TRANSCRIPT OF PROCEEDINGS

IN THE SUPREME COURT OF THE UNITED STATES

SUPERINTENDENT OF INSURANCE OF THE STATE OF NEW YORK, AS LIQUIDATOR OF MANHATTAN CASUALTY COMPANY,

Petitioner

vs.

BANKERS LIFE AND CASUALTY COMPANY, et al.

No. 70-60

Washington, D. C.
October 13, 1971

Pages 1 thru 65

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vs.	:	No. 70-60
BANKERS LIFE AND CASUALTY COMPANY, et al.	:	

Washington, D. C.,

Wednesday, October 13, 1971.

The above-entitled matter came on for argument at 11:37 o'clock, a.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM O. DOUGLAS, Associate Justice
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice

APPEARANCES:

ARNOLD BAUMAN, ESQ., 45 Rockefeller Plaza, New York, New York 10020, for the Petitioner.

WALTER P. NORTH, ESQ., Associate General Counsel, for the Securities and Exchange Commission as amicus curiae.

WILLIAM WARREN KARATZ, ESQ., 40 Wall Street, New York, New York 10005, for the Respondent Irving Trust Company.

IRVING PARKER, ESQ., 70 Pine Street, New York, New York 10005, for the Respondent Bankers Life and Casualty Company

C O N T E N T S

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in No. 60, Superintendent of Insurance of the State of New York against the Bankers Life and Casualty.

Mr. Bauman, you may proceed whenever you're ready.

ORAL ARGUMENT OF ARNOLD BAUMAN, ESQ.,

ON BEHALF OF THE PETITIONER

MR. BAUMAN: Mr. Chief Justice, and may it please the Court:

This case appears in this Court as a result of a grant of certiorari to review the affirmance of judgments by the Second Circuit Court of Appeals, which affirmed a motion of the District Court dismissing the complaint in this case, on the basis that the complaint did not presume an instance of federal jurisdiction under Rule 17 of the Securities Act of 1933 or Rule 10 -- I beg pardon, Section 10 and Rule 10b-5 of the Security Act of 1934.

As I am certain the Court is aware, I shall say merely very briefly that Section 17(a) of the '33 Act deals with the uses of interstate facilities of interstate commerce in connection with stock frauds involved in the purchase of securities.

Section 10(b), which is reproduced at page 3 of our brief, as well as Rule 10b-5, was later passed a year later, and I respectfully urge upon the Court that it was passed to

cover the loopholes, to make up for the loopholes which Congress left when it passed Section 17(a) of the 1933 Act.

Now, I should like merely to refer to one part of Section 10(b), because it is at the crux and the center of the argument that I intend to make.

Section 10, of course, states that:

It shall be unlawful for any one, ... by the use of means of interstate commerce, to use or employ any deceptive device -- and of course I am leaving out irrelevant words -- in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or -- or -- and I shall come to the reason for that emphasis -- for the protection of investors.

I think I can say now, before I discuss the facts with the Court that the reason I stress the "or" in Rule 10b-5 is because I respectfully submit that the court below, both courts below, Judge Herlands in the District Court, and the United States Court of Appeals for the Second Circuit, both tended to read the protection -- the words "in the public interest" as synonymous with the protection of investors. And I respectfully submit to this Court that when the rule was promulgated the Exchange had in mind -- I beg your pardon.

When that section was passed, Congress had in mind a different test for that which is alleged to have been in the public interest from that which is necessary for the protection

of investors.

Q Mr. Bauman.

MR. BAUMAN: Yes, sir?

Q Isn't there an issue in this case as to in connection with the purchase or sale of securities?

MR. BAUMAN: Your Honor, I was just, at this moment, coming to that. I was about to say that Rule 10b-5 presents or gives rise to the second or another one of the issues in this case in that it, in effect, paraphrases Section 17(a), but then adds -- as Mr. Justice Brennan has called to my attention -- in its very last words that it prohibits unlawful actions in connection with the purchase or sale of any security.

Now, the Court of Appeals -- and I should like to use part of my time to discuss the facts with the Court, because I think they're very important in this case. But, in order to put it in focus, I would like to submit that the Court of Appeals felt that where a securities transaction is pure in itself -- in other words, securities worth X dollars are sold for X dollars -- even though that is part of and an integral part, indeed an absolutely necessary part, of an over-all fraudulent scheme, the fact that neither the securities transaction was impure nor were the processes of the marketplace sullied, to use the words of the opinion below, that in such a case, as long as the securities transaction is pure, the

court below felt that it was not "in connection with" a securities transaction.

Now, with the Court's permission, I should like to address myself to the facts of this case, because, as I say, in my view they are that important.

I should say at the very first that I appear as a representative of the Superintendent of Insurance of the State of New York, who, as a result of the transactions which I am about to relate, was appointed liquidator of Manhattan Casualty Company, a New York insurance company, and of course the liquidator was appointed by the Supreme Court of the State of New York, and functions under an order of such appointment.

Until January 24, 1962, Bankers Life was the sole stockholder of Manhattan Casualty Corporation. On that day Bankers sold its Manhattan stock to a group consisting of a man named Bourne and another man named Begole, who had no money at all, as it will come out in a moment, for $5 million.

It had previously been arranged with the Irving Trust Company that at the closing of this Manhattan stock, Irving would appear with a check for $5 million. And at the closing, at the sale from Bankers Life to Bourne and Begole, a representative, an officer of Irving Trust did in fact appear with a check made out in the sum of $5 million payable to Bankers Life.

This was delivered at the closing.

I should point out that at this point in time, and indeed to the best of my knowledge, until after the close of business on January 24th, 1962, Manhattan Casualty had no account at Irving. Nonetheless, Irving did issue this check of 5 million to Bankers Life, obviously to pay for the stock which was being transferred.

Shortly after the closing of this stock, a new board was elected, and the board convened.

Q A new board of Manhattan?

MR. BAUMAN: Yes, sir.

-- and the board convened. It was represented -- and I believe the record best indicates that it was represented at that meeting by the chairman of the board, new board of Manhattan, the man Begole, to whom I previously made reference as a purchaser -- that Manhattan's portfolio of government securities, U. S. Government bonds and securities, totaling some $4,854,000, was an undesirable investment from the point of view of the corporation, and recommended to the board of directors that in order to better the corporate position these bonds should be sold and the money invested in a Certificate of Deposit.

The board of directors, believing that the sale of its portfolio of government securities totaling almost some $5 million was so going to be altered, voted a resolution, relying on the misrepresentations of the chairman, authorizing

the sale of the portfolio of Manhattan government bonds.

They were rapidly sold --

Q Is this -- how were they sold? Did they use some instrumentality of the Stock Exchange or of interstate commerce?

MR. BAUMAN: I'm not -- they were sold to Second District Securities, and I'm not certain whether or not, in that sale, an instrumentality of the Stock Exchange was used. I do not believe so.

Q Well, what is the basis for federal -- what is the utilization of the Stock Exchange, or of -- doesn't the section require that?

MR. BAUMAN: No, sir, it does not. Under Section 10 and Rule 10b-5, it is not required that securities sold be either listed or unlisted or --

Q I know, but it says "by use of any means or instrumentality of interstate commerce, or of the mails."

MR. BAUMAN: Well, I think the reason we are here has not to do alone with the sale of those securities, but the fact that payment, a check in the sum of $5 million, the payment to Bankers Life was in fact mailed to Chicago, the home office of Bankers Life.

Q That's the -- well, I know that is not an issue in the case, but I was just curious to know what really triggered the federal jurisdiction.

MR. BAUMAN: I just verified my own recollection. These securities were not sold. The $4,853,000 worth of Manhattan bonds were not sold on the Stock Exchange.

Q Well, isn't the sale of the securities, though, the sole basis on which the Second Circuit -- isn't that the sole basis that the government claimed that this transaction is within the reach of 10(b)?

MR. BAUMAN: Does Your Honor mean Mr. North, the SEC representative?

Q Well, I'll ask you: how about you? Is it your position that --

MR. BAUMAN: My position, Your Honor, is this: that there were two securities transactions, and in connection with either one of them this Court -- federal jurisdiction was properly invoked.

In the first instance, you had the sale of Manhattan's securities -- I beg pardon; the sale of the stock of Manhattan from Bankers Life to Bourne and Begole. That's securities transaction No. 1, and under Section 10 does not have to involve listed securities.

