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The United States Supreme Court Interprets Rule 10b-5

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Plaintiff, the Securities & Exchange Commission [hereinafter SEC], attacked a merger of insurance companies for violation of commission rule 10b-5 by misrepresentations and omissions in the proxy statement. Plaintiff's suit to enjoin resulted from the action of defendant, National Securities, Inc., which, having purchased control of Producers Life Insurance Co., sought shareholder approval of a merger between the two companies by sending communications to Producers' shareholders. These communications failed to disclose a plan for the surviving company to assume certain obligations which National Securities had undertaken as part of the consideration for its purchases of Producers' stock. The SEC was denied temporary relief. Shortly thereafter, Producers' shareholders and the Arizona Director of Insurance approved the merger. The SEC amended its complaint, but its attempt to unwind the merger resulted in an adverse judgment on the pleadings. The court construed the complaint as seeking to undo a merger approved by the state director of insurance, pursuant to a state statute requiring his approval of a proposed merger unless he found it contrary to law or inequitable or detrimental to stockholders.[1]

On appeal to the Ninth Circuit Court of Appeals, *held*, affirmed: To invalidate the corporate merger, already approved by the Arizona Director of Insurance pursuant to Arizona Revised Statute § 20-731, would at least "impair" if not "invalidate" or "supersede" laws enacted by the State of Arizona "for the purpose of regulating the business of insurance," within the meaning of the applicable provisions of the McCarran-Ferguson Act.[2]

Because of the importance of the questions raised by the administration of securities laws, the Supreme Court of the United States granted certiorari and *held*, reversed and remanded: By regulating the relationship between a stockholder and the company in which he owns stock, Arizona was regulating securities and not the business of insurance. Such regulation is not within the scope of the McCarran-Ferguson Act. *Securities & Exchange Commission v. National Securities, Inc.*, 393 U.S. 453 (1969).

Although the Supreme Court ruled that the McCarran-Ferguson Act did not bar a federal remedy attempting to protect security holders from fraudulent misrepresentations,[3] it is not on account of this ruling that *National Securities* assumes its importance. Rather, it is because for

1. Securities & Exchange Comm'n v. National Securities, Inc., 252 F. Supp. 623 (D.Ariz. 1966).

2. Securities & Exchange Comm'n v. National Securities, Inc., 387 F.2d 25 (9th Cir. 1967); McCarran-Ferguson Act, 59 Stat. 34 (1945), *as amended*, 15 U.S.C. § 1012(b) (1964).

3. Securities & Exchange Comm'n v. National Securities, Inc., 393 U.S. 453, 89 S. Ct. 564 (1969) [hereinafter cited as SEC v. Nat'l Securities].

the first time the Court chose to interpret rule 10b-5,[4] probably the most litigated provision in the federal securities laws, even though it was not called upon to do so.[5] Despite the fact that rule 10b-5 was not argued, the Supreme Court probably chose to interpret it because of the growing criticism directed at the rule,[6] and because of the opportunity to express itself by means of a clarification of the two relatively clear-cut issues in this case. In this connection, the holdings are (1) that mergers do constitute a "purchase or sale" in the context of 10b-5,[7] and (2) that 10b-5 does cover misrepresentations which occur in connection with proxy solicitations.[8] Before discussion of the development of each of these holdings, it would be well to examine how rule 10b-5 was adopted and how the SEC originally interpreted it.

One commentator has described the beginning of 10b-5 thusly.[9] In 1942, a problem came to the attention of staff members in the Philadelphia regional office of the SEC. The problem involved a stockholder who was intentionally disseminating false bad news about his company in an effort to buy its shares cheaply. Although the general feeling in the office was that the SEC should be able to move against the individual, it was foreclosed: section 17(a)[10] of the Securities Act of 1933 could not be used because it applied only to sales of securities—not purchases. Also, it could not use section 10(b)[11] of the Securities Exchange Act as it be-

4. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1968), provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of inter-state 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 cause 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.

5. *See* Justice Harlan's dissent, in which he states that not only was the issue not discussed by the court of appeals but the only issue raised by the Government in its petition for certiorari was "whether the McCarran-Ferguson Act . . . precludes the application of the anti-fraud provisions of the Securities Exchange Act of 1934. . . ." 89 S. Ct. at 573. Furthermore, he states that when respondents' brief on the merits argued that 10b-5 did not apply to the present case, the Solicitor General did not even attempt to present the Government's position on that score because he believed that "the question is not appropriately before this Court for decision." 89 S. Ct. at 573.

