



UNC
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NORTH CAROLINA LAW REVIEW

Volume 43 | Number 3

Article 13

4-1-1965

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Thomas C. Wettach

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Recommended Citation

Thomas C. Wettach, *Securities Regulation -- Rule 10b-5 -- A Federal Corporations Law?*, 43 N.C. L. REV. 637 (1965).

Available at: <http://scholarship.law.unc.edu/nclr/vol43/iss3/13>

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The questions can be answered only by the federal courts. This is exactly the point. The range of cases that can plausibly be argued, to the Supreme Court if necessary, on the basis of "civil rights" is limited only by the imagination of counsel and his sense of ethics. A uniform federal policy may emerge as a result of the legislation, but a means of delay is now readily available to all who would use it. Future events must be weighed. If the balance is uneven because abuse becomes widespread it is to be hoped and expected that the scope of the statute will be limited by legislation or judicial action.

ROBERT A. MELOTT

Securities Regulation—Rule 10b-5—A Federal Corporations Law?

The plaintiff, a corporate director, brought a derivative action in a federal district court against six of his co-directors, alleging a violation of rule 10b-5.¹ This rule makes it unlawful for *any* person to use any instrumentality of interstate commerce or any facility of the securities exchanges to (1) "employ any device, scheme, or artifice to defraud," or (2) "to make any untrue statement of a material fact or to omit to state a material fact . . . or" (3) "to engage in any act . . . or course of business which . . . would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."² The defendants allegedly sought to perpetuate their control by causing the corporation to issue treasury stock to one of the defendants individually or to a third person who would vote the stock as directed by the defendants. The fraudulent aspects of the

¹ 17 C.F.R. § 240.10b-5 (1949). Rule 10b-5 was promulgated by the Securities and Exchange Commission pursuant to § 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) (1958).

² The entire rule 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,

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

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

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1949).

issuance were the alleged withholding from the board of the latest financial statements, the arbitrarily ascribed value of the stock, and the postponement of the annual shareholders' meeting. The plaintiff sought to have the issuance enjoined, but the action was dismissed on the ground that the court lacked jurisdiction of the subject matter.³ The Court of Appeals for the Second Circuit, in *Runkle v. Roto American Corp.*,⁴ reversed, finding the plaintiff had alleged a claim for relief over which the district court had jurisdiction.

While the history of rule 10b-5 has involved critical questions of interpretation and application,⁵ it has evolved as the major anti-

³ Jurisdiction is provided in § 27 of the Securities Exchange Act of 1934, 48 Stat. 902, 15 U.S.C. § 78aa (1958):

The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules . . . thereunder Any suit or action to enforce any liability or duty created by this chapter or rules . . . may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. . . .

In the principal case, the lower court's decision to dismiss for lack of jurisdiction was based upon *Birnbaum v. Newport Steel Corp.*, 98 F. Supp. 506 (S.D.N.Y. 1951), *aff'd*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952). What the court probably meant was that the plaintiff had failed to state a claim upon which relief could be granted. The court undoubtedly had jurisdiction of the subject matter under *Bell v. Hood*, 327 U.S. 678 (1946), since the plaintiff had stated a claim arising under the laws of the United States. The court of appeals could therefore have reversed the dismissal purely on the jurisdictional question without reaching the merits of the case. See generally WRIGHT, FEDERAL COURTS §§ 17-19 (1963).

⁴ CCH FED. SEC. L. REP. ¶ 91455 (2d Cir. Dec. 4, 1964).

⁵ The problems initially encountered by the courts where whether or not the rule provided a private right of action and whether or not the rule afforded the purchaser this right of action. The courts found that a private right of action was implied by the rule. *Kardon v. National Gypsum Corp.*, 73 F. Supp. 798 (E.D. Pa. 1947). In *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964), the Supreme Court held that a private right of action was implied under § 14(a) of the Securities Exchange Act of 1934, 48 Stat. 893, 15 U.S.C. § 78a (1958), (proxy solicitation provision) and thereby eliminated any remaining doubts in this area. The private right of action was predicated on the principles set forth in RESTATEMENT, TORTS § 286 (1934). See generally 3 LOSS, SECURITIES REGULATION 1682-1861 (2d ed. 1961); Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 Nw. U.L. REV. 627 (1962); 61 HARV. L. REV. 858 (1948); Comment, 32 TEXAS L. REV. 197 (1953); Comment, 59 YALE L.J. 1120 (1950). The courts then held that the private right of action was not only afforded to the seller but also to the purchaser. See, e.g., *Ellis v. Carter*, 291 F.2d 270 (9th Cir. 1961). Although the purchaser's private right of action was broadly based on public policy, it had theretofore been thought that the purchaser's rights were exclusively vested in the other provisions

