In the

Supreme Court of the United States

BLUE CHIP STAMPS, et al.,

Petitioners,

v.

MANOR DRUG STORES, etc.,

Respondents.

No. 74-124

Washington, D. C.
March 24, 1975

Pages 1 thru 39

HOOVER REPORTING COMPANY, INC.
Official Reporters
Washington, D. C.
546-6666

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Monday, March 24, 1975

The above-entitled matter came on for argument at 10:06 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
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

ALLYN O. KREPS, ESQ., 611 West Sixth Street, Los Angeles, California 90017, for the petitioners.

JAMES E. RYAN, ESQ., 2222 Tishman Westwood, 10960 Wilshire Boulevard, Los Angeles, California 90024, for the respondent.

DAVID FERBER, ESQ., Solicitor, S.E.C., Washington, D.C., as amicus curiae, supporting respondent.

I N D E X

P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments first this morning in No. 74-124, Blue Chip Stamps and others against Manor Drug Stores.

Mr. Kreps, you may proceed whenever you are ready.

ORAL ARGUMENT OF ALLYN O. KREPS ON BEHALF OF THE PETITIONERS

MR. KREPS: Mr. Chief Justice, and may it please the Court: The important practical question before this Court is whether every security issue subject to the security laws will be the basis for a Federal claim for damages by any person whenever the issue price or current market price is followed by a price rise, or more directly, whether any non-purchaser, non-seller, or potential investor will have a private Federal claim to speculate on the market without cost or risk of loss and at the expense of actual and existing investors and to the burden of the Federal judiciary. This statement may seem extreme and certainly simplistic, but it is the inevitable practical result of the extreme and simplistic position taken by the Securities and Exchange Commission in this case by calling for the complete judicial abandonment of the purchaser-seller rule commonly known as the Birnbaum doctrine.

The fundamental legal issue before this Court upon which this practical problem is bottomed is to determine what

class of persons should be permitted to bring a judicially implied private right of action for damages under rule 10b-5 as promulgated by the SEC to enforce the prohibitions of section 10b of the Securities Exchange Act of 1934. Although no private right of action is set forth expressly in either section 10b by Congress or rule 10b-5 of the SEC, the lower courts have implied such a right of action for purchasers or sellers since the Kardon case in 1946 and the Fischman case in 1951. This honorable Court has recognized this implied right of action for damages inter alia in both Bankers Life and Affiliated Ute, although the existence of the right of action in the plaintiffs there involved or the plaintiffs' standing in the non-constitutional sense was not questioned or in issue in those cases.

The standing of the plaintiff-respondent here is in question precisely because it has never owned, never purchased, or never sold the securities upon which it purports to base its alleged private claim for damages under rule 10b-5.

Now, petitioners concede that a violation of rule 10b-5 in connection with the issuance of these securities has been alleged in the amended complaint, but petitioners contend that as a matter of law palintiff-respondent has no judicially implied private right of action for damages arising from the issuance of the securities precisely because any such alleged damage was not incurred by the respondent in connection with

either the purchase or sale of any security by it.

There being no better point of departure in determining the merits of this contention than rule 10b-5 itself, it should be observed that the express prohibitions of 10b-5 are applicable "in connection with the purchase or sale of any security."

In the Birnbaum case the Second Circuit concluded that rule 10b-5 did not create an implied private right of action for non-purchasers or non-sellers or potential investors but only for the defrauded purchaser or seller. In subsequent cases the lower courts have recognized the salutory regulatory purpose of rule 10b-5 and have applied a liberal definition to the words "purchase or sale" to imply a private right of action for damages in the so-called forced seller situation without requiring a formal consummated transaction. And the lower courts also have recognized that the 1934 Act expressly defines sale or purchase to include contracts for which consideration has been given to sell or purchase and have recognized an implied right of action for damages under 10b-5 in such situations.

That is not the case here because there was no legally enforceable obligation to buy or to sell and no contractual relationship existed between respondent and petitioners or any of them.

Although the Birnbaum rule has been the subject of

some academic criticism, this judicially developed doctrine has resulted in a rational and predictable framework for vindication of the policies underlying rule 10b-5. Even while the SEC urges the abandonment of the purchase-seller rule, it now for the first time after many years recognizes or admits to the practical detrimental consequences of increased liability exposure, strike suits, nuisance settlements, and an impossible standard of draftsmanship imposed upon the draftsmen of the prospectus if the purchaser-seller rule is not retained.

Nonetheless, the SEC advocates that the rule be abandoned so that any person making an investment decision even one not to buy, not to do anything, has a private right of action under 10b-5. In so proposing this subjective standard for standing, even the SEC attempts to ameliorate the recognized detrimental consequences upon all issuers of stock and their existing shareholders by suggesting two limitations, but each limitation is illusory and ineffective.