Q I know, but it has to, nevertheless, involve the use of some instrumentality of interstate commerce.

MR. BAUMAN: Well, in connection with jurisdiction, as I say, although it does not appear as an issue here, I will --

Q The $5 million Irving check was mailed to Chicago.

MR. BAUMAN: Exactly. In payment of those very securities.

Q Right.

MR. BAUMAN: Now, --

Q In payment of the Manhattan stock, was it?

MR. BAUMAN: Yes, sir. Yes, sir.

Q Incidentally, Mr. Bauman, how did Irving Trust happen to finance these two impecunious chaps with $5 million?

MR. BAUMAN: Well, there's a man in this case whose name is Garvin, and Mr. Garvin was a note broker and dealt -- a member of the firm of Garvin, Bantel, also a defendant; and apparently a large dealer in certificates of deposit, and basically a note broker and a stock broker.

In some manner, Bourne and Begole -- Bourne was a similar fellow from Boston; Bourne got together with Garvin. And we contend, the Superintendent of Insurance contends that Garvin arranged -- indeed, it is absolutely provable -- that Garvin arranged with Irving Trust to show up at the closing of the Manhattan stock with a check for $5 million. And Garvin --

Q And this makes Garvin the credit.

MR. BAUMAN: Sir -- and Garvin likewise arranged the

afternoon transactions which -- as I will come to in a moment -- were designed to cover up what had happened in the morning.

Now, I started to respond to Mr. Justice White's question; if I might, Mr. Chief Justice, I should like to come back to that.

I have indicated to the Court that the Superintendent of Insurance contends that there are two securities transactions here, and we rely, as a matter of fact, on both of them. We think that the Court of Appeals was wrong when it said that "we will not reach the question in connection with the sale of the Manhattan securities, as to whether or not this is in connection with, because as to those securities you, not being either a buyer nor a seller, don't have standing."

So, as to that transaction, they never did get to the question. Although I might point out that Judge Hays, who dissented in the Court of Appeals, dissented without talking about standing, but simply said these transactions were obviously at the corner of a fraud, and I dissent.

As to the sale of the government securities, the Court of Appeals fragmented the fact situation here, did not look at the actual fraud but said, as I indicated to the Court before, that since the stock transaction itself was pure, since value was received by the company, and true value, for these government bonds, all you have here is a misappropriation of proceeds of the sale; it's corporate mismanagement, it's

corporate waste, and we don't feel that that's appropriate under Rule 10b-5.

So, it is in connection with those two transactions that I press upon the Court the view that -- and I'll come to this a little later -- that Birnbaum, which is the principal case, on the question of the buyer-seller status, under Rule 10b-5, it being a Second Circuit case in which Augustus Hand wrote the opinion many years ago -- I shall urge upon the Court that in connection with Rule 10b-5 the limitation of the buyer-seller rule of Birnbaum is an artificial limitation, and while I would understand that an expansion of it might somewhat increase federal litigation, I respectfully suggest that, speaking only as a representative of creditors, that whether or not the Court wishes to extend 10b-5 beyond buyer and seller, I respectfully suggest that there should be a third category beyond buyer and seller, namely, that a representative of creditors.

Because, certainly, when one talks about making regulations "in the public interest" or "in the interest of investors", it seems to me that the Congress had to be talking about creditors and the representatives of creditors.

Indeed, in the brief we cite the cases, the most recent one of which is Bailes and going back to Hooper, which is the landmark case, of the Fifth Circuit, which has dealt with this problem over and over and over again; and I

respectfully suggest that a reading of those cases will show that it has consistently permitted a representative of creditors, a trustee in bankruptcy, a receiver, a person like the liquidator, who presumably does precisely the same thing as those gentlemen do, except that because it's an insurance company it's governed by State laws.

And so I would suggest that Birnbaum should be extended to include such a person in the interest of the creditors, which, I suggest, are in the interest --

Q Well, let me see, you are suggesting that the representative of creditors stands in the shoes of the seller, to bring it within a sale, or what?

MR. BAUMAN: I -- with regard --

Q The seller, on the transaction selling the federal bonds.

MR. BAUMAN: Yes.

Q They were sold by Manhattan.

MR. BAUMAN: That's precisely --

Q And you're suggesting that the representative of the creditors of Manhattan should be allowed to stand in the shoes, for the purpose of satisfying the requirement of the sale; is that it?

MR. BAUMAN: That's precisely what I'm suggesting. And I suggest that because when a person is designated in such a capacity, be he a superintendent, a liquidator, a receiver,

or whatever, he is there. His interests are varied and many. His interests are to see that the -- that all creditors, all people involved with the corporation, that the corporation discharges its obligations to any and all people to whom it owes obligations.

Q Who are the creditors of Manhattan at present?

MR. BAUMAN: The creditors of Manhattan at the present time, Your Honor, are mostly policyholders, people with claims against Manhattan, Manhattan Casualty.

Q Well, that's what creditors are, people with claims against you. Who are they, precisely?

MR. BAUMAN: They're the public. They're the insured public.

Q Is there any indication in any of these pleadings as to who they are, or that their claims have been unsatisfied, or that they are --

MR. BAUMAN: There is a reference in the reply brief to that. A short reference in the reply brief to the fact that there are claims outstanding and that, as damages, if we ever get to the trial, that we will prove those damages at the trial; and they will be, among other things, the claims of creditors, sir.

Now, I want to come back, if I may, to the events of that January 24th afternoon. Because we are now at the situation where, through fraudulently induced representation

of the board, the board has authorized the sale of Manhattan's government securities; they have now been sold; the proceeds have been put into the Irving Trust Company, which issued the first $5 million check; and, in addition, Manhattan sends over enough money -- I think it's $150,000 in cash -- to cover the difference between 4,854,500 --

Q That also came out of Manhattan's assets?

MR. BAUMAN: Yes, sir.

Q That 150 also?

MR. BAUMAN: Yes, sir.

And so, now Irving has been fully repaid for the $5 million check. It's whole.

However, at this point in time, may it please the Court, Manhattan was minus $5 million and is very near, if not actually insolvent, in a regulated industry, one in which the Superintendent of Insurance regularly visits and inspects.

So, in order to make this scheme good, one had to come up with a scheme to create a paper asset which would take the place on the Manhattan balance sheet of the $5 million of which the corporation had been looted.

Now, what happened there? Mr. Bourne -- I beg your pardon, Mr. Garvin then arranged an afternoon check swap. Most of these transactions I've told you about, until now, occurred in the morning.

In the afternoon, a representative of the Irving

Trust Company shows up at Belgian-American Bank and Belgian-American Trust -- that's really two entities, but one organization, and I shall refer to them as Belgian-American Bank -- and this representative has a second check for $5 million.

Whereupon, Belgian-American Trust Company issues a Certificate of Deposit in the name of Manhattan Casualty Company for $5 million. This is endorsed by the conspirators, and a so-called loan is arranged with Belgian-American Banking to one of Bourne's companies, called New England Note, for $5 million. The Belgian-American Trust CD, which was paid for with Irving Trust Company money, is used as collateral for the $5 million loan to New England Note.

The proceeds of the so-called New England Note loan are then immediately delivered to Irving Trust's representative, so he came with a check for $5 million and went back with a check for $5 million; and, once again, Irving Trust was whole.

Now, where were we at at that point? At this point, now, Manhattan is out $5 million, it carries the Belgian Trust Certificate of Deposit, even though it's hypothecated as cash on its balance sheet.

Q Doesn't reveal the hypothecation?

MR. BAUMAN: Does not reveal the hypothecation in any way. It carries that $5 million -- plain old fraud, because there isn't any $5 million.

Q Fraud on who?

MR. BAUMAN: Fraud on Manhattan Casualty, sir.

Q Who was defrauded? This is a case, it seems to me, where a fellow took over a corporation and looted it. He was the sole owner. And so who was defrauded?

MR. BAUMAN: The people who were defrauded are the public who have 7-figure claims against this corporation. The people who were defrauded -- if the corporation, sir, is an entity at all, if the corporation is an entity, I would respectfully suggest to you that because it showed $5 million in assets it didn't have on its balance sheet, it is perfectly conceivable to me that people relied on that balance sheet, people outside the company, and those are the people we're talking about as the public.