fraud remedy for both purchasers and sellers of securities. The requisite elements of a 10b-5 action are far fewer than its common law counterpart of fraud and deceit.⁶ The essential requirements are a misrepresentation or omission of a material fact⁷ and detrimental reliance⁸ on such by the party bringing suit. The transaction must have used, either directly or indirectly, an instrumentality of interstate commerce,⁹ e.g., a telephone,¹⁰ the mails, or the facilities of a securities exchange, and must have been "in connection with the purchase or sale of any security." The security involved need not be a stock or bond, for the act's definition of "security" is exceedingly broad.¹¹

of the 1933 and 1934 acts. But the court in *Fischman v. Raytheon Mfg. Co.*, 9 F.R.D. 707 (S.D.N.Y. 1949), *aff'd in part, rev'd in part*, 188 F.2d 783 (2d Cir. 1951), held that even though the plaintiff had a right under § 11 of the 1933 act, when there was added the ingredient of fraud, then the action could be maintained under 10b-5 whether or not he could maintain a suit under § 11 or some other provision of the act. See *Ellis v. Carter*, *supra*. Another pressing problem was that of the statute of limitations, since neither § 10(b) of the act nor the rule provided for one. But it has been held that the statute of limitations for the state in which the court is sitting is applicable to 10b-5 actions. *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 356 U.S. 814 (1961); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Connelly v. Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959). The courts have further held that the defenses of waiver, estoppel, and laches are available to the defendant. See *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210 (9th Cir. 1962). See generally 73 *YALE L.J.* 1477 (1964). Note that it is still significant that the private right of action is predicated in tort. See *Crist v. United Underwriters, Ltd.*, 230 F. Supp. 136 (D. Colo. 1964), where the court held that a private right of action under 10b-5 cannot be transmuted into an action on a contract, express or implied, which will sustain attachment against a resident defendant, even though restitution rather than a damage remedy was sought.

⁶ At common law the elements of deceit were (1) a false representation of (2) a material (3) fact; (4) the defendant must know of the falsity (*scienter*) but make it, nevertheless, for the purpose of inducing the plaintiff to rely upon it, and the (5) plaintiff must justifiably rely upon it to his (6) damage. For a comparison between the common law elements and those of rule 10b-5, see 3 *Loss, op. cit. supra* note 5, at 1431.

⁷ *Kremer v. Selheimer*, 215 F. Supp. 549 (E.D. Pa. 1963); *Cochran v. Channing Corp.*, 211 F. Supp. 239 (S.D.N.Y. 1962); In the Matter of *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). See generally 3 *Loss, op. cit. supra* note 5 at 1430-44.

⁸ See *Howard v. Furst*, 283 F.2d 790 (2d Cir. 1956), *cert. denied*, 353 U.S. 973 (1957); *Mills v. Sarjem Corp.*, 133 F. Supp. 753 (D.N.J. 1955). Cf. *Kremer v. Selheimer, supra* note 7.

⁹ *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953); *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951).

¹⁰ See *Fratt v. Robinson, supra* note 9.

¹¹ See Securities Act of 1933 § 2, 48 Stat. 74, 15 U.S.C. § 77b(1) (1958). It provides that the term "security" includes such things as any note, stock,

In *Roto* the requirement "in connection with the purchase or sale" takes on particular significance since there was only an issuance of treasury stock involved. The court reasoned that the issuance of stock by the corporation was a sale for the purposes of 10b-5. However, in early 10b-5 litigation this would have indeed been a novel idea.¹² The argumentum against the equation of sale to issuance was based upon the SEC's power to regulate. The basis of the power was two-fold: (1) to regulate in the interest of the public and (2) to regulate for the protection of the investor. The argument asserted that the corporation was not an investor in its own stock and, therefore, the rules were not promulgated for its protection.¹³ The courts rejected this in favor of the public policy grounds of regulation, which were found to encompass protection to an issuing corporation.¹⁴ The principle of equating an issuance to a sale is now firmly established. The courts have given the corporation standing to effectuate the protection by permitting it to bring the action itself and by allowing derivative actions. The court in *Roto* recognized a necessity for this standing by stating:

Barring suit by a corporation defrauded under those circumstances would, as a legal and practical matter, destroy any remedy against the perpetrator of the fraud. Suits by individual shareholders would either run afoul of the *privity requirements* . . . or result in smaller recoveries . . .¹⁵

The privity requirement referred to by the court has been a source of judicial controversy since its introduction as a requisite

fractional undivided interest in oil, gas or other mineral rights, or any interest or instrument commonly known as a security.

