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COMMENT

Options Traders, Rule 10b-5, and Standing: Making Sense of It All

"The last decade has been one of dramatic change and growth in the securities market. One evolution has been the emergence and dynamic rise of trading in options."¹

I. INTRODUCTION

The establishment of the Chicago Board Options Exchange (CBOE) in 1973 provided the first national securities exchange for the trading of options contracts.² In its original approval the SEC authorized trading in approximately thirty underlying issues only and limited the nature of the contracts to call options.³ Since its inception, trading in standardized stock options⁴ has proliferated. As Professor Seligman noted, in 1983 options contracts in 378 underlying issues of publicly traded companies were listed for trading on four national options exchanges.⁵ Today no less than five national options exchanges exist,⁶ and the number of listed options in publicly traded companies has grown to approximately 530.⁷

The financial community quickly recognized the options contract's effectiveness as a hedge or buffer against market volatility, in addition to its novel appeal to the more speculative investor. Legislative and regulatory bodies almost immediately recognized the new potential for, and subsequent increase in, trading abuses.⁸ Not surprisingly, the legal profession has also entered the op-

1. *Deutschman v. Beneficial Corp.*, 668 F. Supp. 358, 359 (D. Del. 1987), *rev'd*, 841 F.2d 502 (3d Cir. 1988), *reprinted in* [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,655, at 98,009.

2. See Exchange Act Release No. 9985, [1972-73 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,212, at 82,669 (Feb. 1, 1973) [hereinafter Feb. 1973 Exchange Act Release]. For critiques of the CBOE's maiden voyage, see generally *Securities Exchange Commission, Special Study of the Options Markets*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,945, at 81,283 (Feb. 15, 1979) [hereinafter *SEC Special Options Study*]; Lipton, *The Special Study of the Options Market: Its Findings and Recommendations*, 7 SEC. REG. L.J. 299 (1980).

3. See Feb. 1973 Exchange Act Release, *supra* note 2, at 82,670. Trading in put options was later authorized on all national options exchanges. See Exchange Act Release No. 13,401, [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,030, at 87,730.

4. The terms "standardized stock option(s)," "stock option(s)," and "option(s) contract(s)" are used interchangeably throughout this Comment.

5. Seligman, *The Structure of the Options Market*, 10 J. CORP. L. 141, 144 (1984) (citing BARON'S, Nov. 21, 1983, at 114-20).

6. See, e.g., Wall St. J., Mar. 25, 1988, at 37-38. Included are the Chicago Board Options Exchange (CBOE), American Stock Exchange (AMEX), New York Stock Exchange (NYSE), Philadelphia Stock Exchange (PHILA) and Pacific Stock Exchange (PAC). *Id.*

7. *Id.* The term "listed" means the underlying issue has been authorized for trading put and call options. See also *infra* notes 22-28 and accompanying text (illustrating options contracts currently available in other underlying interests).

8. See Lipton, *supra* note 2, at 302-05, 310-15; Seligman, *supra* note 5, at 142-43. See generally SEC SPECIAL OPTIONS STUDY, *supra* note 2 (critiquing the CBOE's initial trading program).

tions arena in efforts to curb such abuses and redress the new forms of investor fraud. As the federal securities laws are increasingly tested by allegedly defrauded options traders,⁹ one recurrent issue has become prominent in recent years: whether options traders have standing to bring actions arising under section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and its attendant rule 10b-5.¹⁰ This issue will be the primary focus of this Comment and will be examined comprehensively from two perspectives.¹¹

In 1975 the United States Supreme Court in *Blue Chip Stamps v. Manor Drug Stores*¹² approved the requirement that a plaintiff must have been an actual purchaser or seller of securities in order to sustain an action brought under section 10(b)'s rule 10b-5.¹³ This purchaser/seller requirement, known as the *Birnbaum* doctrine, originated in *Birnbaum v. Newport Steel Corp.*,¹⁴ in which the Second Circuit upheld the dismissal of plaintiff's complaint for its failure to fall within the type of fraudulent transaction against which rule 10b-5 sought to protect.¹⁵ While the text of the appellate decision reads as if dismissal were based upon jurisdictional grounds, the lower court's decision rather succinctly dismissed the complaint for failure to state a cause of action.¹⁶ Although the first sections of the *Blue Chip Stamps* opinion are somewhat ambiguous on the issue, the opinion's last section strongly implies, if it in fact does not expressly state, that the purchaser/seller requirement is grounded upon the doctrine of

9. The term "options trader" will be used generically to denote either an options purchaser or a seller. Any necessary distinction between status as a purchaser or as seller will be expressly noted by the use of the more specific term.

10. Because it predominates in all reported cases that involve options-related section 10(b) claims, rule 10b-5 will be the only § 10(b) rule discussed in this Comment.

Section 10(b) states:

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.

15 U.S.C. § 78j(b) (1982).

Rule 10b-5 states in full:

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 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 (1988).

11. See *infra* text immediately following note 19.

12. 421 U.S. 723 (1975).

13. *Id.* at 754-55.

14. 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

15. *Id.* at 464.

16. *Birnbaum v. Newport Steel Corp.*, 98 F. Supp. 507, 509 (S.D.N.Y. 1951).

standing to sue.¹⁷

An established rule quite distinct from the *Birnbaum* doctrine states that before addressing the standing issue, a court must determine that plaintiff has a cause of action.¹⁸ Especially in cases that involve options trading, many courts phrase their holdings in terms of lack of standing when in actuality they ultimately dismiss due to a deficiency in the elements of the rule 10b-5 claim.¹⁹ Thus, *standing* has evolved into a term of art in options cases. This unfortunate situation necessitates a discussion of both the standing doctrine and rule 10b-5's cause of action as applied to options traders.

Because the same ultimate result occurs whether plaintiff's complaint is dismissed for failure to state a claim or for want of federal subject matter jurisdiction, an inquiry into the metaphysical foundations of the options cases may appear moot because federal subject matter jurisdiction necessarily collapses when plaintiff fails to state a rule 10b-5 cause of action. However, given the potentially grave consequences of collateral estoppel if an action at a state level follows from a dismissal on the federal level, the need for proper theoretical grounds becomes clear.²⁰

This Comment attempts to put the standing issue as it relates to options traders into its proper doctrinal perspective, but first some background information is essential. Section II briefly examines the intricacies of the modern options markets. Section III discusses the modern framework of the standing doctrine and also discusses *Blue Chip Stamps* in the context of the doctrinal theory that prevailed at the time of its decision. Section IV examines the evolution of rule 10b-5's cause of action as applied to options traders up to 1980, the year of the seminal rule 10b-5 decision of *Chiarella v. United States*.²¹ Section V analyzes the modern options cases, those decided post-*Chiarella*. Here, the Comment will analyze the elements of rule 10b-5 as they apply to options traders under both the insider-trading or nondisclosure theory, and the affirmative

17. See *Blue Chip Stamps*, 421 U.S. at 755 ("We therefore hold that respondent was not entitled to sue . . .") (emphasis added); *id.* at 754 ("[A]n extension of *standing* to this respondent . . .") (emphasis added); see also *Davis v. Passman*, 442 U.S. 228, 239 n.18 (1979) (majority opinion goes to great lengths to define and distinguish standing, jurisdiction, cause of action, and relief). See generally *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654 (7th Cir. 1973) (addressing the *Birnbaum* doctrine as a jurisdictional standing requirement), *cert. denied*, 416 U.S. 960 (1974).

18. *E.g.*, *National R.R. Passenger Corp. v. National Ass'n of R.R. Passengers*, 414 U.S. 453, 456 (1974) ("for it is only if such a [cause] of action exists that we need consider whether the respondent had standing to bring the action . . .").

19. See, e.g., *Laventhal v. General Dynamics Corp.*, 704 F.2d 407, 410-13 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983); *Deutschman v. Beneficial Corp.*, 668 F. Supp. 358, 363-64 (D. Del. 1987), *rev'd*, 841 F.2d 502 (3d Cir. 1988); *Bianco v. Texas Instruments*, 627 F. Supp. 154, 161 (N.D. Ill. 1985) (granting in part defendants' motions to dismiss by holding that defendant owed no duties to plaintiff under rule 10b-5 and plaintiff therefore lacked *standing*).

20. As one commentator noted, many state antifraud provisions parallel, and in some instances duplicate, federal rule 10b-5. Brooks, *Rule 10b-5 in the Balance: An Analysis of the Supreme Court's Policy Perspective*, 32 HASTINGS L.J. 403, 424 (1980). However, a proclivity exists "on the part of many [other] state courts to rely upon interpretations of rule 10b-5 by the federal courts in applying their own [but different] antifraud statutes." *Id.* at 424-25. Therefore, federal courts would be wise to dismiss a plaintiff's action on the proper theory so as to avoid inadvertently prejudicing a subsequent state action.

21. 445 U.S. 222 (1980).

misrepresentation theory of liability. Having firmly established rule 10b-5's availability to options traders, section VI revisits the doctrine of standing and examines the application of the purchaser/seller requirement to the unique situation of the options trader. Finally, the Comment concludes that options traders have standing to sue under section 10(b) and rule 10b-5 if they have a bona fide cause of action and they are purchasers or sellers. The Comment further concludes that the definitions of purchaser and seller should be flexibly tailored to account for both the uniqueness of the options contract and the modern economic realities that surround its use.

II. BACKGROUND OF THE STANDARDIZED OPTIONS CONTRACT

A. *The Standardized Options Contract*

Today's standardized options contracts are, in one sense, simply legal contractual rights.²² They provide their holder with "the right to buy or sell a specified amount of the underlying interest at a fixed or determined price (called the exercise or strike price) upon the exercise of the option."²³ This right is currently traded in two basic forms: the right to purchase, or "call option," and the right to sell, or "put option."²⁴ The right to buy or sell pertains to an underlying interest, normally in the shares of listed publicly traded companies, but hybrids have emerged. Options contracts are also traded in more exotic underlying interests such as broad-based market indices,²⁵ narrow-based market indices,²⁶ United States Government debt instruments,²⁷ and foreign currencies.²⁸

The modifier *standardized*, as used in the term "standardized options con-

22. In quite another important sense, the options contract is recognized as a security. See *infra* note 126 (quoting the 1982 amendment to the 1934 Act's definitional section 3(a)(10)).

23. THE OPTIONS CLEARING CORPORATION, CHARACTERISTICS AND RISKS OF STANDARDIZED OPTIONS 4 (1987) [hereinafter 1987 OCC PAMPHLET]. This pamphlet may be obtained upon request from The Options Clearing Corporation, 200 South Wacker Drive, Chicago, IL 60606.

24. 1987 OCC PAMPHLET, *supra* note 23, at 4-5; Seligman, *supra* note 5, at 144.

25. Indices measure the values of groups of stocks. 1987 OCC PAMPHLET, *supra* note 23, at 32. As an example, the composition of "[t]he most popular index, the CBOE Standard & Poor's (S&P) 100, is based on the value of the one hundred securities in that index." Seligman, *supra* note 5, at 147. The broad-based (market) index options that are currently available on their respective exchanges are as follows: CBOE—S & P 100 and S & P 500 Indices; AMEX—Major Market and Institutional Indices; PHILA—Value Line and National OTC (Over-the-Counter) Indices; PAC—Financial News Composite Index; NYSE—NYSE Index. See, e.g., Wall St. J., Mar. 25, 1988, at 39. The enormous popularity of these types of options contracts cannot be overlooked. See, e.g., Seligman, *supra* note 5, at 148 (aggregate volume for broad-based stock indices for the week ending November 18, 1983, equalled approximately 13% of the total weekly volume of options contracts traded).

26. See Seligman, *supra* note 5, at 150 (describing this type of hybrid). Among the narrow-based index options currently available on their respective exchanges are: AMEX—Computer Technology and Oil Indices; PHILA—Utilities and Gold/Silver Indices. See, e.g., Wall St. J., Mar. 25, 1988, at 39.

27. See Seligman, *supra* note 5, at 151-53 (describing this type of hybrid). United States Government Debt Indices that are currently available on the CBOE include United States Treasury Bond and five-year United States Treasury Note Indices. See, e.g., Wall St. J., Mar. 25, 1988, at 37.

28. See Seligman, *supra* note 5, at 153-55 (describing this type of hybrid). Foreign Currency options contracts that are currently available on the Philadelphia Stock Exchange include: Australian Dollar, Canadian Dollar, West German Mark, Japanese Yen, and Swiss Francs. See, e.g., Wall St. J., Mar. 25, 1988, at 39.

tract," truly reflects one major innovation in the modern options market that has led to its tremendous growth: uniformity among individual contracts' terms.²⁹ Within a given listed issue, options contracts now vary only within established exercise date and strike price terms. For instance, at the open of the market on March 26, 1988, Pfizer Corporation call options could be purchased at the strike prices 50, 55, 60, 65, and 70 (dollars). These uniform strike prices were available for April, May, and June exercise dates.³⁰

The value of a standardized option contract is established in the marketplace. Although many considerations permeate any theoretical model of valuation, two factors are generally overriding with regard to options contracts: the value of its underlying interest and the time remaining until its mandatory or contractual exercise date.³¹ Again to use Pfizer Corporation as an illustration, the premium for an April call option contract at a strike price of 50 (an "April 50 call") was 4 5/8.³² Because the premium is on a per share basis and every contract represents the right to buy 100 shares of the underlying securities, the value of the April 50 contract equals \$462.50 (\$4 5/8 times 100).

A comparison of the April 50 and May 50 calls will illustrate the element of time value. The values of the May 50 and April 50 call contracts on March 25, 1988, were \$550 and \$462.50, respectively. The monetary difference between the two contracts represents the extra price that investors are willing to pay for the additional month in which to exercise their rights and buy the underlying stock.

A comparison of the values of Pfizer's April 50 and April 60 calls will illustrate the relationship between the underlying stock and the option. The April 50 call's premium of 4 5/8 approximates the difference between the contract's strike price (50) and Pfizer's current market value of \$54.75.³³ On the other

29. The two most important standardized terms are the exercise or strike price and the expiration date. For call options, the strike price is "the price at which the buyer of the option has the right to purchase the underlying interest"; for put options, it is the "price at which the buyer of the option has the right to sell the underlying interest." 1987 OCC PAMPHLET, *supra* note 23, at 5. The expiration date is the last day upon which the holder can demand the writer's performance. *Id.* at 6. Thus, if not exercised before the expiration date, the options contract ceases to exist: the buyer no longer has any rights, the writer no longer has any obligations, and consequently, the options contract no longer has value. *Id.*

One important distinction regarding contract terms and their ensuing obligations should be made here. Unlike all other standardized options contracts, broad-based market index options differ fundamentally with respect to the writer's obligation to perform, should she be called upon to do so at the exercise date. No contractual obligation to deliver the underlying securities exists. Instead, writers are considered to be in strictly cash positions whereby they are obligated to pay in cash "an amount equal to the difference (expressed in dollars) between the exercise settlement value of the underlying index on the day the exercise notice is properly tendered to [The Options Clearing Corporation] and the exercise price of the option, multiplied by a specified index 'multiplier.'" *Id.*

30. See, e.g., Wall St. J., March 25, 1988, at 40.

31. See, e.g., Seligman, *supra* note 5, at 144-45; Black & Scholes, *The Pricing of Options and Corporate Liabilities*, 81 J. POL. ECON. 637, 641 (1973); Rubenstein, *An Economic Evaluation of Organized Options Markets*, 2 J. COMP. CORP. L. & SEC. REG. 49, 54-55, 57 (1979). Other factors include the underlying issue's volatility, current interest rates (primarily bearing upon the value of debt index options), and the general supply and demand of both the options contract and its underlying issue. 1987 OCC PAMPHLET, *supra* note 23, at 6.