The people who wrote policies, the people who have claims against the company; and those are the people with whom I am concerned here.

So that, at the end of January 24th, Manhattan was out 5 million, Mr. Bourne and Begole had the stock for nothing; there was a fraudulent asset on the books. And, as time went on, of course --

Q Now, are you going to tell us what instrumentality of interstate commerce was used in connection now with this second transaction, the sale of the bonds and the $5 million checks and all the other stuff?

MR. BAUMAN: Well, the -- my answer to you, sir, is this: It is my contention that all of these transactions to which I have alluded were part of one over-all scheme.

Q And are these all hooked to that mailing of the initial $5 check of Irving's to Chicago?

MR. BAUMAN: Yes, sir; that's right.

Q Well, the Court of Appeals, though, said they were wholly separate transactions, not tied together. I know you don't agree with them.

MR. BAUMAN: I know the Court of Appeals may have said that, but it seems to me --

Q But let's assume they were right in that. Then where is the federal jurisdiction?

MR. CHIEF JUSTICE BURGER: I think we'll let you answer Justice White after lunch, Mr. Bauman.

MR. BAUMAN: Yes, sir.

[Whereupon, at 12:00 noon, the Court was recessed, to reconvene at 1:00 p.m., the same day.]

AFTERNOON SESSION

[1:00 p.m.]

MR. CHIEF JUSTICE BURGER: Mr. Bauman, you were about to answer Mr. Justice White.

ORAL ARGUMENT OF ARNOLD BAUMAN, ESQ. [Resumed]

MR. BAUMAN: Yes, sir.

MR. CHIEF JUSTICE BURGER: I am sure you are better prepared to answer him now.

MR. BAUMAN: That I am, and I appreciate the opportunity to prepare for that.

As a matter of fact, Mr. Justice White, and members of the Court, throughout the years of this litigation that question has never arisen, but the answer is perfectly obvious, and I shall give it.

In connection with the sale of all the securities, there were innumerable confirmations sent through the mails; in connection with the sale of the $4,854,000 of U. S. Government securities, there were confirmations sent through the mails; in connection with the sale of those securities, there were telephone calls made, using instrumentalities that give jurisdiction pursuant to the Securities law.

Q I was just wondering what it was.

MR. BAUMAN: Well, that's it, sir, and I'm sorry I wasn't better equipped to answer your question before the luncheon recess.

Q It was one of those so obvious that you didn't see it right away.

MR. BAUMAN: Absolutely right, sir.

I want to use my remaining time, also perhaps to clear up an earlier answer I made to Mr. Justice Brennan.

I want to make clear to the Court, if I may, that so far as the U. S. Government securities are concerned, the $4,854,000, we feel that we have met every single element of 10b-5, and we think that the elements of 10b-5 are as follows:

One, that the board of directors was deceived.

Two, that $4,800,000 worth of Manhattan's securities were sold as a direct result of that deception.

Three, the corporation gave up $5 million in securities and got nothing.

Now, both Judge Herlands in the District Court and, I believe, the United States Circuit Court for the Second Circuit held that as to that transaction, and that series of transactions, there was no question of my standing to sue, or the liquidator standing to sue; because Manhattan was, in fact, the seller of securities. It was in connection with the transaction involving the sale of the Manhattan shares between Bankers Life and the buyers that they invoked the Birnbaum doctrine.

And again I want to say that the fragmentation of this one over-all scheme, which had as its sole purpose the

looting of the company of $5 million; without the sale of securities it could not possibly have happened, is where I part company from the Second Circuit.

Q The board of directors was deceived by the sole stockholder?

MR. BAUMAN: Yes.

Q And the directors were therefore his representatives, just managing the company that he fully and wholly owned; is that right?

MR. BAUMAN: Well, he was the sole stockholder; he elected them. Yes. But when the court says --

Q I mean, directors generally represent the stockholders of a corporation.

MR. BAUMAN: Well, Mr. Justice Stewart, it seems to me that,while he may be elected by the stockholders, he has certain public responsibilities as well as, indeed if he has many, to the person who elected him. It seems to me that there are penal statutes -- I beg pardon; I withdraw the word "penal". There are statutes which impose responsibility, financial responsibility for acts of directors, beyond his obligations to the person or persons who elected him.

I do say that -- and the point I do want to stress again, is that if the corporate entity has any meaning at all, it has got to be separate and apart from both its stockholders and directors. And where, as here, a liquidator or receiver

stands in the shoes of the corporation, as opposed to the individual who may own the corporation, he has, or should have, the right to assert public claims involved in the responsibilities of the corporation to the public.

Q So your position would be the same if all the directors were co-conspirators with the sole stockholder?

MR. BAUMAN: Yes, Mr. Justice White, it would be; yes.

Q So that even if they didn't -- he didn't deceive them at all, he deceived the corporation?

MR. BAUMAN: That's correct. That's correct.

Q Whom did he deceive; assuming Mr. Justice White's hypothesis that the directors and the sole stockholder all had full knowledge of this looting, then who would have been deceived?

MR. BAUMAN: The public, who would have relied on the statement of Manhattan's assets.

Q Its balance sheet?

MR. BAUMAN: Yes, sir. But I do hasten to assure the Court, if I may, that that is not the situation in this case.

The board was not fully in on this. As a matter of fact, the board was deceived, and I hope the Court will forgive me for emphasizing that; I merely attempted to reply to Mr. Justice White's question, which is argued in our brief.

There is one other point I want to mention quickly, because I notice I have a very short time to go, and that is there is a citing relied upon by my adversaries, the case of Field against Lew, which is a District Court case, in the Eastern District of New York, written by Judge Zavatt.

That was a case involving a common-law conversion, it was a case in which, because there was a common-law conversion and a sole stockholder was the one who caused it, Judge Zavatt felt that he had ratified the fraud and therefore there was no cause of action.

I merely want to specify that that case, which is relied upon by my adversaries, differs so strongly from this fact situation, because, for one thing, that case dealt with the State common law of conversion, it did not attempt to interpret 10b-5, and there were no allegations of deceit on the board of directors of that corporation.

The factual situation is entirely different, it is not based on the statute that we are here to discuss, and, indeed, I respectfully refer the Court to the opinion in Bailes in the Fifth Circuit, which is cited in the brief, and which comes out exactly on the opposite side of this question of "does knowledge by all the stockholders constitute ratification".

Thank you very much.

Q I take it there is a deceit action pending, is

there not?

MR. BAUMAN: Yes, sir.

May I be permitted one sentence in addition to that?

Q I would like to have it, yes.

MR. BAUMAN: The mere fact, and this is dealt with in the brief, Mr. Justice Blackmun, is that -- is if in fact there is a State remedy, that, as we cited and discussed in the brief, does not oust us of federal jurisdiction if in fact we do fall within Section 10(b) and Rule 10b-5.

In other words, Your Honor will find in the cases, particularly in the Fifth Circuit, the repeated statement -- and in other Circuits -- the fact that there may exist a State remedy in no ways affects the federal remedy.

MR. CHIEF JUSTICE BURGER: Thank you, Mr. Bauman.

Mr. North.

ORAL ARGUMENT OF WALTER P. NORTH, ESQ.,

ON BEHALF OF THE S.E.C., AS AMICUS CURIAE

MR. NORTH: Mr. Chief Justice, and may it please the Court:

The Commission is grateful for the opportunity to participate in this argument before you today. You have, on many occasions, permitted us to file amicus briefs, but participation in the argument means even more to us and I will try to make good use of the time you've awarded us.

I'd like to start in substantially where counsel for

the petitioner left off, on this question of fragmentation, which is, to my way of thinking, the thing that caused the court below to go wrong and is the point at which the arguments now made by the opposition in support of that result is also erroneous.

On pages 2 and 3 of our brief we quote both Section 17 from the '33 Act, which is the antifraud provision there, and Section 10(b) and Rule 10b-5 from the '34 Act, and I direct the Court's attention to this difference between the two, which I say the court below overlooked entirely.

Section 17(a) says: It shall be unlawful for any person in the offer or sale of any securities by use of interstate facilities and so forth to employ fraud.

In other words, the fraud must be in the offer or sale of any securities.

Whereas, in the '34 Act, the requirement is not that the fraud be right inside of the sale or purchase itself, but that it be in connection with the purchase or sale.