6. *See* Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5*, 65 COLUM. L. REV. 1361 (1965); Ruder, *Pitfalls in the Development of a Federal Law of Corporations by Implication Through Rule 10b-5*, 59 NW. U.L. REV. 185 (1964).

7. SEC v. National Securities, Inc., 89 S. Ct. at 572.

8. SEC v. National Securities, Inc., 89 S. Ct. at 573.

9. Manne, *Insider Trading and the Administrative Process*, 35 GEO. WASH. L. REV. 473 (1967). Manne's account is taken from remarks by Milton V. Freeman of the District of Columbia Bar, Conference on Codification of the Federal Securities Laws, sponsored by the Committee on Federal Regulation of the Section of Corporation, Banking and Business Law of the American Bar Association, Chicago, Ill., Nov. 19, 1966, copy on file at the *George Washington Law Review.*

10. Securities Act of 1933, § 17(a), 48 Stat. 84, *as amended,* 15 U.S.C. § 77(q) (1964).

11. Securities Act of 1934, § 10(b), 48 Stat. 891, *as amended,* 15 U.S.C. § 78(j) (1964).

came operative under rules and regulations promulgated by the Commission, because there were none in point. The following morning a member of the Philadelphia staff presented to the full Commission for its consideration what is now rule 10b-5. The rule and press release[12] were distributed to each member of the Commission. The sole response was by Commissioner Sumner T. Pike who inquired rhetorically, "Well, we are against fraud, aren't we?" The rule was unanimously adopted.

According to the Commission, rule 10b-5 was promulgated by the SEC in order to execute section 10(b)[13] of the Exchange Act and close "a loophole in the protection against fraud."[14] The purpose was to give the SEC substantive provisions upon which to act under section 21,[15] since section 10(b) was not self-executing. One year after that day in 1942, the SEC discussed the rule in *Ward La France Truck Corp.*,[16] and concluded:

> [T]here was a clear necessity, [to negate any] unfair advantage over shareholders, for the issuer and those in control to make timely disclosure of the identity of the purchaser, of improved financial and operating condition of the issuer, and of the full terms of the transfer to Salta [the seller] of the Truck Corporation's business and of its liquidation.[17]

Nothing else even vaguely suggestive of analysis appears in the opinions; this case is the sum and substance of early SEC interpretations of rule 10b-5. There has been little detailed analysis in the judicial history of 10b-5,[18] but because of the overwhelming importance of this vaguely

12. The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to broker-dealers. The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase.

SEC Securities Act Release No. 3230 (May 21, 1942).

13. Securities Act of 1934, § 10(b), 48 Stat. 891, *as amended*, 15 U.S.C. § 78(j) (1964), provides:

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

14. Note 10 *supra*.

15. 48 Stat. 899 (1934), *as amended*, 15 U.S.C. § 78(u) (1964). Section 21 empowers the Commission to enforce all sections of the Act through investigative, administrative, and injunctive proceedings.

16. 13 SEC 373 (1943). The facts were similar to those that had originally generated rule 10b-5, except that the purchaser was the corporation rather than the individual who controlled it.

17. *Id.* at 381.

18. H. MANNE, INSIDER TRADING & STOCK MARKET 10-15 (1966).

worded commission rule it was most important for the Court to begin interpreting it.

The first holding of the instant case, to the effect that a merger is a purchase and sale for purposes of 10b-5, is not surprising; the tendency has been this way for some time. Mergers, including consolidations and sales of assets for securities, are undoubtedly the most common direct impersonal transactions except for cash sales, yet they have generated but little 10b-5 law. One of the reasons for the quiescence of 10b-5 in this area is the arms-length bargaining and careful examination that accompany mergers between independent entities; it is hardly a coincidence that most of the mergers in the few relevant 10b-5 cases are short-form rather than arms'-length, and without shareholder vote.[19] Another reason is the applicability of the proxy rules, which embody (in addition to itemized disclosure requirements) a similar concept of fraud[20] and powerful implied rights of action.[21] However, if the proxy rules are inapplicable or if the fraud is not in the proxy statement but solely in some other phase of the transaction, 10b-5 should be operative.