¹² *Hooper v. Mountain States Sec. Corp.* 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 356 U.S. 814 (1961).

¹³ *Ibid.*

¹⁴ *Ibid.* *Hooper* is apparently the first case extending 10b-5 protection to an issuing corporation. The court said:

It greatly expands the protection frequently so hemmed in by the traditional concepts of common law misrepresentation and deceit, the requirement of privity, proof of specific damage, inadequacy of the right of rescission or right to recover up to par value of stock of a much greater market value.

282 F.2d at 201. The inadequacy of a common law remedy and the proof requirements were the prime reasons for extending the protection. For other cases implying a private right of action for the issuing corporation, without discussing the problem, see *New Park Mining Co., v. Cranmer*, 225 F. Supp. 261 (S.D.N.Y. 1963); *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963).

¹⁵ CCH FED. SEC. L. REP. ¶ 91455, at 94769. (Emphasis added.)

to a private right of action. It was first interjected when the court in *Joseph v. Farnsworth Radio & Television Corp.*¹⁶ unfortunately stated:

A semblance of privity between the vendor and purchaser of the security in connection with which the improper act, practice or course of business was invoked seems to be requisite and it is entirely lacking here.¹⁷

The privity with which the court was there concerned was privity of contract. In other words, for a private right of action to exist, the misrepresentation or omission must have been that of either a purchaser or seller and not that of a third person. The doctrine of privity prohibited either the purchaser or seller from suing a third party if he was not an immediate party to the transaction.¹⁸ However widespread the necessity of privity became, it is now fairly apparent that it is no longer requisite to a private right of action under 10b-5.¹⁹ Today, privity is generally recognized as an evidentiary fact to be considered in conjunction with other material facts in determining whether the duty created by 10b-5 was breached.²⁰ However, there is a trend towards its total rejection for any purpose.²¹ The courts adopting the trend permit a suit by either purchaser or seller against any party making a misrepresentation, even though he was not a party to the immediate transaction. The question of privity was not before the court in *Roto*, but its references

¹⁶ 99 F. Supp. 701 (S.D.N.Y. 1951), *aff'd*, 198 F.2d 883 (2d Cir. 1952).

¹⁷ 99 F. Supp. at 706. (Emphasis added.)

¹⁸ The courts, in an effort to lessen the effect of privity and to extend the scope of 10b-5, permitted a charge of conspiracy to sweep in peripheral defendants. It is only necessary, therefore, for the plaintiff to prove that one of the defendants was in privity with him, either as a purchaser or a seller. See, *e.g.*, *Errion v. Connell*, 236 F.2d 447 (9th Cir. 1956); *Thiele v. Shields*, 131 F. Supp. 416 (S.D.N.Y. 1955).

¹⁹ See *New Park Mining Co. v. Cranmer*, 225 F. Supp. 261 (S.D.N.Y. 1963); *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963); *Cochran v. Channing Corp.*, 211 F. Supp. 239 (S.D.N.Y. 1962); *Texas Continental Life Ins. Co., v. Bankers Bond Co.*, 187 F. Supp. 14 (W.D. Ky. 1960), *rev'd on other grounds*, 307 F.2d 242 (6th Cir. 1962); *H. L. Green Co. v. Childree*, 185 F. Supp. 95 (S.D.N.Y. 1960).

²⁰ *Brown v. Bullock*, 194 F. Supp. 207, 229-30 (S.D.N.Y. 1961), *aff'd*, 294 F.2d 415 (2d Cir. 1961).

²¹ See cases cited in note 19 *supra*. The proclivity of the courts toward privity is lucidly shown in *Miller v. Bargain City, U.S.A., Inc.*, 229 F. Supp. 33 (E.D. Pa. 1964), where the court, in making the latest pronouncement on the privity requirement, said: "I find it unnecessary to attempt a definition of this, at best, cloudy phrase, for if 'a semblance of privity' means 'privity' (like 'a little bit pregnant'), I reject it." *Id.* at 37.

to privity as a requirement and to *Farnsworth* apparently mean that it rejects the present trend. Such a result will not afford the investor the maximum protection against *any* person who has defrauded him in connection with the purchase or sale of a security.

