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THE NINTH CIRCUIT EXPANDS THE 10b-5 NET TO CATCH A COLUMNIST—
ZWEIG V. HEARST CORPORATION

In a recent decision, Zweig v. Hearst Corporation, the Court of Appeals for the Ninth Circuit found that a financial columnist may be liable for damages under section 10(b) of the Securities Exchange Act of 1934 and its supplemental rule 10b-5. The columnist's liability could be based upon failure to disclose "scalper" status in a corporation's stock recommended in his daily financial column. By contemplating liability in a private cause of action for damages against the defendant columnist, the court expanded the remedies available to the investing public against the practice of stock scalping. The plaintiffs in

1. 594 F.2d 1261 (9th Cir. 1979).
2. The section provides:
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange: . . .
   (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so 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.
   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.
4. "Scalping" has been defined as "the purchase of securities by a person in a position to influence others by his recommendation or favorable commentary on that security, the recommendation of that security to investors, and the sale of that security after capital appreciation." Peskind, Regulation of the Financial Press: A New Dimension to Section 10(b) and Rule 10b-5, 14 ST. LOUIS U. L.J. 80, 81 (1969) [hereinafter cited as Peskind]. This term was used by the Supreme Court in SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 181 (1963), where the Court found such activities to be fraudulent when practiced by an investment advisor.
5. The plaintiffs actually alleged that three omissions of material fact provided the basis for imposing liability. 594 F.2d at 1265. See note 18 and accompanying text infra.
6. The defendant, Campbell, was previously subject to an injunctive action by the SEC. SEC v. Campbell, FED. SEC. L. REP. (CCH) ¶ 93,580, at 92,703 (C.D. Cal. 1972) (summary of complaint).
Zweig, however, were parties to a merger agreement that predated the column by over three months. As a result, the decision was in favor of persons who, unlike the column's readers, could not have been influenced by the laudatory nature of the column in making their investment decision.

The purpose of this Note is to examine the Zweig decision in light of the Supreme Court's current attempts to retract the scope of liability under rule 10b-5. Given the Supreme Court's stance, the Ninth Circuit's liberal fashioning of the elements of the 10b-5 cause of action and its unexplained departure from its own law and that of the other circuits to justify the extension of liability to these plaintiffs is subject to criticism.

THE FACTUAL BACKGROUND

Alex N. Campbell, a financial columnist for the Los Angeles Herald Examiner, wrote a column recommending the purchase of stock of American Systems, Inc. (ASI). Two days prior to the column's appearance, Campbell purchased 5000 shares of ASI stock. The day after the column, Campbell sold 2,000 of his 5,000 shares.

Each plaintiff in this action owned one third of the shares of Reading Guidance Center, Inc. (RGC), a company that was to merge into ASI.

The practice of scalping stock has been pinpointed as undesirable in the securities market for over fifteen years. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963); REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963). This report documents the scalping activities of an editor of Time magazine who purchased stock in a corporation prior to publication of a favorable article about the company in the magazine's business section. The editor purchased a block of shares prior to assigning a writer to prepare the article. The price of the stock rose dramatically (the editor paid from 6 1/8 to 6 3/4 for his stock and sold some of the shares after the column's appearance for 11 5/8). Over half the customers who responded to a questionnaire about their motives for purchasing the stock stated that either news of the impending article or the article itself prompted their decision to invest. Id. at 72-76. See generally Peskind, supra note 4.

7. 594 F.2d at 1265.
8. Id. at 1270.
9. See notes 47-56 and accompanying text infra.
10. 594 F.2d at 1264-65. Campbell's column contains such laudatory remarks as the following: "American Systems Inc. (over-the-counter $3 5/8) is an interesting company which should appeal to the speculative minded investor." Appellant's Reply Brief at 3-4.
11. 594 F.2d at 1264-65. Campbell's column appeared in the Herald-Examiner on June 4, 1969. On June 2, Campbell purchased the ASI stock for $2.00 per share directly from the company while the market bid price was $3 5/8 per share. Id. at 1264-65. The court alluded to the possibility that Campbell's receipt of the stock at a "bargain price" could have constituted a violation of § 17(b) of the Securities Exchange Act of 1933, 15 U.S.C. § 77q(b) (1976), prohibiting the receipt of "consideration" in exchange for corporate publicity. The court did not pursue the point since the plaintiffs did not present the issue. Id. at 1264 n.5.
12. 594 F.2d at 1265. Campbell sold for $5.00 per share, thereby recouping the original investment of $10,000 in the ASI stock while holding the balance of the shares for "future profits". Id.
13. Id.
under a plan of reorganization entered into in February, 1969.14 The closing date for the merger was June 10, 1969, when ASI would transfer to the RGC shareholders stock with a market value of $1,800,000. The market value, and therefore the number of shares, would be determined by the average closing bid for the ASI stock on the five days preceding the closing date.15 In effect, the plaintiffs and their company relied on the free market to determine the ultimate number of shares to be received in the transaction.

Campbell's column appeared six days prior to the closing date for the merger and the price of ASI stock rose dramatically.16 As a result of this price rise, the number of shares the plaintiffs received on the closing date of the merger was diluted.17 Plaintiffs brought suit under section 10(b) and rule 10b-5, alleging that Campbell's failure to apprise readers of his activities misrepresented the objectivity of the column,18 causing inflation of the stock price and resulting in their loss of a greater percentage interest of ASI in the merger transaction.19 The district court found that Campbell owed no duty to disclose his status as a shareholder in the ASI corporation. The court dismissed the complaint, finding that Campbell's honest report of the information provided him by the officers of ASI fulfilled his duty not to make any intentional misrepresentations of material fact.20

14. Id.
15. Id.
16. Id. The plaintiffs presented the opinion of an expert witness who stated that the rise in the stock price was due to the publication of Campbell's column, given the "thin float" of the ASI stock (500,000 shares outstanding). The closing bid price between June 3 and June 9 was $4.35 per share. The expert claimed that the stock would not have risen above the $3.25 market price without the column's publication. Id. at 1265 & n.6. The plaintiffs attributed the marked increase in the number of individual investors who were buying the stock compared to brokers and investment companies to the column's appearance. In addition, the current information about ASI was less than positive. The company never earned a profit and just repudiated a contract with its sole distributor for its portable telephone. Appellant's Opening Brief at 28.
17. 594 F.2d at 1270. The merger agreement stated that the minimum price for the ASI stock would be $3.33 per share and therefore 540,540 or 51.9% would be the maximum number of shares issued to RGC. Id. at n.15. Since the price rose to $4.35 per share, RGC only received 413,793 shares or 45.3% of the merged corporation. Id. at 1270.
18. The plaintiffs alleged that three omissions of material fact provided the basis for imposing liability: (1) that the defendant invested in the subject stock at a discount price two days before his column was to be published, and intended to sell it on the short-swing rise in price; (2) that he made a practice of "scalping" the stocks of companies he wrote about by buying their stock shortly before his columns were published and then selling the stock at a profit after the column caused a jump in the market price; and (3) that his favorable columns were often reprinted as advertisements for the companies in a financial journal in which the defendant had an interest. Id. at 1265.
19. See notes 16, 17, and accompanying text supra.
THE LAW OF RULE 10b-5

The appellate court's holding that a financial columnist has a duty to disclose stock ownership of companies recommended in his or her newspaper column is an expansion of liability under the disclosure provisions to yet another member of the financial community. Section 10(b) and rule 10b-5 counteract a variety of fraudulent activities practiced by a diverse group of market participants. The number of broad purposes and philosophies underlying the Securities Acts have often given the courts justification for their expansive interpretation of rule 10b-5 while applying its remedies to a host of fraudulent situations.

Until some of its recent decisions, the Supreme Court approved the liberal interpretation and expansive application of rule 10b-5. In SEC v. National Securities, Inc., the Court acknowledged "[t]he broad antifraud purpose" of rule 10b-5 and characterized its inquiry as determining whether the "alleged conduct is the type of fraudulent behavior which was meant to be forbidden" by the rule. This flexible construction suggested


"We believe that § 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involves a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws."