The SEC proposes first an enhanced burden of proof upon plaintiff potential investors and nonpurchasers who claim they would have bought or sold but for the alleged 10b-5 violation. Whatever slight burden this may place on the skill of pleaders in drafting complaints, it is clear that it does not provide any means of permitting summary disposition of cases before trial. Any recipient of a prospectus, anyone with

notice of a stock issue or recipient of a press release as in Texas Gulf Sulphur could subsequently bring a claim as to any stock having a post issue or market price rise by simply alleging receipt of the allegedly defective prospectus or the press release, the fact of subsequent price increase and the obvious conclusion that he would have bought at the issue price or then market price if he had been informed correctly that the stock was a bargain or would increase in value. Hindsight will invariably disclose some statement in a prospectus that appears to be either overemphasized, as alleged here, or underemphasized in the light of a subsequent price rise.

In this case, respondent watched the market price rise for over 2 years before filing the instant lawsuit. In the face of the expressed statutory mandate of the 1933 Act and as reflected by rules and policies of the SEC that all prospectuses embody a conservative philosophy, it is apparent that such factual situations of price rise will occur not infrequently. But the SEC offers the issuer no rational means of complying with the conservative disclosure standards of the 1933 Act and yet avoiding the inevitable line of potential investor claimants at the Federal courthouse.

The second limitation by the SEC is to impose vicarious liability upon the corporation only when it benefits from the alleged violation of rule 10b-5 by its officers.

Presumably this limitation is a recognition by the SEC that the purposes of the securities laws are not served by forcing corporations to pay potential investors and nonpurchasers from proceeds derived from actual purchasers and actual investors.

This second limitation is also illusory, since motive is not an element of a 10b-5 claim and section 20(a) of the 1934 Act expressly imposes such vicarious liability upon the corporation for such acts. Thus, however meritorious such a limitation on vicarious liability might be, Congress has not seen fit to impose it, and accordingly judicial imposition would be inappropriate.

But more fundamentally, the position of the SEC totally ignores the problem of what the substantive elements of a private claim by nonpurchasers and potential investors would be. For example, how many potential investors and non-purchasers can sue. If one million shares are issued and sold at $10 per share for $10 million to 1,000 persons, can everyone sue who received a prospectus or had knowledge of the issue but decided not to invest? If a thousand additional potential investors did so, 10,000, and so on? At least under the present rule the liability is limited to those one million shares, the money damages to a maximum of $10 million since that was the total price received and the suit is limited to purchasers, only they would be able to sue for the amount paid and that assumes the diminution of the value of the stock to

zero, and the number of potential plaintiffs is limited to 1,000, the actual number who purchased the shares. Under the SEC proposal, the number of potential investors and nonpurchasers and thus potential plaintiffs is totally unknown and only limited to those who saw or alleged they saw the prospectus notice or news release involved, and the amount of potential liability is not $10 million, it is also unknown and without limit. Stocks have been known to increase many times over issue price, and there are innumerable post issuance opportunities to be an alleged potential investor. Stocks are sold and resold after initial issuance, and there is no limitation under the SEC proposal --

QUESTION Mr. Kreps, did the Court of Appeals reject the Birnbaum rule?

MR. KREPS: In our view, Mr. Justice White, and in the view of Judge Hufstedler in dissent, the Court of Appeals did reject the Birnbaum rule because --

QUESTION: They didn't say it did. It seemed to me they said this didn't violate the rule because this sale followed as a result of an anti-trust decree.

MR. KREPS: That's correct, Mr. Justice White.

QUESTION: Aren't you taking on more than you need to; say that here is another court of appeals that embraced the Birnbaum rule, it just didn't apply it to this case.

MR. KREPS: The Ninth Circuit Court of Appeals, Mr.

Justice White, analytically rejected the Birnbaum rule because --

QUESTION: You want us to say that this case opposes one way or another the validity of the Birnbaum rule, just forget about the rationale of the Court of Appeals and go right to what you think is the heart of the matter, the Birnbaum rule.

MR. KREPS: That's correct, Mr. Justice White, and that is the position of the SEC.

QUESTION: Well, they are not always right either.

MR. KREPS: We agree that they are particularly not right in this case, Mr. Justice White. But we also think the majority of the panel below did not expressly reject the Birnbaum rule in name because it recognized that another panel of the Ninth Circuit in the Mount Clemens case had already expressly accepted the Birnbaum rule. Judge Hufstedler in dissenting --

QUESTION: You think we have had a considered discussion by a court of appeals, namely, the Ninth Circuit, as to whether the Birnbaum rule ought to continue? They never really faced up to it and talked about the Birnbaum rule as such, have they?

MR. KREPS: Yes, Mr. Justice White. In the Mount Clemens decision another panel of the Ninth Circuit expressly --

QUESTION: Not in this case.

MR. KREPS: Not in this case, the majority did not. Judge Hufstedler in her dissent said that they should adopt the

Birnbaum rule, that it exists in the Ninth Circuit, and that the majority was trying to ride around it with their so-called functional equivalent analysis which I think she correctly dissected as being without merit.

QUESTION: Does not the Court of Appeals, including the Ninth Circuit, normally not permit one panel of the court of three judges to overrule the holdings of another panel, especially if they are recent?