Although *Roto* did not reject the privity requirement, it did reject, for the purposes of this case, and perhaps for all 10b-5 actions, the doctrine that the directors constitute the corporation. The rejection was out of necessity, for otherwise the result would have been that the corporation had defrauded itself. The result is, of course, justifiable since it prohibits directors from taking advantage of their fiduciary capacity. *Roto* is not clear as to the percentage of directors who voted in favor of the issuance, but it is fair to assume that a majority so voted. If such actually was the case, the court's rejection of the doctrine seems to require a conceptualistic realignment of fictions, for it has been held in other contexts that board action is corporate action.²²

Roto is not important because it expands the interpretation of any single element of a 10b-5 action, but rather because it exemplifies the widening application of the rule to acts of corporate mismanagement and breaches of fiduciary duties. The growing latitude of application is succinctly stated by the court:

It is no answer simply to state that the federal security laws are not concerned with corporate mismanagement or breaches of fiduciary obligations. That Congress could not or did not attempt to resolve all corporate ills, does not mean that it chose to leave without the federal sphere problems *basic to the entire regulatory system*.²³

This statement in juxtaposition with the corporation's standing to sue and the rejection of privity by other courts gives rise to the implication that 10b-5 is more than an anti-fraud rule; it is a substantive federal corporations law.²⁴

The idea of a federal corporations law based on 10b-5 was rejected in *Birnbaum v. Newport Steel Corp.*²⁵ In that case the majority shareholder of Newport sold his controlling interest to Wilport Co. at a premium, making misrepresentations to the minority share-

²² See, e.g., *Baltimore & O. R.R., v. Foar*, 84 F.2d 67 (7th Cir. 1936).

²³ CCH FED. SEC. L. REP. ¶ 91455, at 94769. (Emphasis added.)

²⁴ See Ruder, *Pitfalls in the Development of a Federal Law of Corporations by Implication Through Rule 10b-5*, 59 Nw. U.L. Rev. 185 (1964).

²⁵ 98 F. Supp. 506 (S.D.N.Y. 1951), *aff'd*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952).

holders of Newport about a previous offer from another company. The minority shareholders alleged that the misrepresentations constituted a violation of 10b-5. The court, instead of finding a violation, took the narrow approach that the rule was aimed only at a fraud perpetrated on the buyer or seller and had no relation to breaches of fiduciary duty resulting in fraud on the minority.²⁶ This approach was taken before the introduction of privity, and one commentator²⁷ has concluded that the privity requirement as represented by *Farnsworth* was nothing more than an effort to keep the question of corporate mismanagement in the state courts.

Notwithstanding *Birnbaum* and the privity requirement, the limits of application of 10b-5 have greatly expanded. The duty of disclosure under 10b-5 has been applied to the "insider," traditionally a director, officer, or controlling shareholder.²⁸ But the SEC in *In The Matter of Cady, Roberts & Co.*²⁹ rejected the "insider" concept as a limit to the duty to disclose and instead rested the obligation of disclosure³⁰ upon two principal elements:

²⁶ For another approach to this case, see *Perlman v. Feldmann*, 219 F.2d 173 (2d Cir. 1955). For a discussion of corporate opportunities, see 74 HARV. L. REV. 765 (1961).

²⁷ Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725, 786 (1956). See generally 3 Loss, *op. cit. supra* note 5, at 1763-70.

²⁸ See *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951).

²⁹ 40 S.E.C. 907 (1961). For comments on this case, see 30 U. CHI. L. REV. 121 (1962); 71 YALE L.J. 736 (1962). The defendant in this case was stock brokerage firm. One of the members was also the director of a corporation listed on an exchange. Immediately after the corporation voted to reduce its dividend, the director-associate relayed the information to the defendant. Aware of the dividend reduction, defendant sold the stock of the corporation held in discretionary accounts before news of the reduction reached the exchange. When news of the reduction did reach the exchange, a decline in the market resulted. Failure to disclose the reduction to the purchaser was found to be a violation of 10b-5. Here, there was no intent to defraud, since normally the news would have already reached the exchange except for the unexplained delay in communication.