32. See, e.g., Wall St. J., Mar. 25, 1988, at 40.

33. *Id.* As the expiration date draws nearer, the element of time value decreases, eventually to the point of insignificance. Therefore, the value of a given options contract at its expiration date, and

hand, because the market value of the underlying stock is not close to the April 60 call's strike price, the call option's premium is relatively small and probably reflects only the minor value attributable to the remaining time before the contract's expiration.³⁴ Thus, market manipulation of the option contract's underlying securities or index can affect the value of the options contract itself.³⁵

B. *Overview of the Modern Options Markets*

Although a comprehensive survey of the evolution and current state of operations of the options market is beyond the scope of this Comment,³⁶ an examination of the basic underpinnings of today's options markets is necessary to understand the uniqueness of options transactions.

Standardized options contracts of publicly traded companies can be "written,"³⁷ and thereby conceived, in either of two forms. First, actual holders of underlying shares can write options.³⁸ Second, for those who desire a bit of risk in their lives, *phantom* holders can also write call options. This latter group, so-called *naked* option writers, commit themselves potentially to delivering underlying shares that, at the time that the options contract is written, they do not own.

After the options contract is written, the next step in issuing the options contract, that is, getting it to the market, involves sending a request to issue the contract by the options writer's broker to a "Clearing Member,"³⁹ if the broker himself is not one, who in turn sends it on to The Options Clearing Corporation (OCC).⁴⁰ The OCC, acting as an intermediary, then issues and guarantees each

the excess, if any, of the market value of a 100 lot of such contract's underlying securities over such contract's strike price should be approximately equal.

34. See, e.g., *id.*

35. Indeed, due to the relatively short exercise period inherent in the standardized options contract, the potential for financial devastation of an optionholder's position looms far greater than the corresponding risks that the holder of the underlying securities may confront. In the previous Pfizer Corporation example, if an investor purchases the April 50 call for \$462.50 plus commissions at the opening of the market on March 26, 1988 and some time before the April expiration date, Pfizer stock plummets to \$40 per share and remains there until after the exercise date, the options trader's loss would be total (assuming the contract was retained until the expiration date, and not resold). Conversely, a Pfizer stockholder would incur only partial loss, and more importantly, would still have the potential to recover any past loss.

36. For a comprehensive illustration of the modern options markets' dynamics, see Seligman, *supra* note 5, at 144-47 & 171-78; Johnson, *Is It Better to Go Naked on the Street? A Primer on the Options Market*, 55 NOTRE DAME LAW. 7, 10-13 (1979-80). For a descriptive analysis of the over-the-counter options market that preceded the CBOE, see Johnson, *supra*, at 9-10.

37. The "writer" is the one who sells the options contract and thereby obligates himself to perform, if selected, according to the contract's terms. 1987 OCC PAMPHLET, *supra* note 23, at 5. The Options Clearing Corporation (OCC) exclusively establishes who will be called on to perform or deliver under the contract based upon a random selection process. The ultimate number called will depend upon how many optionholders wish to exercise their contractual right to buy (or sell, in the case of a put option). See Seligman, *supra* note 5, at 146; see also *infra* note 40 (describing the nature of the OCC).

38. This type of option is called a *covered* call. 1987 OCC PHAMPHLET, *supra* note 23, at 7.

39. Clearing members are those brokerage firms who, pursuant to OCC requirements, are qualified to carry the accounts of options writers or their brokers. 1987 OCC PAMPHLET, *supra* note 23, at 70. Clearing members then guarantee the obligations of the options writers to the OCC. *Id.*

40. The OCC is a clearing agency regulated by the Securities Exchange Commission (SEC). 1987 OCC PAMPHLET, *supra* note 23, at 70.

options contract.⁴¹ In essence, purchasers buy all options contracts from the OCC through the exchange that lists the underlying issue for options trading. Therefore, all purchasers look "to the OCC, and not to an individual writer, for [the options contract's] performance" because the OCC acts as the primary guarantor.⁴² As a consequence of the OCC's multiple roles coupled with the standardized options' uniform contract terms, the options market achieves increased market liquidity.⁴³

The selection of underlying issues that will be listed for options trading is generally decided by the exchanges without either the issuer's participation or consent.⁴⁴ The exception to this general rule surfaces when the underlying issue is traded on the over-the-counter NASDAQ⁴⁵ market. Here, the stock will not be listed for options trading without the issuer's consent.⁴⁶ Thus the issuer has no control over the listing of its issue(s) for options trading in most instances.

The unique features of standardized options contracts and their modern markets raise several issues with respect to the application of rule 10b-5 claims of fraudulent options trading. One issue, the topic of this Comment, concerns standing to bring such claims. Any analysis of standing as it relates to options traders must include a general discussion of the standing doctrine.

III. THE STANDING DOCTRINE⁴⁷

Courts may utilize standing to preclude a determination of a case's merits.⁴⁸ The standing requirement thus "focuses on the party seeking to get his complaint before a federal court and not on the issues [or claims] he wishes to have adjudicated."⁴⁹ Two foundations underlie standing requirements. The "case or controversy" clause in Article III of the Constitution⁵⁰ requires courts

41. Seligman, *supra* note 5, at 145.

42. *Id.*

43. *Id.* at 146; Johnson, *supra* note 36, at 24-25; see also Hayes & Tennenbaum, *The Impact of Listed Options on the Underlying Shares*, 8 FIN. MGMT. 72, 76 (1979) (describing increased liquidity in the options contract's underlying securities).

44. 1987 OCC PAMPHLET, *supra* note 23, at 71.

45. NASDAQ is the acronym for the National Association of Securities Dealers Automated Quotation System.

46. 1987 OCC PAMPHLET, *supra* note 23, at 71.

47. This Comment will not comprehensively analyze the standing doctrine. For a comprehensive analysis, see generally 13 C. WRIGHT, A. MILLER & E. COOPER, *FEDERAL PRACTICE AND PROCEDURE*, ¶ 3531, at 338 (2d ed. 1984); see also *id.* at 338 n.1 (a comprehensive listing of commentators who have addressed the standing doctrine).

48. *Id.* ¶ 3531, at 338.

49. *Valley Forge Christian College v. Americans United for Separation of Church and State*, 454 U.S. 464, 484 (1982) (quoting *Flast v. Cohen*, 392 U.S. 83, 99 (1968)); see also *Warth v. Seldin*, 422 U.S. 490, 500 (1975) ("[S]tanding in no way depends on the merits of the plaintiff's contention."); *Cowin v. Bresler*, 741 F.2d 410, 420 (D.C. Cir. 1984) ("[T]he fact that a cause of action exists does not mean that any person can invoke section 10(b)'s protections.").

50. The applicable section of Article III provides in full:

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their authority;—to all Cases affecting Ambassadors, other public Ministers and Consuls;—to all Cases of admiralty and maritime Jurisdiction;—to Controversies to which the United States shall be a Party;—to Controversies between two or more States;—between a

to inquire "whether the plaintiff has made out a 'case or controversy' between himself and the defendant within the meaning of Article III."⁵¹ The Supreme Court has announced and reaffirmed three requirements under Article III for a plaintiff's standing to sue in federal courts: 1) injury in fact; 2) fair traceability; and, 3) redressability.⁵² Injury in fact constitutes some personally sustained injury that in general must be more than merely abstract.⁵³ Traceability relates to a requisite "fair" nexus between defendant's conduct and plaintiff's injury in fact.⁵⁴ Redressability pertains to the power of the court to satisfy, "by a favorable decision," plaintiff's injury.⁵⁵

In addition to Article III's minimums, courts have also identified and utilized prudential considerations or limitations in formulating standing requirements. First, "the plaintiff's complaint [must] fall within the zone of interests to be protected or regulated by the statute . . . in question."⁵⁶ Second, courts will not adjudicate "abstract questions of wide public significance" which amount to 'generalized grievances.'⁵⁷ Finally, "plaintiff generally must assert his own legal interests," not merely those of others.⁵⁸ These types of considerations are founded on the courts' reluctance to decide abstract questions that involve wide public significance, because other governmental institutions are more competent to address such questions.⁵⁹

In two major respects, prudential limitations and Article III requirements differ. Article III requirements are mandatory; prudential concerns are discretionary.⁶⁰ But Congress can legislatively grant standing and "courts lack authority to create prudential barriers to standing in suits brought under a statute in which Congress has done [so]."⁶¹

At the time of the *Blue Chip Stamps* decision in 1975, the prevailing test for standing utilized two of the six current standing requirements: injury in fact and zone of interests.⁶² *Blue Chip Stamps* can be viewed as addressing both requirements. In examining the *Birnbaum* doctrine in light of the express language of

State and Citizens of another State;—between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

U.S. Const. art. III, § 2, cl. 1.

51. *Warth*, 422 U.S. at 498.

52. *Valley Forge Christian College*, 454 U.S. at 472.

53. *Id.* at 472 (citing *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91, 99 (1979), "[Plaintiff] personally has suffered some actual or threatened injury as a result of the putatively illegal conduct of the defendant . . .").

54. *Id.* (quoting *Simon v. Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26, 41 (1976), "the injury 'fairly can be traced to the challenged action'").

55. *Id.* (quoting *Simon*, 426 U.S. at 41, "[the injury] 'is likely to be redressed by a favorable decision.'").

56. *Id.* at 475 (quoting *Association of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 153 (1970)).

57. *Id.* (quoting *Warth v. Seldin*, 422 U.S. 470, 499-500 (1975)).

58. *Id.* at 474 (quoting *Warth*, 422 U.S. at 499).

59. *See, e.g., Warth*, 422 U.S. at 500.

60. *See* C. WRIGHT, *LAW OF THE FEDERAL COURTS* 74 (4th ed. 1983).

61. *Id.*

62. *See* *Association of Data Processing Serv. Orgs. v. Camp*, 397 U.S. 150, 152-53 (1970) (utilizing two-part test involving "injury in fact" and "zone of interest[s]"); *see also* *Herpich v. Wal-*

the 1934 Act, the *Blue Chip Stamps* court initially concluded that the Act did not offer redress to a plaintiff who does not actually purchase or sell securities and sustains only noneconomic injury.⁶³ The Court's analysis thus incorporates the injury in fact requirement, and under such requirement a plaintiff's injury is easily quantified.

Blue Chip Stamps also addressed the "zone of interest" concern.⁶⁴ The Court, already fearful of the potentially rampant expansion of rule 10b-5 private actions,⁶⁵ utilized policy concerns⁶⁶ and an absence of legislative intent⁶⁷ to conclude that investors who were not actual purchasers or sellers did not fall within the class of those who rule 10b-5 sought to protect—those defrauded "*in connection with*" the purchase or sale of securities.⁶⁸

As previously stated, the doctrine of standing appears to have evolved into a term of art in rule 10b-5 options cases because the analyses of the standing issue and the federal cause of action in many of the decisions have been merged. Having discussed the doctrine of standing, the focus of this Comment now shifts to the rule 10b-5 cause of action.

IV. THE MODERN PERSPECTIVE UNDER SECTION 10(b)'S REGULATORY SCHEME

A. *Private Causes of Action in General*

In 1946, twelve years after the 1934 Act's promulgation, the implied private cause of action under section 10(b) and rule 10b-5 was first recognized in *Kardon v. National Gypsum Co.*⁶⁹ Hence, an era of expanding the cause of action under rule 10b-5 had begun. Over twenty years later, the Supreme Court officially affirmed the implied cause of action.⁷⁰ Concomitant with the expanding scope of the rule 10b-5, however, was a judicial perception that the floodgates of litigation had also been opened.

In 1952 the United States Court of Appeals for the Second Circuit in *Birnbaum v. Newport Steel Co.* foresaw section 10(b)'s implied cause of action under rule 10b-5,⁷¹ an action Justice Rehnquist would later call "a judicial oak which

lace, 430 F.2d 792, 805 (5th Cir. 1970) (citing the same two-part test in an action under section 10(b)).

63. "In contrast, a putative plaintiff, who neither purchases nor sells securities but sues instead for intangible economic injury . . . is more likely to be seeking a largely conjectural and speculative recovery . . . [that] will depend on the plaintiff's subjective hypothesis." *Blue Chip Stamps*, 421 U.S. at 734-35.

64. See Froelich & Spiegel, *Standing of Federal Securities Plaintiffs—Which Way the Trend*, 24 DE PAUL L. REV. 510, 515 (addressing the discussion of the standing requirement in the *Birnbaum* decision); cf. *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654, 657 (7th Cir. 1973) (*Birnbaum*'s purchaser/seller requirement is a "jurisdictional question").

65. See *Blue Chip Stamps*, 421 U.S. at 737, 748-49.

66. *Id.* at 737-49.

67. See *infra* note 280 and accompanying text.

68. Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1982) (emphasis added).

69. 69 F. Supp. 512 (E.D. Pa. 1946).

70. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

71. 193 F.2d 461, 463-64 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

has grown from little more than a legislative acorn."⁷² *Birnbaum* limited the breadth of the private action under section 10(b) and rule 10b-5 by holding that a plaintiff must be either an actual purchaser or seller of securities in order to have standing to sue.⁷³ Twenty years later the Supreme Court sanctified this holding in *Blue Chip Stamps*.⁷⁴ One year after *Blue Chip Stamps*, the Court in *Ernst & Ernst v. Hochfelder*⁷⁵ analogized section 10(b)'s underpinnings to common-law fraud and held that scienter, not negligence, was the requisite standard of conduct under rule 10b-5.⁷⁶ One year after *Hochfelder*, in *Santa Fe Industries, Inc. v. Green*,⁷⁷ the Court held that actionable rule 10b-5 conduct must exhibit manipulation or deception. In 1980 the Court added its latest hurdle to rule 10b-5's private cause of action in *Chiarella v. United States*.⁷⁸ In nondisclosure insider trading actions under rule 10b-5, defendant must have derived the informational advantage upon which his trading was based from a position of "trust and confidence."⁷⁹ In other words, defendant by virtue of such a relationship must have owed the allegedly defrauded plaintiff a duty to disclose the privileged information before trading on it for his personal benefit. This series of cases thus strongly suggests that the Supreme Court is consciously narrowing the availability of rule 10b-5's private cause of action.⁸⁰

B. *Elements of the Modern Rule 10b-5 Cause of Action*

The modern rule 10b-5 action involves multiple requirements, and depending upon which case is read, the phraseologies frequently differ. To generalize, liability under rule 10b-5 requires fraud, scienter, materiality, reliance, causation, and injury. Analogous to the common law, fraud under rule 10b-5 can take the form of either nondisclosure or affirmative misrepresentation, but the alleged conduct must exhibit either manipulative or deceptive attributes.⁸¹ Scienter is the requisite culpability standard.⁸² Materiality is whether a "substantial likelihood" exists "that the disclosure of the omitted [or misrepresented fact] would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."⁸³ Although requiring no

72. *Blue Chip Stamps*, 421 U.S. at 737 (1975).