MR. KREPS: Mr. Chief Justice Burger, I think that was the problem the majority of the panel was faced with in our case. And I think the majority's decision and their seizing on this concept of functional equivalent is a classic law school text book example of hard facts making bad law.

QUESTION: Well, are you suggesting that what they did was do indirectly, that is, overrule its earlier panel decision, without saying so, by indirection?

MR. KREPS: Yes, Mr. Justice Burger. I do not think you can reconcile the reasoning or purported reasoning of the majority panel below with the panel in Mount Clemens. And when we petitioned for a rehearing in banc, the panel in Mount Clemens voted for granting that rehearing in banc, and we fell -- we received five votes and fell just one vote short of getting a rehearing in banc in the Ninth Circuit. I think if we had had that rehearing, the outcome would have been different, because I can see no intellectual basis for

distinguishing the majority decision of the panel below from overruling Birnbaum. They simply tried to ride around it, because I think they were unduly impressed by the allegations of the amended complaint here.

QUESTION: Mr. Kreps, I notice that neither you nor your opponent seem to have cited Justice Stewart's opinion for the Court last year in the Amtrack case where the Court held that the provision of one type of civil remedy excluded another. I should think in view of the provision of section 11 as well as the Act of 1933, that might be of some significance to your case.

MR. KREPS: Mr. Justice Rehnquist, I concur that it is, particularly on another issue that is attempted to be raised by the SEC at the last minute, and that is whether there is a private remedy under section 17 of the 1933 Act other than is set forth in section 12(2) of the '33 Act. The problem is that there is no civil remedy whatsoever provided by Congress in section 10 of the Act --

QUESTION: The '34 Act.

MR. KREPS: Of the '34 Act, that's correct, Mr. Justice Stewart. There is none under the '34 Act at all expressly provided by Congress as there is under the '33 Act. And the entire remedy that is before the Court here has been judicially created commencing with the Kardon case in 1946.

QUESTION: But never -- or am I mistaken? Has it

ever been explicitly accepted by this group?

MR. KREPS: It has never been explicitly accepted in the sense that the standing of the plaintiff was in issue. I think that Affiliated Ute and Bankers Life and particularly footnote 10 in Bankers Life indicates that the Court accepted the concept of an implied judicial remedy under section 10 and 10b-5.

QUESTION: Borak involved something else, didn't it? The Borak case suggests something else.

MR. KREPS: Yes. That did not involve that issue.

One other --

QUESTION: The Court, we did, denied cert in Birnbaum itself, did it not, in '52?

MR. KREPS: Yes, Mr. Justice Brennan.

QUESTION: And then the Seventh Circuit rejected it in unison and perhaps last October we denied cert there, didn't we?

MR. KREPS: You denied cert with three Justices voting to grant cert. I believe Mr. Chief Justice Burger, Mr. Justice White, and Mr. Justice Douglas.

QUESTION: If I am not mistaken, that was not a final judgment. Not that that goes to the jurisdiction of the Court, but, I mean, in other words, the defendants might still have prevailed in that case, if I remember correctly.

MR. KREPS: That's correct, Mr. Justice Stewart.

QUESTION: Do you know whether Congress has ever been asked to address this question?

MR. KREPS: No, I do not, Mr. Justice Brennan. It certainly should be, and we did not intend to urge before the Court this morning that it overrule the lower courts in recognizing a judicially and implied private right for damages under section 10, but certainly that could be a legitimate issue before this Court.

I would like to return briefly to one more example of the dangers of the rule advocated by the SEC to extend this private implied right for damages to potential investors.

Consider the potential investor who has only $1,000 to invest and considers stocks A, B, and C, but buys only A. Does he have a claim for a price rise of B and C? What if stock A rises more than B and C or less than B but more than C? Then if you multiply the number of stocks A, B, and C by the number of different stocks traded or issued each year and have this investor with only a thousand dollars to invest, how many lawsuits does he have? Or in fact, does this potential investor even have to invest in any stock at all but simply use the thousand dollars for an alternative investment and play the market without cost or risk of loss? And what if the alternative investment rises more than stock A, B or C? Has he been damaged no matter how fraudulent the prospectus discouraging him to purchase stock A, B, or C? And one final problem: What

of the tremendous burden on the Federal courts to be forced to litigate the potential merits of all those potential investor claims brought as questionable class actions, all claims seeking speculative lost profits? The purchaser-seller rule as developed and refined over the past quarter century accomplishes the salutory purpose of establishing rational and predictable requirements of standing for the proper vindication of rule 10b-5 claims with probable merit. In aggravated cases of alleged actual fraud, such as claimed in one count here, potential investors and nonpurchases have an appropriate common law remedy in State court just as respondent is pursuing in the California State court. But the purposes and policies of the Federal security laws are not served and cannot be reconciled by allowing any and all nonpurchasers and potential investors to speculate on the market without cost or risk of loss and at the expense of that securities market actual investors in a Federal court system already overburdened with litigation. Accordingly standing under 10b-5 should not be extended judicially to such potential investors and nonpurchasers as respondent in the instant case.