³⁰ In *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951), the court's rationale foreshadowed that of the SEC in *Cady, Roberts*, but seems to have been limited to the "insider" concept, which was rejected by the Commission. The court said:

The rule is clear. It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his position but not known to the selling minority stockholder, which information would have affected the judgment of the sellers. The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholder.

Id. at 828-29. The test as to what information need be disclosed seems to

[F]irst, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.³¹

The SEC found that the anti-fraud provisions were not intended as a specification of particular acts of fraud, but rather as an encompassment of an infinite variety of forms and devices used to take advantage of investors. The expansion of the duty to disclose seems justifiable since it affords maximum protection to the investor.

Expansion in yet another direction is represented by *New Park Mining Co. v. Cranmer*,³² where an insider took advantage of opportunities rightfully belonging to the corporation. Here, a corporation sued a director, alleging three separate violations of the rule, each involving a separate transaction. In the first transaction, the defendant was negotiating the acquisition of stock in a new venture for the corporation. Instead of acquiring all of the offered stock for the corporation, he was able to appropriate for himself a sizeable portion without consideration. The court found that this was a fraud on the corporation because the defendant's acquisition proportionately reduced the value of the shares acquired by the corporation. In the second transaction the defendant induced a third party to acquire mining leases, which had been offered to the corporation, in the names of the third party and of the corporation. Again the corporation furnished the sole consideration, and was defrauded by purchasing the third party's interest for 40,000 shares of its own stock, of which 11,000 went to the defendant. Within the same time scope, the corporation was allegedly defrauded by its purchase, at an inflated price, of its own stock from another third party. This purchase was facilitated by the defendant. Both acts in the second

be inherent in *Speed*, viz., that information which would affect the judgment of either the buyer or seller. At common law there was a duty to disclose "special facts" which used essentially the same test implied in *Speed*. *Strong v. Repide*, 213 U.S. 419 (1909). The test should apply a reasonable man standard in determining which facts would affect the judgment, otherwise it becomes subjective and allusive. See *Kohler v. Kohler Co.*, 319 F.2d 634 (7th Cir. 1963). See generally 3 Loss, *op. cit. supra* note 5, at 1456-66; 62 MICH. L. REV. 880 (1964).

³¹ 40 S.E.C. at 912.

³² 225 F. Supp. 261 (S.D.N.Y. 1963).

transaction constituted a single violation of 10b-5. In the third transaction, the corporation was allegedly defrauded by the defendant's failure to disclose to the corporation the fact that the defendant was to have an interest in a venture that the corporation was to enter with another company. The corporation lost a considerable amount of money in exploration of the proposed venture, which proved to be worthless. The court found that the agreement to purchase the half interest was itself a purchase for the purposes of 10b-5. Note that in none of the transactions did the defendant deal directly with the corporation. The court said of the entire sequence of events:

A purchaser or seller of stock is not limited under Section 10(b) and Rule 10b-5 to an action against the other party to the purchase or sale; he can sue a third party if in connection with the purchase or sale that person defrauded him. . . . It is immaterial whether the purchase or sale was part of a larger scheme of corporate mismanagement if the elements of a claim under Section 10(b) and Rule 10b-5 are otherwise present.³³

The court was apparently willing to take cognizance of the entirety of each transaction and not merely the 10b-5 violations. It is doubtful that the court was willing to decide *every* appendant issue, since the court was uncertain whether the money spent in exploration in the third transaction was sufficiently connected to the 10b-5 violation to permit recovery for the loss. This uncertainty implies that the court was willing to apply a test of proximity, but it is difficult to ascertain the degree of proximity necessary to justify deciding an appendant issue.

Another approach generally taken in this area is that of invoking the doctrine of pendent jurisdiction,³⁴ which permits a federal court to decide non-federal claims when the non-federal claim arises out of the same cause of action as a federal claim.³⁵ This has traditionally meant that the federal and non-federal claims constitute nothing more than a shift in the theory of recovery. The difficulty with this approach lies in the fact that not all acts of corporate mismanagement and breaches of fiduciary duty can be said to arise out of the same cause of action as that arising from

³³ *Id.* at 266.

³⁴ *Hurn v. Oursler*, 289 U.S. 238, 245-46 (1933).