73. *Birnbaum*, 98 F. Supp. 506, 508 (S.D.N.Y. 1951), *aff'd*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

74. 421 U.S. at 737.

75. 425 U.S. 185 (1976).

76. *Id.* at 212-14, *see also supra* note 10 (illustrating section 10(b) and rule 10b-5).

77. 430 U.S. 462 (1977).

78. 445 U.S. 222 (1980).

79. *Id.* at 230; *see infra* notes 128-200 and accompanying text (discussing the requisite relationship).

80. Brooks, *supra* note 20, at 431.

81. *See supra* notes 76-77 and accompanying text.

82. Scienter is "a mental state embracing intent to deceive, manipulate or defraud" *Hochfelder*, 425 U.S. at 193-94 n.12; *see also id.* at 199 (section 10(b)'s terms "manipulative," "deceptive," and "contrivance . . . connote intentional or willful conduct designed to defraud investors.").

83. *Basic, Inc. v. Levinson*, 108 S. Ct. 978, 983 (1988) (quoting with approval *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

less than all the elements, the options cases under rule 10b-5 primarily involve reliance, causation, and injury.

Reliance "is a corollary of materiality"⁸⁴ that "provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury."⁸⁵ Plaintiff's reliance also must have been reasonable.⁸⁶ When nondisclosure is involved, proving reliance may border on the impossible.⁸⁷ Therefore, some courts rely on a fraud-on-the-market theory under which reliance will be satisfied "by a showing that the market price was affected by the misstatement or omission and plaintiff's injury is due to a purchase or sale at the then fraudulently induced market price."⁸⁸ The Supreme Court has previously held that reliance may be presumed in face-to-face transactions.⁸⁹ Recently, however, the Court announced in *Basic Inc. v. Levinson*⁹⁰ that "[i]t is not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory" for open market or faceless transactions.⁹¹

Causation has two components: transactional and loss causation.⁹² Transactional causation constitutes inducement; that is, "but for the wrongful conduct, the transaction would not" have been consummated.⁹³ Because of its similarity to reliance, transactional causation "may be subsumed in the reliance finding."⁹⁴ Loss causation addresses the question whether, but for the wrongful conduct, plaintiff's actual economic injury would not have occurred.⁹⁵ Although reliance and causation are closely related, *Basic* did not go so far as to dispense with a plaintiff's showing of causation.⁹⁶

Finally, some type of injury must have resulted from defendant's conduct. Section 28(a) of the 1934 Act limits recovery to actual damages,⁹⁷ and proving

84. T. HAZEN, *THE LAW OF SECURITIES REGULATION* 463 (2d ed. 1985).

85. *Basic*, 108 S. Ct. at 989.

86. See e.g., *id.*

87. See Langevoort, *Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement*, 70 CALIF. L. REV. 1, 36-37 (1982); see also *infra* notes 177-95 and accompanying text (discussing this issue more comprehensively).

88. T. HAZEN, *supra* note 84, at 465. See generally Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C.L. REV. 436 (1984) (thoroughly examining the fraud-on-the-market theory).

For some decisions that have entertained a fraud-on-the-market theory and accepted it in support for a presumption of reliance, see *Piel v. Speiser*, 806 F.2d 1154 (3d Cir. 1986); *Lipton v. Documentation, Inc.*, 734 F.2d 740 (11th Cir.), *cert. denied*, 469 U.S. 1132 (1985); *Ross v. A. H. Robins Co.*, 607 F.2d 545 (2d Cir.), *cert. denied*, 446 U.S. 946 (1980); *Blackie v. Barrack*, 524 F.2d 891 (9th Cir.), *cert. denied*, 429 U.S. 816 (1976); see also *infra* notes 227-44 and accompanying text (discussing the application of the fraud-on-the-market theory to an options trader's rule 10b-5 action).

89. See *infra* notes 190-93 and accompanying text.

90. 108 S. Ct. 978 (1988).

91. *Basic*, 108 S. Ct. at 989-93.

92. Loss causation is also called causation in fact.

93. T. HAZEN, *supra* note 84, at 467.

94. *Id.*

95. See *id.*

96. *Basic*, 108 S. Ct. at 993 (White & O'Connor, JJ., dissenting).

97. The applicable language of section 28(a) states, "[N]o person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb(a) (1982).

them may be no small feat.⁹⁸

C. *The Options Cases Prior to 1980*

The history of cases that address rule 10b-5 actions in an options contract context exemplify the courts' struggle with the interaction between the 1934 Act's definitional provisions and the *Birnbaum* doctrine. Although numbering few before 1980, these cases nonetheless illustrate issues with which courts continue to grapple today.

The *Globus, Inc. v. Jaroff*⁹⁹ cases are the earliest reported cases in which plaintiff based his rule 10b-5 action on an option contract. *Globus I* and *Globus II* involved a shareholders' derivative suit for money damages upon a nondisclosure theory that was brought against, among others, a corporation board of directors. Plaintiffs alleged that the directors had obtained shareholder approval of a resolution that granted a restricted stock option by means of a misleading proxy statement.¹⁰⁰ Of most importance in *Globus II* was the court's statement that an options contract was within the definition of a "security" under the language of section 3(a)(10) of the 1934 Act.¹⁰¹

Defendant initially attacked the complaint on two grounds: lack of subject matter jurisdiction and failure to state a cause of action.¹⁰² In addressing *only* the latter,¹⁰³ the *Globus I* court rejected defendant's contention that the *Birnbaum* doctrine precluded the action because the *corporation* did not purchase or

98. See generally T. HAZEN, *supra* note 84, at 470-75 (comprehensively illustrating the issues that arise with proof of damages). The options cases present unique applications of the damages requirement. Not only are options now expressly defined as "securities" under the 1934 Act, see *infra* note 126 (quoting § 3(a)(10) of the 1934 Act, 15 U.S.C. § 78c(a)(10) (1982), as amended), but they also represent rights to purchase their underlying securities. Moreover, pursuant to *Blue Chip Stamps* the purchase of a stock option constitutes the purchase of its underlying securities for purposes of the purchaser/seller requirement. Therefore an investor who purchases options is also deemed to have purchased its underlying securities. This rationale taken to its logical conclusion results in a somewhat anomalous situation: the investor has two distinct potential sources of damages from purchasing only options—the options themselves and their underlying securities—but is monetarily at risk only with respect to her investment in the options. To allow such an investor to recover for damage with respect to the underlying securities violates section 28(a)'s mandate that recovery under the 1934 Act is limited to only "actual" damages incurred; see *supra* note 97 and accompanying text (discussing § 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a) (1982)).

99. 271 F. Supp. 378 (S.D.N.Y. 1967) (addressing plaintiff's subsequent motion for summary judgment) [hereinafter *Globus II*]; *Globus, Inc. v. Jaroff*, 266 F. Supp. 524 (S.D.N.Y. 1967) (addressing defendant's motions to dismiss the complaint) [hereinafter *Globus I*].

100. See *Globus I*, 266 F. Supp. at 379. The option agreement gave a Techmation executive the option to buy 10,000 shares per year for 10 consecutive years. *Id.* The alleged material nondisclosures included, *inter alia*, the option price, "which on the date of the 'Notice of Special Meeting' [of the] shareholders was 60%" of the OTC ask price. *Id.* at 380.

101. *Id.* at 380. The court's finding was a liberal interpretation of section 3(a)(10), 15 U.S.C. § 78c(a)(10) (1982) because at the time that section did not expressly include options in its definition of "securities." See *infra* note 126 (quoting the current version of § 3(a)(10) after the 1982 amendments).

102. See FED. R. CIV. P. 12(b)(1) & (6).

103. The court addressed only the Federal Rule of Civil Procedure 12(b)(6) defense because "if a claim is stated, then the court has jurisdiction over it, and may not dismiss on either ground." *Globus I*, 266 F. Supp. at 527. The quotation provides a prime example of how the standing requirement as explicated in *Birnbaum* has been confused theoretically with cause of action. The standing requirement should focus on the plaintiff, not the merits of the case. See *supra* note 49 and accompanying text.

sell securities.¹⁰⁴ The facts of both decisions failed to disclose whether any stock was actually issued pursuant to the option. But by negative implication, the Board's grant and subsequent approval of the option alone appears to underlie the court's determination that the corporation was a seller of securities and plaintiffs had *derivative* standing to sue.

Another 1975 decision, *Wulc v. Great & Western Industries, Inc.*,¹⁰⁵ based its conclusion that an option agreement was a security under the 1934 Act upon language in *Blue Chip Stamps*.¹⁰⁶ In *Wulc*, plaintiff was an employee of a corporation that was the target of a takeover from whom he had been granted stock options. Pursuant to the terms of the merger agreement between the bidding corporation and his employer, the bidding corporation assumed liability for plaintiff's option. After the merger, the bidding corporation failed to fulfill that obligation when plaintiff subsequently sought to exercise his options. Plaintiff then brought an action under rule 10b-5. Defendants moved to dismiss¹⁰⁷ pursuant to the *Birnbaum* doctrine on the grounds that plaintiff never actually owned any stock in either corporation. The court upheld plaintiff's standing by initially stating that "[a]n option is a contract, and comes within the definition of a 'security' under the statutes."¹⁰⁸ Next, in efforts to satisfy the requisite purchaser/seller requirement, the court utilized a forced seller theory to allow plaintiff standing.¹⁰⁹

A year later the United States District Court for the Southern District of New York faced a similar case in *601 West 26 Corp. v. Solitron Devices, Inc.*¹¹⁰ There, the writer of call options requested injunctive relief to prohibit Solitron Devices, Inc. from publicly disseminating favorable earnings reports. Plaintiffs

104. See *Globus I*, 266 F. Supp. at 528.

105. [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,361, at 98,786 (E.D. Pa. 1975).

106. The pertinent language in *Blue Chip Stamps* provides:

A contract to purchase or sell securities is expressly defined by § 3(a) of the 1934 Act, 15 U.S.C. § 78c(a), as a purchase or sale of securities for the purposes of that Act. Unlike respondent, . . . the holder of puts, calls, options and other contractual rights or duties to purchase or sell securities have been recognized as "purchasers" or "sellers" of securities for purposes of Rule 10b-5, not because of a judicial conclusion that they were similarly situated . . . , but because the definitional provisions of the 1934 Act themselves grant them such a status.

421 U.S. 723, 750-51 (1975) (footnote omitted). The statutes cited by the Court provide: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire," 15 U.S.C. § 78c(a)(13) (1970), "[t]he terms 'sale' and 'sell' each include any contract to sell of otherwise dispose of." 15 U.S.C. § 78c(a)(14) (1970).

107. Defendants moved to dismiss pursuant to Federal Rules of Civil Procedure 12(b)(1), (5), (6) and (7). The court summarized, "Basically defendants contend that the complaint fails to allege any civil cause of action under the Securities Exchange Act of 1934" [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 98,787. Interestingly, the court interpreted *Blue Chip Stamps* to require "a plaintiff to be either a purchaser or seller of a security, in order to state a *cause of action* under Section 10(b)." *Id.* (emphasis added).

108. *Id.* at 98,788 (citing § 3(a)(13) of the 1934 Act).

109. The *Wulc* court was unclear as to exactly how the forced seller theory applied to plaintiff's particular situation. See *id.* at 98,788. The theory, however, is commonly applied to allow plaintiffs standing under rule 10b-5 when stockholders are effectively forced to sell out of their investments by defendant's use of fraudulent means. The classic scenario is the "freeze out." See generally T. HAZEN, *supra* note 84, at 453-54 (discussing forced seller doctrine). For a discussion of the forced seller doctrine as it relates to standing and options traders, see *infra* notes 268-77 and accompanying text.

110. 291 F. Supp. 882 (S.D.N.Y. 1968), *aff'd*, 420 F.2d 293 (2d Cir. 1969).

alleged that defendants "failed to follow generally accepted accounting procedures in their audit."¹¹¹ Accordingly, "the resulting [financial] reports presented an unduly favorable earnings picture, [and] as a consequence . . . Solitron stock rose in price" during the period in which plaintiff had written calls on the stock.¹¹² The optionholders subsequently called for delivery of over half of the underlying shares; plaintiff then *borrowed* shares and delivered them. The court sustained defendants' contention that plaintiff lacked standing. It apparently reasoned that because the shares were delivered pursuant to and in accordance with a pre-existing contractual obligation, no sale of securities had occurred. Hence, plaintiff had no standing.¹¹³

A final pre-1980 decision representative of one of the "modern" (post-1980) views¹¹⁴ is *Lloyd v. Industrial Bio-Test Laboratories, Inc.*¹¹⁵ In a class action, plaintiffs brought section 10(b) and rule 10b-5 actions for money damages against defendants based upon call options that plaintiffs had purchased "in reliance on the integrity of the market and on information released," that concerned a new drug produced and marketed by defendants.¹¹⁶ In their misrepresentation action, plaintiffs alleged that information contained in the Syntex Corporation's annual report and subsequent public announcements and press releases "painted a rosy picture of imminent approval" from the Food and Drug Administration (FDA), but they "did not reveal that the test results submitted to the FDA . . . concealed irregularities."¹¹⁷ When the irregularities were eventually disclosed, the FDA gave notice of its possible withdrawal of the drug's marketing approval. As a result, Syntex stock plummeted, as did the value of plaintiffs' call options.

Defendants contended "that the complaint [was] insufficient because it [did] not allege any fraud in connection with the purchase or sale of a security."¹¹⁸ The court ruled that plaintiffs had standing.¹¹⁹ First, the court stated that options contracts were themselves securities under section 3(a)(10) of the 1934 Act.¹²⁰ Second, the court rejected defendants' additional argument for dismissal

111. *Id.* at 883.

112. *Id.* at 885-86.

113. The court's analysis is sufficiently interesting to warrant quoting:

The 1934 Act defines the term "sale" and "sell" to include "any contract to sell or otherwise dispose of." If a writer of a call option "otherwise disposes" of securities which *he does not own*, then apparently plaintiff *has standing*. However, if a writer of a call option does not "dispose" of a security because he does not own it, then, despite plaintiff's considerable pecuniary interest in Solitron, plaintiff may not seek relief from a violation of the Act.

Id. at 886 (citation omitted) (citing 15 U.S.C. § 78c(a)(14) (1964)) (emphasis added). The fact that the shares were borrowed was irrelevant.

114. See cases cited *infra* note 229 for other modern views.

115. 454 F. Supp. 807 (S.D.N.Y. 1978). Other defendants included "Syntex Corporation, and one of its subsidiaries (collectively 'Syntex'), certain of the officers and directors of Syntex and Industrial Bio-Test Laboratories, Inc." *Id.* at 809.

116. *Id.* at 810.

117. *Id.* at 810.

118. *Id.*

119. *Id.* at 810-11.

