminating dividends, with prior full disclosure, violates § 10(b) of the Exchange Act,"³²⁸ and concluded in the negative. The court distinguished *Cochran* and *Mutual Shares* on the grounds that in these two cases "nondisclosure of the intent to systematically lower dividends caused the manipulation to be deceptive and prevented the shareholders from being able to protect their investment. Here we cannot find any action that deceived or defrauded the shareholders."³²⁹

322. *Id.* at 544.

323. *Santa Fe Indus. v. Green*, 430 U.S. 462, 476 (1977) (citations omitted).

324. See *supra* text accompanying notes 115-45.

325. See *supra* text accompanying notes 316-22.

326. See *supra* text accompanying notes 291-97.

327. 533 F.2d 978 (6th Cir. 1976), *cert. denied*, 430 U.S. 954 (1977).

328. *Id.* at 982.

329. *Id.* at 984. It should be observed that in *Marsh* the court took the position that the defendants' activities were manipulative but that they did not violate section 10(b) because they did not fall within the antifraud language of Rule 10b-5. The court said: "Only those

B. *Manipulative Intent*

It seems clear that under the common law a specific intent to affect the market is necessary for manipulation. The requisite intent is different, however, depending on whether the manipulation is effected by the use of materially false or misleading statements or omissions in order to manipulate a stock, or by trading. The latter type of activity raises difficult questions as to the nature of the intent that is required, particularly in the context of corporate control transactions, where the defendant's ultimate goal is likely to be to gain or keep control over the company, rather than to profit directly from a change in the price of its shares. The discussion of manipulative intent in this Article is therefore divided between manipulation by non-trading activities and manipulation by trading.

1. MANIPULATION BY OTHER MEANS THAN TRADING

The weight of authority holds that making false or misleading statements for the purpose of influencing the public's valuation of a security constitutes manipulation under Section 10(b). In *Atchley v. Qonaar Corp.*,³³⁰ a shareholder of Qonaar claimed that controlling persons of that company and of Kroehler Mfg. Co. had deliberately depressed Qonaar's reported earnings in order to artificially reduce the price of the stock, and thus enable a subsidiary of Kroehler to make a tender offer for Qonaar's shares at a price below their real value. According to the complaint, several means were employed to accomplish this objective, including actually reducing the volume of the company's business and making false accounting entries.³³¹ The plaintiffs also charged that material facts were omitted from the tender offer materials. The suit was brought under both sections 10(b) and 14(e).

The district court dismissed the complaint on the ground that the alleged actions to reduce the company's earnings involved at most a breach of fiduciary duty by Qonaar's officers and directors. Under *Santa Fe*, a breach of fiduciary duty does not state a cause of action

manipulative devices prohibited in SEC Regulations are unlawful under the Exchange Act." *Id.* at 982. The court apparently believed that an SEC rule under section 10(b) could proscribe nondeceptive but manipulative conduct. Even if *Santa Fe* allowed any room for this view, it no longer appears tenable after *Schreiber*. See *supra* text accompanying notes 49-50. See also *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1361 (N.D. Tex. 1979) (Judge Higginbotham holding that improper restriction of dividends was not manipulative under section 10(b) and Rule 10b-5). For a discussion of Judge Higginbotham's views on manipulation, see *supra* text accompanying notes 231-41.

330. 704 F.2d 355 (7th Cir. 1983).