³⁵ *Ibid.* See generally WRIGHT, *op. cit. supra* note 3, §§ 19, 78; 62 COLUM. L. REV. 1018 (1962).

the violation of the rule, and the courts would not have jurisdiction of such claims under the doctrine of pendent jurisdiction.⁸⁶

A third view would be to consider the acts of corporate mismanagement, in which the elements of 10b-5 are present, as "basic to the entire regulatory system," and therefore, covered by the rule itself.⁸⁷ Thus, once the elements of 10b-5 have been established, the court will be able to decide all of the collateral questions without the restriction imposed by pendent jurisdiction. The merits of this view are the relative ease of deciding the jurisdictional problems and the avoidance of piecemeal litigation. The basis of this view is in the assertion that 10b-5 is a federal substantive corporations law. Such an assertion is supported by *Roto*, and by the following language which foreshadowed *Roto*:

It creates many managerial duties and liabilities unknown to the common law. It expresses federal interest in management-stockholder relationships which theretofore had been almost exclusively the concern of the states. . . . Section 10(b) provides stockholders with a potent weapon for enforcement of many fiduciary duties. It can be said fairly that the Exchange Act . . . constitutes far reaching federal substantive corporation law.⁸⁸

This approach represents a substantial change of attitude from that expressed in *Birnbaum*, which now stands only for the proposition that third parties cannot assert claims based upon a sale or purchase to which they were not a party.⁸⁹ How much greater the latitude will become for calling collateral problems "problems basic to the entire regulatory system" is open to speculation.

That 10b-5 has become a federal substantive corporation law is apparent. Whether or not the rule itself is a sufficient basis for such law is open to serious debate. At this stage in its expansion, it would seem appropriate for the courts to apply at least a quantum of restraint before the body of law developing appurtenant to the rule, for deciding the collateral issues, becomes too encom-

⁸⁶ See, e.g., *Ellis v. Carter*, 291 F.2d 270 (9th Cir. 1961); *Wolfson v. Blumberg*, 229 F. Supp. 192 (S.D.N.Y. 1964).

⁸⁷ It is possible to state this in another way, namely, that a breach of fiduciary duty is a genus of fraud which the courts are willing to treat under the anti-fraud provisions, even though not traditionally considered a "fraud." Cf. *S.E.C. v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

⁸⁸ *McClure v. Borne Chem. Co.*, 292 F.2d 824, 834 (3d Cir.), cert. denied, 368 U.S. 939 (1961).

⁸⁹ See *Kremer v. Selheimer*, 215 F. Supp. 549 (E.D. Pa. 1963).

passing. If, in view of the growth of large interstate corporations and the basic structure of the American economy, a federal corporations law would be advantageous or desirable,⁴⁰ then it is for Congress to so provide.

THOMAS C. WETTACH

Torts—Implied Warranty—Privity

The overwhelming majority of jurisdictions reject the requirement of privity of contract between the consumer of a product and the manufacturer in an action on an implied warranty.¹ In *Terry v. Double Cola Bottling Co.*,² North Carolina retained its rule requiring privity. The court there affirmed a compulsory nonsuit in an action against the manufacturer where the plaintiff's evidence showed that she had purchased from a lunchroom, an intermediate seller, a bottled drink allegedly containing a green fly.³ However, Justice Sharp, in a thorough concurring opinion,⁴ attacked the food manufacturers' fortress of privity under the present North Carolina law and urged the court to adopt the majority rule. This case presents the question: is it necessary to abandon the privity requirement in order to provide adequate remedies for an injured consumer or ultimate user?

At common law, the courts required privity of contract in a negligence action against the manufacturer.⁵ However, when manufacturers began making extensive use of distributors and retailers to peddle their products to the public, the courts realized the injustice of this requirement.⁶ The initial onslaught began in *Mac-*

⁴⁰ Some of the obvious advantages would be in the relative ease of obtaining service of process, the jurisdictional requirements, and the most important would be that of uniformity. For the problems appendant to 10b-5 as a corporation law, and its effect on such things as the stock market, directors, etc., see Ruder, *supra* note 24.

¹ Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099 (1960). Dean Prosser stated that no state has adopted this privity requirement since 1935 but many have rejected it. *Id.* at 1110.

² 263 N.C. 1, 138 S.E.2d 753 (1964).

³ *Id.* at 3, 138 S.E.2d at 754.

⁴ *Id.* at 3, 138 S.E.2d at 754. Justice Sharp concurred because she found a lack of evidence that the fly was in the bottle when it left the defendant's control.

⁵ *Winterbottom v. Wright*, 10 M. & W. 109, 152 Eng. Rep. 402 (Ex. 1842).

⁶ See generally Prosser, *supra* note 1.