Now, you're not ascribing anything, any meaning at all to those words in that difference between these two statutes if you rule,as the court below did, that this is not a case stated under 10(b) and 10b-5 in this case.

Then I would direct your attention to the bottom of page 3 and the top of page 4, to the fact that Rule 10b-5 has three subparagraphs. I submit that the court below refused to

take any cognizance of subparagraphs (1) and (3) of that rule. They fragmented this thing down to the point where they refused to look at it as an over-all scheme, device, or artifice to defraud, which is the words used in subparagraph (1); or to look upon it, as subparagraph (3) says, as engaging in an act, practice, or course of business which operates as a fraud or deceit upon any person.

They analyzed this case solely in terms of the second paragraph, the second subparagraph of Rule 10b-5, and even there took an unduly limited and restricted view of it, because it says that it shall be unlawful to make any untrue statement of a material fact or to omit to state a material fact in connection with the purchase or sale of securities.

As counsel has already said, there's abundant evidence that they did misrepresent to the directors, and they did fail to disclose to the directors their true intention as to what they were going to do with the proceeds of this sale of bonds.

Remember, they had earlier in the day gone to the bank and got a $5 million check written, with nothing behind it. They obviously had to be intending to convert the proceeds of the sale of the bonds in order to cover the check; and that's exactly what they did. And they deceived the directors in that respect.

So I say that the court, by refusing to look at the

thing in that sort of a way, and by refusing to connect that one sale of government bonds, -- which, by the way, is the particular transaction that the government relies on in this case -- they refused to look upon that as part of an over-all scheme. And the other parts of which were also essential to the scheme, and all of which should be considered as a package not as individual fragmented facts.

Q But you do separate the bonds from the stock, I take it?

MR. NORTH: We separate the bonds from the stock only to the extent that we say that the government relies on the bond sale as the basis for which we say the Court of Appeals below should be reversed.

Q But not that you couldn't go further?

MR. NORTH: Certainly not.

Q You don't need to go any further than this, is that it?

MR. NORTH: That as long as we show that some one part of the scheme involved the purchase or sale, or was in connection with the purchase or sale of --

Q Well, you aren't saying that in your view the stock transaction was a separate transaction?

MR. NORTH: We say the stock transaction was a part of the over-all scheme, the same as the bond sale, and the same as these subsequent things they did, the transactions they

carried out in the afternoon of that day, while they went through this business of chasing themselves out around a circle and coming back, where they ended exactly where they started from; that was all a part of the scheme to defraud.

The reason that we didn't dwell upon the sale of Manhattan's own stock, from Bankers Life to the defrauders, as a part of our case is because that runs directly contrary to Birnbaum, which says that the defrauded party must be either a purchaser or a seller. Well, of course, Manhattan itself didn't sell anything or buy anything.

Q Is the Commission asking that Birnbaum be reconsidered?

MR. NORTH: We have suggested that on a number of occasions. We have suggested it in the Second Circuit itself.

Q Are you suggesting it here?

MR. NORTH: And we suggested it in this case, largely just by way of a footnote that says that we have never agreed to that theory.

But we realize that in order to win this case on that ground you'd have to overturn Birnbaum, whereas you don't necessarily have to overturn it in the other context.

Incidentally, I think it's quite significant in that regard that Judge Hays, who dissented, as one member of the three-judge panel that decided this very case we're arguing today, he just flatly would overrule Birnbaum.

Let me read you just two sentences of his, but his opinion is only a page and a half long, and it's reprinted in the Appendix on pages 109 to 110; just two sentences.

He says: "Manhattan was the victim of a 'scheme to defraud'" -- which is the language of the Rule. "Since the vital center of the scheme, the vehicle for the perpetration of the fraud, was the sale of Manhattan's stock, it seems to me to be completely unrealistic to say that the fraud was not committed 'in connection with the purchase or sale of any security'."

Well, now, Judge Hays knows, just as well as any of us here in the room do, that the sale of Manhattan stock did not involve Manhattan as either the purchaser or the seller; so he is saying in so many words that when you've got an over-all scheme to defraud, you don't fragment it, you look at the over-all scheme, and if any part of it was in connection with the purchase or sale of securities, that's the answer. The answer doesn't lie in the question of whether the plaintiff himself happened to be a purchaser or a seller.

And it seems to me that anything short of that simply overlooks the difference in the wording between Section 17 of the '33 Act and Section 10(b) and Rule 10b-5 of the '34 Act, because the one says it must be in connection with the sale, whereas the other simply says -- one says it must be in the sale or in the purchase, whereas the other simply says it has

to be in connection with a purchase or sale by any person.

I'd like to deal for just a moment with this question of whether we're pursuing a purely self-inflicted fraud that really didn't hurt anybody, because Mr. Begole, or Mr. Begole and Bourne themselves were the sole owners of this corporation.

That kind of a position, of course, overlooks that community of interest which a corporation represents, over and beyond the interest of the stockholders or stockholder alone. If you had, for example, a corporation that had outstanding bonds or debentures or other form of debt securities, you certainly wouldn't say that they weren't -- that that interest wasn't to be protected, and likewise the interest of other creditors and policyholders, is all a part of the overall corporate community that the statute is designed to protect, not just to protect alone the shareholder who, in this case, was the sole shareholder and who is the one who perpetrated the fraud.

Q Well, do creditors normally have a right to bring a suit on behalf of the corporation?

MR. NORTH: You mean under 10b-5?

Q No. It could be under State law or under normal corporate law.

MR. NORTH: The representative of the creditors certainly would have that right, and here the plaintiff in this

case is the Superintendent of Insurance.

Q Could bring a derivative action on behalf of the corporation?

MR. NORTH: How's that?

Q Do creditors normally have the right to bring derivative actions on behalf of the corporation?

MR. NORTH: No, I don't know as I'd say that. But I don't think that's the key thing here. The key thing here is that the action is being brought by the Superintendent of Insurance derivatively on behalf of the corporation, which in turn had some creditors. So that the creditors are a part of the community of interest which is being protected by this suit under 10b-5.

Q Have those creditors' claims been unsatisfied?

MR. NORTH: I don't know to what extent there are still outstanding unsatisfied claims, I think I would have to refer that question, maybe, to private counsel; but I do know that --

Q But wouldn't that be an important factor, if the creditors have been paid in full, wouldn't that be a relevant fact?

MR. NORTH: In the process, to whatever extent the creditors have been paid, I would assume that in the process someone else has been subrogated to their rights. The Superintendent of Insurance is not bringing this action on

behalf of Mr. Begole, that's certain.

And there is abundant authority for the proposition that creditors are entitled to protection. Your own case here of Pepper versus Litton, which is cited in our brief, while it predates the Federal Securities laws, makes it perfectly clear that a so-called self-inflicted fraud by somebody who controls the corporation still can't be relied upon as a means of defeating the action which is brought on behalf of creditors, or anyone who has dealt with or contracted with the corporation.

Q So you look at this as something like a transfer by a corporation in fraud or prejudice?

MR.NORTH: Yes, something to that effect.

Q That might amount to an act of bankruptcy, for example.

MR. NORTH: That's it. That could be.

Now,the leading case, I think, in this area that actually does come under the Federal Securities laws, whereas Pepper versus Litton was just before the '34 Act, the leading case that does come under the Federal Securities laws is the Hooper versus Mountain States case. And in there it was plainly held that even though the corporation itself was controlled by the person who committed the fraud that that didn't mean there couldn't be recovery to the benefit of creditors or anybody else who had dealt with the corporation

in reliance on the fraudulent transaction.

And the Bailes case, which was referred to here earlier, is to the same effect, and it's so recent that it doesn't even appear in our brief; it was decided since our brief was written.

I think it's important in this connection to note that Congress, at the very time it was drafting this statute, had in mind, in relation to insurance companies, the fact that creditors and policyholders could be involved.

The House Report -- I am paraphrasing or quoting now approximately from a footnote on page 27 of our brief. The House Report on the bill which became the 1934 Act noted that"over 15 million individuals hold insurance policies, the value of which is dependent upon the security holdings of insurance companies."

That's quoted exactly from the House Report.

The Senate Report went on to observe that the current value of securities held by insurance companies, and consequently the welfare of the countless individuals who have a financial interest in such institutions is directly affected by the activities -- and he's talking now about the activities in the trading and sale of securities.