331. *Id.* at 360-61.

under the federal securities laws.³³² The Seventh Circuit reversed. The court conceded that a party cannot "bootstrap" a state claim for breach of fiduciary duty into a federal securities claim by alleging that the defendants failed to reveal the culpability of their improper motives.³³³ But where there are more "substantial" allegations, a cause of action under sections 10(b) and 14(e) may be stated, even though "some of the plaintiffs' allegations may fall within the confines of *Santa Fe*."³³⁴ Here, "[p]laintiffs alleged a series of underlying facts which were not disclosed which would have affected the valuation of the stock."³³⁵

Other courts have expressly held that false or misleading disclosures made for the purpose of affecting the price of a security constitute manipulative conduct under section 10(b). For example, in *Pellman v. Cinerama, Inc.*,³³⁶ the district court refused to dismiss a complaint alleging that controlling persons of Cinerama "manipulated the market price of Cinerama stock and obtained shareholder approval of [a "going private"] merger by means of a materially false and misleading proxy statement."³³⁷ As in *Atchley*, the court held that a section 10(b) claim involving concealment of the company's true value from the public was not automatically subject to dismissal under *Santa Fe* simply because it also involved a breach of fiduciary duty.³³⁸ Similarly, in *Gilbert v. Bagley*,³³⁹ a claim that controlling persons of a company manipulated the market for the company's stock through false and misleading financial reports was held to state a claim under section 10(b) and Rule 10b-5.³⁴⁰ In that case, the corporation had agreed in the settlement of a previous action to purchase shares of qualified shareholders at a price of \$19 per share. The plaintiffs now claimed that controlling persons had manipulated the market in order to keep the price artificially high and thus discourage shareholders from selling their shares at \$19.³⁴¹ In both *Pellman* and *Gilbert*, as well as in *Atchley*, the claim was that the misrepresenta-

332. *Atchley v. Qonaar*, FED. SEC. L. REP. (CCH) ¶ 98,725 at 93,642-43 (N.D. Ill. Mar. 29, 1982). See *supra* note 77.

333. 704 F.2d at 358 (citing *Panther v. Marshall Field & Co.*, 646 F.2d 271, 288 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981)).

334. *Id.*

335. *Id.* (citation omitted).

336. 503 F. Supp. 107 (S.D.N.Y. 1980).

337. *Id.* at 108.

338. *Id.* at 109. See *supra* note 77.

339. 492 F. Supp. 714 (M.D.N.C. 1980).

340. *Id.* at 727.

341. *Id.* at 722.

tions were made specifically to affect the price of the stock.³⁴²

2. MANIPULATION BY TRADING

Where a person is accused of manipulating a stock through trading, his activities—the purchase and sale of securities in the open market—are in themselves consistent with the perfectly innocuous (if not praiseworthy, in our capitalist system) purpose of making a profit.³⁴³ This is in contrast with other manipulative techniques, such as false statements, bribery, or fictitious transactions, which, being deceptive or at least wrongful in themselves, require a less specific intent to make them manipulative. The question that has to be raised here is

342. In *Jordan v. Global Natural Resources, Inc.*, 564 F. Supp. 59 (S.D. Ohio 1983), *later proc.*, 102 F.R.D. 45 (S.D. Ohio), *later proc.*, 104 F.R.D. 447 (S.D. Ohio 1984), the district court refused to dismiss a claim that misleading statements made by Global in the course of a proxy fight were “manipulative” under section 10(b), even though the defendant’s alleged intent was “to further the control of the incumbent directors, rather than to manipulate the price of shares on the market.” *Id.* at 65. The court held that it is enough to show that the defendant “intentionally disseminated false and misleading statements and omitted information necessary to make the information not misleading . . . with a reckless disregard for the effect of its actions on the market.” *Id.* The court relied on the Supreme Court’s opinion in *Ernst & Ernst v. Hochfelder*, which left open the question of whether recklessness would satisfy the requirement that the defendant in a section 10(b) action act with scienter, and on subsequent decisions of the lower federal courts holding that recklessness does satisfy the scienter requirement. *Id.* at 65-66. Because *Jordan* dispenses with any requirement of specific intent for manipulative conduct under section 10(b), it seems out of line with other decisions. For the Supreme Court’s discussion of the term *scienter*, see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

343. The following discussion of the requisite intent for manipulation by trading, written shortly after enactment of the Exchange Act, can hardly be improved upon:

[P]urchase of a large amount of stock by an individual desiring it for purposes of either investment or speculation may raise the price in the same manner that it is forced up by a pool seeking public participation. The acts in each case are objectively the same; the sole distinguishing feature is the purpose for which they are undertaken, and this is the Act’s criterion of illegality. . . . It is apparent . . . that [manipulative purpose] is less inclusive than the specific intent of the criminal law which is strictly defined as the knowledge which a reasonable man has, or should have in the light of surrounding circumstances, that certain consequences will follow as a result of his acts. The large speculator, buying heavily, might be said to intend that others enter the market and buy also, since he can be reasonably certain that this will be the result. Yet the Act was obviously not intended to curb such activity. Furthermore, the fact that this consequence is agreeable to the trader is not the decisive element, since, although he may know that others will enter the market and raise the price, thereby increasing the paper value of his holdings, he does not necessarily carry on the transaction for that end; this result may be incidental to his underlying aim of securing a profit from anticipated price changes caused by the “natural” forces which make prices. In the instance of manipulation, the principal object, the immediate end to which the activity is directed is inducing others to trade. It is this subjective difference in the primary objective that constitutes the line, often a tenuous one, dividing the legal from the illegal.

Comment, *supra* note 23, at 633-34 (footnotes omitted).

what specific intent is required to state a cause of action for manipulation in a corporate control transaction in which the ultimate purpose of the defendant's trading is to achieve, retain or consolidate control.

One possible approach to determining whether such trading activity is manipulative is to look at its effect on the market mechanism. Economists tell us that a market economy (in securities as well as other goods and services) is one in which decision-making is broadly based and each participant becomes an active part of a massive market-making apparatus. Buyers express the prices at which they are willing to buy and sellers express the prices at which they are willing to sell. Their combined activities yield the prices at which the particular security is exchanged.³⁴⁴ In a perfect market, the purchases and sales of a large number of participants collectively from the "unseen hand" of the market establish a price. No single participant can by itself influence that price.³⁴⁵

Modern American securities markets may, in the case of the most actively traded stocks, approximate a perfect market; but in general that is not an accurate description of the markets. Many securities are not traded actively.³⁴⁶ Furthermore, the markets for active issues are often dominated by institutional investors, which tend to engage in very large purchases and sales.³⁴⁷ A purchase or sale, or a series of purchases or sales, by a single investor may affect the market for a stock. Furthermore, this effect may be quite predictable, both to the participant itself as well as to anyone else who knows that a large trade is about to occur.³⁴⁸ Under these circumstances, to define "manipulative" as any transaction or series of transactions that

344. P. BARKLEY, INTRODUCTION TO MICROECONOMICS 53-57 (1977).

345. E. MANSFIELD, MICROECONOMICS 20 n.2 (3d ed. 1979).

346. In 1984, 62% of the trading volume on the New York Stock Exchange (in terms of number of shares traded) was in the 250 most actively traded securities, while the remaining 38% of volume was spread out over 2,069 securities. NEW YORK STOCK EXCHANGE, FACT BOOK 1985 10, 37 (30th ed. 1985).

347. In 1984, 49.8% of share volume on the New York Stock Exchange was in transactions of 10,000 or more shares, while only 11.3% of share volume was in transactions of 100-900 shares. *Id.* at 8. In the fourth quarter of 1980 (the most recent period for which such figures are available), 64.9% of public (i.e., nonmember) share volume on the New York Stock Exchange was accounted for by institutional investors. *Id.* at 56.