In two recent cases, the Courts of Appeal for the Second[22] and Seventh Circuits[23] have held that a merger involves a purchase and sale of securities for purposes of section 10(b) of the Securities Exchange Act of 1934[24] and rule 10b-5 of the General Rules and Regulations Under the Securities Exchange Act of 1934.[25] These decisions, and the instant case, represent the culmination of a recent line of decisions which finally extended 10(b) protection to merger situations after years of vacillation by the SEC.

In 1935 the SEC, in the note to rule 5 of form E-1, the form for most registrations, took the position that for registration purposes there was "no sale" to shareholders when a statutory merger or consolidation was approved by vote of the shareholders.[26] By 1943, the Commission was apparently of the view that a merger or consolidation did not involve a sale for any purpose, including the anti-fraud provisions.[27] This

19. A. BROMBERG, SECURITIES LAW: FRAUD—SEC. RULE 10B-5, § 6.3(2), 117-18 n.n.31-35 (1969).

20. SEC Rule 14a-9(a), 17 C.F.R. § 240.14a-9(a) (1968):

> No solicitation subject to this regulation shall be made by means of any proxy statement . . . or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading. . . .

This is the substance of clause 2 in 10b-5.

21. J. I. Case Co. v. Borak, 377 U.S. 426 (1964).

22. Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1967).

23. Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir. 1967), *cert. denied*, 389 U.S. 977 (1967).

24. 15 U.S.C. § 78(j)(b) (1964).

25. 17 C.F.R. § 240.10b-5 (1968).

26. SEC Securities Act Release No. 493(c) (Sept. 20, 1935).

27. In National Supply Co. v. Leland Stanford Jr. Univ., 134 F.2d 689 (9th Cir. 1943),

policy was formalized once again in 1951, when the Commission adopted rule 133 of the General Rules and Regulations Under the Security Act of 1933.[28] This rule specifically provides that a statutory merger or consolidation shall not involve a sale for "purposes . . . of section 5 of the Act [the registration provisions]."[29] The Commission expressly provided that as a matter of statutory construction it does not deem the "no sale theory," which is described in the rule, as being applicable for purposes of any of the anti-fraud provisions of the Securities Act of 1933 and the Securities and Exchange Act of 1934.[30] Although the Commission did not expressly argue that such a transaction should be considered a sale, this was the interpretation placed on the new rule and commentary by at least one text writer.[31]

In any event, the SEC is now squarely in favor of applying section 10(b) and rule 10b-5 to these situations.[32] The reason for the change of position seems to stem from a realization, acquired over years of administrative experience, that there is a great opportunity to defraud investors by use of corporate mergers. Although the SEC has been criticized for the basic inconsistency,[33] the Commission's present position with respect to the anti-fraud provisions is in accord with the intent of section 10(b). The purpose of enacting section 10(b) and adopting rule 10b-5 was to enlarge the provisions of section 17(a) of the 1933 Act so as to prohibit fraud in connection with the "sale" as well as the "purchase" of securities.[34]

Despite the SEC's struggle with the question, the problem presented here received little judicial consideration prior to the instant and the two aforementioned cases.

In 1943, when a similar question was presented in the case of *National Supply Co. v. Leland Stanford Junior Univ.*,[35] the Ninth Circuit indicated that a consolidation did not involve a sale of securities or an exchange amounting to a sale, thus agreeing with the then current position of the SEC that a consolidation was not a sale for purposes of section 10(b).[36] Then in 1960, in *H. L. Green Co. v. Childree*,[37] a district court

cert. denied, 320 U.S. 773 (1943), the Commission filed an amicus curiae brief expressing its opinion that a consolidation did not involve a sale. *Id.* at 694.

28. SEC Securities Act Release No. 3420 (Aug. 2, 1951).

29. 17 C.F.R. § 230.133 (1968). This is the "no sale" theory of the Commission.

30. SEC Securities Act Release No. 3420 (Aug. 2, 1951).

31. I L. Loss, SECURITIES REGULATIONS 524n.17 (2d ed. 1961).

32. Brief for SEC as Amicus Curiae at 5, Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir. 1967); Brief for SEC as Amicus Curiae at 6-28, Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir. 1967).

33. I L. Loss, *supra* note 37, at 522.

34. Dasho v. Susquehanna Corp., 380 F.2d 262, 266 (7th Cir. 1967); Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 201 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961).

35. 134 F.2d 689 (9th Cir. 1943), *cert. denied*, 320 U.S. 773 (1943).

36. *Id.* at 694.