So, while it can be said that Congress was not perhaps directly concerned with creditors and policyholders, as such, to the extent that part of the community of interest

that makes up an insurance company is the creditors and policyholders, that is a part of what Congress was directing itself to when it enacted the antifraud provisions of the 1934 Act.

Q Would you take the same approach if the sale of the bonds went through and there had been no previous intention to steal the money, and then one of the officers did just walk off with the cash?

MR. NORTH: Well, that would be a little harder case, but --

Q Well, it's the proceeds --

MR. NORTH: I realize that.

Q -- and he suddenly gets the idea, walking back from the bank, that it might be well to go to South America; and he goes. The corporation never gets the proceeds.

MR. NORTH: I wouldn't be prepared to concede that there would not be a 10b-5 action even under those circumstances; but this case is much stronger than that, because there was a preconceived plan or scheme to do this very thing, and the sale of the securities was a part of that scheme.

Q Doesn't the Court of Appeals seem to think that perhaps the Securities laws weren't intended just to cover ordinary fraud by a director or an officer, and it would be difficult to contain the reach of the 10(b) if this case were covered?

MR. NORTH: That is a part of the type of reasoning

that the court below used in this case. But as long as you maintain the integrity of the requirement that the fraud be in connection with the purchase or sale of securities, there is certainly no danger that the Federal Securities laws are going to take over the whole field of corporate management, mismanagement, and looting, and everything else where securities transactions are not involved; the securities transaction must still be a part of the fraudulent scheme in order for the Federal Securities law to apply.

Q That would be true, you say, even if you eliminated the purchaser-seller requirement? As long as there was a sale somewhere.

MR. NORTH: Mr. Justice White, I assume you are talking now about the requirement that the plaintiff himself be a purchaser or a seller.

I think the requirement that the purchaser or seller himself -- or the --

Q The plaintiff.

MR. NORTH: -- the plaintiff himself be a purchaser or seller can be done away with and still not make this Federal Securities law's antifraud provision an undue incursion upon the State law of fraud. As long as it is in connection with the puurchase or sale.

That's why I would say that even this initial sale of all Manhattan stock to Begole should come within the purview

of this, and would in some other circuits, though obviously it can't in the Second Circuit unless and until the Birnbaum case is overruled.

MR. CHIEF JUSTICE BURGER: I think your time is up, Mr. North.

MR. NORTH: I believe it is, Your Honor, and I'm sorry if I ran over.

I thank you very much.

MR. CHIEF JUSTICE BURGER: Thank you.

Mr. Karatz.

ORAL ARGUMENT OF WILLIAM WARREN KARATZ, ESQ.,
ON BEHALF OF RESPONDENT IRVING TRUST COMPANY

MR. KARATZ: Mr. Chief Justice, and may it please the Court:

Plaintiff's basic contention here is that a claim under the Federal Securities law is stated because Manhattan's sole shareholder misappropriated Manhattan's funds insofar as the proceeds from the sale of Manhattan's bonds were concerned.

There are at least two reasons why plaintiff is wrong in asserting that Manhattan has any claim under Federal law in connection with this transaction.

First, there was no deception of or damage to Manhattan, because Manhattan's sole shareholder knew of, participated in, benefitted from, and fully ratified the allegedly fraudulent transaction.

Since Manhattan, by way of its sole shareholder, could not have been deceived, suffered no damage, there was no Federal fraud in connection with the sale of any securities, either the Manhattan bonds or anything else.

Now, Mr. Bauman and Mr. North have suggested that there is something to a corporation other than its shareholders. I would suggest that it is standard corporate law that when shareholders fully ratify the action taken by a corporation, that becomes corporate action.

Now, it may be that such action would constitute a fraud on creditors. There is long-established common law in this area. If corporate insiders, by their actions with regard to the corporation, in some way damage creditors, creditors have remedies at common law and by statute in all the States. They have remedies by way of an action for fraudulent conveyance. They have remedies by way of an action for illegal dividend.

There was no need for Congress to provide creditor remedies. Those remedies already were available to creditors. And I suggest that if you have sole stockholder approval of an action, certainly under Federal law and Federal Securities law, there can be no fraud on the corporation.

Q Why is it so important to you, though, to be in the State court rather than the Federal court?

MR. KARATZ: Your Honor, if I may be very frank about

the reason why we are here today -- and, quite frankly, I'm glad I'm here today because I think this is an important issue of law -- because Chief Judge Ryan invited the defendants to make a motion to dismiss.

If I may tell you quite frankly what the tactics of defense counsel was in this case, we were going to take it through the trial in the Federal courts and then get the case dismissed. Because we did not think that there was a Federal claim here.

We went all the way through years of pretrial discovery, thousands of pages of testimony, hundreds of documents. Chief Judge Ryan, when Mr. Parker made a motion for summary judgment, refused to decide the motion for summary judgment on its merits, stating that in his view the complaint did not spell out a claim, and suggested to counsel that a motion to dismiss be made; because he felt that this was not a Federal action and that the Federal courts in the Southern District of New York should not have to go through the trial that would take weeks if not months.

We made that motion to dismiss pursuant to the suggestion of Judge Ryan, and we were sustained in our belief all the way up to this Court that there is no Federal claim here.

Now, in response to Judge Blackmun's question as to why we preferred to be in the State courts, we don't necessarily

prefer to be in the State Courts, Your Honor, we just feel that that's the place where we should be, because of the state of the law.

And I might say that, as a member of the bar of New York, I do not believe that the calendar of the Southern District should be clogged with 10b-5 cases, as it is today, which do not rightfully belong there.

The second reason why plaintiff is wrong in asserting that there's been an injury to Manhattan in connection with the purchase or sale of securities is that this case does not involve any impurity in any securities transaction.

As the courts below concluded, there can be no fraud in connection with a securities transaction when none of the following three facts are involved:

First, this case does not involve the purchase or sale of any securities for more or less than its fair market value.

Second, this case does not involve any actual or potential manipulation or abuse of the trading process.

Third, this case does not involve any injury to any Manhattan shareholder or to any other member of the investing public.

What this case does involve, Your Honors, is a claim that defendant Begole, the sole shareholder of Manhattan, misappropriated Manhattan funds for his own benefit, and that

this misappropriation was not reported to the Superintendent of Insurance of the State of New York.

Q Mr. Karatz, you represent Irving Trust?

MR. KARATZ: Yes, sir.

Q What did Irving Trust get out of the deal? Some kind of a fee for these $5 million checks?

MR. KARATZ: No. Quite frankly, Your Honor, Irving received no fee for the five -- let me break up the checks. The first $5 million check, the one payable to Bankers Life and Casualty Company, which constituted the payment by Mr. Begole for the stock, was delivered by the Irving officer to the Bankers Life representative at the closing as a convenience to Mr. Garvin, who was one of the leading members of the New York brokerage community. Mr. Garvin's house was well recognized as a leader in the area of government bond securities, and certificates of deposit.

I might say that the way business is done on Wall Street is by requests being made by people who are respected, and those requests being honored. Millions of dollars of business are done every day by all of the leading banks in New York City on word of mouth, without any paper being transferred.

Mr. Garvin came to Mr. Gunter, who was an assistant secretary of Irving Trust Company, who had known Mr. Garvin for years, who had known his brokerage house for years, and

requested that $5 million be given in return for funds which would be returned to Irving the same day. This was a convenience to Mr. Garvin. It was something which is not unusual in the Wall Street community.

Q And the second check?

MR. KARATZ: The second check, Your Honor, let me say how that came about.

After the first transaction, namely the closing at Manhattan, had taken place, Mr. Gunter got back to the bank, he received a telephone call from Mr. Garvin, and he said that there was a second half to the transaction. Mr. Gunter replied to Mr. Garvin, -- and this is all in testimony in pre-trial discovery -- "I wasn't aware of any second half of the transaction." And Mr. Garvin just said, "Well, this is just a simple check swap which is going to take place at Belgian-American Bank. You will give $5 million and you will get back $5 million."

And Mr. Gunter, under those circumstances, did not feel that there was any reason why he shouldn't go along with the request of this respected member of the brokerage community and did so.

Q By this time, I gather, the bank had been paid the proceeds of the sale?