120. *Id.* (citing 15 U.S.C. § 78c(a)(10) (1964)).

that "the options [that plaintiffs had] purchased and sold were not issued by defendants but by an entity unrelated to them."¹²¹ The court held that privity of contract was not required under section 10(b) or rule 10b-5.¹²²

The above cases developed two significant principles. Some cases expressly held that an option contract was a "security" per se under section 3(a)(10).¹²³ In other cases, the prevailing view emerged that an options contract falls under the purview of sections 3(a)(13) and (14) and constitutes a purchase or sale of the underlying securities. And while *Wulc* went so far as to say that *Blue Chip Stamps* brought the options contract under section 3(a)(10)'s definitional ambit,¹²⁴ this is simply not so. *Blue Chip Stamps* addressed only the issue of a foregone purchase of common stock; the issue of whether the options contract constituted a security was not involved.¹²⁵

Regardless of whether *Wulc*, or *Solitron*, or possibly even the *Globus* cases assumed that an options contract was in fact a security under the 1934 Act in their eagerness to address the purchaser/seller requirement, Congress laid all potential squabbling on this issue to rest in 1982 by amending section 3(a)(10). The definition of a "security" under the 1934 Act now expressly includes puts and calls.¹²⁶

V. CHIARELLA V. UNITED STATES AND MODERN OPTIONS CASES UNDER SECTION 10(b)

Before *Chiarella* was decided in 1980, rule 10b-5 decisions in general struggled over the questions whether a defendant was under a duty to disclose or abstain,¹²⁷ and if so, to whom the duty was owed. One general rule appears to

121. *Id.* at 811. Defendants' argument here reflects the modern options market phenomenon: the creator of a standardized options contract could be virtually anyone. See *supra* notes 37-46 and accompanying text (explaining how standardized options contracts are created).

122. *Lloyd*, 454 F. Supp. at 811.

123. *E.g., id.* at 810-11; see also *SEC v. Texas Gulf Sulphur Corp.*, 401 F.2d 833, 852, 856-57 (2d Cir. 1968) (en banc) (upholding SEC's rule 10b-5 actions for insider trading against the recipients of employee stock options), *cert. denied*, 404 U.S. 1005 (1971); *Lubin v. Belco Petroleum Corp.*, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 96,543, at 94,237 (S.D.N.Y. 1978) (involving rule 10b-5 action based on put option or option to sell a limited partnership interest).

Although language in *Globus I*, *Globus II* and *Solitron* may support the argument that options contracts were in fact securities under the 1934 Act is unclear, section 3(a)(10) did contain language at the time of these decisions that certainly added support to such a conclusion: a "right to subscribe to or purchase, any of the foregoing [previously enumerated instruments which included common stock]; and "in general, any instrument commonly known as a 'security.'" 15 U.S.C. § 78c(a)(10) (1976).

124. *Wulc*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 98,787-88.

125. See *Blue Chip Stamps*, 421 U.S. at 725-28.

126. Section 3(a)(10) of the 1934 Act reads in part:

The term "security" means any note, stock, treasury stock, bond, debenture, . . . any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof) or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"

15 U.S.C. 78c(a)(10) (1982).

127. The so-called "abstain or disclose" rule requires that before trading, those under its ambit must disclose nonpublic information accessed by virtue of their position with the issuer or "abstain from trading in or recommending the securities concerned while inside information remains undis-

have finally emerged: "When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."¹²⁸ In *Chiarella*, the Supreme Court stated that "the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or similar relation of trust and confidence between them.'"¹²⁹ Relationships of trust and confidence were stated to be "specific relationship[s] between parties."¹³⁰ In theory, particular relationships that generally give rise to duties include fiduciaries and beneficiaries,¹³¹ agents and principals,¹³² and most importantly, corporate insiders¹³³ and shareholders.¹³⁴ The corporate insider holds a fiduciary relationship with his corporation's shareholders¹³⁵ that encompasses the duty to disclose.¹³⁶

The rationale behind the abstain or disclose rule is sound. Intuitively, the duty is based on fairness. From a practical standpoint, it seeks to protect investors from insiders' obvious informational advantages.¹³⁷ The duty effectuates section 10(b)'s underlying purpose "to protect the investing public and to secure

closed." *Texas Gulf Sulphur*, 401 F.2d at 848; see also *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961) (espousing similar rule).

128. *Chiarella v. United States*, 445 U.S. 222, 235 (1980). *Chiarella* involved an insider-trading criminal action based on section 10(b) and rule 10b-5. Defendant was an employee of a financial printer who deduced names of takeover targets from documents prepared pursuant to requests from his employer's clients. He eventually purchased and sold stock of the targets without first disclosing the information. The Court held "that a duty to disclose . . . does not arise from the mere possession of nonpublic market information." *Id.* at 235. His conviction consequently was overturned.

129. *Id.* at 228 (RESTATEMENT (SECOND) OF TORTS § 851(2)(a) (1981)); see also *Dirks v. S.E.C.*, 463 U.S. 646, 657-58 (reaffirming this statement in *Chiarella*).

130. 445 U.S. at 233.

131. *Id.* at 359.

132. *Id.* at 233.

133. Traditional insiders include officers, directors, and controlling shareholders. See, e.g., *In re Cady, Roberts & Co.*, 40 S.E.C. at 911; Langevoort, *supra* note 87, at 20. For purposes of this Comment, the term "insider" will not include corporations who issue the option contract's underlying interest (the "underlying issuer").

In *Dirks v. S.E.C.*, 463 U.S. 646 (1983), the Supreme Court announced that corporate insiders' abstain or disclose duty, owed to shareholders, can be derivatively extended to their tippees on the basis that the information has been improperly passed to them. *Id.* at 659-60. Initially, the insider's tip must be of such a magnitude to have otherwise constituted a breach of the fiduciary duty owed to the shareholders. *Id.* at 661-63. Additionally, the tippee must know or be chargeable with knowledge that the disclosure made to him was such a breach. *Id.* If the two conditions above are satisfied, a tippee can be held liable under rule 10b-5 for illegal insider trading. *Accord* *Lloyd v. Industrial Bio-Test Laboratories, Inc.*, 454 F. Supp. 807 (S.D.N.Y. 1978); *O'Connor & Assocs. v. Dean Witter Reynolds, Inc.*, 529 F. Supp. 1179 (S.D.N.Y.), *aff'd on reh'g*, 600 F. Supp. 702 (S.D.N.Y. 1981).

134. *Chiarella*, 445 U.S. 228. This list should not be viewed as exclusive; other types of "prior dealings" between the parties may suffice. See *id.* at 232.

135. *Dirks*, 463 U.S. at 654 (citing *Chiarella*, 445 U.S. at 227-35); see also *Chiarella* 445 U.S. at 228 n.8 (quoting *Gratz v. Claughton*, 187 F.2d 46, 49 (2d Cir.) (Hand, L., J.), *cert. denied*, 341 U.S. 920 (1951)) (stating the same rule); *id.* at 228-29 (discussing *In re Cady, Roberts & Co.*); *Pepper v. Litton*, 308 U.S. 295, 307 (1939) (stating a similar rule).

136. *Strong v. Reptide*, 213 U.S. 419 (1909); *accord* *Bianco v. Texas Instruments*, 627 F. Supp. 154 (N.D. Ill. 1985) (involving options trading); *O'Connor & Assocs. v. Dean Witter Reynolds, Inc.*, 529 F. Supp. 1179 (S.D.N.Y. 1981) (involving options trading), *aff'd on reh'g*, 600 F. Supp. 702 (S.D.N.Y. 1985).

137. *In re Cady, Roberts & Co.*, 40 S.E.C. at 912 n.15; see also *Chiarella*, 445 U.S. at 228-29 (quoting *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 809 (D. Del. 1951)); *Laventhal v. General Dynamics Corp.*, 704 F.2d 407, 412 (8th Cir.) (options traders' rule 10b-5 action), *cert. denied*, 464 U.S. 846 (1983).

fair dealing in the securities markets . . . so that [a fully] informed judgement can be made by all investors who trade in such markets."¹³⁸

A. The Nondisclosure Cases

The post-*Chiarella* options cases that involve actions for nondisclosure continue to struggle over the duty issue. These cases have developed two distinct lines of thinking with respect to whom the requisite duty is owed,¹³⁹ although one line seems to be emerging as the dominant view.¹⁴⁰ In one line, *O'Connor & Associates v. Dean Witter Reynolds, Inc.*¹⁴¹ is the seminal case for the proposition that an actionable rule 10b-5 violation requires only that the defendant breach some duty owed to someone; others may then bring a proper civil action so long as they can establish the other rule 10b-5 elements.¹⁴² The *O'Connor* decision refused to follow *Chiarella* and distinguished its holding on the civil standing issue by noting that *Chiarella* involved a criminal action while *O'Connor* involved a civil action.¹⁴³ The *O'Connor* court expressly stated that the *fiduciary* duty owed by corporate insiders to shareholders did not extend to options traders¹⁴⁴ because the optionholders lacked an equity interest in the corporation.¹⁴⁵ Yet the court went on to state that "by virtue of their fiduciary duty to the corporation and its shareholders, corporate insiders become subject

138. *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 235 (2d Cir. 1974).

139. The split occurs when defendants are individuals who face insider trading allegations under section 10(b) and rule 10b-5. Otherwise, the cases appear to be generally in accord with respect to nondisclosure actions against the corporation that issues the options contract's underlying securities (the "underlying issuer"). *But see* *Backman v. Polaroid Corp.*, 540 F. Supp. 667 (D. Mass. 1982) (upholding an action against nonprofit foundations controlled by individual defendants). Therefore, this Comment will primarily focus on alleged insider trading violations against individuals.

140. *See* cases cited *infra* note 153.

141. 529 F. Supp. 1179 (S.D.N.Y. 1981), *aff'd on reh'g*, 600 F. Supp. 702 (S.D.N.Y. 1985) (rehearing based upon *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984)); *accord* *Backman v. Polaroid Corp.*, 540 F. Supp. 667 (D. Mass. 1982).

O'Connor represents the first reported post-*Chiarella* rule 10b-5 action in an options contract context. It involved defendants' motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) "because [the complaint did] not allege a fiduciary relationship between themselves and *O'Connor*." *O'Connor*, 529 F. Supp. at 1183. The facts show that Amax, Inc. publicly announced a takeover proposal submitted by Standard Oil of California, Inc. (Socal) conditioned upon approval by Amax. Amax immediately rejected the bid. Plaintiff *O'Connor & Associates* (*O'Connor*) was an options trader. It sold Amax calls as the stock's price skyrocketed following the offer and rejection. *O'Connor* alleged that unknown insiders employed by defendants Amax or Socal tipped unknown customers and registered representatives of the brokerage houses of Dean Witter Reynolds, Inc. and A. G. Becker, Inc., who in turn purchased call options during the period in which *O'Connor* wrote the calls. Defendants who moved for dismissal included the alleged tippees—Dean Witter, A.G. Becker, their employees and customers—and Amax; Socal did not join in the motion. *See id.* at 1182-83. Only Amax's motion was granted. *Id.* at 1194.

142. *O'Connor*, 529 F. Supp. at 1185-86; *see also* *Starkman v. Warner Communications*, 671 F. Supp. 297, 305 (S.D.N.Y. 1987) (similarly interpreting *O'Connor*).

143. *O'Connor*, 529 F. Supp. at 1185. Ironically, the court alternatively relied upon *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983), another criminal rule 10b-5 action.

144. *O'Connor*, 529 F. Supp. at 1185; *accord* cases cited *infra* note 153.

145. *O'Connor*, 529 F. Supp. at 1184-85. *But see infra* notes 154-59 and accompanying text (illustrating that some optionholders maintain concurrent equity positions and therefore are owed fiduciary duties).

to the *separate* duty to either 'abstain or disclose' "¹⁴⁶ and owed this duty "to the [entire] investing public." "¹⁴⁷ In *O'Connor*, the investing public included options traders.¹⁴⁸

The second line of cases strictly adhere to *Chiarella*, which requires a stringent relationship of trust and confidence between the parties.¹⁴⁹ The leading case in this line is *Laventhal v. General Dynamics Corp.*¹⁵⁰ *Laventhal* involved an options trader's private rule 10b-5 action against the underlying issuer and individual corporate insiders. The *Laventhal* court expressly "disapproved" of two prior cases that upheld an optionholder's nondisclosure action against corporate insiders.¹⁵¹ Thus, other than those cases where the insider contemporaneously trades with the options trader,¹⁵² the decisions that follow *Laventhal* refuse to find that underlying issuers or individual insiders owe a duty to abstain or disclose to the investing public, including options traders.

Cases in the *Laventhal* line¹⁵³ rest their holdings on an optionholder's lack

146. *Id.* at 1187.

147. *Id.* (citing *Shapiro*, 495 F.2d at 240) (emphasis added); accord *Bianco v. Texas Instruments*, 627 F. Supp. 154, 163 (N.D. Ill. 1985) (upholding options traders' 10b-5 action against corporate insiders "[b]ecause the securities laws are designed to protect the entire open market . . ."). But see *Chiarella*, 445 U.S. at 231 (in disapproving jury instruction, the court stated, "In effect, the trial court instructed the jury that petitioner owed a duty to everyone; to all sellers, indeed, to the market as a whole.").

148. Although *O'Connor* spoke of corporate insiders' duties in broad terms, the decision also specifically addressed whether tippees—those with whom the corporate insiders have shared their information—were under the duty to abstain or disclose. The court eventually held such a duty was derivatively imposed from their insider-tippers. *Id.* at 1187; accord *Dirks v. SEC*, 463 U.S. 646, 654 (1983) (citing *Chiarella*, 445 U.S. at 227-35); see also *Chiarella*, 445 U.S. at 231 n.12 (recognizing that *Shapiro* had upheld tippees' liability). *Contra Moss v. Morgan Stanley, Inc.*, 719 F.2d at 13-14, 15-16 (flatly rejecting any extension of a derivative duty owed to shareholders other than those of the tipper's corporation), *cert. denied*, 456 U.S. 1025 (1989). Thus under *O'Connor*, both corporate insiders and their tippees fall under the abstain or disclose requirement; but the underlying issuer owes no duty.

In one respect *O'Connor* misconstrues *Chiarella's* explication of the duty requirement. In general, post-*Chiarella* decisions that have addressed civil nondisclosure actions under rule 10b-5 almost invariably hold that there must be more than just a "duty in the air." *Moss v. Morgan Stanley, Inc.*, 553 F. Supp. 1347, 1353 (S.D.N.Y.), *aff'd*, 719 F.2d 5 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984).

149. See *supra* note 79 and accompanying text.

150. 704 F.2d 407 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983). See generally Note, *Laventhal v. General Dynamics Corporation: No Recovery for the Plaintiff-Option Holder in a Case of Insider Trading Under Rule 10b-5*, 79 Nw. U.L. REV. 780 (1984) (discussing *Laventhal* and arguing plaintiff option holder should not have standing to sue).