37. 185 F. Supp. 95 (S.D.N.Y. 1960). This case involved an action in which a corporation alleged that it had been fraudulently induced to issue shares pursuant to a plan of merger.

said in its decision that a merger "may or may not involve a purchase and sale" within section 10(b).[38] More recently, *Simon v. New Haven Board & Carton Company*[39] allowed a derivative action involving a merger transaction to be brought under section 10(b). The court said that a corporate issuance of stock is a "sale" within the meaning of the rule that provides that it is unlawful 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 a purchase or "sale" of any security.[40]

In 1963, the Seventh Circuit considered an attack on a merger where a violation of section 10(b) of the Exchange Act, among other things, had been alleged, but the opinion sets forth no distinct holding that a statutory merger is not a sale under the Securities and Exchange Acts.[41] *Voege v. American Sumatra Tobacco Corp.*[42] is a holding by a district court that a merger is a sale under section 10(b). In this case the plaintiff was allowed to bring an individual action as a seller although she did not accept the tender offer. The rationale used by the court was that a sale includes a contract to sell,[43] and the corporate charter is a contract to sell since it requires a shareholder to accept in exchange whatever cash or securities may be offered in a merger.

Vine v. Beneficial Finance Co.[44] and *Dasho v. Susquehanna Corp.*[45] provided the first thorough discussions of the problem at the appellate level. *Vine* allowed the plaintiff to bring an action on his own behalf, on the theory that there was a "constructive" sale of plaintiff's securities within the meaning of section 10(b) and rule 10b-5 when the merger was consummated without his consent.[46] The court reasoned that once the merger was consummated plaintiff's shares were in effect frozen. Therefore, in order to realize any value for them, he would eventually have to exchange them for cash either by accepting Beneficial's offer under the merger agreement or by pursuing his rights to an appraisal. Since the allegedly fraudulent merger placed the plaintiff in this inextricable position the court dispensed with the "needless formality" of having to actually exchange his shares in order to become a seller, and construed the definition of "sale" in section 3(a) to include this plaintiff.

In *Dasho*,[47] the district court attempted to distinguish a sale of shares from a merger by saying that a merger is an automatic involuntary conversion of one type of security for another, whereas a sale requires a

38. *Id.* at 96.
39. 250 F. Supp. 297 (D. Conn. 1966).
40. *Id.* at 298.
41. Borak v. J. I. Case Co., 317 F.2d 838, 847 (7th Cir. 1963), *aff'd*, 377 U.S. 426 (1964).
42. 241 F. Supp. 369 (D. Del. 1965).
43. Securities Exchange Act § 3(a)(14), 15 U.S.C. § 78(c)(a) (1964).
44. 374 F.2d 627 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1967).
45. 380 F.2d 262 (7th Cir. 1967), *cert. denied*, 389 U.S. 977 (1967).
46. 374 F.2d 627, 634 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1967).
47. Dasho v. Susquehanna Corp., 267 F. Supp. 508, 511, 514-15 (N.D. Ill. 1966), *rev'd*, 380 F.2d 262 (7th Cir. 1967), *cert. denied*, 389 U.S. 977 (1967).

volitional act.[48] The court of appeals disposed of this argument by concluding that the district court was unduly impressed by semantic and conceptual difficulties.[49] The court stated that the broad definition given the words "purchase" and "sale" in the anti-fraud provisions of the Securities Exchange Act indicated an intention that the words were not to be limited to transactions ordinarily governed by commercial law.[50]

In the instant case, respondents argued that the complaint failed to allege any misstatement "in connection with the purchase or sale of any security" relying on the "no-sale doctrine."[51] It is clear that a merger or similar transaction entails a sale[52] and presumably, a corresponding purchase for the 1933 Act. Securities Act rule 133 (no sale), which excludes mergers and related transactions from the definition of "sale," is carefully restricted to the registration and related requirements of Securities Act § 5 and does not cover the fraud provisions.[53] The test used by the Court was whether the alleged conduct was the type of fraudulent behavior which was meant to be forbidden by the Statute and the rule.[54] The deception in the instant case furthered a scheme which resulted in Producers' shareholders losing their status in that company and becoming shareholders in a new company. Moreover, by voting in favor of the merger, each approving shareholder individually lost any rights under Arizona law to obtain an appraisal of his stock and payment for it in cash. Therefore, the Court was correct in stating that the deception affected individual shareholders' decisions in ways not at all unlike those involved in a typical cash sale or share exchange,[55] which would be covered by the anti-fraud provisions.