22. The language of both § 10(b) and rule 10b-5 provide liability for violative conduct by "any person". See notes 2 & 3 supra. Section 3(a)(9) of the 1934 Act, 15 U.S.C. § 78c(a)(9) (1976), broadly defines "person" to mean: "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." Despite the broad language, a number of courts have construed § 10(b) and rule 10b-5 as principally directed against the activities of corporate insiders. "One of the primary purposes of the Securities Exchange Act was to outlaw the use of inside information by corporate officers and principal stockholders for their own financial advantage to the detriment of uninformed public security holders."

23. SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) ("design of the statute is to protect investors"); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d at 236-40 (equal access to information, "to protect fair dealing", prevents inequitable and unfair practices and insures fairness); Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 101 (10th Cir.) (equalization of bargaining position), cert. denied, 404 U.S. 1004 (1971); SEC v. Texas Gulf Sulphur Co., 401 F.2d at 858 (dominant congressional purpose is to promote free markets)."
that any conduct could be actionable under rule 10b-5 if it served the anti-
fraud design of the statute. Of course, the expansive interpretation in the
circuits was also facilitated by the high court’s similar rulings in its pre-
1975 decisions.

The Court’s opinion in Affiliated Ute Citizens v. United States is charac-
teristic of this period. Although proof of reliance was traditionally required
in a private cause of action, the Supreme Court insisted that the rule was
to be liberally and flexibly construed and held that in a nondisclosure case,
“positive proof of reliance is not a prerequisite to recovery.”

The proliferation of 10b-5 cases is the result of the private cause of action
for damages implied from the provisions of the rule. This private right of
action was recognized as a necessary and effective means of enforcing the
rule since it gave individual investors motivation for policing the securities
markets, thereby augmenting the resources of the Securities Exchange
Commission. Because the private cause of action was grounded in tort
principles, elements of the common law action for fraud have provided
the framework for determining 10b-5 violations.

Naturally, the restraints on 10b-5 liability result from a failure to prove all
the requisite elements of the private cause of action. The circuits, however,
have been flexible in assessing the presence of the traditional elements prior

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28. See, e.g., White v. Abrams, 495 F.2d 724 (9th Cir. 1974) (flexible duty under rule
10b-5); Eason v. General Motors Acceptance Corp., 490 F.2d 654 (7th Cir. 1973) (plaintiff need
not be a purchaser or a seller), cert. denied, 416 U.S. 960 (1974); City Nat’l Bank v. Vander-
boom, 422 F.2d 221 (8th Cir.) (negligent conduct is actionable), cert. denied, 399 U.S. 905
31. See notes 153-159 and accompanying text infra.
33. Id.
34. The first case to imply a private right of action based upon a violation of rule 10b-5 was
imposition of civil liability upon its reading of the Restatement of Torts § 286, holding an actor
liable for a violation of a legislative enactment if the intent of the act is to protect an interest of
another and the interest invaded is one the enactment is intended to protect. 69 F. Supp. at
513. The Supreme Court finally recognized the implied right of action for damages in Superin-
35. Sargent v. Genesco, Inc., 492 F.2d 750, 760 (5th Cir. 1974) (implementation of rule
10b-5 is dependent on private enforcement); James v. Gerber Products Co., 483 F.2d 944, 950
(6th Cir. 1973) (should encourage private enforcement to reduce incidence of fraud); Fratt v.
Robinson, 203 F.2d 627, 632 (9th Cir. 1853) (nothing “would more certainly tend to deter
fraudulent practices” than a private right of action).
36. J.I. Case Co. v. Borak, 377 U.S. 426, 431-32 (1964); Colonial Realty Corp. v. Bache &
37. See note 34 supra.
38. See Loss, supra note 22, at 1430-44; Note, The Reliance Requirement in Private Actions
Under SEC Rule 10b-5, 88 Harv. L. Rev. 584, 585 (1975); Comment, Negligent Misrepresen-
to awarding damages. In the past, the required elements of a 10b-5 cause of action were: standing to sue, privity, causation, reliance, materiality, and scienter. Absent Supreme Court guidance on the necessity for circumstances which would give rise to a common law action for deceit.” Loss, supra note 22, at 1435. See also Vanderboom v. Sexton, 294 F. Supp. 1178 (W.D. Ark. 1969), rev’d on other grounds, 422 F.2d 1233 (8th Cir.), cert. denied, 400 U.S. 852 (1970); Note, The Nature and Scope of the Reliance Requirement in Private Actions Under SEC Rule 10b-5, 24 CASE W. RES. L. REV. 363, 367 (1973) (common law fraud is a “starting point from which the courts can develop a federal common law that will promote the broad policy goals of 10b-5”).


41. The necessity for privity of contract as a prerequisite to recovery was first articulated in Joseph v. Farnsworth Radio & Television Corp., 99 F. Supp. 701 (S.D.N.Y. 1951), aff’d per curiam, 198 F.2d 883 (2d Cir. 1952). This requirement that plaintiff buy from or sell to the defendant has now been rejected almost overwhelmingly. See Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d at 238-39; Mount Clemens Indus., Inc. v. Bell, 464 F.2d 339, 342-43 n.6 (9th Cir. 1972); Herpich v. Wallace, 430 F.2d at 805 n.12. But see Fridrich v. Bradford, 542 F.2d 307 (6th Cir. 1976) (decision suggests that privity is still essential to impose liability), cert. denied, 429 U.S. 1053 (1977).

42. It is universally required that plaintiff show causation of his injury. See, e.g., Affiliated Ute Citizens v. United States, 406 U.S. at 154; Titan Group, Inc. v. Faggan, 513 F.2d 234, 239 (2d Cir. 1975); Glegg v. Conk, 507 F.2d 1351, 1359 (10th Cir. 1974), cert. denied, 422 U.S. 1007 (1977).


Some cases have explicitly held that Affiliated Ute does not apply to misrepresentation cases. St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 562 F.2d 1040 (8th Cir. 1977), cert. denied, 435 U.S. 925 (1978); Holdsworth v. Strong, 545 F.2d 687 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977); Landy v. FDIC, 486 F.2d 139 (3d Cir. 1973), cert. denied, 416 U.S. 960 (1974).

Other decisions have held that the Affiliated Ute approach should apply to misrepresentations directed to a large class. Carras v. Burns, 516 F.2d 251, 257 (4th Cir. 1975) (reliance can be inferred from proof of materiality in either misrepresentation or omission case). See also Herbst v. Int’l Tel. & Tel., 495 F.2d 1308, 1315 (2d Cir. 1974); Swanson v. American Consumers Indus., Inc., 475 F.2d 516, 520-21 (7th Cir. 1973). For a discussion of the post-Affiliated Ute reliance requirements, see Campbell, Elements of Recovery Under Rule 10b-5: Scienter, Reliance, and Plaintiff’s Reasonable Conduct Requirement, 26 S.C. L. REV. 653, 674-685 (1975); Note, The Reliance Requirement in Private Actions under SEC Rule 10b-5, 88 HARV. L. REV. 584 (1975).


and the parameters of a given element, the circuit courts often have reached disparate conclusions. 46

Recent Supreme Court decisions, adopting conservative approaches to the elements of scienter, 47 standing to sue, 48 and materiality, 49 have provided definitive statements on the necessity of proving each of these elements. In addition, these decisions are recognized as limiting the overall scope of liability under rule 10b-5. 50 The best example of Supreme Court retraction of rule 10b-5 liability is the decision in Ernst & Ernst v. Hochfelder. 51 By holding that scienter, an intent to deceive, be proven in a private 10b-5 action, 52 the Court precluded liability for misconduct that was merely negligent. 53 In Blue Chip Stamps v. Manor Drug Stores, 54 the Court insisted


47. See notes 51-53 and accompanying text infra.


49. In TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976), the Court adopted a test for materiality under the proxy rules. It found facts to be material if a reasonable shareholder would consider them important in making an investment decision. Id. at 449. The Court seemed to suggest that this standard would also apply to 10b-5 cases by citing, without distinction, materiality cases construing various securities provisions, including rule 10b-5. Id. at 445-46 n.8. The Court also distinguished the decision in Affiliated Ute, a 10b-5 case. Id. at 447 n.9.