MR. KARATZ: No, sir. There was an attempt to indicate to the court that there was a nice cleancut arrangement,

whereby you had a morning transaction and an afternoon transaction. The facts in this case are not that simple. And I would refer Your Honors, for a detailed statement of them, to the Appendix in my brief, where we do try to take you step by step through these complex transactions.

In response to your question, Mr. Justice Brennan, when Mr. Gunter went to Belgian-American in the afternoon, the government bonds of Manhattan had not yet been sold. Certainly the amount for which they were sold had not yet been indicated.

The way that this operated was that the government bond transaction, the sale of government bonds, was a private transaction between Manhattan Casualty and Second District Securities, a large bond house in New York.

The bonds were gradually delivered to Second District and notices came from Second District during the course of the day and on into the evening as to the amount which was being paid for the bonds. For the amount being paid for the bonds depended on the going rate for those bonds at the particular time of delivery.

So, during the entire course of the day, afternoon, and into the evening -- and I might say that Mr. Gunter's responsibility was in the security clearance division of the bank. The securities clearance division has to do with receipt of securities and payment for securities. And literally

hundreds of millions of dollars of transactions are dealt with every day by Irving Trust Company alone, in this particular division of the bank.

So when Mr. Gunter went home that evening, which was, as I recall the testimony in pretrial, 8 or 9 o'clock, he still wasn't sure exactly how much had been received for the securities during the course of the day. I might also say that, as has been pointed out to Your Honors, the bonds ultimately produced only $4,800,000-odd.

$150,000 check of Manhattan, drawn on another bank, was delivered to Irving sometime during the late afternoon of January 24th. That check was payable to the order of Manhattan Casualty Company, and that check constituted a credit to Manhattan's account at Irving, and in fact that's exactly what form it took. The Manhattan check, drawn on another bank, payable to itself for $150,000, was credited to Manhattan's account at Irving.

Q We're told that there were false entries made by Irving Trust. Is that right?

MR. KARATZ: I deny that, sir. They were not false entries.

The entries which were made at Irving were corrected when Mr. Gunter came to understand what he thought the true situation was. If I may, sir, go into Mr. Gunter's examination before trial:

Mr. Gunter originally was led to believe by Mr. Garvin that the morning check for $5 million would be covered by a receipt by Irving Trust later on in the day of securities which would be sold, and the proceeds applied to cover the $5 million check.

Q Sold by Irving?

MR. KARATZ: No. Sold by Manhattan to Second District. They would just be delivered to Irving for purposes of re-delivery to the purchaser of the bonds.

Mr. Gunter was also informed, as I mentioned in reply to an earlier question, that the second transaction, the second $5 million transaction, was just a check swap.

It turned out, however, that when the documentation for what had gone on during the course of the day started to come into the bank, and it started to come in on January 24th, Mr. Gunter gathered that he had misunderstood what the true situation was and made the entries which complied with the written instructions which he was receiving from various people.

Now, what were the written instructions?

Mr. Gunter received sometime during the course of the day, on January 24, a letter from Manhattan Casualty Company, signed by Mr. Sweeny as president of Manhattan, instructing Irving to transfer $5 million from Manhattan's account at Irving to Belgian-American.

Now, this was duly signed by a representative of Manhattan Casualty, whose name appeared on Irving's books as an authorized signatory for the Manhattan account, which was also opened on January 24th.

Q Do I understand that Manhattan had maintained an account with Irving?

MR. KARATZ: No. Manhattan opened an account on that very day.

Q When the $150,000, plus or minus, check came in?

MR. KARATZ: That certainly was one of the first items in it, sir.

Q So this is all a brand-new account on Irving's books?

MR. KARATZ: Well, let me say this, Mr. Justice Brennan, -- I'm sorry; Blackmun. It is a new account as of January 24th, but Manhattan Casualty had been a customer of Irving's in years past. They were not a customer as of January 24th, but it was not really a new customer, it was just a renewal of an old relationship.

To go back to Mr. Justice Douglas's question: when Mr. Gunter, at the end of the business day or early the next day -- because, as I say, he didn't leave the bank because of the rush of business until late in the evening -- saw this letter from Mr. Sweeny, he recognized the afternoon transaction as having been a transfer of Manhattan's funds to Belgian-

American, a transfer which should be debted to the Manhattan account at Irving. And that's exactly what he did. So --

Q How much was there in the account at that time?

MR. KARATZ: As of that time, Your Honor -- well, I'm sorry, Mr. Justice Marshall, as of which time?

Q The time when he had credited, I think in the evening was when he --

MR. KARATZ: Well, let me say, at the time that he credited the -- well, I'm sorry, when he debited or credited, sir? I mean, which item are we talking about?

Q Well, why not do it on both?

MR. KARATZ: Okay. Let me tell you the history of the situation, so far as Irving is concerned.

Q Well, when they issued the $5 million check, how much did Manhattan have in Irving?

MR. KARATZ: When Irving issued --

Q Zero.

MR. KARATZ: -- the $5 million afternoon check, Mr. Gunter of course did not know that he was supposed to be doing this pursuant to the instructions of Manhattan. At that time he was acting pursuant to these oral instructions of Mr. Garvin, saying that this was the second half of the transaction.

By the time he saw the letter from Mr. Sweeny, instructing the $5 million transaction to take place in the afternoon of January 24th, Manhattan had credited to its

account the $4,800,000 proceeds from the sale of the securities, plus the $150,000 check.

Q I thought you said it was late at night and they hadn't sold them all yet?

MR. KARATZ: No, but the bookkeeping entries were actually made on January 25th as of January 24th, by the time they caught up with those --

Q From what I understand about bookkeeping entries is, I assume that it means that money is passed, or am I mistaken?

MR. KARATZ: Well, no, sir. Actually, at the time the bookkeeping entries were made, the money in fact was there.

Q In the afternoon?

MR. KARATZ: No, I'm talking about the entries, sir, to the Manhattan account.

Q Yes. When were they made, in the afternoon, weren't they?

MR. KARATZ: No, the entries to the Manhattan account were made on January 25th as of January 24th, at which time they were able to catch up with all of the business which had accumulated during the day.

And, Your Honors, once again I have to emphasize that we are dealing here with the department of a bank which has literally hundreds of millions of dollars of transactions every day; this is not an isolated situation.

Q Which they do just by telephone?

MR. KARATZ: Pardon?

Q Which they do just by telephone?

MR. KARATZ: Many of them, sir, are done just by telephone. Many are done on the faith and good word of the people in the financial community. If you cannot rely on that on Wall Street, then you would have to close up a good many of the financial institutions that you have today.

And let me say, sir, that the first entry in the Manhattan account was the crediting of the $150,000 check, which was received late in the afternoon of January 24.

Have I answered your question, sir?

Q I've heard what you said!

[Laughter.]

MR. KARATZ: As I have stated previously, Your Honors, the unique facts in this case may indeed form the basis for State action, based on such theories as embezzlement, fraudulent conveyance, conversion, corporate waste, or violation of the New York State insurance law.

However, these unique facts do not -- and I emphasize it, Your Honors, do not -- involve any wrongdoing prohibited by Federal Securities laws.

The Congressional purpose underlying the enactment of the Securities Act was to promote free and open public securities markets, and to protect the investing public from

suffering inequities in trading.

These Acts were not intended to constitute a general Federal corporation law. In fact, Congress has often rejected the idea of a general Federal corporate code.

More specifically, --

Q Mr. Karatz, I come back to my question: What real difference does it make to Irving Trust Company whether this litigation is resolved on the State side or the Federal side? What is it that you fear in being brought under the Federal umbrella at this point?

MR. KARATZ: May I be very frank with Your Honor?

Q I would like to have you answer it, because I think before the only answer you gave me was that you were reluctant in clogging the federal court calendar.

MR. KARATZ: Here once again, sir, I will go into our strategy, which, possibly, is something I should not do.

Quite frankly, I do not believe that my opponent is happy in the New York State courts. He has much more experience in the Federal courts, he's more familiar with finding his way around the Federal courts; rightly or wrongly, that's the conclusion we have reached, that he would be unhappier in the State courts. It's not a question of where we would be happiest.

To return to the question of the Congressional intent: Congress did not intend, by the enactment of the Securities laws, to create Federal law which would govern every

corporate management transaction.