The second holding, by which the Court applied 10b-5 to proxy solicitation, is rather surprising in view of the fact that in section 14(a)[56] of the Securities Exchange Act of 1934, Congress specifically authorized the SEC to develop and enforce rules governing proxy solicitations.[57] section 14(a), like 10b-5, was one of the vehicles through which Congress sought greater protection for the private investor.

Prior to the adoption of the Securities Exchange Act of 1934, essentially the entire proxy field was left to the frail framework provided by state law. Indeed, most state corporate statutes merely authorized the use of proxies. Once past this statutory authorization, there was—and

48. *Id.* at 511.

49. 380 F.2d 262, 267 (7th Cir. 1967), *cert. denied*, 389 U.S. 977 (1967).

50. *Id.* at 266. The court also stated that it was impressed by the argument of the Commission that the proposed merger of Gypsum into Susquehanna involved both a purchase (the acquisition by Susquehanna of 435,000 shares of its own stock) and a sale (the issuance of Susquehanna shares to Gypsum shareholders by Susquehanna).

51. SEC v. National Securities, Inc., 89 S. Ct. at 571.

52. A. BROMBERG, *supra* note 19, at § 6.5(2), 138.2 n.95 (1969).

53. SEC Securities Act Release No. 2059 (July 13, 1961).

54. SEC v. National Securities, 89 S. Ct. at 572.

55. *Id.*

56. Securities Exchange Act of 1934, ch. 404 § 14(a), 48 Stat. 895 (1934), *as amended*, 15 U.S.C. § 78(u)(a) (1964).

57. II L. LOSS, SECURITIES REGULATION 857-66 (2d ed. 1961).

still is—virtually no state case law to guide anyone through the maze of problems that arise in even normal proxy solicitation situations. Not only was there an absence of state law, but prior to the 1934 Act proxy solicitation methods of many publicly held companies were materially if not totally deficient. During this period, the average shareholder received an annual proxy card printed in small type which was so broad as to permit management to take almost any type of action it desired.[58] As a result of these deficiencies, Congress adopted section 14(a) of the 1934 Act,[59] which gave broad powers to the Commission to adopt rules governing the solicitation of proxies as may be necessary or appropriate in the public interest or for the protection of investors. When the Commission adopted its first proxy regulations under section 14(a) in 1935, it marked the beginning of a totally new body of substantive and procedural law with respect to the solicitation of proxies.[60]

> The purpose of section [14] to the Commission rules . . . is to provide shareholders with an opportunity to exercise their corporate franchise on the basis of accurate and adequate information.[61]

While the proxy rules adopted by the Commission went as far as they could, the Act failed to grant the Commission authority to regulate solicitation of proxies of securities traded over the counter. However, by virtue of the significant 1964 Amendments to the Securities Exchange Act of 1934, proxy regulatory control was extended to certain over-the-counter securities.[62] Although these amendments were not in effect at the time of the conduct charged in the instant case, the Court made it clear that, even if they were in effect, 10b-5 would control. In the words of the Court: "But the existence or nonexistence of regulation under section 14 would not affect the scope of section 10(b) and rule 10b-5."[63]

Judicial decisions concerning the overlap of rule 10b-5 and section 14(a) are few in number, and despite some hesitant judicial language there has been no serious challenge to the position taken now by the Supreme Court.[64] Although there was probably nothing to prevent 10b-5 from being used when the proxy rules were also applicable, the question remained open until now.

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58. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13-14 (1934), *cited in* Von Mehren & McCarroll, *The Proxy Rules: A Case Study in the Administrative Process*, 29 LAW & CONTEMP. PROB. 728 n.2 (1964).

59. Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78(n)(a) (1964).

60. SEC Securities Act Release No. 378 (Aug. 21, 1935); E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 81-84 (1957).

61. Statement of The Securities & Exchange Commission with Respect to Proposed Amendments, *Hearings Before a Subcommittee of the Senate Committee on Banking & Currency on S. 1642*, 88th Cong., 1st Sess. 389 (1963).

62. Securities Exchange Act of 1934, § 14(a), *as amended*, 78 Stat. 569 (1964), 15 U.S.C. § 78(u)(a) (1965).

63. SEC v. National Securities 89 S. Ct. at 573.

64. For a summary of holdings under the proxy rules, *see* Sowards & Mofsky, *Federal Proxy Regulation: Recent Extension of Controls*, 41 ST. JOHN'S L. REV. 165, 212-16 (1966).