151. *Laventhal*, 704 F.2d at 413 n.5 (disapproving *In re McDonald Douglas Corp. Secs. Litig.*, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,737 (E.D. Mo. 1982) and *Backman v. Polaroid Corp.*, 540 F. Supp. 667 (D. Mass. 1982)). After *Laventhal* the United States District Court for the Eastern District of Missouri reversed itself. See *In re McDonald Douglas*, 567 F. Supp. 126, 127-28 (E.D. Mo. 1983).

152. See, e.g., *Bianco v. Texas Instruments*, 627 F. Supp. 154, 163-64 (N.D. Ill. 1985).

153. The following nondisclosure options-related cases collectively constitute the *Laventhal* line: *Laventhal v. General Dynamics Corp.*, 704 F.2d 407 (8th Cir. 1983) (neither the underlying issuer or its insiders owed a duty to abstain or disclose to options traders), *cert. denied*, 464 U.S. 846 (1983); *Starkman v. Warner Communications*, 671 F. Supp. 297 (S.D.N.Y. 1987) (same); *Bianco v. Texas Instruments*, 627 F. Supp. 154 (N.D. Ill. 1985) (only underlying issuers owed no abstain or disclose duty to options traders; insiders who contemporaneously traded in options owed the duty); *In re McDonald Douglas*, 567 F. Supp. 126 (E.D. Mo. 1983) (neither the underlying issuer or its insiders owed a duty to abstain or disclose to options traders). *Bianco* and *Starkman* permitted affirmative misrepresentation under rule 10b-5. See *infra* note 212 and accompanying text.

of an equity interest.¹⁵⁴ Although courts have had occasion,¹⁵⁵ none to date has distinguished between covered-call writers,¹⁵⁶ naked-option writers, and mere optionholders for purposes of analyzing the abstain or disclose duty. Along a continuum beginning with investors who only own stock and ending with those who only trade the stock's option and do not own the underlying stock (for example, mere optionholders), covered-call writers fall somewhere in the middle—they are *both* stockholders and optionholders. A corresponding continuum with respect to duties owed to these varieties of options traders, however, does not exist. By virtue of their equity interest, stockholders have a fiduciary duty that circumscribes the lesser duty to abstain or disclose.¹⁵⁷ Yet with stockholders, all duties arbitrarily end.

Refusing to extend the duty to abstain or disclose to options traders who maintain concurrent holdings of the underlying stock seems illogical, at the very least.¹⁵⁸ Such a shareholder is no less a shareholder because she has chosen to create a derivative security. Her pre-writing equity position has not changed, and therefore any pre-existing fiduciary relationships should theoretically remain unaffected.¹⁵⁹ Turning now to actions brought by options traders who do not concurrently own equity interests, several sound policy arguments have been advanced in support of not subjecting *corporate* defendants to a duty to abstain or disclose owing to such a class of options traders.

The *Laventhal* line appears to be incessantly mindful that an underlying issuer's "potential liability to options holders is limited only by the whims of the options writers."¹⁶⁰ If underlying issuers were allowed to be sued, the innocent shareholders would certainly be the ones to suffer.¹⁶¹ Given an insider's level of control over the underlying issuer, contribution from those individuals who were actually culpable might be impractical absent a derivative suit.¹⁶² Second, a corporation has no effective control over the number of options contracts that

154. See *Laventhal*, 704 F.2d at 411-13; *Starkman*, 671 F. Supp. at 304-06; *Bianco*, 627 F. Supp. at 159-61; *In re McDonald Douglas*, 567 F. Supp. at 127.

155. See, e.g., *Starkman*, 671 F. Supp. at 300 (plaintiff was a stockholder who sold covered calls); *Weintraub v. Texasgulf, Inc.*, 564 F. Supp. 1466 (S.D.N.Y. 1983) (plaintiff was holder of both options and stock).

156. Covered call writers are those who either write or purchase options while concurrently maintaining an equity position in the options contract's underlying securities. See *supra* note 38 and accompanying text.

157. See *supra* notes 143-48 and accompanying text.

158. Cf. *Gratz v. Claughton*, 187 F.2d 46, 49 (2d Cir.) (a corporate director's fiduciary duty extends to incipient as well as pre-existing shareholders), *cert. denied*, 341 U.S. 920 (1951).

159. See *Langevoort*, *supra* note 87, at 42. *Chiarella* suggests shareholder status alone may suffice to meet the "prior dealings" threshold. 445 U.S. at 232-35. At this point an additional question can be raised: Does a former shareholder's prior dealings suffice if she now trades only in the options contracts?

160. *Bianco*, 627 F. Supp. at 161.

161. See, e.g., *Basic Inc. v. Levinson*, 108 S. Ct. 978 (1988) (White & O'Connor, JJ., dissenting) (quoting *Texas Gulf Sulphur*, 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring), *cert. denied*, 394 U.S. 976 (1969)).

162. To frustrate matters further, even if the derivative suit was to prevail, the insider may be covered by an indemnification agreement with the underlying issuer if he is found to be liable. See T. HAZEN, *supra* note 84, at 211-13 (discussing the use of indemnification contracts).

are written and the resulting pool of potential plaintiffs.¹⁶³ Basic ideals of fairness suggest that this virtually unlimited exposure to liability outweighs any benefits to be derived from allowing recovery from a corporation rather than those individuals who are responsible for the corporation's acts.

Some commentators have espoused economic arguments to support such options traders' rule 10b-5 actions.¹⁶⁴ One economic theory that has been advanced states that standardized options contracts reduce risk in the capital markets through risk diversification and consequently facilitate trading in the underlying securities.¹⁶⁵ Because the corporation receives the benefits, the argument continues, it should also incur the costs as a matter of basic fairness.¹⁶⁶ This argument fails to realize that option writing shareholders are the only parties who directly avail themselves of any beneficial risk diversification. Any residual benefits that may inure to the underlying issuer should be viewed as merely gratuitous because the underlying issuer derives no *direct* monetary benefit from a standardized option transaction.¹⁶⁷

Some commentators have also advanced the argument that upholding options traders' rule 10b-5 actions will result in much needed investor confidence.¹⁶⁸ At first glance this particular policy concern would appear to have substantial merit, given that one of the broad purposes behind the 1934 Act is to protect trading on all national securities markets.¹⁶⁹ This concern, however, implicitly calls for market certainty, and the nature of the options contract is inapposite to such a concern. The options contract inheres tremendous risk. Those unable to handle potentially catastrophic financial losses simply have no business in the options markets. A section 10(b)-based options insurance that would directly affect the investments of hundreds, thousands, or perhaps millions of innocent shareholders is a matter of broad social policy better left to Congress than the Judiciary Branch.¹⁷⁰ The culpable individuals, not the underlying issuers, are the proper pocketbooks from which to rectify wrongs.

The reasons for denying recovery from underlying issuers do not support a

163. The *Laventhal* line is in accord with this proposition. See cases cited *supra* note 153.

164. E.g., Note, *Private Causes of Action for Option Investors Under SEC Rule 10b-5: A Policy, Doctrinal, and Economic Analysis*, 100 HARV. L. REV. 1959, 1965 (1987). But see, e.g., Wu, *An Economist Looks at Section 16(b) of the Securities Exchange Act of 1934*, 68 COLUM. L. REV. 260 (1968) (arguing for allowing insider trading on a purely economic foundation).

165. J. COX & M. RUBENSTEIN, *OPTIONS MARKETS* 444 (1985). But see *Deutschman v. Beneficial Corp.*, 841 F.2d at 508 (implying that this proposition is too speculative).

166. See Note, *supra* note 164, at 1969. But see Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801, 809 (1980) (stating pure fairness has "little substance").

Section 10(b) and rule 10b-5 answer the question as to what conduct is unfair. Those who wish to use fairness to broaden enormously substantive coverage of these provisions seek to substitute judicial conscience for Congress's manifestation of social conscience. No case has yet raised this type of *prudential* standing argument.

167. See *supra* notes 37-42 and accompanying text (discussing the origination of a standardized options contract).

168. See Note, *supra* note 164, at 1965.

169. See generally *Securities Exchange Act of 1934*, § 2, 15 U.S.C. 78b (1982) (setting forth Congress' reasons for regulating national securities markets).

170. See *supra* note 57 and accompanying text and *infra* note 171.

similar conclusion with regard to fraudulent actions of corporate insiders. If market integrity and investor confidence is the driving policy consideration, the proper solution should address the root of the problem. Any lack of public confidence is derived from the well-publicized insider trading cases.¹⁷¹ As a consequence, the general public perceives that the small investor has virtually no control over his investments when up against formidable informational advantages.

Potential liability concerns as set forth above apply equally to corporate insiders. Here too, courts have recognized the potentially vast horizons of liability. In addition, the 1934 Act exacerbates the liability concern by requiring that plaintiffs sue for actual damages.¹⁷² Ideally Congress should amend the 1934 Act's civil liability provisions in order to establish a single potential pool limited in amount to the insider's illegal profits. Such a provision would protect against unreasonable exposure to rule 10b-5 liability.¹⁷³ But a sufficient system of statutory and judicially evolved checks on insiders' potential exposure to rule 10b-5 liability already exists.

The Federal Rules of Civil Procedure specifically allow an award of attorney's fees for spurious claims.¹⁷⁴ Rule 10b-5 requires that the plaintiff meet the burden of showing scienter, not negligence.¹⁷⁵ Moreover, plaintiffs must show that the insider traded deceptively, or, in the case of tipper/tippee liability, that the tipper gave information pursuant to a personal profit motive.¹⁷⁶ If all the preceding is not ominous enough, plaintiff may still have to show reliance and causation. Stringent burdens of proof provide defendants with better chances for pretrial interception—for example, through summary judgment. All the preceding mechanisms currently help to assure that defendants will be potentially subject to liability only in the most worthy cases. Nonetheless courts remain incensed about defendants' potential rule 10b-5 liability. This Comment will now shift its discussion back to the duty requirement: the main device that the courts have created to limit defendants' exposure to rule 10b-5 liability.

As previously stated, *Laventhall* provides the foundation for the dominant view with respect to options traders' standing to sue for rule 10b-5 actions in-

171. See, e.g., Newsweek, May 26, 1986, cover page (cover story is entitled "Greed on Wall Street" and concerns Dennis Levine's illegal trading activities); Time, Dec. 1, 1986, cover page (Ivan Boesky's picture constitutes the entire cover page and beside it appears the caption: "Investor 'Ivan the Terrible' Boesky.")

172. See *supra* note 97 (quoting the 1934 Act's section 28(a) in part).

173. See, e.g., Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified as amended in scattered sections of 15 U.S.C.).

In *Elkind v. Liggett & Myers, Inc.*, 613 F.2d 156 (2d Cir. 1980), which involved a class action, the Second Circuit prorated an insider's total illegal profits to each member of the class. The *Elkind* formula is arguably at odds with a plaintiff's "actual damages" requirement under section 28(a). See *supra* note 97 (quoting § 28(a)). But see *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.) (innovatively fashioning a recovery within § 28(a)'s confines), *cert. denied*, 382 U.S. 879 (1965).

174. FED. R. CIV. P. 11. For a securities case that utilized this device, see *Browning Debenture Holders' Committee v. DASA Corp.*, 560 F.2d 1078 (2d Cir. 1977).

175. See *supra* text accompanying note 76.

176. See *Dirks v. SEC*, 463 U.S. 662, 646 (1983) (test for actionable tippees' trading is "whether the insider [tipper] personally will benefit, directly or indirectly, from his disclosure").

volving nondisclosure.¹⁷⁷ The *Laventhal* court based its conclusion that plaintiff lacked of standing on the "lack of [any] transactional nexus between the defendant's trading and the plaintiff's loss."¹⁷⁸ As the cases that have followed *Laventhal* illustrate, transactional nexus has become dispositive in determining whether the underlying issuer or its insiders owe a duty to disclose to options traders.

Rule 10b-5's loss causation requirement theoretically encompasses transactional nexus. Under the *Laventhal* line, transactional nexus has become inextricably linked to a defendant's duty to disclose.¹⁷⁹ Transactional nexus appears to have two components: transactional privity and contemporaneous trading. Transactional privity seeks to avoid the imposition of liability on "those who possess only a tangential relationship to the transaction."¹⁸⁰ The *Laventhal* line considers the option transaction, either the purchase or sale, to be a third-party contract because the corporation itself does not issue the option contract.¹⁸¹ Therefore, no relationship of trust and confidence between the underlying issuer and its insiders and the options trader is deemed to exist, and consequently, any options trader's loss is judged to be too speculative to sustain a cause of action.¹⁸²

Laventhal followed the interpretation of the requisite causation announced in *Fridrich v. Bradford*.¹⁸³ *Fridrich* focused exclusively on the insider's ultimate "act of trading."¹⁸⁴ In *Fridrich* the court concluded that plaintiffs lacked causation and dispositively founded this conclusion on a lack of any effect or influence on plaintiffs' respective expectations and trading decisions as a result of the insider's acts of trading. In short, under *Fridrich*, plaintiffs who trade on impersonal markets lack both the requisite reliance and causation in an insider trading action based upon a nondisclosure theory.¹⁸⁵

Paraphrasing *Fridrich*'s inquiry—but for the insider's trading, plaintiff would not have sustained his loss—illustrates the undue hardship of its position on loss causation. In order for a plaintiff to meet *Fridrich*'s "but for" causation requirement, defendant must transact at a volume that would noticeably affect the value of the security in the market. For example, if the transactions at issue were sales of securities made by the defendant, then the quantity of such sales must have been made at such a magnitude as to depress the security's market

177. After plaintiff argued *O'Connor*'s duty requirement, the *Laventhal* court stated, "[N]otwithstanding this reasoning, we find no standing in the present case since plaintiff and defendant lacked any transactional connection in their trading." *Laventhal*, 704 F.2d at 413.

178. *Id.* at 412.

179. *See id.* at 413.

180. *Id.* at 414 (citing *Blue Chip Stamps*, 421 U.S. at 749-50); *see also* *Fridrich v. Bradford*, 542 F.2d 307, 323 (6th Cir.) (Celebrezze, J., concurring) (recognizing the insider's vast potential for liability and the need to limit such exposure by requiring some "causative link" between the insider's breach of the duty to disclose and plaintiff's trading activities), *cert. denied*, 429 U.S. 1053 (1977).

181. *Laventhal*, 704 F.2d at 412. The post-*Chiarella* options cases uniformly recognize that a corporation does not issue standardized option contracts.

182. *Id.*

183. 542 F.2d 307 (6th Cir.), *cert. denied*, 542 U.S. 307 (1977).

184. *Id.* at 318.

185. *But see infra* note 188 and accompanying text.

value and thus cause the plaintiff a loss. Moreover, to say the plaintiff relied on the markets' lack of the undisclosed information appears too speculative for the *Fridrich* court to accept.¹⁸⁶

To *Fridrich* and *Laventhal* alike, preventing the horror of a defendant's vast exposure to liability seems to be reconciled with the allowance of certain seemingly deceptive insider trades on the grounds that the investors *qua* investors assume certain market risks. The *Fridrich* court stated that "[i]nvestors must be prepared to accept the risk of trading in an open market without complete or always accurate information."¹⁸⁷ This statement is preposterous. No rational investor enters a market with the understanding that he probably will be defrauded in some manner.¹⁸⁸ His expectation is market integrity by virtue of information dissemination.¹⁸⁹ Therefore, he assumes economic or financial risks in their purest forms that do not include fraudulent or deceptive components.