With the Court's permission, I would reserve my remaining time for rebuttal.

MR. CHIEF JUSTICE BURGER: Very well, Mr. Kreps.

Mr. Ryan.

ORAL ARGUMENT OF JAMES E. RYAN, ON BEHALF OF RESPONDENT

MR. RYAN: Mr. Chief Justice, and may the Court please: I feel constrained to comment upon two of the arguments just made by Mr. Kreps. One is in response to a question by the Court whether or not the Ninth Circuit in this case has abandoned the Birnbaum rule.

In the Mount Clemens case which involved a situation where there was a public auction of securities, the plaintiffs in that action brought a 10b-5 action on the grounds that they had been defrauded from making a bid at that auction. They were not offerees such as we are in this case. They had no transactional or causal nexus with the party selling the shares. So that the Ninth Circuit in Mount Clemens found that there was no standing under 10b. I feel by that they did adopt a portion, at least, of the Birnbaum rule.

Another argument that counsel has made concerns the unknown quantity of claimants that may arise. He gave an example of an offering of a million shares and there may be 50 million people that will come later when the stock goes up and say, "Gee, I would have bought that stock." That is not the situation here. Here we have an exact amount of shares offered to an exact amount of offerees at an exact price. The amount of persons that could bring a claim out of this action is wholly limited.

QUESTION: But how do you distinguish that situation in the language of the rule from the situation that your opposing counsel was posing to the Court? What is it in rule 10b-5 that would, if we allow this, prevent the many other suiters who are not precisely in this situation?

MR. RYAN: I should preface that by saying that I have ceded 10 of my minutes to the counsel for SEC. He is going for the home run, and I am going for the base hit. He is asking the Court that the Birnbaum rule in total be abolished. I am saying that, fine, if that's necessary, that will get us our day in court, then fine. But we are submitting to this Court that that is not necessary in our case.

The purchaser-seller language as we know is court-created. 10b just says that in connection with the purchase or sale. We submit that when Congress enacted that statute, it would not have needed the language"in connection with" if it wished to limit causes of action under that section to strictly --

QUESTION: But it is a construction of the statute that the courts have been engaged in, isn't it? It's not just some judicial policy; it's a construction of the Federal statute.

MR. RAYN: That's correct. However, since Birnbaum was decided in 1952, the cases are legion which have attempted to get away from the harshness of that rule. The court below

in our case likewise saw a harshness in the rule. There have been the forced seller exceptions, there have been the aborted purchaser-seller exceptions, there have been any number of exceptions, including the most recent opening of the doors to injunctive relief.

QUESTION: What is so harsh about it? I mean it's just a line drawing that you have in every single area of the law, isn't it?

MR. RYAN: Well, in the situation where you would have a case such as ours, I think that it's presented by the anomaly of the situation. If the petitioners in this case in making their offering had persuaded the respondents to purchase some but not all of the shares to which we were entitled, then I think we clearly would have no problem with the purchaser-seller rule. What the petitioners are suggesting is that since their fraud, since their misleading statements were so successful that we didn't buy it at all, that therefore we are outside the standing requirements. And we feel that that is not what Congress intended. That is the atypical fraud, which has been pointed out by several circuits, that Congress did not intend to just outlaw the typical kinds of fraud. And this is certainly an atypical kind. This is a highly unusual situation where you have an offeror putting out securities that it hopes won't sell. And that's the anomaly of the situation. I think to deny the respondents standing in this

case to bring a 10b-5 action sanctions the total success of their fraud.

QUESTION: You think it can be limited to that category, do you?

MR. RYAN: I do, your Honor. I feel that in this case I've stressed in my brief that we have a unique set of circumstances. We have a unique set of facts. I think that the Ninth Circuit recognized this. I think we had discussed the Birnbaum rule and the exceptions thereunder to the effect that there have been cases where courts have created what we may call a fiction, if no else, whereby they found a contract to purchase or sell. We've had situations where persons bought illusory stock. That's no purchase at all. But in the present case the Ninth Circuit saw that to deny the plaintiffs in this case standing would be harsh. They found that the peculiar unique right that flowed from that consent decree, that duty that was upon the petitioners herein to make a fair offering served as the functional equivalent of a contract. And I think that this case can properly be limited to that area of exceptions which the courts have now recognized in the Birnbaum rule.

QUESTION: What if we disagreed with you that this was a rational distinction and that if the Birnbaum rule was to be followed, you must lose the case? What should we do then if we disagree with you that there is a limited exception

possible here? Should we reach the issue of overruling Birnbaum or not accepting Birnbaum or rejecting it, or should we remand to the Ninth Circuit?

MR. RYAN: Well, I think first if this Court feels that our case as presented in the amended complaint does not fall within one of the exceptions or is not an exception in and of itself because of its peculiarity, then I think the Court has to reach the whole Birnbaum rule and whether or not it --

QUESTION: Why wouldn't we remand to the Ninth Circuit and let them give their considered attention to the Birnbaum rule as such? It hasn't here in this case.

MR. RYAN: Not in this case it has not.