This formula is a stronger requirement than an earlier definition of materiality, that which an investor "might" consider important, accepted by many lower courts. See, e.g., Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1970); Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968); Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963).


52. Id. at 193.

53. Id. at 214. Many lower courts held, prior to the Hochfelder decision, that intent to injure was unnecessary for 10b-5 liability. See, e.g., White v. Abrams, 495 F.2d at 729, 734; Smallwood v. Pearl Brewing Co., 489 F.2d 578, 606 (5th Cir.), cert. denied, 419 U.S. 873 (1974). Some courts held that negligent conduct was sufficient. Parrent v. Midwest Rug Mills,
that only actual purchasers or sellers may recover under rule 10b-5 and denied liability to persons who did not purchase because of the alleged misrepresentation. Consequently, the liberal decision in Zweig v. Hearst Corporation is contrary to the current trend advanced by these restrictive opinions of the Supreme Court. The Zweig court asserted that its decision is "fully consistent with the spirit and letter of the securities laws." Such justification may have sufficed in earlier days when an expansive interpretation of rule 10b-5 was the norm. Given the current reevaluation and retrenchment of the Supreme Court, together with the Court's demand that some elements of the 10b-5 action remain sacrosanct, the Ninth Circuit's decision must be viewed skeptically since it was the product of a questionable interpretation of the elements of a 10b-5 cause of action.

THE COURT'S ANALYSIS

The Court of Appeals for the Ninth Circuit held that the defendant columnist could be liable for the losses sustained in the merger transaction due to the appearance of the column and the attendant rise in the market value of the ASI stock. Reversing the grant of dismissal, the appellate court

Inc., 455 F.2d 123, 126 (7th Cir. 1972); City Nat'l Bank v. Vanderboom, 422 F.2d 221, 229-30 & n.9 (8th Cir.), cert. denied, 399 U.S. 905 (1970). While the Supreme Court rejected negligence as the appropriate standard of conduct for 10b-5 liability, the Court left open the question of whether recklessness suffices. Ernst & Ernst v. Hochfelder, 425 U.S. at 194 n.12.

54. 421 U.S. 723 (1975). The plaintiff in Blue Chips was a retailer which had been offered the securities of Blue Chip Stamps under the latter's antitrust consent decree. The plaintiff did not purchase the securities and claimed that it had forgone purchase based on an unduly pessimistic prospectus. Id.

55. Id. The Court embraced the purchaser-seller doctrine first announced in Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952), holding that a plaintiff must be a purchaser or seller of securities to maintain an action under rule 10b-5. Id. at 464.

56. 421 U.S. 723 (1975). The plaintiff in Blue Chips was a retailer which had been offered the securities of Blue Chip Stamps under the latter's antitrust consent decree. The plaintiff did not purchase the securities and claimed that it had forgone purchase based on an unduly pessimistic prospectus. Id.

57. 594 F.2d at 1270.

58. See notes 25-33 and accompanying text supra.

59. 594 F.2d at 1271.

60. Id. The court applied the summary judgment standard as the scope of review of this dismissal order because it felt the motion to dismiss actually "functioned" as a motion for summary judgment. Id. at 1263-64. The court based this decision on its reading of the lower court transcript, finding the parties "did not expect the judge to try the facts" but rather "intended the motion to dismiss to test the legal sufficiency of the plaintiffs' claim." Id. at 1263. The court's posture was apparently influenced by a variety of factors. The trial court characterized its action as viewing the evidence "in a light most favorable to the plaintiffs", a summary judgment standard. Id. at 1263-64 & n.2. The appellate court also held that some of the lower court's findings of fact were inappropriate since "there was ample evidence to the contrary in plaintiffs' offer of proof." Id. at 1264 n.3. Finally, the court viewed with displeasure the fact that the findings of fact and conclusions of law were drafted by the plaintiff's attorneys and not the court and therefore "... scrutinize[d] them more carefully." Id. at 1264 n.2.
found that Campbell’s failure to disclose his activities in connection with the ASI stock was a violation of rule 10b-5. 61

To ascertain whether the defendant’s conduct was a 10b-5 violation, the court first inquired whether the necessary element of materiality was present. 62 The concept of materiality is fundamental to the scheme of the securities laws, 63 and courts usually assess the materiality of an omission or a misrepresentation under rule 10b-5 by using the same criteria that is employed under other provisions of the securities laws. 64 In like manner, the Ninth Circuit applied a standard for materiality that was recently formulated by the Supreme Court in a proxy violation case. 65 The majority found that investors would have considered the defendant’s lack of objectivity 66 and his motivations 67 important in making investment decisions regarding companies praised in the column. 68 The court was influenced by the nature of the column, finding its style, tone, and approval of investment in ASI grounds for holding the nondisclosure of his stock ownership material to the readers’ evaluation of the column’s objectivity. 69

After determining that the defendant’s nondisclosure of stock ownership was material to the readers and presuming his intent to profit, 70 the court

61. 594 F.2d at 1271. The court remanded for determination of whether the requisite intent could be shown. Id. The appellate court did presume an intent to profit in order to aid in its analysis. Id. at 1265. The court also remanded for trial court evaluation the measure of damages. Id. at 1268 n.12. The court indicates that the measure of damages should be limited to the difference between the value that would have been paid in the merger had Campbell revealed the material facts in his column and the value that actually was paid. Id. This formula recognizes the possibility that even a column disclosing all facts could have caused an elevation of the price of the stock, a loss the plaintiffs would have to absorb.

62. 594 F.2d at 1266.


64. See, e.g., Republic Technology Fund, Inc. v. Lionel Corp., 483 F.2d 540, 551 (2d Cir. 1973) (same test for 10b-5, § 17(a) of the 1933 Act, and § 14(e) of the 1934 Act), cert. denied, 415 U.S. 918 (1974); Gilbert v. Nixon, 429 F.2d 348, 355 (10th Cir. 1970) (§ 12(2) of the 1933 Act and 10b-5 cases use 10b-5 authority for materiality); Kahan v. Rosenstiel, 424 F.2d 161, 174 (3d Cir.) (§ 14(a) of the 1934 Act case is good authority for 10b-5), cert. denied, 398 U.S. 950 (1970).


66. 594 F.2d at 1266.

67. Id. The court cited Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972), where the Supreme Court implied that motivations were material. Id. at 152.

68. 594 F.2d at 1266.

69. Id.

70. Id. at 1265.
turned its attention to the issue of the defendant's duty to disclose. The majority implied that only the elements of materiality and duty to disclose, when accompanied by scienter, are required to hold a defendant liable under rule 10b-5. This position was supported by the United States Supreme Court's decision in Affiliated Ute.

Generally, the "duty to disclose" belies precise definition. Until the Affiliated Ute decision, it was never postulated as a distinct element of the 10b-5 cause of action. Although opinions have indicated that assessing the duty to disclose is the initial inquiry in imposing liability under rule 10b-5, finding this duty has often depended upon the presence of the other traditional elements. As a result, the parameters of the duty to disclose have been explained in terms of scienter, causation, and materiality. A duty to disclose was generally imposed to eliminate inequity when one with non-public information benefits by its use in trading securities. This basic philosophy supports imposing a duty whenever the other elements are proven. Also, the very purpose of the securities laws, particularly section 10(b) and rule 10b-5, is to encourage disclosure in certain situations. Therefore, the concept of a duty to disclose can be seen as inextricably intertwined with the presence of any of the other elements required in actions under these provisions.