In *Affiliated Ute Citizens v. United States*¹⁹⁰ the Supreme Court held "positive proof of reliance is not a prerequisite to recovery."¹⁹¹ *Fridrich* distinguished this holding because defendant in *Affiliated Ute* had engaged in face-to-face "prior business dealings" with the plaintiffs.¹⁹² *Fridrich* went on to say that this type of relationship does not exist in impersonal markets.¹⁹³ In order to tie the *Fridrich* decision into *Laventhal*'s transactional nexus requirement, some semblance of privity between the parties must exist before the potential for a rule 10b-5 violation can even arise.¹⁹⁴ In actions against the underlying issuer, no semblance of privity will ever exist except in face-to-face transactions. Given the design of the options markets, most options traders will be hard pressed to prove some semblance of privity with individual insiders or underlying issuers, aside from serendipity.¹⁹⁵

186. This strongly suggests that *Fridrich* rejects any fraud-on-the-market theory. *But see* *Basic Inc. v. Levinson*, 108 S. Ct. 978 (1988) (writ of certiorari was granted to the Sixth Circuit to decide whether the fraud-on-the-market theory was appropriate in order to presume reliance); *Fridrich*, 542 F.2d at 320 n.27 (summary of the footnote appears in the text immediately following). Interestingly, *Fridrich* may have also left open the question whether an actionable breach occurs when an alleged affirmative misrepresentation affects the market price of the stock to such an extent that a plaintiff could reasonably rely. *See Fridrich*, 542 F.2d at 320 n.27.

187. *Fridrich*, 542 F.2d at 318.

188. *See Basic, Inc. v. Levinson*, 108 S. Ct. 978 (1988) (quoting *Schlanger v. Four-Phase Sys. Inc.*, 555 F. Supp. 535, 538 (S.D.N.Y. 1982) ("[I]t is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?").

189. *See Basic*, 108 S. Ct. at 991-92 ("An investor who buys or sells stock at the price set by the market does so in reliance upon the integrity of that price."). *But see Zlotnik v. TIE Communications*, 836 F.2d 818, 823 (3d Cir. 1987) (reliance on the integrity of the market is different from reliance on the integrity of the market price).

190. 406 U.S. 128 (1972).

191. *Id.* at 154.

192. 542 F.2d at 319.

193. *Id.* at 320-21.

194. *But see id.* at 325 (Celebrezze, J., concurring) ("Since there is no practical method for matching purchases and sales in the open market, requiring privity in the common law sense as an element of rule 10b-5 would create an insurmountable obstacle for plaintiffs.") (citations omitted); *see also Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 239 (2d Cir. 1974) ("privity . . . is not a requisite element of a Rule 10b-5 cause of action for damages").

195. In other words, proof of privity would require the fortuitous matching of the insider

Conversely, the *O'Connor* line recognizes these inherent hardships and accordingly follows *Shapiro v. Merrill Lynch Pierce Fenner & Smith, Inc.*¹⁹⁶ *Shapiro* recognized the virtual impossibility of identifying "a particular defendant's sale with a particular plaintiff."¹⁹⁷ *Shapiro*, following *Affiliated Ute*, concluded causation in fact may be presumed.¹⁹⁸ Therefore, *Shapiro* phrased its causation inquiry in terms of hypothetical reliance: whether, but for the insider's failure to disclose, the plaintiff would have traded as he did.¹⁹⁹ In short, once a breach of duty occurs, a resultant injury is presumed, although the plaintiff must still prove the extent of his injury.

The second aspect of *Laventhal's* transactional nexus requirement narrows any potential duty to disclose to those instances where defendant contemporaneously trades with the plaintiff. In the options cases, not only is a temporal congruity required, but also a market congruity. In other words, it is not enough that the defendant trades simultaneously with plaintiff, the trading must occur within the same market—the options market.²⁰⁰

Temporal congruity addresses judicial concerns over the length of time defendant is exposed to liability.²⁰¹ Its premise espoused in *Fridrich*, for example, is that noncontemporaneous traders "do not suffer the disadvantage of trading with someone who has superior access to information."²⁰²

Market congruity essentially perfects the contemporaneous trading require-

trader's options transaction with those of outsiders. See *Langevoort*, *supra* note 87, at 42; see also *supra* notes 37-42 and accompanying text (illustrating the creation of a standardized option and the OCC's intermediary role in the process). But see *infra* notes 246-47 and accompanying text (arguing privity does exist with regard to an underlying issuer and an analogous warrant).

196. 495 F.2d 228 (1974).

197. *Id.* at 236; see also *Fridrich*, 542 F.2d at 324 (Celebrezze, J., concurring) ("[T]he mechanics of the marketplace make it virtually impossible to identify the actual investors with whom an insider is trading.").

198. 495 F.2d at 238-40. In turn, reliance and transactional causation are subsumed by causation in fact. *Id.* at 239. Furthermore, causation in fact is subsumed by a showing of materiality. *Id.* at 239-40.

199. The lower court in *Shapiro* seems to treat an actionable insider transaction as a combination of two elements: the ultimate trade and the failure to disclose. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 353 F. Supp. 264, 278 ("[I]t is not the act of trading which causes plaintiffs' injury, it is the act of trading without disclosing material inside information . . .") (emphasis added), *aff'd*, 495 F.2d 228 (2d Cir. 1974). Thus, the trade itself effectuates the failure to disclose and such a failure seems to indicate *ipso facto* that a loss has occurred.

200. *Laventhal*, 704 F.2d at 414 (citing *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88 (2d Cir. 1981)); *Bianco v. Texas Instruments*, 627 F. Supp. 154, 164 (motion to dismiss overruled as to individual corporate insiders alleged to have traded contemporaneously in options). But see *Backman v. Poloroid Corp.*, 540 F. Supp. 667, 671 (D. Mass. 1982) (overruling defendants' motion to dismiss as to the options trader; defendants sold only stock).

201. "To extend the period of liability well beyond the time of the insider's trading simply because disclosure was never made could make the insider liable to all the world." *Wilson*, 648 F.2d at 94.

Conversely, *Shapiro* would hold open the potential class of injured plaintiffs from the time that the insider initially trades until the time he finally discloses, if ever. 495 F.2d at 237; see also *Basic Inc. v. Levinson*, 108 S. Ct. 978 (1988) ("[P]laintiffs are former Basic shareholders who sold their stock after Basic's first public statements . . . [and before the misstatements were rectified]."). In *Basic*, for example, the length of defendants' period of potential liability would extend over 14 months. See 108 S. Ct. at 981. Virtually all the options cases, including those in the *O'Connor* line, hold to the contrary and require temporal congruity for each actionable insider transaction.

202. 542 F.2d at 326 (Celebrezze, J., concurring).

ment, which in turn connects the duty and causation requirements that constitute the essence of *Laventhal*'s transactional nexus.²⁰³ It assists in making the transaction less tangential and seeks to narrow further defendants' potential exposure to liability. In one respect, market congruity is superfluous. It assumes informational advantages used in stock transactions do not present "informational imbalances" with respect to transactions that involve the stock's corresponding options contracts.²⁰⁴ This is not so. The option trader is at the same informational disadvantage because the options contract's value is correlative to the value of the underlying securities. In efforts to protect the fraudulent insider from exposure to unlimited liability, *Laventhal* here allows a prudent insider a virtual free reign over options traders.

The situation has not yet been addressed in which an insider trades exclusively in either calls or puts and the plaintiff trades exclusively in the other. Because the call and put contracts are exclusive in their respective origins and subsequent secondary trading markets, the lack of any kind of relationship between the parties would appear to negate any transactional privity, or for that matter, any transactional nexus under *Laventhal*. In addition, the price or trading volume of the type of options contracts that the insider did *not* trade would not directly reflect any of the insider's trading activities, even if such trading were based upon confidential information and done contemporaneously with the plaintiff's trading. Therefore, in order to satisfy the reliance requirement, a court would have to accept plaintiff's argument that the options market in which he traded and its corresponding market volume and price data reflected a *deceptive absence* of the undisclosed information that allowed the insider to profit from trading the other.

In order to clarify the perspective of the next portion of this Comment's discussion—the affirmative misrepresentation cases—the previous analyses regarding insider trading or nondisclosure actions should be briefly summarized. The *O'Connor* decision confronts the unfair rigidity of rule 10b-5's judicially evolved rule structure as it applies to the unique situation of the modern options trader. While the *Laventhal* line seemingly disregards the coverage of the 1934 Act²⁰⁵ as well as the purposes behind rule 10b-5,²⁰⁶ *O'Connor* does not. By requiring temporal congruity in trading, both lines of cases aptly recognize the potential for liability far beyond a culpable insider's actual profits and seek practical limitations. But the *Laventhal* line, through its requirement of market congruity, opens "a large loophole for individual insiders to profit from confidential

203. See *Laventhal*, 704 F.2d at 414 ("Here, although it would appear there are sufficient allegations of contemporaneous trading, it is clear there is only a speculative nexus between *Laventhal*, as an options holder, and the corporate insiders dealing with stock.").

204. *Laventhal*, 704 F.2d at 144 ("[T]here was no informational imbalance in the separate transactions performed by the [defendant and plaintiff] because they in no way can be said to have been 'trading' with one another.").

205. The 1934 Act was intended to cover all national markets. H.R. No. 1383, 73d Cong., 2d Sess. 11 (1934).

206. "The 'disclose or abstain' rule accomplishes two salutary purposes of rule 10b-5: it insures the integrity of the marketplace and it compensates for the inequity of trading with a corporate insider . . ." *Fridrich*, 542 F.2d at 324 (Celebrezze, J., concurring) (citation and footnote omitted).

information."²⁰⁷ In allowing this loophole, the *Laventhal* line fails to recognize the interdependence between the options and stock values, in addition to a general need for market integrity.

B. *The Affirmative Misrepresentation Cases*

In several areas of law, the duty to speak truthfully when one has chosen to speak is axiomatic.²⁰⁸ Courts have historically found misfeasance to be a more palatable wrong than nonfeasance.²⁰⁹ The pre-*Chiarella* options cases under rule 10b-5 were no exception.²¹⁰ Material affirmative misrepresentations are expressly prohibited by section 10(b) and rule 10b-5, while nondisclosure or insider trading theories may require some extrapolation.²¹¹ Nevertheless, the options cases decided after *Chiarella* are split once again as to whether options traders are owed the duty to speak truthfully.

Those decisions that refuse to impose such a duty²¹² follow *Laventhal's* statement that underlying issuers and their insiders generally owe no duties to options traders.²¹³ In addressing affirmative misrepresentations, the approach announced in the *Laventhal* decision, which focuses upon to whom a duty is owed fails to recognize the duty of the underlying issuer. Before any statement is made, the lack of an existing duty to options traders might have some merit. Once one has chosen to speak, however, a separate duty to speak truthfully²¹⁴ or to correct a material prior statement that has become materially misleading²¹⁵ clearly arises.

Correspondingly, this duty should be owed to all those who would reasonably be expected to hear and reasonably rely on the statement.²¹⁶ The culpable

207. Langevoort, *supra* note 87, at 42.

208. See generally W. KEETON, D. DOBBS, R. KEETON, & D. OWEN, PROSSER & KEETON ON THE LAW OF TORTS 736-49 (5th ed. 1985) (discussing the legal distinction between nonfeasance and active misrepresentation) [hereinafter PROSSER & KEETON]. In the area of federal securities law, see *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir.) ("[A] duty to speak the full truth arises when a defendant undertakes to say anything."), *cert. denied*, 435 U.S. 952 (1978); *Etshokin v. Texasgulf, Inc.*, 612 F. Supp. 1212, 1217 (N.D. Ill. 1984) ("We think the latter holding conflicts with the principle that one who has spoken must under rule 10b-5 speak the whole truth.") [hereinafter *Etshokin I*]. Cf. *Basic Inc. v. Levinson*, 108 S. Ct. 978 (1988) (implying that one who has once spoken undertakes a duty to speak truthfully).

209. See PROSSER & KEETON, *supra* note 208, at 736-37.

210. See, e.g., *Lloyd v. Industrial Bio-Test Laboratories*, 454 F. Supp. 807 (S.D.N.Y. 1978) (discussed *supra* notes 112-18 and accompanying text).

211. Compare rule 10b-5(2) (expressly prohibiting affirmative misstatements) with Rule 10b-5(1) & (3) (implicitly prohibiting insider trading). See *supra* note 10 (illustrating rule 10b-5).

212. *Bianco v. Texas Instruments Inc.*, 627 F. Supp. 154 (N.D. Ill. 1985) (regarding the affirmative misrepresentation action against the underlying issuer); *Starkman v. Warner Communications*, 671 F. Supp. 297 (S.D.N.Y. 1987); see also *Deutschman v. Beneficial Corp.*, 668 F. Supp. 358 (D. Del.), *rev'd*, 841 F.2d 502 (3d Cir. 1988) (distinguishing *Laventhal* and refusing to apply it to cases involving affirmative misrepresentations made to the public).

In all the cases above, the affirmative misrepresentation charges were brought against the underlying issuer.

213. E.g., *Deutschman*, 668 F. Supp. at 361-62; *Starkman*, 671 F. Supp. at 302-04.

214. See *Deutschman*, 841 F.2d at 506.

215. See *supra* note 10 (quoting rule 10b-5(b)).

216. The RESTATEMENT (SECOND) OF TORTS states:

One who makes a fraudulent misrepresentation is subject to liability to the persons or class

actor should be able to reasonably foresee or "assume from appearances" that his statements will reach options traders.²¹⁷ This is evident when the actor's statement is issued in the form of a public release or announcement and a well-established market in the particular options contracts exists. In such a case, the plaintiff's status as a nonequity investor or the fact that a defendant did not actually issue the options contract becomes meaningless, as does any discussion of transactional privity.²¹⁸

Given the correlation between stock and options values, to say that options traders rely on the misstatements less than shareholders, or alternatively to say that given the speculative nature of the options contracts, options traders assume risks of active fraud, is senseless.²¹⁹ The decisions that implicitly reason so²²⁰ imply that options trading is on the same level of social undesirability as gambling.²²¹

Before examining those cases that extend options traders a duty to speak truthfully, several concluding points may be noted. The *Chiarella* decision dealt solely with a nondisclosure action.²²² *Laventhal* too addressed only the duty to disclose. Hence the *Laventhal* decision may have left open the question of any duty to speak truthfully in an affirmative misrepresentation action.²²³ Even Judge Cardozo in his oft-cited opinion *Ultramares Corp. v. Touche, Niven & Co.*²²⁴ implied that concerns over "a liability in an indeterminate amount for an indeterminate time to an indeterminate class"²²⁵ may be less significant in the case of intentional misrepresentation.²²⁶

When a verbal or written statement has been made and incorporated into

of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.

RESTATEMENT (SECOND) OF TORTS § 531 (1981) (emphasis added); see also *id.* at comment c (substantial certainty), d (reasonable expectations), e & f (class of individuals).