QUESTION: The Court of Appeals has done it in a previous case.

MR. RYAN: It did do so. I believe that it did adopt the Birnbaum rule in the Mount Clemens case.

QUESTION: And the Seventh Circuit is --

QUESTION: But that's arguable, isn't it?

QUESTION: They've done it in another case and we have the benefit of their thinking on the other side. It has been canvassed in the courts of appeals, including this one.

MR. RYAN: I believe there are three or four circuits that have not directly reached the Birnbaum issue, but --

QUESTION: But, Mr. Ryan, I take it if Judge Hufstedler

is right and in Mount Clemens they did adopt, that panel did adopt, the Third Circuit rule, then the practice that the Chief Justice suggested earlier, I would suppose if we did what my Brother White suggests, would result automatically, would it not, in this panel following Mount Clemens?

MR. RYAN: If this Court found that this present case did not come within one of the exceptions. Then you would go back and I would think that the court would follow Mount Clemens.

QUESTION: I take it that argues -- unless they would go in en banc.

MR. RYAN: Pardon?

QUESTION: Unless that went en banc.

QUESTION: This Court has on occasion, when there were contrasting panels in a circuit and the circuit certified the case is a doubtful question, remanded and said in effect, "Resolve your own conflicts first," has it not?

MR. RYAN: Yes.

QUESTION: But you say there is no conflict between what the panel did in Mount Clemens and what the panel did in this case. In Mount Clemens they apparently thought so, or at least had some doubt about it, did they not?

MR. RYAN: They had some doubt about it. But again the petition for a rehearing in banc was denied.

QUESTION: What was the vote on the denial?

MR. RYAN: There were five dissenting. If I knew the total number, I would do some quick subtraction on how many voted for. Six to five.

QUESTION: You have a litigation pending in the State courts, do you, on this same basic claim?

MR. RYAN: We have that.

QUESTION: You do?

MR. RYAN: Yes.

QUESTION: Mr. Ryan, on that same point, do you consider your State remedy inadequate? And if so, in what respect?

MR. RYAN: Well, for two reasons I consider it inadequate. One, the burden of proof, as I understand it, in a State securities action is greater than it is under 10b.

QUESTION: Why would that be so? Isn't this garden variety fraud that you allege in the final analysis?

MR. RYAN: It's fraud that we allege in the final analysis. However, the test, as I understand it under the Securities Exchange Act, the plaintiff is not required to bring in each and every one of the offerees and have him sit on the stand and say,"But for the fraud of the defendants I definitely would have purchased the stock." As I understand it it's a lesser burden of proof, that is, that the misstatements or the fraud of the defendants in a particular 10b case have influenced or would have influenced his decision. Whereas,

under the State securities law and common law fraud, he would have to go through the normal elements of a fraud case to show actual reliance.

QUESTION: Do you think that this kind of situation lends itself to a class action when the proof under this Ninth Circuit holding, the proof in each case would be likely to vary a great deal?

MR. RYAN: Well, again, Mr. Chief Justice, I think that as the rules on proof under 10b-5 actions, that the decision of the investor was influenced or would have been influenced. I don't think it creates an imponderable burden for the plaintiff in a class action. I think if you first prove that the allegations, or I should say the statements contained in what we term the negative prospectus, are truly misleading and/or false, then I think that you at that point have fraudulent conduct, and I think that fraudulent conduct in and of itself would probably affect the decision of any potential investor in a class action.

QUESTION: Well, can a plaintiff in a 10b-5 action even though he may never have read the prospectus simply take the stand and say, "If I had read it, it would have influenced me against buying," and that brings him within the class that is entitled to recover?

MR. RYAN: No, I do not think it goes that far. I think that he would have to show some knowledge on his part of

the prospectus. But I don't think it needs to go too far beyond that.

QUESTION: You indicated earlier, did you, that if he has read about it in the newspaper, in the Wall Street Journal, for example, that would be enough, even if he had not seen the prospectus?

MR. RYAN: You are speaking of the persons who are in the selective class that I represent? It is possible. I haven't given that any thought. I'm presuming that the persons who would come within the class in this case would be those who had received and considered the prospectus. I suppose that a Wall Street Journal article or any other type of publication concerning this offering, if it contained misleading items and was read by one of the selected offerees, would possibly serve the same function. It might just as well persuade him.

We feel that the test to be used in the purchaser-seller cases such as this and as was applied in the Eason case is determine whether or not the plaintiffs are within that class intended to be protected by Congress. We feel that the nature of the history of this case, that being the consent decree, the duty of the petitioners to make a fair and full disclosure, a fair and full and honest offering to the plaintiffs, is that it makes them that type of person intended to be protected by Congress.

I see a common strain in all of the cases which have considered Birnbaum and have carved out the several exceptions. And that common strain I see is a transactional or causal nexus.