An earlier Ninth Circuit decision, White v. Abrams, adopted a "flexible duty" approach to 10b-5 cases, intending that the duty to disclose replace

71. Id. at 1266.
72. Id.
73. Id. at 1271. See notes 52, 53, and accompanying text supra.
75. The Affiliated Ute Court recognized the necessity of proving causation-in-fact but did not consider proof of reliance dispositive of the causation requirement. Id. at 153-54. The Court stated that the test for causation was the existence of the duty to disclose and the materiality of nondisclosure. Id. at 154. Since materiality is itself a distinct element, only the other half of the causation test, the duty to disclose, stands as the other necessary criterion for imposing 10b-5 liability. Of course, Affiliated Ute predated Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). Scienter is now an undisputed element as a result of the latter decision. See notes 51-53 and accompanying text supra.
76. White v. Abrams, 495 F.2d at 732; Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d at 363.
77. See notes 40-45 supra.
78. Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d at 363.
79. The duty to disclose does not extend to all investors in the market, rather only those causally connected with the insiders trading are beneficiaries of the duty. Fridrich v. Bradford, 542 F.2d 307 (6th Cir. 1976).
80. The Supreme Court has suggested that the presence of the duty to disclose is predicated on the materiality of the nondisclosure. Affiliated Ute Citizens v. United States, 406 U.S. at 153. See also Rochez Bros. v. Rhoaides, 491 F.2d 402, 408-09 (3d Cir. 1973), cert. denied, 425 U.S. 933 (1976).
82. 495 F.2d 724 (9th Cir. 1974).
83. Id. at 734.
the traditional emphasis on scienter.\textsuperscript{84} Despite the fact that proof of scienter has been reaffirmed by the Supreme Court,\textsuperscript{85} the Zweig court considered the following factors delineated in the \textit{White} opinion relevant to the determination of the duty to disclose:\textsuperscript{86} (1) defendant's relationship to the plaintiff; (2) defendant's access to the information as compared to that of the plaintiff; (3) defendant's benefit derived from the relationship; (4) defendant's awareness of whether plaintiff was relying on their relationship in making his or her investment decisions; and (5) defendant's activity in initiating the transaction in question.\textsuperscript{87} The court found a clear duty to disclose to the readers employing the above factors.\textsuperscript{88} Campbell's status as an informal financial advisor in a position to influence the market provided the requisite relationship, despite the absence of fiduciary duties.\textsuperscript{89} He controlled the information and his salary provided a financial benefit from his relationship with the readers.\textsuperscript{90} Finally, the column apparently initiated many of the purchases that caused the stock's rise in price.\textsuperscript{91}

The majority's finding of a conflict of interest inherent in Campbell promoting the purchase of ASI stock, even though his presumed intent was a quick sale, exacerbated the need for a duty to disclose.\textsuperscript{92} The court relied on the \textit{Affiliated Ute} decision,\textsuperscript{93} suggesting that Campbell's activities were analogous to the "market making" that demanded disclosure in that case.\textsuperscript{94} The majority recognized that most disclosure cases involve a corporate insider or a tippee receiving and acting upon information concerning the inherent value of the firm.\textsuperscript{95} Although the "market information",\textsuperscript{96} the fact

\textsuperscript{84} Id.
\textsuperscript{85} Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).
\textsuperscript{86} 594 F.2d at 1268. Crocker-Citizens Nat'l Bank v. Control Metals Corp., 566 F.2d 631, 636 n.2 (9th Cir. 1977), supports the conclusion that the \textit{White} duty analysis is still good law, despite those parts that have been overruled. For other cases applying the \textit{White} analysis, see Hughes v. Dempsey-Tegeler & Co., Inc., 534 F.2d 156 (9th Cir.), cert. denied, 429 U.S. 896 (1976); Robinson v. Cupples Container Co., 513 F.2d 1274 (9th Cir. 1975); Marx v. Computer Sciences Corp., 507 F.2d 485 (9th Cir. 1974).
\textsuperscript{87} 594 F.2d at 1268.
\textsuperscript{88} Id. at 1269.
\textsuperscript{89} Id.
\textsuperscript{90} Id.
\textsuperscript{91} Id. This is only an assumption on the court's part, based upon the plaintiffs' offer of proof. Id.
\textsuperscript{92} Id. at 1268.
\textsuperscript{93} Id.
\textsuperscript{94} Affiliated Ute Citizens v. United States, 406 U.S. at 153. See also Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1970).
\textsuperscript{95} 594 F.2d at 1266.
\textsuperscript{96} "Market information" has been defined as "information about events or circumstances which affect the market for a company's securities but which do not affect the company's assets or earning power." Fleischer, Mundheim & Murphy, \textit{An Initial Inquiry into the Responsibility to Disclose Market Information}, 121 U. PA. L. REV. 798, 799 (1973), includes an analysis of Campbell's activity based upon the SEC action taken against him. Id. at 828-35. The language of both § 10(b) and rule 10b-5 refer only to "material" information. See notes 2 & 3 supra.
that the column was less than objective and would be used for later advertisement, was considered novel, the court still found that withholding such information was a basis for 10b-5 liability.

Having found a duty to the readers of the column, the court turned to an analysis of the duty to the plaintiffs. The Ninth Circuit recognized the conceptual difficulty in finding a duty to plaintiffs who did not read the column prior to the merger decision. It refused, however, to let the "rubrics of reliance or duty" preclude its extension of the duty to disclose in this unusual situation. In essence, the court based the duty to disclose upon the fact that, despite not having relied on the column in making their decision to invest, the plaintiffs suffered a loss due to the column's misrepresentation of objectivity. To support its rationale, the majority pointed out that the plaintiffs and RGC agreed to the merger on the assumption the exchange would be consummated in accordance with the dictates of a fully informed market, and Campbell's activities precluded the existence of such a market.

The elementary philosophy underlying the securities laws is to insure a fully informed marketplace. Rectifying infractions that frustrate this purpose is the primary role of rule 10b-5. The operative definition of a fully informed market is one whose participants possess relatively equal access to information. Given the Affiliated Ute precedent, some notable decisions have protected any and all purchasers in the open market from nondisclosure because these persons are deprived of the benefit of equal access to information. Because the fact the column was published while its author was in possession of the stock was unknown to the purchasers in the market, the equal access test was not met. Therefore, the Zweig court's objection to the price rise following publication of Campbell's column

Therefore, there may be no reason to differentiate between corporate information and market information when imposing liability under these provisions.

97. 594 F.2d at 1271.
98. Id. at 1269.
99. Id. at 1270.
100. Id. at 1271.
101. Id. at 1269-71.
102. Id. at 1269.
103. Id.
104. Id. at 1270.
108. See notes 30-33 and accompanying text supra.
adheres to the open market protection recently afforded under rule 10b-5 and complies with the basic purposes of the securities laws.\footnote{111}

**Criticism of the Decision**

The Zweig decision is novel in that it contemplates liability for damages against a new class of market participants. The legitimacy of this extension, however, is undermined when the court's dubious conclusions as to the duty to disclose and the materiality of the nondisclosure to these plaintiffs are scrutinized. In addition, the Ninth Circuit's failure to conform its decision to the existing law outlining the "in connection with" requirement and the concept of positive non-reliance provides further grounds for criticizing the Zweig decision and its treatment of the elements necessary in a private cause of action under rule 10b-5.

"Quasi-Insider" Liability

One aspect of the Zweig decision presenting a significant departure from the current law of rule 10b-5 is the extension of liability for nondisclosure to one who was neither an insider nor a tippee\footnote{112} but was actually the independent creator of the information. Campbell was characterized as a "quasi-insider".\footnote{113} This is the first case to impose civil liability on a person in the defendant's position,\footnote{114} one bereft of any fiduciary duties.\footnote{115} Aside from

\footnote{111: 594 F.2d at 1270. The Congressional attitude towards interference with the price mechanism is evident in the earliest legislative history of the securities acts. The drafters stated: The concept of a free and open market for securities necessarily implies that the buyer and seller are acting in the exercise of enlightened judgment as to what constitutes a fair price. Insofar as the judgment is warped by false, inaccurate, or incomplete information regarding the corporation, the market price fails to reflect the normal operation of the law of supply and demand. S. Rep. No. 1455, 73d Cong., 2d Sess. 68 (1934).}

\footnote{112: An insider is a person who: (1) possesses inside information, (2) knows or should know the information is non-public, and (3) received the information in his business capacity by virtue of a relationship enabling access to the information. 5 A. Jacobs, The Impact of Rule 10b-5, § 66.02(a), at 3-281 (1975) [hereinafter cited as Jacobs]. See also Cady, Roberts & Co., 40 S.E.C. at 912; 1 A. Bromberg, Securities Law: Fraud—SEC Rule 10b-5, § 4.4, at 76 n.33.1 (1967) [hereinafter cited as Bromberg]. Tippees are persons given inside information by insiders in other than their business capacity. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969); Kuehnert v. Texstar Corp., 286 F. Supp. 340 (D.C. Tex. 1968) (person who has access through insider to information that should be used only for corporate purposes and not for the personal benefit of anyone), aff'd, 412 F.2d 700 (5th Cir. 1969); Bromberg, Corporate Information: Texas Gulf Sulphur and Its Implications, 22 Sw. L. J. 731 (1968).}