348. A type of insider trading known as "front-running of blocks" occurs when a securities firm trades options with the advance knowledge that a "buy" or "sell" recommendation on that stock will be made by an industry analyst. See Poser, *Spotlight on Front-Running*, INVESTMENT DEALERS' DIGEST 15 (May 15, 1985). Although this practice does not clearly violate SEC rules and none of the exchanges has a specific rule against it, front-running has been a concern since options trading began in 1973. See *Paine Weber Fined by Big Board, CBOE for 'Front-Running'*, Wall St. J., June 12, 1985, at 12, col. 2; Safire, *Soft on Brokers*, N.Y. Times, July 8, 1984, at A17, col. 6; Weiner, *Options Probe Seen Tied to Possible Use of 'Front Running'*, Wall St. J., Apr. 26, 1984, at 4, col. 1. If securities markets were perfect

detracts from the "perfection" of the market would mean that all or most large-scale investments would be forbidden. It would penalize market participants purely because of their size, or at least it would oblige large-scale participants to spread their investments over a larger number of different securities than prudent management might dictate.³⁴⁹

Given the impracticality—and perhaps unfairness—of such a broad definition of manipulation by trading activity, the federal securities law has narrowed the definition by requiring specific intent. We have already seen that section 9(a)(2) of the Exchange Act requires that the defendant must have the intent to induce others to purchase or sell the security,³⁵⁰ but the Ninth Circuit Court of Appeals has held that this specific intent is not a requirement for manipulation under section 10(b).³⁵¹

What kind of intent (or purpose) then, is required? Perhaps not too much light can be shed on this question, which Professor Loss has suggested is better left to the metaphysicians.³⁵² A few thoughts may be put forward, however, in the context of corporate control transactions.

In a contested takeover, the underlying purpose of the tender offeror is usually to gain control of the company, while that of the target's management (and perhaps of its allies) is to maintain its control. Similarly, in a negotiated merger, the goal of both sides is to obtain terms that are as favorable as possible. The fact that neither side is interested in affecting stock prices *as an end in itself* does not prevent any of their trading activities that are designed to achieve these ultimate goals from being manipulative. For example, in

markets, however, this offense could not occur because no single transaction could affect the market.

349. The "defensive" investor's portfolio should contain no more than thirty common stock issues. B. GRAHAM, *supra* note 140, at 54.

350. See *supra* text accompanying notes 191-205; see also *Trane Co. v. O'Connor Sec.*, 561 F. Supp. 301 (S.D.N.Y.), *appeal dismissed*, 718 F.2d 26 (2d Cir. 1983) (where purchases of 1.5 million shares of a company's stock by an arbitrageur over a nine-month period, in the expectation that the buyer would profit in the event that the company were to be a takeover target, was held not to violate section 9(a)(2), despite the fact that the purchases may have increased the price of the stock). The court said:

O'Connor's purpose was not to create an artificial demand for Trane stock nor to induce public investment to its detriment. Defendants simply engaged in these Trane transactions in the expectation of a profit. . . . If what defendants did constituted manipulation within the meaning of Section 9(a), most large scale transactions in a single security would be prohibited.

Id. at 305.

351. *United States v. Charnay*, 537 F.2d 341 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976), *aff'd*, 577 F.2d 81 (9th Cir. 1978).

352. L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 993 (1983).

Schlick v. Penn-Dixie Cement Corp.,³⁵³ the complaint alleged that a company in merger negotiations caused its subsidiary to buy the parent company's stock in order to increase its price and thereby obtain a more favorable exchange ratio in the merger. The Second Circuit Court of Appeals held that a cause of action for manipulation under section 10(b) and Rule 10b-5 was stated.³⁵⁴

In *Crane v. Westinghouse Air Brake Co.*,³⁵⁵ which involved a contested tender offer, a "white knight" (a company friendly to the target company) made heavy open-market purchases of the target company's stock and secret sales of the stock off the market on the last day of the tender offer, in order to make the market price of the stock equal or exceed the tender-offer price and thus to discourage shareholders from tendering their shares. The Second Circuit held that these activities were manipulative under section 9(a)(2).³⁵⁶ They would presumably also violate section 10(b).