Counsel has expressed concern over the opening of the floodgates should the plaintiffs in this action be permitted to have their day in court. I cannot strenuously enough emphasize that we are not suggesting that the man on the street who might have bought IBM this morning at 10 o'clock stands in the same shoes as the plaintiffs in this action. Here we had an offering that was made pursuant to consent decree. We had a specific price. We had a specific time. The defendants in this case had a duty to make an offering, and we do not feel that there is any relationship between a man on the street and a person who owned a right or entitlement such as we did to purchase these shares.

QUESTION: Mr. Ryan, let's assume for the moment that no offering had been made at all as may have been required by the consent decree. Would your clients have had a cause of action, this cause of action?

MR. RYAN: If no offering had been made.

QUESTION: None. No offering had been made although the consent decree may have required it. In other words, could your clients have enforced the consent decree by suit against petitioner?

MR. RYAN: I would like to be able to distinguish the Control Data Corporation case and the like, but I don't think it can be. I don't think it's in this case. I don't think it's dispositive. We have stated in our briefs that we do not pretend to enforce that consent decree in this action. The purpose of the consent decree, as I see it, and I am sure as the Ninth Circuit saw it, serves as a background and the history as to why these plaintiffs and these defendants had such a unique relationship, why were not the man on the street that might invest tomorrow in any stock. That consent decree answers that question. So we are not attempting to enforce the consent decree. I don't think we can. I think the cases are clear on that, the Armour and the Control Data Corporation cases.

QUESTION: So you had no right under the decree and no contractual right to have a chance to buy these securities.

MR. RYAN: Well, I am not saying that we didn't have a contractual right.

QUESTION: What was it?

MR. RYAN: Well, as the Ninth Circuit stressed, it was a functional equivalent of a contract to purchase these shares. We should not, as the Ninth Circuit said and also in Eason, I believe, we should not go for form over substance. I think that's what we are getting at here.

QUESTION: To say it's a functional equivalent is

to say it's not a contract.

MR. RYAN: You mean you distinguish --

QUESTION: The situation should be treated as if there were one, although in fact there is none. Isn't that it?

MR. RYAN: I think so.

QUESTION: Yes.

MR. RYAN: I have nothing further.

MR. CHIEF JUSTICE BURGER: Very well.

Mr. Ferber.

ORAL ARGUMENT OF DAVID FERBER ON BEHALF OF THE SEC AS AMICUS CURIAE, SUPPORTING RESPONDENT

MR. FERBER: Mr. Chief Justice, if the Court please: The petitioner is urging this Court to sanction a doctrine that would deprive the conceded victim of a securities fraud of standing to bring any action for his damages solely because he was not a purchaser or seller of securities.

There have been four cases decided by this Court that there are implied causes of action under the Securities Exchange Act, two of them involving 10b, the Affiliated Ute case and the Superintendent of Insurance case. The standing of the injured plaintiff here to bring such an action is the only issue in this case before the Court. The fraud here was that of deceiving persons who had an investment decision to make, and they were deceived, and for that reason they are seeking damages. The dissenting judge below admits there was

a violation of 10b-5, and the petitioner concedes this.

QUESTION: Well, as stated, then, the way you have just stated it, that broadly, that would mean, I guess you can argue that the broad issue that Mr. Kreps submitted to us is here.

MR. FERBER: I certainly think it is. It's an issue that the Seventh Circuit has said, "We will not adopt this doctrine." Several circuits have held, "We do adopt this doctrine," and I certainly think it is ripe for review by this Court under those circumstances.

QUESTION: And presented by this case.

MR. FERBER: And I think it is presented by this case because at least it is arguable with respect to the exemptions that the Court drew whether or not that is a valid exemption, and as we point out in our brief, there is probably just as much litigation now as to what is exempt under the so-called Birnbaum purchaser-seller doctrine as to whether or not the doctrine should be applicable.

QUESTION: What is the Ninth Circuit's rule on it?

MR. FERBER: Well, the Ninth Circuit --

QUESTION: As of now.

MR. FERBER: The Ninth Circuit's rule is that they believe that purchaser-seller limitation is applicable. They are making an exception in this case because of the existence of the antitrust decree. At about the same time a different

panel of that circuit, very shortly before this opinion, in the Mount Clemens case, which was very similar to this in some respects, the Court determined that because the plaintiff there was not the purchaser or seller, he had no cause of action.

Now, in the Mount Clemens case what happened was this: A hundred percent of the shares of a company was being sold at auction, of a subsidiary company in financial difficulties. The company that was in difficulty, whose shares were being sold, had an officer who had formerly been an officer of the plaintiff. The plaintiff said we are going to bid at that sale, and this officer, according to the allegations, lied to him and told him that the business of the subsidiary was no good. They didn't bid in the sale, and ultimately the officer who had lied allegedly, he was head, or an officer, of a different company that ended up with that subsidiary.

QUESTION: So you have one,you say that the Mount Clemens followed the Birnbaum rule?

MR. FERBER: The court relied solely on the purchaser-seller doctrine in Mount Clemens.

QUESTION: I'm asking you. Do you say that Mount Clemens they followed it?

MR. FERBER: Yes, your Honor.

QUESTION: And in this case they walk around it.

MR. FERBER: In this case they walked around it.