Absent compelling reasons, it would seem inappropriate to inject the antifraud doctrine of Rule 10b-5 into a case where the unique question is the fiduciary duty owed by a sole shareholder to his corporation and its creditors.

Once again, I emphasize, Your Honors, that State common and statutory law have long provided adequate remedies for whatever creditors there may be in this picture. And with regard to the creditors, Your Honors, let me say this:

At the time of the liquidation, all of the policyholders of Manhattan were reinsured, so those policyholders are no longer in the picture.

Insofar as any other creditors are concerned, we have strained, through years of pretrial discovery, to find out if in fact any creditors exist. We have yet to be given any concrete information as to whether there is in fact any creditors.

But once again I emphasize to Your Honors that even if there are creditors, the creditors are perfectly capable of having their remedy by way of the long-established State remedies. Mr. Bauman is bringing an action in the State courts. There is the place, under State law, to look into the situation, to see whether there are creditors and, if there are creditors, to provide the proper remedy.

There is no reason why the Federal courts, by way of

an implied cause of action under Section 10(b), should preempt this entire well-developed area of State law of creditor's rights, when it is clear, from the reading of the Securities Acts as a whole, that Congress did not so intend.

It should be left to Congress to decide whether the enforcement of a substantial part of what is now corporate law should be assumed by the Federal courts.

And I might say in this respect, Your Honors, that Congress has not been delinquent. Congress is constantly analyzing the Securities Acts to decide whether there should be amendments thereto. There are hearings going on across the street at the present time with regards to possible amendments to the Securities Acts. There are also hearings going on with regard to the proper division of jurisdiction between the Federal and the State courts.

I suggest that this is something that should be left to Congress to analyze, and,by way of carefully held hearings, determine to what extent Congress wants to take over general corporate law.

The petitioner and the Commission, in urging this Court to reverse the decision of the courts below, are, in effect, asking for an extension of Rule 10b-5 far beyond any other case. They are, in effect, asking this Court to hold that an alleged act of corporate mismanagement, which does not involve a manipulation or deception intrinsic to the securities

transaction, to be a Federal wrong.

Such an extension of the coverage of the Securities Act is not necessary in order to carry out the Congressional intent.

I know that Your Honors have held in prior cases that the Securities Act should be broadly construed, so as to carry out the Congressional intent. I happen to wholeheartedly agree with that. I also wholeheartedly agree that there should be a private cause of action under Section 10(b); but I do not believe that Section 10(b) should be construed in such a way as to bring within the scope of federal jurisdiction matters which Congress never intended the Federal courts to exercise jurisdiction over.

Judge Herlands, in dismissing the complaint herein, not only examined the complaint but he examined the entire pretrial record, which was years in the making. After taking the motion to dismiss under advisement for over nine months, he came out with his, what I believe to be, well-considered opinion, and his well-reasoned opinion, in which he concluded that under the unique facts in this action you did not have a federal claim.

The Court of Appeals for the Second Circuit affirmed Judge Herlands.

And I might say also that, possibly because Judge Herlands came through with a lengthy opinion, we forget Judge

Ryan. Not only was a motion to dismiss made before Judge Herlands, but a similar motion was made before Judge Ryan, who also considered the matter in excess of nine months and then came out with an opinion agreeing with Judge Herlands.

The Court of Appeals affirmed the opinions of both Judge Herlands and Judge Ryan, and I think it's a matter of general knowledge that it is the Second Circuit which, after all, has had to give consideration to most of the Securities Acts cases. And I think it's fair to say the Second Circuit has uniformly broadly interpreted the Securities Act cases before it, so as to provide a remedy, when one is necessary, to carry out the Congressional intent.

As Judge Herlands stated below, this is an another of many of the recurring cases in which the question basically is: Does the plaintiff belong in the State courts or has he spelled out a Federal claim?

This case, once again I emphasize, involves a misappropriation of corporate assets by a sole shareholder of a corporation. It involves no injury to any public investor, it involves no purchase or sale of any securities for less than its fair value, and it had no effect whatsoever on any securities market.

On these unique facts, I suggest, Your Honors, the plaintiff has stated no Federal claim, and that he should pursue his remedy in a State court action which was brought

against these same plaintiffs, based on the same facts, and in which he asks for the same damages.

If I may, Your Honors, there were just a few questions posed this morning to Mr. Bauman which I might respond to. I believe Mr. Justice White asked how the bonds were sold. I believe I responded to that, that it was a private sale transaction between Manhattan and Second District Securities.

Once again, there no securities market was involved. No public exchange was involved.

If I may go to this question of creditor standing, under the Securities laws: It is my position that Congress did not intend to provide any rights under the Securities laws to creditors as a class. The Securities laws, if you read them, from the beginning to the end, were composed to provide remedies to security holders, to purchasers and sellers of securities.

Once again, I suggest that was no need to provide a remedy to creditors, because creditors already have adequate remedy in the State courts.

I would suggest that if you look at the Field versus Lew case, you will see -- which was referred to by Mr. Bauman and which is cited at length in my brief -- you will see that it is very relevant to the issue before Your Honors. What Field versus Lew does is to analyze what a corporation is,

and in that case it was concluded by the District Court that when the sole stockholder of a corporation ratifies and participates in a corporate transaction, it is corporate action. The corporation thereafter has no remedy against the sole stockholder. The remedy of any creditor who is damaged is by way of an action for fraudulent conveyance or some similar type of action.

Now, if the situation has resulted in a Trustee in Bankruptcy being appointed under the Bankruptcy law, then I think the Field case clearly demonstrates the division of responsibility that a Trustee in Bankruptcy has. A Trustee in Bankruptcy can sue on behalf of the corporation, and he can sue on behalf of the creditors.

But I suggest that what was happening in Field was that the Trustee in Bankruptcy, the plaintiff there, was being told that because of the ratification of the actions by the sole stockholder, he had no cause of action on behalf of the corporation. That doesn't mean he doesn't have a cause of action on behalf of the creditors.

But to carry that analysis into this case, if in fact what Mr. Bauman is doing is suing on behalf of creditors, then I suggest that under the Birnbaum doctrine he has no standing to sue because the creditors are not purchasers or sellers of a security. And I suggest, Your Honors, that Birnbaum not only is law in the Second Circuit, it's law in all the circuits

which have carefully considered the question, and I think rightfully should remain the law.

MR. CHIEF JUSTICE BURGER: Mr. Parker.

ORAL ARGUMENT OF IRVING PARKER, ESQ.,

ON BEHALF OF RESPONDENT BANKERS LIFE AND CASUALTY CO.

MR. PARKER: Mr. Chief Justice, may it please the Court:

I appear principally in the interest of respondent Bankers Life and Casualty Company, as to whom the facts and the proceedings in this case are unique.

However this Court may interpret Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder, petitioner has not and he cannot state a claim for which relief can be granted against Bankers Life.

Neither the complaint itself nor the complaint supplemented by a comprehensive discovery record provides a single factual allegation which in any respect supports any claim against Bankers Life.

The only conceivable reason that Bankers Life was made a party to the action and is here today is that it happened to own the stock of Manhattan Casualty Company and sold it in January 1962, after months of negotiations.

The sale was arm's-length, and the only conclusion which the record permits is that the sale was free from any impropriety in any respect whatsoever on the part of Bankers

Life.

In November 1963, shortly after the action was commenced, and the insurance department had completed a lengthy investigation into the circumstances which led to the liquidation of Manhattan, the petitioner, the Superintendent of Insurance as liquidator of Manhattan, was deposed. Upon deposition, the essence of the petitioner's testimony was that he could not assert any facts to justify inclusion of Bankers Life as a party in any way connected with any of the alleged wrongs upon which the action was based.

The utter speculative basis upon which Bankers Life was named a party was clearly revealed by the petitioner's testimonial admission that he could not factually support any claim against Bankers Life, and to attempt to do so he required an opportunity to conduct discovery proceedings. And so petitioner proceeded to discover.

By early 1968, petitioner concluded some four and one-half years of discovery --

Q You are speaking now of the Federal discovery?

MR. PARKER: Yes, Your Honor.

-- in this case. Through his attorneys, petitioner deposed almost 40 witnesses, and amassed a record of some 12,000 pages of transcript and hundreds of documents, but petitioner still could not provide a single factual allegation to justify retention of Bankers Life as a party to the action.