\footnote{113: 594 F.2d at 1267 n.9. The court defined "quasi-insiders" as "people who obtain nonpublic information from a source outside a corporation about events or circumstances which will affect the market in the corporation's stock." Id.}

\footnote{114: Neither "outsiders" nor "quasi-insiders" have been held civilly liable. Outsiders have been held criminally liable under the securities acts. U.S. v. Charnay, 537 F.2d 341 (9th Cir.), cert. denied, 429 U.S. 1000 (1976). Quasi-insiders have also been held criminally liable. U.S. v. Chiarella, 588 F.2d 1358 (2d Cir. 1978), cert. granted, 441 U.S. 942 (1979); U.S. v. Feltz, 433}
the Supreme Court's apparent intent to limit the scope of liability under rule 10b-5.116 There is no judicial statement that a person in the defendant's position should not be subject to liability for damages.117 In fact, the language of rule 10b-5 permits imposing liability upon "any person".118

Examination of the Ninth Circuit's analysis of Campbell's duty to his readers and of the materiality of the nondisclosure suggest that imposing liability upon a person in Campbell's position is proper despite the hint of disapproval emanating from the Supreme Court's recent restrictive opinions. If the plaintiffs were readers of the column who relied upon its favorable presentation of the investment possibilities of ASI in purchasing stock, the court's analysis would present compelling reasons for imposing liability upon a financial columnist who abused the relationship with his readers with an intent to profit.

The Ninth Circuit, however, is asserting liability against a columnist in favor of plaintiffs who were parties to a merger agreement predating the column by over three months. Breach of the duty to disclose to these plaintiffs was inadequately supported when compared to the majority's persuasive determination of the duty to disclose and the materiality of the nondisclosure to the readers. Consequently, the very factors that sustain the columnist's liability appear less credible when the actual outcome of the entire decision is considered.

**Duty to Plaintiffs Who Did Not Read the Column Prior to Investing**

While the court insisted that materiality and the duty to disclose are dispositive,119 its analysis of both these elements in relation to the plaintiffs who took part in the merger agreement did not support the majority's conclusion. Conspicuously absent from the determination of a duty to disclose is any mention of the *White v. Abrams* decision. While the Zweig court embraced the factors enumerated in that opinion as dispositive of the defendant's duty to disclose to his readers,120 it failed to reconsider those same

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115. The decision in SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963), imposing liability on a financial adviser for scalping stock under the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 et seq. (1976), focused upon the fiduciary duties of the adviser that were breached. *Id.* at 194. In Zweig, the court refused to recognize the *Capital Gains* precedent as controlling. 594 F.2d at 1267-68 & nn. 10, 11. The Zweig court explicitly stated that Campbell had no fiduciary duty to his readers. *Id.* at 1269.

116. See notes 47-56 and accompanying text supra.

117. The Supreme Court, however, has granted certiorari in U.S. v. Chiarella, 588 F.2d 1358 (2d Cir. 1978), *cert. granted*, 99 S. Ct. 2158 (1979). Perhaps some guidance will be forthcoming from the high court on the propriety of imposing liability on persons outside the corporation.

118. See note 3 supra.

119. 594 F.2d at 1266.

120. See notes 86, 87, and accompanying text supra.
factors in assessing the duty to these plaintiffs. In fact, the last two factors
enumerated in White would deny the finding of such a duty. First, it was
impossible for Campbell to have been aware of the plaintiffs' reliance on
their relationship in making the investment decision since the plaintiffs made
their decision long before the column was contemplated. The final factor
is also contrary to the finding of a duty since the time sequence obviously
prevented the column from playing a part in initiating the merger transac-
tion.

Two other factors outlined in White, the relationship between the par-
ties and the benefit derived from the relationship, are also apparently
lacking in this situation. While Campbell relied upon his relationship with
the readers to provide his salary, he had no pecuniary interest in connection
with these plaintiffs. The court found the requisite relationship in the
readers' dependence on the column for their investment advice, but the
plaintiffs did not look to the column in making their decision to invest, pre-
cluding a direct analogy to the readers' relationship. Because Campbell con-
tinued to have sole access to the pertinent market information, this factor
remains intact in both situations.

While the Ninth Circuit in White recognized the dangers in enumerating
these factors for fear the list would be incomplete, failure to satisfy
four of the five factors considered important by that court and reaffirmed in
an earlier part of the Zweig decision surely illustrates the tenuous grounds
upon which the majority imposed a duty to the plaintiffs who participated in
the preexisting merger. Of course, the conclusion is buttressed by the
court's own intimation that the rubrics of duty would support a contrary
decision.

Materiality to the Plaintiffs

It should be noted that the court did not refer to the materiality of the
defendant's nondisclosure as it related to these plaintiffs. Rather, the majority
only spoke of the materiality to the readers of the column. The stan-

121. 495 F.2d at 735-36. See text at note 87 supra.
122. A column on ASI was recommended to Campbell in "either late May or in early June." Appellant's Opening Brief at 6-7. The merger agreement was executed in February. 594 F.2d at 1265.
123. See note 122 supra.
124. 495 F.2d at 735-36. See text at note 87 supra.
125. Id.
126. See text at note 90 supra.
127. See text at note 89 supra.
128. See text at note 87 supra.
129. 495 F.2d at 736.
130. Id. at 735.
131. 594 F.2d at 1271.
132. Id. at 1266.
The standard for materiality is whether a reasonable investor would consider the fact important in making his or her investment decision. Since the appellate court was considering an investment decision made more than three months prior to the appearance of the misleading column, perhaps its silence on this issue is understandable. It is impossible to conceive how information that was nonexistent at the time of the investment decision could be important, and therefore material, to these plaintiffs.

When faced with a situation similar to Zweig, where plaintiffs are contractually bound to sell their stock, other circuits invariably deny liability for any act subsequent to the date the plaintiffs undertook their obligations because these activities are immaterial or irrelevant to the plaintiffs' investment decisions. By failing to address the materiality of the nondisclosure to these plaintiffs, the majority decision in Zweig provides no insight into why defendant's activities in connection with his column should be considered material.

Consequently, the analytical omissions in the Zweig decision make it an imperfect vehicle for extending civil liability to a defendant who is not an insider or a tippee. While the duty to disclose the columnist's position as a scalper of the ASI stock to his readers is adequately explained, extension of that duty to plaintiffs who participated in a preexisting merger is the result of a dubious interpretation of existing law. In light of the Supreme Court's unenthusiastic response to the proliferation of 10b-5 actions, the Ninth Circuit's expansive and open-ended conception of 10b-5 liability should be viewed as inimical to the position evinced in recent Supreme Court opinions.

The "In Connection With" Requirement

The language of both section 10(b) and rule 10b-5 require that a violation actionable under these provisions be "in connection with the purchase or sale of securities." While mergers are generally recognized as providing a basis for standing, the "in connection with" language demands a nexus.

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133. Id. See note 49 supra.
135. See notes 2 & 3 supra.
usually expressed in temporal terms,138 between the fraud and the purchase or sale. Use of the "in connection with" language "intended only that the device employed . . . would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities."139 Therefore, the general rule is that fraud must precede or be contemporaneous with the purchase or sale to provide the requisite nexus.140 An exception to this rule was developed in cases involving a continuous fraudulent scheme.141

In other contexts under rule 10b-5, the point in time when the parties are "committed", not the later closing date, is dispositive of the issue of when a purchase or sale occurs.142 In Zweig, the court acknowledged that the plaintiffs were contractually committed prior to the publication of the column.143 Therefore, if the point of commitment is determinative, the facts in this case indicate the purchase occurred prior to the column's appearance. Consequently, the purchase preceded the fraud, and since this is not a case of a continuous fraudulent scheme,144 the general rule that a fraud subsequent to the transaction lacks the requisite nexus to satisfy the "in connection with" requirement would deny these plaintiffs standing.145


139. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 860.