217. See PROSSER & KEETON, *supra* note 208, at 745.

218. Because the plaintiff's losses would presumably be caused by his reliance upon misstatements and by their subsequent effects, the contemporaneous trading requirement would appear to be inapplicable. See *Deutschman*, 841 F.2d at 506 (rejecting the applicability of *Laventhal* and *Chiarella*).

219. See *Deutschman*, 841 F.2d at 507 ("[S]ince the price of option contracts is closely dependent upon the price of the underlying stocks, the degree of risk involved in trading in one over the other is not self-evidently greater.").

220. See *Deutschman*, 668 F. Supp. at 364 ("There is no reason why options traders, who have chosen a greater risk . . . and do not meaningfully contribute to capital formation, should recover at the expense of the corporation's shareholders.").

221. See, e.g., *id.* at 364. But see *id.* at 507 (rejecting defendants' argument that "purchasers of option contracts . . . are entitled to less protection under the 1934 Act because option trading, like blackjack or craps, is 'gambling'").

222. *Chiarella v. United States*, 445 U.S. 222 (1980).

223. Cf. *Fridrich v. Bradford*, 542 F.2d 307, 320 n.27 ("We specifically do not reach the question of availability of the [rule 10b-5] remedy to open market situations where the insider trading with resultant price changes has in fact induced the plaintiffs to buy or sell to their injury."), *cert. denied*, 429 U.S. 1053 (1977).

224. 255 N.Y. 170, 174 N.E. 441 (1931).

225. *Id.* at 179, 174 N.E. at 444.

226. *Id.* at 186, 174 N.E. at 447-48.

the value of the underlying stock,²²⁷ the option's correlative value will follow.²²⁸ Those who invest in options in reliance on such statements satisfy reliance and causation requirements in a manner far less attenuated than satisfying the same requirements in actions involving alleged nondisclosure. The cases that have extended options traders the duty to speak truthfully still impose heavy evidentiary burdens upon the plaintiff with respect to showing reliance, materiality, and causation.²²⁹ If a misstatement caused the plaintiff to immediately trade thereupon, then to allow presumptions here would seem to be unfair to the defendant, because the market would not have been affected by the misstatement. If trading occurs later on, however, presumptive reliance makes more sense.

An interesting application of the reliance requirement arises when the following series of commonplace options transactions occurs. Suppose an options trader writes calls, then a misrepresentation occurs that causes a rise in the value of the underlying securities, and consequent to such rise the options trader chooses to cover his position.²³⁰

From his initial sale of calls, the options trader believes that the underlying securities are overvalued and thus relies "on the market's ability, given accurate information, to correct" the value in the future.²³¹ In essence, the options writer relies both on "the integrity of the market"²³² and the underlying securities' future value in order to obtain profits.²³³ Here, however, defendant "[b]y inflating the price of the stock" has "interfered with the market's ability to correct itself."²³⁴ If the misrepresentation causes the price of the underlying securities

227. This theory is called the efficient-capital-market theory. See Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, 25 WM. & MARY L. REV. 373, 373 n.1, 374-81 (1984); see also *In re LTV Securities Litigation*, 88 F.R.D. 133, 134 (N.D. Tex. 1980) (citing literature on the theory).

228. See Rubenstein, *supra* note 31, at 54-55.

229. *Deutschman v. Beneficial Corp.*, 841 F.2d 502 (3d Cir. 1988) (upholding an option trader's action against the underlying issuer and two insiders and expressly rejecting the applicability of *Laventhal and Chiarella*); *In re Digital Equip. Corp. Sec. Litig.*, 601 F. Supp. 311 (D. Mass. 1984) (upholding options trader's action against underlying issuer and expressly rejecting the application of *Laventhal* in affirmative misrepresentation actions); *Etshokin I*, 612 F. Supp. at 1212 (certain insiders' motions to dismiss overruled and underlying issuer and other corporate insiders' motions to dismiss granted but upon a finding at law of no breach of the duty owed to the option trader); see also *Etshokin v. Texasgulf, Inc.*, 612 F. Supp. 1220, 1229 (N.D. Ill. 1985) (holding in part that the duty to speak truthfully is owed to options traders) [hereinafter *Etshokin II*]. Cf. *Weintraub v. Texasgulf, Inc.*, 564 F. Supp. 1466 (S.D.N.Y. 1983) (overruling certain individual defendants' motion for summary judgment).

230. For cases with comparable fact patterns, see *Deutschman*, 668 F. Supp. at 299-301; *Etshokin I*, 612 F. Supp. at 1213; 601 West Corp. v. *Solitron Devices, Inc.*, 291 F. Supp. 882, 883 (S.D.N.Y. 1968); see also *Zlotnik v. TIE Communications*, 836 F.2d 818, 823 (3d Cir. 1987) (involving the a similar fact pattern, but with an analogous "short" sale of stock).

Covering a position means that instead of risking the potential delivery of the written options contract's underlying securities, the writer alternatively purchases a call option of the same series from the secondary market. Thus, the options writer has effectively substituted someone else's obligation to deliver for his own. If the option holder requires the writer is chosen to perform and deliver the underlying securities, the writer simply makes a similar demand upon the options contracts which he had subsequently purchased.

231. *Zlotnik*, 836 F.2d at 823.

232. *Id.* (emphasis added).

233. *Cf. id.*

234. *Id.*

to move up to a price level that prompts the options trader to cover, or the trader does not so choose to cover but is consequently called to deliver the underlying securities according to the options contract, the costs of either transaction are directly attributable to defendant's wrongful conduct. The question then becomes whether reliance has occurred on either the subsequent covering or delivery transaction, and in addition, whether reliance may be presumed.

In *Zlotnick v. TIE Communications*,²³⁵ a case that involved an analogous "short" sale of stock where the short seller chose to cover his position,²³⁶ the United States Court of Appeals for the Third Circuit disallowed plaintiff's theory of presumed reliance on the market's natural ability to correct.²³⁷ However, the court did overrule defendant's motion to dismiss and allowed plaintiff an opportunity to show either "actual" or "actual indirect" reliance.²³⁸ It follows from *Zlotnik*, and more recently from *Basic*,²³⁹ that an options writer who relies on the integrity of the market price of the underlying securities and chooses to cover could raise a presumption of reliance.²⁴⁰

A paramount policy consideration is the concern over defendant's potential exposure to liability in actions for affirmative misrepresentations. Burdens of proof are one way to alleviate the concern. Another ingenious way is to net all losses and gains from all transactions that follow from the misstatement to assure that plaintiffs recover for only actual economic injury in the aggregate.²⁴¹ These methods, however, impose no limits on the length of time to which defendant should be exposed to potential liability.

Under *Shapiro* the potential class of plaintiffs would remain open until the misstatement has been rectified, if ever.²⁴² The other approach, limiting the period of liability only to the period in which the defendant contemporaneously trades, is erroneous.²⁴³ This Comment advocates a compromise position that

235. 836 F.2d 818 (3d Cir. 1987).

236. Plaintiff, a "short" seller, covered his position by prematurely purchasing shares before his obligation to repay the shares arose in an effort to minimize potential loss. See *id.* at 820-21 (explaining the mechanics of the "short" sale).

237. *Id.* at 823 (plaintiff asserted reliance on the market rather than on the market price). See *supra* notes 231-34 and accompanying text (discussing this distinction).

238. *Zlotnik*, 836 F.2d at 824. Actual indirect reliance is a fraud-on-the-market theory whereby the plaintiff relies on the "integrity of the market price" or the present value of the stock. *Id.*; see also *Basic Inc. v. Levinson*, 108 S. Ct. 978 (1988) (affirming a lower court's use of the same theory to raise the presumption of reliance).

239. *Basic*, 108 S. Ct. at 991-92 (1988) (affirming a lower court's use of a fraud-on-the-market theory to raise a presumption of reliance).

240. Cf. *Deutschman*, 841 F.2d at 504 ("[The complaint] alleges that Deutschman suffered losses when, upon disclosure of the facts, call options on Beneficial stock that he had purchased in reliance on the market price created by defendant's misstatements, became worthless."); *Starkman v. Warner Communications*, 671 F. Supp. 297, 307 (S.D.N.Y. 1987) (referring to the oral argument on defendant's motion for summary judgment, "[P]laintiffs all but admit that they did not rely on either the alleged material misrepresentations or the market price.>").

241. In *Etshokin II* the court netted all options losses and gains arising after the alleged misconduct (misrepresentations) to conclude that plaintiff had not sustained actual damages under § 28(a). See *Etshokin II*, 612 F. Supp. at 1231-34. The gains resulted from the appreciation in value from options purchased in covering transactions. See *supra* text accompanying note 230 (describing the particular transaction in *Etshokin II*).

242. See *supra* note 201 and accompanying text.

243. See *supra* note 218.

would extend the period of potential liability from the time of the misstatement to the time in which the misstatement was fully absorbed in the market.²⁴⁴ Obviously this timespan does not cover those who rely actually on the misstatements or indirectly on the integrity of the market price past the time of full absorption, but *some* allowable recovery better serves the injured class and upholds market integrity better than no recovery. In order to soften the harshness of an arbitrarily limited class of potential plaintiffs, the burden of proving the open liability period could be fairly put upon defendant. After all, the perpetrator has voluntarily chosen his own course of action.

C. *Special Situations*

Stock warrants and stock rights. Warrants and rights present other unique scenarios. Like standardized call options, both give the holder a right to buy prescribed securities. They are also expressly defined as securities under the 1934 Act's section 3(a)(10).²⁴⁵ Unlike standardized options contracts, warrants and rights can originate with the underlying issuer.²⁴⁶ If so, the requisite transactional nexus between the underlying issuer and purchaser conceivably exists under the *Laventhal* line. In actions for misrepresentation based upon the original issuance of warrants or rights, little argument can be made that the contemporaneous trading requirement has not been met, even if *Laventhal* is the chosen precedent.²⁴⁷ However, problems may arise with the contemporaneous trading requirement if the charge is insider trading on secondary markets.²⁴⁸

Secondary market transactions involving warrants and rights pose the same types of concerns that arise when secondary market transactions involving standardized options are involved. Under *Laventhal*, no distinguishing factor exists when individual insiders trade in warrants or stock rights that would require any modification to the temporal and market congruity, and causation requirements. In addition, if applied to rule 10b-5 actions involving warrants or rights, the principles in those decisions that have recognized various duties owed to options traders should not change given the additional semblance of privity inherent with warrants and rights.

*Index options.*²⁴⁹ Actions that involve market index options could present

244. See *Texas Gulf Sulphur Co.*, 401 F.2d at 853-54 (stating that insiders may commence trading once the market has fully absorbed the disclosed information).

245. 15 U.S.C. 78c(a)(10) (1982).

246. See, e.g., R. BREALEY & S. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 524 (1984).

247. See *Starkman v. Warner Communications*, 671 F. Supp. 297, 298-99 (S.D.N.Y. 1987) (plaintiffs were also purchasers of warrants; defendant's motion for summary judgment was granted only as to the options-based claim); *Kusner v. First Pa. Corp.*, 531 F.2d 1234, 1239 (3d Cir. 1976) ("If [warrant] purchasers can prove that they parted with that consideration as a result of material misrepresentations in a prospectus, they may recover in a direct action . . ."); see also *Lutgert v. Vanderbilt Bank*, 508 F.2d 1035 (7th Cir. 1975) (plaintiff's rule 10b-5 action involved stock rights issued in conjunction with an original issuance of stock; action dismissed on other grounds—plaintiff was not entitled initially to any of the rights).

248. Secondary markets are the markets in which transactions subsequent to the initial sales of securities to the initial purchasers take place.

249. See *supra* note 25 and *supra* note 27 and accompanying text (discussing various index options available for trading).

potential plaintiffs with insurmountable obstacles. Decisions that choose to follow *Laventhal* should bar actions under either affirmative misrepresentation or nondisclosure (including insider trading) theories. Not even a scintilla of privity exists to sustain actions against corporate issuers of securities who comprise a percentage of the index's weighted value. Equally troublesome, even to those courts that have sustained options traders' actions, is the causation requirement. To illustrate, suppose XYZ Corp. comprises ten percent of the S & P 100's²⁵⁰ weighted value. Assume further that when a previous misrepresentation is subsequently rectified, it occurs on the same day the United States Government issues an unfavorable report that bears upon the future state of the economy. If the value of a given class of S & P 100 options drops fifty percent, then how much can or should be attributable to the misrepresentation? Absent such a dramatic governmental release, what percentage of a loss, if any, can be attributed to a drop in value following a misrepresentation? As to the latter, fifteen percent of the fifty percent decline might appear logical at first glance. But this assumes far too much given the enormous complexity of other market forces at work on the ninety-nine other companies that comprise the index.

Reliance presents another problem. Assuming that an allegation of insider trading is involved and defendant is an insider of one of the index's component corporations, to be actionable under *Laventhal* and *Fridrich*, the insider's contemporaneous trading of the pertinent class of index options contracts must have been of such an extraordinary magnitude as to create a cognizable change in the index's value upon which the plaintiff must rely. If the insider were held liable on the fraud-on-the-market theory, she would theoretically be liable to all those who traded in all the market index options of which the pertinent underlying issue constitutes a component.

Stock brokers. When a stock broker trades a plaintiff's account fraudulently using options contracts, rule 10b-5 affords a cause of action. Under nondisclosure and affirmative misrepresentation theories, options traders' actions against their brokers generally have been upheld.²⁵¹ Given the face-to-face nature of the transactions, fraudulent broker transactions should not present any unduly harsh burdens of proving materiality, reliance, and causation.²⁵² Even if *Laventhal* is the chosen precedent, broker-agents owe fiduciary-like duties to their client-principals.²⁵³ The relevant issue in these cases usually has been whether the client-options trader has engaged in a requisite purchase or sale of section 3(a)(10) securities.

Although the cases that involved options-based rule 10b-5 actions against brokers number surprisingly few,²⁵⁴ *Savino v. E.F. Hutton & Co., Inc.*²⁵⁵ com-

250. See *supra* note 25 (discussing this particular index option).

251. See cases cited *infra* notes 254-56.

252. Given the face-to-face transaction, *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), would appear to control and presumptions may arise. See *supra* notes 190-92 and accompanying text (discussing *Affiliated Ute*).

253. See *Affiliated Ute*, 406 U.S. at 152.

254. For other cases that involved rule 10b-5 actions against brokers see *Prudential-Bache Securities, Inc. v. Cullenther*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,421, at 97, 188

prehensively examined the status of an options trader's brokerage account against the definitional provisions of section 3(a)(10). The court found that when options that satisfy section 3(a)(10) are traded within the plaintiff's account, a valid rule 10b-5 action may be based thereupon.²⁵⁶ Alternatively, the *Savino* court found that the plaintiff's arrangement with the broker constituted a section 3(a)(10) "investment contract."²⁵⁷

VI. STANDING TO SUE AND OPTIONS TRADERS

With the previous analyses of the requirements of an options trader's rule 10b-5 action as a guide, the following discussion of the theoretical standing requirements as applied to options traders is relatively straightforward. The purchaser/seller aspect of the injury in fact requirement and the prudential concerns regarding section 10(b)'s protected zone of interests warrant particular attention. The other general standing requirements can be dispensed with rather quickly.