Similarly, in *Charnay*,³⁵⁷ the Ninth Circuit Court of Appeals held that charges that persons who had made an offer to purchase a company's assets had induced others to sell its shares in the market by guaranteeing a minimum amount, for the purpose of depressing the price of the stock and thereby in inducing the company's directors to accept the asset-purchase offer, constituted an indictable offense for market manipulation under section 10(b).³⁵⁸

In each of these three cases, the end purpose of the manipulator was to accomplish a purpose relating to corporate control, and the trading was effected for the purpose of accomplishing this end. Nevertheless, the intent to interfere with the free interplay of supply and demand in the market made the activities manipulative. It should also be noted that all three situations involved deception. In *Schlick*, where the negotiations for an exchange ratio in a proposed merger were based upon the market prices of the two companies' securities, there would necessarily be an understanding between the parties that these market prices were set by the free interplay of supply and demand, without interference by either of the parties. Any trading by the parties would be contrary to that understanding and therefore deceptive. In *Crane*, the secret sales off the market were deceptive, because the tender offeror had a right to expect that all sales would be reflected in the market price of the stock. Similarly, in *Charnay*, the

353. 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975).

354. *Id.* at 378-79.

355. 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970).

356. *Id.* at 798.

357. *See also supra* text accompanying notes 226-30.

358. *Charnay*, 537 F.2d at 350.

secretly guaranteed recovery to the sellers could be expected to deceive investors into believing that the selling price of the shares on the stock exchange represented the price that sellers were prepared to receive for their shares.

In all three cases, the fact that deceit was an integral part of the scheme is made clear by asking whether the scheme would have worked if the other party had known of it at the time. In *Schlick*, the answer is clearly in the negative, as knowledge of the scheme would certainly have influenced the course of the negotiations. In *Charnay*, it is unlikely that the American Stock Exchange, where the stock was listed, would have permitted the sales to occur if it had known of the secret guarantees to the sellers. In *Crane*, the answer is not quite so clear. Even if the tender offeror had known that sales were being made off the market, the effect of the purchases on the price of the stock would have been the same, and shareholders might have been deterred from tendering their shares. On the other hand, if shareholders of the target company had known that the market price was an artificial one, which would likely not have been maintained once the purchases by persons interested in defeating the tender offer ceased, they might well have tendered their shares in the belief that the market price would eventually decline as soon as the tender offer ended.

Thus, trading effected for the purpose of creating an artificial market price for a security, although undertaken as a means of achieving or maintaining corporate control is a manipulative practice. On the other hand, market activity initiated for the purpose of achieving or maintaining control is not manipulative just because it happens to influence the price of a security.³⁵⁹ In *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*,³⁶⁰ Chris-Craft had made an exchange offer, in which it offered Piper shareholders a package of Chris-Craft securities, including common stock, in exchange for shares of Piper stock. In this complex litigation, Bangor Punta Corporation, which had made a competing tender offer, claimed that Chris-Craft had violated sections 9, 10(b) and 14(e) by manipulating Piper's stock. Bangor Punta's theory was that Chris-Craft had induced several institutional investors to buy Chris-Craft stock, thereby inflating its price, with the result that Chris-Craft's offer to Piper shareholders "would be decep-

359. This, of course, is the same point that was made earlier about *Schreiber* (a case that did not, however, involve trading activity). Actions which have the incidental effect of influencing the price of a security are usually not considered manipulative. See *supra* text accompanying notes 86-93; Comment, *supra* note 23, at 636. But see *supra* note 352.

360. 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 910 (1973), reh'g denied, 430 U.S. 976 (1976).

tively attractive."³⁶¹ This in turn was said to have had the secondary effect of driving up the price of Piper stock and of causing Bangor Punta to pay more for Piper stock than it otherwise would have been required to pay.³⁶²

The Second Circuit Court of Appeals held that the evidence did not support the allegations of manipulation.³⁶³ The court also said:

The securities laws do not proscribe all buying or selling which tends to raise or lower the price of a security. . . . So long as the investor's motive in buying or selling a security is not to create an artificial demand for, or supply of, the security, illegal market manipulation is not established. See Section 9(a)(2).³⁶⁴