Although the Supreme Court did not deal with this question in *Borak*,[65] the court of appeals left the issue open, expressly stating that no opinion would be given as to whether misleading proxy material may constitute manipulative or deceptive practices within the prohibition of Securities Exchange Act section 10(b).[66]

A series of cases originating from the Southern District of New York has shed some light on the issue but that court has not remained consistent. The first case in the series involved a situation of an allegedly fraudulent transaction in securities between a corporation and its management, in which the use of the mails to send notices of stockholders meetings and letters concerning corporate activities, designed to facilitate the sale of the securities, was held sufficient to serve as the jurisdictional basis for a derivative action under rule 10b-5.[67] A year later, in *Barnett v. Anaconda Co.*,[68] Judge Bryan regarded as an open question whether fraud in proxy statements could constitute a violation of section 10(b), as distinct from a violation of section 14(a). *Simon v. The New Haven Board and Carton Co.*,[69] although not one of the series, represents possibly the first square and considered holding that a rule 10b-5 derivative cause of action will lie when a corporation is caused to issue stock in a merger authorized by shareholders as a result of deceptive proxy material. In *Richland v. Crandall*[70] the court considered, but found it unnecessary to decide, whether 10b-5 applied to proxy materials within the proxy rules. Although the court noted the "similarity"[71] of proof under 10b-5 and the proxy rules, it brought to light an important distinction when it said that under section 10(b), a plaintiff must show an intent to defraud, or at least guilty knowledge, on the part of the directors, whereas under section 14(a) the use of any proxy statement that is false or misleading with respect to any material fact is outlawed.[72] Finally, in *Miller v. Steinbach*,[73] in which the contention was a proxy statement was false and misleading for failure to disclose that merger negotiations were being conducted, the court declined to dismiss the 10b-5 claim after finding a cause of action stated under the proxy rules.[74]

There is no doubt that stocks and bonds issued by insurance companies are securities for purposes of the SEC statutes.[75] In view of the great similarity of the definitions of "security" in the 1933 and 1934

65. J. I. Case Co. v. Borak, 377 U.S. 426 (1964).
66. Borak v. J. I. Case Co., 317 F.2d 838, 846-47 (7th Cir. 1963), *aff'd on other grounds*, 377 U.S. 426 (1964).
67. Kane v. Central American Mining & Oil, Inc., 235 F. Supp. 559 (S.D.N.Y. 1964).
68. 238 F. Supp. 766 (S.D.N.Y 1965).
69. 250 F. Supp. 297 (D. Conn. 1966).
70. 262 F. Supp. 538, 552-53 (S.D.N.Y. 1967).
71. *Id.* at 553.
72. *Id.*
73. 268 F. Supp. 255 (S.D.N.Y. 1967).
74. *Id.* at 278-79.
75. *See* I L. Loss, SECURITIES REGULATIONS 496-500 (2d ed. 1961).

Acts, Securities Act § 2(1),[76] and Securities Exchange Act § 3(a)(10),[77] the anti-fraud provisions of both Acts, including 10b-5, should therefore be applicable to securities of insurance companies. A more difficult question, however, was the one presented in the instant case—whether 10b-5, though generally applicable to insurance companies, should be applied to insurance company proxy statements, or for that matter any other proxy statements, in the face of express authorization by Congress to the SEC in section 14(a) to regulate proxy matters. Given the federal commitment to investor protection, the Supreme Court had, in the author's opinion, a respectable basis for using 10b-5 to cover proxy statements.

Rule 10b-5, which has come to be known as "the SEC fraud rule,"[78] should have had careful and rigorous analysis, investigation, and discussion by expert individuals capable of recognizing the economic and financial ramifications of a broadly based fiduciary concept. Such treatment is nowhere apparent in the history of rule 10b-5,[79] but hopefully the Supreme Court's decision in the instant case will be the start of the long awaited unravelling of this highly complicated and technical rule.

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76. "The term 'security' is defined in sufficiently broad and general terms so as to include within that definition the many types of instruments that within our commercial world fall within the ordinary concept of security." H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933).

77. *Cf.* Section 3(a)(14) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(c)(a) (1964).

78. III L. LOSS, SECURITIES REGULATIONS 1474-81 (2d ed. 1961).

79. H. MANNE, INSIDER TRADING AND STOCK MARKET 10-15 (1966).