140. "Quite obviously, the 'fraud' must be in connection with the purchase or sale of a security. No case has been called to our attention which has sustained federal jurisdiction under 10(b) for a fraud committed or practiced after a purchase or sale." Pepsico, Inc. v. W.B. Grace & Co., 307 F. Supp. 713, 719 (S.D.N.Y. 1969). See also Baschio v. Sinclair, 486 F.2d 1029 (9th Cir. 1973); Horst v. W.T. Cabe & Co., Inc., FED. SEC. L. REP. (CCH) ¶ 96,213, at 92,461 (S.D.N.Y. 1977). But see Lanning v. Serwold, 474 F.2d 716 (9th Cir. 1973) (no rule that fraud must precede the sale).

141. Davis v. Davis, 526 F.2d 1286 (5th Cir. 1976); Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir.), cert. denied, 419 U.S. 873 (1974); Lanning v. Serwold, 474 F.2d 716 (9th Cir. 1973).


143. 594 F.2d at 1265.

144. This cannot possibly be a "continuous scheme" case since Campbell, the party to the fraud in question, had no relation whatever to the formulation or adoption of the merger agreement (even assuming the possibility that the latter was procured through fraudulent means, an assumption for which there is no evidence in the opinion).

145. The dissenting judge felt "the majority effectively removed the substantive content in the requirement of 'in connection with . . . .'" 594 F.2d at 1272 (Ely, J., dissenting).
The court did not directly address the standing issue in its decision. It did, however, characterize the plaintiffs' position as subject to an "executory" agreement. 146 Recently, a line of cases have held that fraud committed during the pendency of an executory contract is actionable under rule 10b-5. 147 These cases, although adopting the general rule that the fraud must precede or be contemporaneous with the purchase or sale to be actionable, reasoned that the defrauded plaintiffs had standing to bring suit despite the fact the purchase or sale actually preceded the fraud. 148 In Horst v. W.T. Cabe & Co., 149 the court stated that this exception to the general rule stems from the courts' refusal to allow individuals to take advantage of their contractual relationship in committing fraud upon others. 150

If the Zweig majority relied upon the executory contract exception, the court inappropriately applied it to the present fact situation because Campbell was not a party to the original merger and, thus, was not taking advantage of any contractual position. In fact, the court pointed out that Campbell may have been unaware of the merger's existence. 151 As a result, it can only be postulated that the majority is extending the executory contract doctrine beyond the parameters imposed by earlier decisions. 152 Absent a valid application of the executory contract doctrine, the decision can be criticized for its failure to indicate how the fraud was "in connection with" the purchase or sale of securities, as that element of the private 10b-5 cause of action has been construed.
The Reliance Requirement

The final critique of this decision concerns assertion of liability against a defendant despite affirmative evidence that the plaintiffs did not rely upon the column in making their decision to invest. The Ninth Circuit failed to discuss the implications of this position when proof of the requisite causation element was considered.

Until the Supreme Court decision in *Affiliated Ute*, proof of reliance upon the fraudulent conduct in making investment decisions was required in order to recover in a private cause of action for damages. Although the Court stated that a plaintiff need not prove reliance in a nondisclosure case, causation still must be proven. The Supreme Court also stated that the test for causation is the presence of materiality and the duty to disclose, thereby replacing reliance as the traditional test for causation. Reliance had been a prerequisite “to restrict the potentially limitless thrust of Rule 10b-5 to those situations in which there exists a causation in fact between the act and the injury.”

Since the decision in *Affiliated Ute*, the lower courts have debated the necessity for proof of reliance. These courts have construed the Supreme Court’s holding as establishing a “presumption” of reliance, allowing the defendant an opportunity to rebut with positive proof of non-reliance. The implication of this rebuttable presumption was succinctly stated by one circuit, holding that if the plaintiff’s decision regarding the transaction would not have differed had the disclosure been made, causation cannot be shown. Therefore, positive proof of non-reliance precludes a finding of

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156. *Id.* at 154.
157. *Id.*
158. See cases cited in footnote 154 *supra*.
161. See, e.g., *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d at 1048; *Chelsea Assoc. v. Rapanos*, 527 F.2d 1266, 1271 (6th Cir. 1975); *Rochez Bros. v. Rhoades*, 491 F.2d 402 (3d Cir. 1974).
163. In *Rochez Bros. v. Rhoades*, 491 F.2d 402 (3d Cir. 1974), the court stated:

If defendant is able to demonstrate that there was clearly no reliance, that is, that even if the material facts had been disclosed, plaintiff’s decision as to the transac-
causation in circuits adopting this position\textsuperscript{164} despite the Supreme Court's formulation of a "new" test for causation.\textsuperscript{165} The \textit{Zweig} decision marks the Ninth Circuit's departure from this rebuttable presumption approach.\textsuperscript{166}

Regarding plaintiffs who are contractually committed to a purchase or sale, decisions in other circuits have denied liability for actions subsequent to the decision to invest. Non-reliance was usually evidenced by the prior contract, precluding any finding of causation.\textsuperscript{167} Since the plaintiffs in the instant action also were contractually committed prior to the fraud, the \textit{Zweig} majority's unprecedented approach to reliance and causation is inconsistent with past Ninth Circuit decisions.\textsuperscript{168} By preserving a cause of action for plaintiffs who made their decision to invest months prior to the publication of the fraudulent column, the \textit{Zweig} decision focuses on the defendant's actions as the sole cause of the plaintiff's losses.\textsuperscript{169} This decision, however, surpasses other opinions allowing recovery based upon loss causation alone\textsuperscript{170} as these decisions did not completely eliminate the vestiges of reliance.\textsuperscript{171}

The \textit{Zweig} majority embraced, without comment, the \textit{Affiliated Ute} holding that materiality establishes causation.\textsuperscript{172} The Ninth Circuit, however, stretched that analysis, reaching a result unforeseen by the Supreme Court.

\textsuperscript{164} See cases cited in footnote 162 supra.

\textsuperscript{165} See note 157 and accompanying text supra.

\textsuperscript{166} Crocker-Citizens Nat'l Bank v. Control Metals Corp., 566 F.2d at 636 n.3; Blackie v. Barrack, 524 F.2d at 906.


\textsuperscript{168} See note 166 and accompanying text supra.

\textsuperscript{169} See notes 101-04 and accompanying text supra.

\textsuperscript{170} In Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1976), the Second Circuit suggested a bifurcated approach to the requirement that causation be shown in a 10b-5 action. The court required a showing of both "loss causation", that the omission caused the economic harm (\textit{id.} at 380) and "transaction causation", that the violation caused the plaintiff to enter the transaction in question (\textit{id.}). The latter is more commonly referred to as "reliance". \textit{id.} at n.11. To accommodate the decision in \textit{Affiliated Ute}, the \textit{Schlick} court held that a plaintiff need only show materiality in a nondisclosure case and not traditional reliance. \textit{id.} at 380-81. See also BROMBERG, supra note 112, § 8.6, at 209-11.

\textsuperscript{171} See, e.g., Blackie v. Barrack, 524 F.2d at 906 & n.23 (although presumes reliance of purchases in the open market, does not dispense with need for a "transactional nexus"); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d at 236-40 (limits recovery to those who purchase during the period of nondisclosure); Chris-Craft Indus., Inc. v. Piper-Aircraft Corp., 480 F.2d at 375 (presume reliance "where it is logical" to do so).

\textsuperscript{172} 594 F.2d at 1271.
when it abolished the necessity for proof of reliance to a successful showing of causation.\textsuperscript{173} Since the Supreme Court was not addressing a preexisting agreement situation in \textit{Affiliated Ute}, there is some doubt, particularly in light of its recent conservative approach to the 10b-5 elements, whether the Court would approve this extension of its analysis.\textsuperscript{174} In addition, the other circuits have responded by denying recovery to plaintiffs in similar situations.\textsuperscript{175} Justice Blackmun, author of the majority opinion in \textit{Affiliated Ute}, described the Court's holding in a later concurring opinion\textsuperscript{176} as "simply provid[ing] the causal link between the omission of material information and the shareholder's act of purchasing or selling the stock."\textsuperscript{177} This account of the decision implies that the Supreme Court was considering only the normal progression of a fraud inducing the latter purchase or sale. Therefore, the \textit{Zweig} majority's dependence upon this case to mask its dubious causation analysis is probably misplaced and to some extent misleading.