QUESTION: So what is the rule of the Ninth Circuit? To walk around or --

MR. FERBER: As in many of the other circuits, the Ninth Circuit says, We subscribe to the Birnbaum rule, but we find exceptions in this case and in that case and in the other case.

QUESTION: We apply the Birnbaum rule when we want to.

MR. FERBER: Precisely.

QUESTION: Mr. Ferber, is it a fair statement to say that the Birnbaum principle was submitted to the district court and decided in this case?

MR. FERBER: Yes. I believe so, your Honor.

QUESTION: You, I take it, would say that the exception purportedly carved out by the Ninth Circuit really can't withstand analysis, and that if you are going to have the Birnbaum rule, the result reached below shouldn't have been reached.

MR. FERBER: I just can't accept that we are going to have the Birnbaum rule. I mean, I don't know, I think that any exception to it is probably a reasonable one, because it doesn't make any sense to me. To me it is completely arbitrary.

QUESTION: In other words, both the rule and the exceptions are fictions in your approach.

MR. FERBER: I think the rule is basically, although it's arbitrary -- I don't know that I can say it's a fiction. I think the exceptions, like most exceptions from it, would be good.

I should say, though, first of all --

QUESTION: Well, you are saying if you don't believe in a rule, then you think any exception to it is fine.

MR. FERBER: Well, I suppose that's right.

(Laughter.)

But let me say this: It does not mean -- giving up the rule does not mean that all the parade of horribles that were set forth by the petitioner would necessarily occur or would occur. There are various distinctions. I think there are many cases where the lower courts have talked in terms of the Birnbaum rule because other circuits had mentioned it, but that there were other reasons they could have held that the plaintiff had no action. For example, one of the cases cited is someone against Wolfson. I can't think of the name of it at the moment. What was charged in that case was that the officers of the company had manipulated the securities and then bought some of the company's securities at a low price and subsequently manipulated it some more and sold back to the company at the higher manipulated price.

Now, the action was brought by a stockholder of the company, not as a derivative action. And the court said, well,

under the Birnbaum rule you are not a plaintiff -- a purchaser or seller, you are just a stockholder.

On the other hand, had they brought it as a derivative action, the company was certainly a purchaser or seller, and I certainly don't suggest that the plaintiff in that type of situation should necessarily have a cause of action. His injury was indirect through his corporation.

On the other hand, I think that case illustrates, had the plaintiff, because the market was low and had been so manipulated, sold his stock, he would presumably have a cause of action under the Birnbaum rule. He would be a seller.

So that is why I am saying it is an arbitrary rule and I guess the correct -- it is an artificial rule.

QUESTION: Mr. Ferber, has the Commission ever asked the Congress to do anything about the Birnbaum rule?

MR. FERBER: We don't think this Court has ever acted on the Birnbaum rule. It is not a rule --

QUESTION: That wasn't my question.

MR. FERBER: Well, no, your Honor. I was perhaps jumping ahead. What I am saying is we're --

QUESTION: After all, it's been around for 23 years now.

MR. FERBER: It's been around and there have been --

QUESTION: Has the Commission been as restive as it is now under it?

MR. FERBER: Well, we have filed briefs in a great many of the Courts of Appeals urging that the so-called rule not be accepted.

QUESTION: Has that been a reason not to go to Congress with it?

MR. FERBER: Well, in part this Court only now, about two or three years ago in Affiliated Ute and Superintendent of Insurance was the first that this Court had made clear that there is a private cause of action under rule 10b-5. The district, lower courts for some time had been finding such an action. But until at least there was judicial opinion at the top, there at least might have been some question in Congress why should we be running up there.

QUESTION: Well, I gather if we sustain the Birnbaum rule , then the Commission will go to Congress and ask them to overrule it.

MR. FERBER: I would think that that is certainly a possibility.

QUESTION: Do you always wait until this Court has acted, or have you sometimes gone to Congress with recommendations on the basis of Courts of Appeals' holdings?

MR. FERBER: I don't recall any incidents where we have on an interpretation of a Court of Appeals gone to Congress. I don't want to say, your Honor, that we never have.

QUESTION: Well, it has been around a long time in

the Second Circuit, and that's where an awful lot of these transactions take place.

MR. FERBER: That's true. The Second Circuit has been punching more holes in the rule than almost any of the other circuits, so that there are in many instances -- for example, it's the Second Circuit that said it doesn't stop an injunction, a private person can enjoin.

QUESTION: You and Mr. Ryan seem to disagree a little bit. He at least intimates rather strongly for me that the Ninth Circuit has just punched a hole, to take your phrase, punched another hole in the Birnbaum doctrine. You are taking the position that they have wiped it out, if I understood you.

MR. FERBER: No, your Honor, I don't say they have wiped it out. That's why we supported the petition because we felt they hadn't wiped it out, that they had carved out an exception where we felt they should have wiped it out.

I should say, by the way, on the en banc hearing, I may be wrong, but I think, if I'm not mistaken, there are 15 or 16 judges on the Ninth Circuit. That's one of the real big ones. So that the vote of five --

QUESTION: Thirteen.