In terms of fairness,²⁵⁸ tracing an options trader's economic injury to a defendant's conduct otherwise culpable under rule 10b-5 has been discussed previously.²⁵⁹ Simply put, standing to sue under Rule 10b-5 should extend to plaintiffs who sue the individual culpable actors and not the underlying issuer. The redressability requirement²⁶⁰ presents no problems. A favorable decision pursuant to a request for monetary damages or injunctive relief will certainly alleviate the past or future harm that an options trader can incur.²⁶¹ An options trader's rule 10b-5 action will not founder on the courts' prudential considerations, be-

(E.D. Va. 1987); *Merrill Lynch, Pierce, Fenner & Smith v. Del Valle*, 528 F. Supp. 147 (S.D. Fla. 1981); *Alvord v. Shearson Hayden Stone, Inc.*, 485 F. Supp. 848 (D. Conn. 1980); see *infra* cases cited in note 256.

255. 507 F. Supp. 1225 (S.D.N.Y. 1981).

256. *Id.*; *Gutter v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 644 F.2d 1194 (6th Cir.) (holding an options writer writing through his brokerage account was a seller of securities under the 1934 Act), *cert. denied*, 455 U.S. 909 (1982); see also *Pierson v. Dean Witter Reynolds, Inc.*, 551 F. Supp. 497 (C.D. Ill. 1982) (upholding plaintiff's rule 10b-5 action; options contracts were traded in a nondiscretionary account); *Darrell v. Goodman*, [1979-80 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,349, at 97,325-26 (S.D.N.Y. 1980) (trades of individual securities within a brokerage account can satisfy the purchaser/seller requirement).

257. *Savino*, 507 F. Supp. at 1236-39. Unlike standardized options contracts, commodities futures contracts are not § 3(a)(10) securities. *Glen-Arden Commodities, Inc. v. Costantino*, 493 F.2d 1027, 1033 (2d Cir. 1974). Because a commodities trader cannot therefore base a rule 10b-5 action upon the contract itself, his trading account's status as a § 3(a)(10) "investment contract" becomes quite significant. For citations of numerous cases that have addressed the commodities account-investment contract issue, see *Savino*, 507 F. Supp. at 1235-36 n.8.

258. See *supra* note 54 and accompanying text.

259. See *supra* notes 154-89 and accompanying text.

After a close reading of *Laventhal*, one is tempted to infer that the case addressed the fair traceability issue of the standing doctrine. *Laventhal*'s reliance on *Chiarella*'s duty requirement would strongly suggest otherwise and *Laventhal* should be interpreted as addressing an options trader's cause of action under rule 10b-5. Further supporting this proposition, *Chiarella* addressed whether defendant's conduct was criminally culpable under rule 10b-5. See *supra* notes 127-38. *Chiarella* did not involve in any respect the standing to sue doctrine. Therefore, this Comment has addressed *Laventhal* in a narrow sense, as the decision bore only upon an option trader's rule 10b-5 cause of action.

260. See *supra* notes 52-54 and accompanying text.

261. But see *infra* note 286 and following text (discussing standing to sue in equity).

cause the action does not require adjudication of a generalized grievance or an abstract question.²⁶² A court is specifically requested to determine whether conduct has been fraudulent under a statute and its attendant rules.

A. *Injury in Fact: the Purchaser/Seller Aspect*

It would appear that a purchase or sale of an options contract satisfies the injury in fact requirement for standing.²⁶³ The only issue, then, is whether a purchase or sale has occurred. The purchaser/seller requirement as applied to options traders is unique in two significant respects. First, an options contract is itself a security under section 3(a)(10).²⁶⁴ Second, the options contract is recognized as a purchase or sale of the contract's underlying securities.²⁶⁵ Thus, when an options trader writes an option, the transaction constitutes a sale of securities.²⁶⁶ Alternatively, when an options trader buys an option, the transaction constitutes a purchase of securities.²⁶⁷

A more difficult scenario arises when the plaintiff has foregone an opportunity to purchase the option's underlying stock. This situation, which occurred in *Blue Chip Stamps*, involves what Professor Hazen describes as a "frustrated purchaser."²⁶⁸ The notion of frustration has an interesting twist in its application to options contracts. For example, suppose an options trader purchases call options in expectation that the value of the underlying securities will move upward. Subsequent to her purchase, a public misstatement of negative press drives down the options contracts' values within her series to the point of worthlessness. If unable to sell at the time of the options contract's expiration date, the holder has two choices. She can humbly elect to take her losses by allowing the contracts to expire. Alternatively, she can exercise her right to buy the underlying securities, most assuredly at a price above the prevailing market price. If she chooses the latter course, under *Blue Chip Stamps* she would be a purchaser, but of the *underlying* securities.²⁶⁹ But if the former course is chosen, can it be said that the option trader has been effectively *forced* to sell her securities?

In the former course of action above, an options trader who was similarly situated would seek to resell his original purchases in an attempt to recover at least something. However, if the options value is worthless or nearly worthless, there may not be any receptive buyers on the secondary market. Therefore, a

262. See *supra* note 57 and accompanying text.

263. See *supra* notes 62-63 and accompanying text.

264. See *supra* note 126 (quoting § 3(a)(10)).

265. See *supra* note 106 (quoting the applicable passage in *Blue Chip Stamps* and § 3(a)(13) & (14)).

266. See, e.g., *Deutschman*, 841 F.2d at 506-07; *Gutter*, 644 F.2d at 1196-97; see also *supra* note 126 (quoting § 3(a)(10)).

267. *Backman v. Polaroid Corp.*, 540 F. Supp. 667, 671 (D. Mass. 1982); see also *supra* note 126 (quoting § 3(a)(10)).

268. T. HAZEN, *supra* note 84, at 454.

269. See *Blue Chip Stamps*, 421 U.S. at 725-28.

high probability exists that the options trader's loss will be total upon the contract's expiration.

In this particular situation, the options trader should be viewed as a forced seller.²⁷⁰ Unlike stocks, options contracts have extremely short lives. After the expiration date, all rights expire and no second chance for value recovery exists.²⁷¹ Furthermore, a clearly identifiable event has transpired in which actual monetary loss has occurred; no speculation exists here.²⁷² To require the purchase of the option's underlying securities in order to perfect standing would create enormous economic waste and in addition increase the plaintiff's potential loss.²⁷³ For these reasons, an options trader who is similarly situated and *who makes reasonable efforts to resell* in order to minimize her losses, but due to options market dynamics cannot successfully do so, should be deemed a seller upon expiration of the held contracts. She is, in essence, a forced seller.

Just as there can be forced sellers of options contracts, so can there be forced buyers of options contracts.²⁷⁴ The forced buyer situation arises when, for example, an options trader who has previously written call options confronts the dilemma whether to cover his potential obligation to deliver the underlying shares or simply take his chances and if called, then deliver.²⁷⁵ To these latter, "naked," options writers, such a dilemma in a practical sense will likely ever arise. Given the choice between purchasing and delivering underlying shares perhaps at a cost of hundreds of thousands of dollars, and purchasing cover options at a few thousand dollars, only one alternative really exists: COVER!

If a naked options writer in this situation chooses to cover, surely his covering transaction should constitute a requisite purchase.²⁷⁶ By contrast, if covered options are involved and the options writer chooses to perform and delivers securities that he currently holds, technical problems with the purchaser/seller requirement may arise.²⁷⁷

B. Section 10(b)'s Zone of Interests

Until the amendments to the 1934 Act's definitional provisions occurred in 1982,²⁷⁸ the issue whether the interests of options traders came within the zone of interests protected by the 1934 Act caused much difficulty. The 1934 Act's original definitional provisions did not state that options contracts were "securi-

270. See T. HAZEN, *supra* note 84, at 454-56.

271. See *supra* note 29.

272. See *supra* note 63 and accompanying text.

273. The additional loss is represented by the extent of the cost of stock purchased to deliver in the case of a naked option or to the extent of the market value of the stock held and delivered in the case of a covered option.

274. "When the market price of [the underlying stock] rose as a result of the [disclosure of the truth], [the plaintiff] was forced to cover the options he had sold." *Etshokin II*, 612 F. Supp. at 1227 (emphasis added).

275. See the fact patterns in *supra* notes 230 and 236.

276. E.g., *Etshokin II*, 612 F. Supp. at 1231-34 (illustrating that the proper rule 10b-5 transactions were the covering transactions).

277. See *supra* notes 110-13 and accompanying text (discussing *Soliton Devices*).

278. See *supra* note 126 (quoting § 3(a)(10) as amended).

ties.”²⁷⁹ In addition, the 1934 Act’s legislative history provides little help.²⁸⁰ Furthermore, support for the proposition that the zone of interests protected by the 1934 Act did not include options traders is intuitively derived from the fact that standardized stock options and national options markets did not exist at the time of the 1934 Act’s passage. However, in support of the proposition that options traders’ interests were protected before 1982, the Act’s legislative history was clearly designed to broadly cover national markets’ participants.²⁸¹ In addition, section 10(b) applied, and still does apply, to “a purchaser or seller of ‘any security’ against ‘any person’ who has used ‘any manipulative device or contrivance.’”²⁸²

In 1982, Congress officially amended section 3(a)(10)’s definition of “security” to include options. The effect of the 1982 Amendments is to include expressly options traders’ interests under section 10(b)’s protections.²⁸³ Thus, the issue of whether options traders come within the zone of interests protected by the 1934 Act has finally been taken from the realm of dispute; no longer will the courts be able to dismiss options traders’ standing based on judicial considerations. As another consequence, the nature of the plaintiff’s theory of fraud (nondisclosure or affirmative misrepresentation) should not matter for purposes of determining standing under section 10(b) and rule 10b-5.²⁸⁴

One sound policy consideration does, however, stand out in support for allowing options traders standing to sue in general. Private actions aid enforcement of the federal securities laws for violations “that might otherwise go undetected due to the SEC’s limited resources.”²⁸⁵ This supplemental enforcement theory as applied to the standing issue makes much sense—if only from the standpoint of the sheer number of options trades that occur. Given the huge increase in options trading, the SEC cannot conceivably monitor, let alone efficiently prosecute, all the insider trades.

C. *Standing to Sue and Equitable Relief*

Finally, some courts have relaxed the purchaser/seller requirement and granted plaintiffs standing under section 10(b)’s rule 10b-5 when equitable relief

279. See, e.g., 15 U.S.C. 78c(a)(10) (1976) (as an example of the pre-1982 version of § 3(a)(10)).

280. As one court recently stated:

[T]he question of what constitutes the proper plaintiff class under section 10(b) and rule 10b-5 cannot be conclusively determined by resort to the text of those enactments; as one might expect, neither the statute nor the law speaks directly to the question of who may sue since the right to sue was created afterwards by the judiciary. *Cowin v. Bressler*, 741 F.2d 410, 424 (D.C. Cir. 1984) (citations omitted); see also Note, *supra* note 164, at 1962 (stating the same).

281. See, e.g., S. Rep. No. 792, 73d Cong., 2d Sess. 1-5 (1934).

282. *Herman & McClean v. Huddleston*, 459 U.S. 375, 382 (1983).

283. See *supra* note 126 (quoting § 3(a)(10) as amended).

284. See also H.R. Rep. No. 792, 73d Cong., 2d Sess., 11 (1934) (“Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value.”). This quotation suggests that section 10(b) was intended to prohibit insider trading as well as affirmative misrepresentations, and that Congress has always thought the misfeasance-nonfeasance distinction to be meaningless under section 10(b).

285. Note, *supra* note 164, at 1963 n.24 (citing *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 25 (1977); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432-33 (1964)).

rather than money damages was requested.²⁸⁶ *Blue Chip Stamps* would appear to allow derivative suits, but only if the corporation were a purchaser or seller.²⁸⁷ It would seem odd indeed to allow an options trader standing to bring a derivative suit. To obtain injunctive relief, the plaintiff must first prove the substantially likelihood that he will prevail on the merits. But if he has no cause of action in the first place, it would be erroneous to allow him standing to seek, equitable relief. Therefore, unless the options trader is at least in a position of a forced buyer or seller, he should not have standing to sue for equitable relief.

III. CONCLUSION

To determine whether options traders have standing to sue under section 10(b) and rule 10b-5, one must first ascertain whether options traders possess a judicially cognizable cause of action. With regard to actions based on insider trading, the dominant view under *Laventhal* clearly requires the existence of transactional nexus between the insider's and plaintiff's trading. This can only be accomplished when both trade contemporaneously in the same type of options contracts. Conversely, the minority view under *O'Connor* extends the abstain or disclose duty to the entire investing public, including options traders. The result for those jurisdictions adopting *O'Connor* will be a recognition of the economic realities that affect options trading and an allowance of more section 10(b) and rule 10b-5 actions based on options transactions.

With regard to affirmative misrepresentation actions under rule 10b-5, *Laventhal's* approach is misplaced. The recent trend recognizes this and is properly heading toward a jurisdictional expansion of the duty to speak truthfully to national market participants, including options traders.²⁸⁸ Correspondingly, a long-awaited wider acceptance of presumptive reliance based on an options trader's reasonable reliance on the integrity of the market price should quickly follow.

Just because a cause of action exists, standing does not automatically follow. The purchaser/seller requirement is essential to the standing determination with regard to actions based on options trading. Therefore, the courts need to be sensitive to the uniqueness of the options contracts. Courts must recognize the interdependency of the options markets and other national securities markets in order to tailor the standing requirements accordingly. In addition, courts must endeavor to understand the nontraditional ways that an option "purchase or sale" can occur so that plaintiffs who otherwise have suffered actual economic harm are not erroneously dismissed for lack of standing because of a misunder-

286. See, e.g., *Kahan v. Rosenstiel*, 424 F.2d 161 (3d Cir.), cert. denied, 398 U.S. 950 (1970); *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967). *Contra* *Cowin v. Bresler*, 741 F.2d 410, 419-25 (D.C. Cir. 1984) (rejecting any relaxation of the purchaser/seller requirement based on *Blue Chip Stamps*).

287. *Blue Chip Stamps*, 421 U.S. at 738 (citing *Schoenbaum v. Firstbrook*, 405 F.2d 215, 219 (2d Cir.), cert. denied, 395 U.S. 906 (1969)).

288. See generally *Deutschman v. Beneficial Corp.*, 841 F.2d 502 (3d Cir. 1988) (holding that options traders are owed certain disclosure duties and expressly rejecting the application of *Laventhal* and *Chiarella* in actions of affirmative misrepresentation).

standing of a transaction's economics. Furthermore, one court one day will have to come to grips with the significance of section 3(a)(10)'s amendment in 1982. By amending the definition of a security under the 1934 Act, Congress appears to have expressly granted standing under section 10(b) by virtue of the change. If so, the Judiciary cannot construct standing barriers except for the purpose of maintaining the integrity of Article III. By virtue of *Blue Chip Stamps*' sanctification of the purchaser/seller requirement, such integrity is effectively maintained.

To answer the question whether options traders have standing to sue under section 10(b): yes, if they are at the least *forced* purchasers or sellers, but only if they indeed have a cause of action.

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