**Possible Justification for the \textit{Zweig} Decision**

As indicated, the \textit{Zweig} opinion does not present any authority for its treatment of the standing and causation issues. In addition, the opinion does not resolve the apparent problems that arise from a strict analysis of these 10b-5 elements. The court, however, is dealing with a triangular fraud situation.\textsuperscript{178} Fraud to the readers of the column resulted in a loss to the plaintiffs upon consummation of their merger. A comparison to other triangular fraud decisions and their resolution of the standing and causation issues suggests an alternative method of viewing the \textit{Zweig} decision and a possible justification for the court's refusal to allow a strict evaluation of the elements to impede liability.

Plaintiffs in analogous positions have been successful in two Second Circuit decisions,\textsuperscript{179} cited as authority for the so-called "forced seller" exception to

\textsuperscript{173} See notes 30-33 and accompanying text \textit{supra}.

\textsuperscript{174} The Supreme Court, in \textit{Ernst & Ernst v. Hochfelder}, 425 U.S. 185 (1976), suggested that the harm to the investors should not be the focal point in imposing liability under § 10(b) in its decision to require scienter for actions under that provision. \textit{Id. at} 198. Therefore, a decision focusing upon the economic loss to the plaintiff, as the \textit{Zweig} decision does, would certainly appear to conflict with current Supreme Court attitudes towards 10b-5 liability.

\textsuperscript{175} See cases cited in footnote 167 \textit{supra}.

\textsuperscript{176} \textit{Piper v. Chris-Craft Indus., Inc.}, 430 U.S. 1, 51 (1976) (Blackmun, J., concurring).

\textsuperscript{177} \textit{Id. at} 51 (emphasis added).

\textsuperscript{178} A triangular fraud is a fraud practiced by A upon B resulting in harm to C.

the standing requirements of the purchaser-seller rule. In *Vine v. Beneficial Finance Co.*, the plaintiff sought to use rule 10b-5 to attack fraud in a tender offer to his fellow shareholders that enabled the defendant to consummate a short-form merger with the plaintiff under Delaware law. The Second Circuit characterized the plaintiff as a "forced seller" as a result of the fraud and granted standing to sue.

The decision in *Crane Co. v. Westinghouse Air Brake Co.* awarded forced seller status to a defeated tender offeror. The plaintiff Crane proposed a merger with the defendant corporation to be accomplished through its tender offer to defendant's shareholders. The plaintiff brought suit under rule 10b-5 to contest alleged market manipulations that misled the shareholders, inducing them to vote against the plaintiff's tender offer and in favor of a competing offeror.

Both cases recognized the rights of the plaintiff to sue for damages resulting from fraud directed against third party shareholders rather than the plaintiffs themselves. Although the Zweig court did not cite these cases as authority for its decision to grant standing to the plaintiffs, the appellate court did characterize the plaintiffs as "forced purchasers" of the ASI stock due to the merger agreement. As such, the court may be intimating its reliance on these "forced seller" cases to extend the 10b-5 remedy to those plaintiffs who are contesting fraud practiced against the readers.


182. *DEL. CODE tit. 8, § 253 (Supp. 1964)* requires no shareholder vote to effect a merger of this kind. A short-form merger occurs when a parent corporation, owing almost all of the stock of the subsidiary corporation, merges with the subsidiary. Beneficial Finance acquired 95% of the stock of the Crown Finance Co. via the allegedly fraudulent tender offer. The plaintiff was owner of the remaining 5% interest. Beneficial was thereby able to merge Crown Finance without the plaintiff's approval.

183. 374 F.2d at 635.


185. *Id.* at 797. The "forced seller" status actually arose from Crane's being forced to divest itself of stock due to a threat of a divestiture action under the anti-trust laws. *Id.* at 798. Crane was required to exchange its Westinghouse shares for American Standard stock as a result of the eventual merger of the latter companies. Therefore, Crane was left holding a number of shares of American Standard, its largest competitor. *Id.*

186. American Standard was the competing tender offeror. Acting in concert with the Westinghouse management, *id.* at 796, Standard purchased 170,000 shares of Westinghouse on the New York Stock Exchange and secretly resold 120,000 shares on an over-the-counter market, both transactions occurring on the last day of the plaintiff's tender offer. *Id.* at 793.

187. These manipulations, see note 186 supra, caused the market price of Westinghouse to rise above the price offered in the plaintiff's tender offer. As a result, the shareholders rejected the plaintiff's offer. 419 F.2d at 797.

188. 594 F.2d at 1270.
The formula for proof of reliance advanced by the Second Circuit also is relevant to the decision in Zweig. If third party reliance caused the plaintiff's injury, the Second Circuit looked to the third parties' reliance upon the deception where the plaintiff is in a position that does not require an exercise of volition. Since the Zweig plaintiffs were bound by the merger agreement, their "forced" purchase of the ASI stock required no further act of volition. Market purchases of the ASI stock after the column's appearance were presumed to be in reliance upon the column. This presumption apparently is based upon the earlier Ninth Circuit decision of Blackie v. Barrack, holding that during the period of nondisclosure, traders need not prove direct reliance upon the activities of the defendant. Finally, since the readers' purchase of stock upon the recommendation of Campbell's misleading column was presumed to have caused both the quick rise in price and dilution of the plaintiffs' interest in the merged corporation, causation is adequately proven despite plaintiffs' actual non-reliance.

While the Ninth Circuit's approach in Zweig closely parallels the rationale of the forced seller cases, it should be noted that these decisions were a product of the earlier liberal approach to 10b-5 liability. The current attitude of the Supreme Court, particularly its distaste for case-by-case erosion of the purchaser-seller requirement, has cast their present viability in doubt, a doubt certainly heightened by the appellate court's failure to cite this strong authority from its sister circuit to support extenuation of the elements.

189. The Second Circuit states:

We have held that where the success of the 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 was in fact the cause of plaintiff's claimed injury.

Crane Co. v. Westinghouse Air Brake Co., 419 F.2d at 797, citing Vine v. Beneficial Finance Corp., 374 F.2d at 635.

190. 594 F.2d at 1271.

191. 524 F.2d at 906. See also Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d at 237-38; Reeder v. Mastercraft Electronics Corp., 363 F. Supp. 574, 581 (S.D.N.Y. 1973); Bromberg, supra note 112, § 8.6, at 212 (a person who trades during the period in question may be harmed by a deception that affects prices and conditions in the market, regardless of whether he has relied on or ever heard of the deception).

192. See note 91 and accompanying text supra.

193. See note 17 supra.


195. The failure of the Ninth Circuit court to cite authority from its sister circuit that would have clarified the court's analysis and justified its result is intriguing. Two distinct considerations may have played a part in the court's reluctance to cite this authority. First, the defendants in both Crane and Vine were held liable for manipulations designed to intentionally injure the third-party plaintiffs. Crane Co. v. Westinghouse Air Brake Co., 419 F.2d at 798; Vine v. Beneficial Finance Co., 374 F.2d at 635. In Zweig, however, the court acknowledged the fact that the merger plan was "perhaps unknown to Campbell". 594 F.2d at 1265. The decision does
AN ALTERNATIVE TO 10b-5 ABROGATION

Comparison to another facet of the Crane case,\(^{196}\) encouraging legislation extending the available alternatives to courts facing a Zweig situation, is suggested. In Crane, the 10b-5 action was based upon the defendant's nondisclosure of manipulative activity constituting a distinct violation of the securities laws under Section 9(a)(2) of the Securities Exchange Act of 1934.\(^{197}\) Section 9(a)(2)\(^ {198}\) is the most comprehensive of the various antimanipulative provisions in section 9 of the Act,\(^ {199}\) and express civil liability for its breach is afforded through section 9(e).\(^ {200}\) Section 9(a)(2) is limited, however, to

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not suggest that Campbell was intentionally interfering with the merger's consummation. Perhaps this distinction prevented the Ninth Circuit's citation to these decisions.