An inference may be drawn from the court's citing of section 9(a)(2) that the strict requirement of intent that is written into this provision of the Exchange Act (that the trading be effected for the purpose of inducing others to buy or sell the security) should serve as a guideline, but not as an inflexible limit, for determining the intent requirement of the general antimanipulative provisions, sections 10(b) and 14(e).³⁶⁵

VI. CONCLUSION

Stock market manipulation is a serious crime that was well known at least as long ago as the nineteenth century and still occurs today.³⁶⁶ It is a serious offense because it injures or destroys the integrity of the markets by falsifying the public's valuation of securities. Manipulation thus may not only cheat investors by misleading them into buying or selling securities at spurious prices; the damage done to the markets may have much broader effects. These include affecting the use of securities as collateral for loans, the determination of prices at which a company is able to issue additional securities, and the valu-

361. *Chris-Craft*, 480 F.2d at 381.

362. *Id.* at 381.

363. "In the instant case, unlike *Crane*, the requisite purpose and wilfulness for a market manipulation claim cannot be inferred from the established facts." *Id.* at 383.

364. *Id.* The danger that section 9(a)(2) is designed to protect against is the use of "the high, artificially created market price [caused by the defendant's trading] to deceive people into thinking the stock was of great value and thus persuade them to buy the stock at the inflated price." *Spencer Co. v. Agency Rent-A-Car, Inc.*, FED. SEC. L. REP. (CCH) ¶ 98,301, at 91,896 (D. Mass. Sept. 21, 1981), *later op.*, FED. SEC. L. REP. (CCH) ¶ 98,361 (D. Mass. Nov. 17, 1981), *later proc.*, 542 F. Supp. 237 (D. Mass. 1982) (footnote omitted).

365. For discussion of section 9(a)(2), see *supra* text accompanying notes 190-207.

366. See, e.g., *In re Pagel, Inc.*, FED. SEC. L. REP. (CCH) ¶ 83,909 (Aug. 1, 1985) (revoking the registration of a broker-dealer firm for manipulating the price of a security in the over-the-counter market by increasing the price in its published quotes, at a time when the public was selling more shares than it was buying).

ation of securities for taxation and other purposes.³⁶⁷ Because of the insidious and widespread effects of manipulation, its elimination was one of the central purposes of the Exchange Act.³⁶⁸

In recent years, plaintiffs in cases involving tender offers and other corporate control transactions have attempted to use the antimanipulative provisions of the Exchange Act to attack allegedly unfair or otherwise improper activities, including those that have withstood state law challenges. In many instances, the challenged actions were in no way deceptive but were fully disclosed. Furthermore, while the actions may have incidentally affected the price of securities, this was not their purpose. To the limited extent that such challenges were successful, the result was to stretch the concept of manipulation beyond any reasonable definition of the term. The Supreme Court's *Schreiber* decision has correctly curbed this tendency by holding that misrepresentation or nondisclosure is a requirement for manipulation under section 14(e) and, by extension, section 10(b) of the Exchange Act. While the decision did not go further than this, it is plain that manipulation also requires a specific intent to influence the market price of the security and to do so in a deceptive manner.

This is not to say that manipulation may not be present in corporate control transactions. In view of the importance of the market price of the securities, there is an obvious temptation to manipulate in many such instances. However, a pattern of activity is not manipulation merely because an impact on the price of a security is one of its incidental effects. It is manipulation only if deception is used as an integral part of a scheme, one of whose primary objects is to influence the market price of a security, and if such market influence is an essential step in achieving the defendant's corporate control purpose. Nevertheless, the fact that the ultimate purpose of the actions may be something else, such as to gain or maintain corporate control, does not prevent them from being manipulative.

367. See Poser, *Restructuring the Stock Markets: A Critical Look at the SEC's National Market System*, 56 N.Y.U. L. REV. 883, 886 (1981).

368. See Exchange Act § 2, 15 U.S.C. § 78b.