MR. FERBER: Thirteen is it? I knew it wasn't just a five-six. It was a somewhat bigger majority that had voted against the --

QUESTION: The notation? is that the five judges

authorized the publication of their names. I take it a sixth judge might have voted for rehearing in banc but not wanted to authorize the publication of the fact.

MR. FERBER: I'm sorry, Mr. Justice Rehnquist. That had not occurred to me. I suppose it is possible.

QUESTION: I suppose your position would be that it's not uncommon for courts of appeals or other courts, intermediate courts, to evolve exceptions to rules over a period of time and that sometimes the exceptions sometimes swallow up the rule.

MR. FERBER: That's right.

QUESTION: But you now say that this exception doesn't swallow up the entire rule.

MR. FERBER: It certainly does not, and it leaves this completely arbitrary rule on the books.

QUESTION: And there is a square conflict in the circuits.

MR. FERBER: There is a square conflict.

QUESTION: Because the Seventh Circuit has explicitly declined to follow the Birnbaum rule.

MR. FERBER: Exactly, your Honor.

QUESTION: And whether this Court of Appeals for the Ninth Circuit can be said to have done more or less the same thing in fact or not done it is rather unimportant because other courts of appeals have said, "We do follow the Birnbaum rule."

MR. FERBER: That's right.

And why, for example -- one of the cases in the Second Circuit is illustrative, it seems to me, of the inequity. Actually, in that case they ultimately did find sale. But this was the case where in connection with a tender offer, the allegations were that there had been a misleading offer. Most of the stockholders turned over their shares, 90-some percent. And the corporation therefore was merged out of existence into the other one. The man who sued was one who had not sold his securities, and we urged the Court of Appeals in the Second Circuit at that time since he was not a seller in that sense to ignore or overrule their initial Birnbaum rule, and the Court of Appeals, however, did not do that. Instead they said ultimately he is going to have to sell his securities and therefore we will treat him as a seller.

Now, it seems to us that the logic would be that this man was defrauded. I would just like to --

MR. CHIEF JUSTICE BURGER: Your time has expired, unless you just want to cite a --

MR. FERBER: I just wanted to say that this Court in the case against Borak case stated that where rights under the Securities Exchange Act have been invaded, Federal courts may use any available remedy to make good the wrong done.

MR. CHIEF JUSTICE BURGER: Mr. Kreps, you have six

minutes left.

REBUTTAL ARGUMENT OF ALLYN O. KREPS

ON BEHALF OF PETITIONER

MR. KREPS: Mr. Chief Justice, and may it please the Court: With respect to the question of whether Birnbaum is actually an issue in this case and in further response to the question of Mr. Justice Blackmun, the motion to dismiss in the district court was expressly made on the ground of the Birnbaum rule, and the memorandum opinion of the district court squarely substantiated the dismissal of the complaint on the Birnbaum rule.

With respect to whether Birnbaum is in issue here and there is the inconsistency in the circuits, we again submit that there is an inconsistency in the Ninth Circuit between Mount Clemens and the majority panel below, and Judge Hufstedler in her dissenting opinion on page 143 of our appendix says flatly, "The result reached by the majority is inconsistent with the holding and reasoning of this court's recent decision in Mount Clemens Industries, Inc. v. Bell," and we think the reason that the majority found it necessary to adopt this exceptionally fuzay equivalent function analysis was that there, as now conceded by respondents, was no contractua right under the consent decree. And really what the functional equivalent language says is that we in essence are finding these people third party beneficiaries of a contract or a

consent decree. And the obvious danger of that reasoning is that every stock issue has an underwriting contract, and if you applied that reasoning, you could find every underwriting contract between the issuer and the underwriter and the subsequent brokers as a contract made for the ultimate benefit of the potential purchasers, and then you do genuinely get into the parade of true horribles which I indicated in my opening argument.

The only explanation we have for the panel below, the majority, going awry as much as it did is the hard facts alleged in the complaint. But if there is any merit to those hard facts, they may be vindicated in the State court action which is currently pending.

One last point, and that is with respect to Mr. Justice Brennan's question on the Eason case in the Seventh Circuit. Should the purchaser-seller rule be abandoned or bent in any manner? As the Eason court favored, it should be noted that in the Eason case the plaintiffs there in the words of the court suffered "as investors and as principles in the transaction" and they were shareholders in the corporation that sold stock for certain assets, and then they executed a personal guarantee of the liabilities on the acquired assets to someone else. They certainly could have brought an action, a derivative action on behalf of their own corporation as a result of the purchase or sale, and I think

the language of the Eason court indicates that they actually were principals involved. So that may not even be a departure from the purchaser-seller rule.

In any event, it would not be a sufficient departure to encompass the respondent in this case because everyone concedes that they are not purchasers, not sellers, not investors, and have never expended one dime. They are only seeking.

Thank you very much.

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

Thank you, gentlemen. The case is submitted.

[Whereupon, at 11:06 a.m., the oral argument in the above-entitled matter was concluded.]