The second factor that may have precluded direct reliance on these opinions is the possibility that this "forced seller" exception to the standing rules may no longer be viable since the Supreme Court decision in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). Most commentators feel that this exception should still stand since the Court was not confronting a "forced seller" situation. See, e.g., JACOBS, supra note 112, at § 38.01(c)(iv)(C) (1975); Whitaker & Rotch, The Supreme Court and the Counter-Revolution in Securities Regulation, 30 ALA. L. REV. 335, 358 (1979); Note, Blue Chip Stamps v. Manor Drug Stores: The Future of Standing under Rule 10b-5, 61 IOWA L. REV. 497, 542-43 (1975). But the Supreme Court did indicate its distaste for case-by-case exceptions to the purchaser-seller requirement. At least one commentator agrees that the exception has doubtful viability since the Supreme Court's pronouncement. See Gallagher, 10b-5 After Blue Chip Stamps: How Stands the Judicial Oak?, 80 DICK. L. REV. 1, 36-37 (1975). Therefore, it is possible that the viability of the "forced seller" exception has been jeopardized by the high court. Perhaps the Ninth Circuit avoided direct reliance upon these decisions since citing to them would probably have demanded a stand in the controversy surrounding the exception.

196. See notes 184-187 and accompanying text supra.


   To effect, alone or with one or more persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.


   Any person who willfully participates in any act or transaction in violation of subsection (a), (b), or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction . . . No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violations and within three years after such violation.
manipulations involving securities listed on a national securities ex-
change.\footnote{201} Manipulative activity in unlisted securities traded on the over-
the-counter market is actionable only under the general antimanipulative
language of section 10(b) and rule 10b-5.\footnote{202} It should be noted that the ASI
stock was traded only over-the-counter;\footnote{203} therefore, Campbell’s activity was
not actionable under section 9(a)(2). The facts of the case and the court’s char-
acterization of Campbell’s behavior,\footnote{204} however, indicate that the de-
fendant’s liability was based on the manipulative nature of his activities.\footnote{205}
Although few plaintiffs have successfully attempted recovery for violations of
section 9(a)(2),\footnote{206} opting instead for the protection of rule 10b-5,\footnote{207} it ap-
pears that the plaintiffs in Zweig may have been able to recover under section
(9)(e) if that remedy were available to them.

The elements of a cause of action under section 9(e) are: (1) damages sus-
tained as a result of the manipulative activities; (2) purchase or sale at a price
affected by manipulative activities; and (3) willful participation by the de-
fendant in manipulative activities.\footnote{208} The plaintiffs in Zweig sustained dam-
ages due to Campbell’s activities, evidenced by their loss of a greater per-

\footnote{201. See note 198 supra.}
\footnote{202. Securities and Exchange Commission Rule 10b-1, 17 C.F.R. § 240.10b-1 (1978). See also
S.E.C. 106 (1949); Barrett & Co., 9 S.E.C. 319, 328 (1941); Edward J. Mawod & Co., Se-
\footnote{203. Appellant’s Opening Brief at 5, Appellant’s Reply Brief at 3.}
\footnote{204. 594 F.2d at 1269-71.}
\footnote{205. Id.}
\footnote{206. The difficult requirements of proof and the security for cost and short limitations period
for the express civil action under § 9(e) have proved less appealing to the private plaintiff. LOSS, supra
note 22, at 1747-51; BROMBERG, supra note 112, § 7.1, at 144-45.
The government has proceeded under § 9 more easily. See, e.g., United States v. Re, 336
F.2d 306 (2d Cir.), cert. denied, 379 U.S. 904 (1964); United States v. Dardi, 330 F.2d 316 (2d Cir.),
cert. denied, 379 U.S. 845 (1964); United States v. Minuse, 142 F.2d 388 (2d Cir.), cert.
denied, 323 U.S. 716 (1944); Wright v. SEC, 112 F.2d 89 (2d Cir. 1940).
207. The statute of limitations under § 9(e) bars suit brought more than three years after the violation
or more than one year after plaintiff’s discovery of the violation, see note 200 supra, whereas the statute of limitations of the forum state is applied in the implied cause of action
under § 10(b) and is often more generous than § 9(e). Ernst & Ernst v. Hochfelder, 425 U.S. at
210 n.29; Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90 (10th Cir.), cert. denied, 404 U.S.
For example, the applicable period in an action brought in New York is the later of 6 years after
the violation, and 2 years after the discovery of, or the time plaintiff should have discovered the
fraud. Klein v. Shields & Co., 470 F.2d 1344, 1346 (2d Cir. 1972). Some states have 6 year
limitation periods. Morgan v. Koch, 419 F.2d 993, 997 (7th Cir. 1969) (Indiana); Charney v.
Thomas, 372 F.2d 97, 100 (6th Cir. 1967) (Michigan).
1978); Jeweleror Inc. v. Pearlman, 397 F. Supp. 221 (S.D.N.Y. 1975); Schneider v. Sears, 265 F.
Supp. 257 (S.D.N.Y. 1967).}
centage interest in the merger transaction. This loss occurred because the price of the stock at the merger's consummation was directly affected by Campbell's column and his undisclosed purchase of the ASI stock. On the issue of the defendant's willful participation in the manipulative activities, circumstantial evidence of a defendant's pecuniary interest in the rise of the stock's price has sufficed in other decisions. Therefore, Campbell's resale of the stock at a price elevated by his laudatory column may have provided the requisite intent under section 9(e).

As indicated, the Ninth Circuit either altered or ignored existing law defining the elements of the 10b-5 cause of action in holding the defendant columnist liable. The court's departure from precedent in order to reach this result arguably would not have occurred had the section 9 remedies against manipulative conduct been available to the court, since section 9 does not require proof of the common law elements.

In addition to the Supreme Court's traditional approach to 10b-5 recovery, the Court has also insisted that rule 10b-5 is not a catchall for causes of action more appropriately brought under other sections. The Zweig situation illustrates the need for legislative action to accommodate both policies motivating the Supreme Court. If the plaintiffs could have proceeded under section 9, the Ninth Circuit probably could have avoided formulating questionable 10b-5 case law to arrive at a result the court felt was justified by the manipulative nature of the defendant's offense.

CONCLUSION

The Ninth Circuit Court of Appeals appears to have abrogated many of the elements of the 10b-5 cause of action in its fervent attempt to justify the possible liability of a columnist under these unique circumstances. Without the benefit of precedent, the majority sidestepped or ignored the law of 10b-5 liability as it exists in other circuits as well as its own.

209. See note 17 supra.
210. See note 91 and accompanying text supra.
212. See note 61 supra. Absent satisfactory explanation to the contrary, fact that person who has purchased stock in series of transactions and thus has raised its price, and disposes of such stock before true effect of purchases has been dissipated by other market factors, gives rise to inference of manipulative purpose regarding such purchases. Thorton & Co., 28 S.E.C. 208 (1948), aff'd, Thorton v. SEC, 171 F.2d 702 (2d Cir. 1948).
214. The drafters of the proposed model securities code have eliminated the restriction of the anti-manipulative provisions to the exchange markets. ALI FEDERAL SECURITIES CODE § 1710 (1978 Draft); See Comments and history to § 1308 in ALI FEDERAL SECURITIES CODE § 1308 (2d Tentative Draft 1973).
While it is possible to empathize with the court's distaste for the scalping activities presented in this case, its unbridled erosion of the 10b-5 elements conflicts with the policies underlying the Supreme Court's recent posture. The Supreme Court did not demonstrate its displeasure with an expansive reading of rule 10b-5 by making blanket denials of liability in all cases. Rather, the Court has chosen to signal its retraction of the scope of liability through reaffirmation of the traditional approaches to the elements of the 10b-5 cause of action.

Therefore, while the Supreme Court is demanding the traditional proof of the elements, the Ninth Circuit has allowed a liberal construction of these same elements to impose liability in this situation. As such, it is difficult to predict the ultimate impact the Zweig decision will have on 10b-5 liability. Perhaps the Ninth Circuit is charting its own course on a return voyage to the days of liberal and flexible interpretation. Or perhaps the decision will retain its current status, that of a curious anomaly that is the product of its own egregious facts.

Kathleen A. Gallichio
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