Consequently --

Q That goes to the merits, doesn't it?

MR. PARKER: Your Honor, it goes to this jurisdictional question.

Q Because there are other defendants, other than Bankers?

MR. PARKER: There are, Your Honor. And the fact of the matter is, Your Honor --

Q So that if there is a cause of action against one of them under the Securities Act, this should be reversed, shouldn't it, now?

MR. PARKER: No, Your Honor. There is precedent for what I am contending for here. And I will come to that, Your Honor.

Q All right.

MR. PARKER: In any event, in April of 1968, Bankers Life moved before the District Court for summary judgment, pursuant to Rule 56, on the ground that there was no triable issue of fact as to Bankers Life, and that it was entitled to judgment as a matter of law.

Bankers Life was the only defendent who so moved.

When the motion was made, the petitioner indicated his need for, and he obtained sufficient time within which to search the discovery record, in the hope that he could find something upon which to base an opposition to that motion.

The motion was heard upon extensive and comprehensive affidavits before Judge Sylvester Ryan, who found that petitioner had nowhere charged that Bankers Life had participated in the negotiations for the raising of the purchase price for the Manhattan stock, or even that Bankers Life had any knowledge of those negotiations, and Judge Ryan's exact words are at page 42a of the Appendix.

Nevertheless, Judge Ryan denied the summary judgment motion, but he did so expressly stating that it was not on the merits and it was without prejudice, and he explained that he could not dispose of the motion because of the need, first, to determine petitioner's questionable claim of Federal jurisdiction. And so the motions to dismiss for lack of jurisdiction were made. And it is as a result of the dismissal of the complaint and its affirmance by the Court of Appeals that the respondents who made such motions are here.

As to Bankers Life, it simply is not involved in the questions presented, whether there were schemes or devices employed by others in connection with any transactions complained of by the petitioner or relied upon by the SEC.

The absence of any connection of Bankers Life with any schemes or devices was confirmed by petitioner's attorney in open court as long ago as November 1963; first referring to the facts of the sale of the Manhattan stock, petitioner's attorney describing his claim stated, and I quote: "Thereafter

the complaint alleges that defendants, other than Mr. Parker's client, namely Bankers Life, entered into a scheme to cover up this depletion of the corporate assets which was successful for about a year and a half." Close the quote.

Since the time that statement was made, petitioner has been unable to alter the admitted lack of any connection between any of the transactions complained of and Bankers Life.

The conclusion, set forth at page 37 of petitioner's main brief, plainly evidences that the heart of his purported Federal claim is based upon the circumstances of the sale of the Manhattan government bonds and the misappropriation of the proceeds of that sale, with none of which Bankers Life had any connection whatsoever.

These transactions occurred after the purchaser had acquired the stock, had taken control of the company, and had installed a board of directors.

It was petitioner's own analysis of his complaint, supplemented by the extensive discovery record, which led Judge Ryan to the conclusion that I mentioned before; namely, that there was no charge in this entire record whatsoever made that Bankers Life participated in or even had any knowledge of the transactions relating to the raising of the purchase price for the Manhattan stock.

The absence of any basis for asserting any Federal claim against Bankers Life is also confirmed by petitioner's

Reply Brief.

First, as to the brief for Bankers Life: The principal point of the brief for Bankers Life is that no Federal claim has been asserted against Bankers Life, and that Federal jurisdiction does not exist as to it.

Q Now, are you suggesting that we should -- even if we reverse the Court of Appeals, we should, nevertheless, give judgment for Bankers Life?

MR. PARKER: In thirty seconds I will answer your question, if I may, Your Honor.

Thank you.

As to the petitioner's Reply Brief, he has not in any respect controverted this inescapable conclusion that there is no Federal jurisdiction as to Bankers Life, or that dismissal of the complaint was unquestionably correct as to Bankers Life.

Nevertheless, we believe that the judgment below should be affirmed in all respects. We believe, further, that in any event that judgment should certainly be affirmed as to Bankers Life.

Q But the one --

MR. PARKER: When the Court of Appeals, sir, and I think I can anticipate your question, because I will not overlook it, when the Court of Appeals for the Second Circuit was presented with a similar situation involving multiple defendants,

in Schoenbaum against Firstbrook, which is reported at 405 Fed 2d at 215, a case involving Rule 10b-5, a case which was heard en banc, that court affirmed dismissal of the complaint for lack of jurisdiction in respect of that single defendant as to whom there was no showing made of any participation in the wrongs complained of.

Q Shouldn't we have the judgment of the Court of Appeals on that aspect of the case before we dealt with it?

MR. PARKER: Dividing Bankers Life from the others? There was no occasion for them to do it, Your Honor; I think, as the Court of Appeals saw it, --

Q Well, I understand that.

MR. PARKER: Yes.

Q I mean that on their approach there was no Federal jurisdiction as to anybody.

MR. PARKER: And I think they were correct about that, Your Honor. And I think they are correct.

Q All right, I understand that. But assume they were wrong about that.

MR. PARKER: That there was Federal jurisdiction in some form as to some parties?

Q As to some parties, yes.

MR. PARKER: Still, I would think, and I think that on the basis of Schoenbaum v. Firstbrook, the Court of Appeals would certainly have dismissed this to us.

Q Well, shouldn't they have the chance to do it first?

MR. PARKER: I don't see that there is any need for it, Your Honor.

Q Well, it would require us to make some deal in the first instance with this record, in terms of whether you can be distinguished from the other parties.

MR. PARKER: Well, I think that, on the basis of the briefs alone, that will appear, Your Honor. I wouldn't expect the Court to be troubled --

Q How many thousands of pages were there?

MR. PARKER: There are 12,000, and I would not expect the Court to be troubled by that.

Q Thanks!

[Laughter.]

MR. PARKER: But I respectfully submit, Your Honor, that on the basis of the briefs alone this will appear. Because the facts are there, they are uncontroverted. And I think what is most important of all, Your Honor, is --

Q Does Mr. Bauman concede that?

MR. PARKER: Does he concede what I say?

Q Yes.

MR. PARKER: I have not asked him, Your Honor, and I don't know.

We respectfully submit, Your Honor, that what is

before Your Honors, and what Your Honors will be willing to consider, that you will see that there has been a grave injustice committed here in respect of Bankers Life. And that the only way left to remedy the injustice of having made Bankers Life a party to an action in which it does not belong is to affirm dismissal of the complaint as to it, and thereby, in some measure, offset the effects of the unworthy challenge to the integrity of Bankers Life in connection with a perfectly proper sale of the Manhattan stock which it made.

Thank you very much, Your Honors.

MR. CHIEF JUSTICE BURGER: Mr. Bauman, do you -- I thought there was some question pending to you that was going to be picked up. Perhaps I am mistaken.

MR. BAUMAN: I think perhaps I did it after the luncheon recess, Your Honor.

MR. CHIEF JUSTICE BURGER: I think that was the one --

MR. BAUMAN: At least I attempted to.

MR. CHIEF JUSTICE BURGER: I think that was the one I was carrying in mind that there was a question pending.

MR. BAUMAN: If there is an outstanding question, I will be happy to try to answer it.

MR. CHIEF JUSTICE BURGER: Very well.

No questions?

MR. BAUMAN: Thank you, sir.

MR. CHIEF JUSTICE BURGER: The case is submitted.

MR. BAUMAN: Before we leave, Mr. Chief Justice, I don't know whether or not Mr. Justice Stewart asked about outstanding claims and the amounts of outstanding claims, if in fact he did, I will be happy to reply very briefly; if he didn't, I shall leave quietly.

Q Well, it's been insisted on the other side that this record doesn't show the existence of any creditors whose claims have been unsatisfied.

MR. BAUMAN: And we said in our Reply Brief that we'll prove it at the trial. But I do want to assure the Court -- and the Deputy Superintendent of Insurance of the State is standing next to me -- that claims do exist, and some exceeding over a million and a half dollars, which will not be paid under the present circumstances.

Q Well, you could have put that in during the depositions, couldn't you?

MR. BAUMAN: We did not go into the question of -- perhaps we should have; we did not go into the question of damages.

Q Is this a public record, the New York liquidation proceedings?

MR. BAUMAN: I would be sure that's true.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen.

[Whereupon, at 2:10 p.m., the case was submitted.]