In the

Supreme Court of the United States

BANKERS TRUST COMPANY

PETITIONER,

V.

SAMUEL MALLIS and
FRANKLYN KUPPERMAN,

RESPONDENTS.

No. 76-1359

Washington, D. C.
November 30, 1977

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IN THE SUPREME COURT OF THE UNITED STATES

BANKERS TRUST COMPANY, Petitioner,	:	
v.	:	No. 76-1359
SAMUEL MALLIS and FRANKLYN KUPFERMAN, Respondents.	:	

Washington, D.C.
Wednesday, November 30, 1977

The above-entitled matter came on for argument at 1:07 o'clock p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

JACK H. WEINER, Esq., 1775 Broadway, New York, New York 10019; for the Petitioner.

JOHN L. WARDEN, Esq., 48 Wall Street, New York, New York 10005; for The New York Clearing House Association, as amicus curiae.

NOEL W. HAUSER, Esq., 350 Fifth Avenue, New York, New York 10017; for the Respondents.

HARVEY L. PITT, General Counsel, SEC, Washington, D.C. 20549; for Securities & Exchange Commission, as amicus curiae.

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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 1359, Bankers Trust against Mallis.

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

ORAL ARGUMENT OF JACK H. WEINER, ESQ.,

ON BEHALF OF THE PETITIONER

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

Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934 does not proscribe all fraudulent schemes that have anything to do with securities. It only proscribes and renders unlawful those fraudulent schemes that are, quote, "in connection with the purchase or sale of any securities" end of quote.

The case presents two questions. One, whether a pledge of securities as collateral for a commercial loan was a purchase or sale herein within the meaning of the 1934 act which defines purchase, quote, "to include any contract to buy, purchase, or otherwise acquire"--end of quote--to permit a pledgee to bring an action under Section 10(b) and Rule 10b-5.

The second question is whether the "in connection with" requirements of the act are satisfied when a bank which releases collateral to its debtor upon the repayment of the indebtedness, as it was required to do under law, and the alleged sale is the pledge of securities by a third party to a

plaintiff who is totally unknown to the bank.

The facts in this case are fairly simple.

Q Did you say they are simple?

MR. WEINER: Yes, Your Honor, they are fairly simple.

Q I read the briefs in this case a week ago in an airplane, and I thought I was going crazy. [Laughter]

Maybe the altitude was getting to me.

MR. WEINER: Maybe I could help to clarify it. Feel free to interrupt and ask any questions, Justice Stewart. [Laughter]

Q We will not hesitate, counsel.

MR. WEINER: Thank you, sir.

Bankers Trust is a bank. It received approximately 40,000 shares of Equity National stock as collateral for a loan in August of 1970. At that time the lending officers received an opinion letter of counsel that the stock would be negotiable within six months. When a bank receives a pledge of stock, it does not look to the collateral for repayment. It primarily asks how the indebtedness is going to be repaid and looks at the credit worthiness of the borrower, plus other elements relating to repayment. A banker does not make a loan with the expectation that he is going to be required to foreclose on collateral to collect its indebtedness, regardless of whether the collateral is stock, real estate, cattle, or accounts receivable financing. A banker does not want to be

involved in an expensive foreclosure proceeding. He does not want to have to use lawyers. He merely wants the return of the monies he loaned.

The bank in this case played no role whatsoever in arranging with Mallis and Kupferman, the respondents herein, to borrow money from Franklin National Bank, which they then loaned to Arnold and Fowler and received a pledge of collateral from Arnold and Fowler.

Q Let me just isolate, if I may, the very first part of the transaction--

MR. WEINER: Good.

Q --which you described where the Bankers Trust received the pledge from the Georgia Bank.

MR. WEINER: It received it from Mr. Kates.

Q From Mr. Kates. Would you go so far as to say that if Mr. Kates had made a fraudulent representation with respect to the value of the securities that he was pledging to Bankers Trust and Bankers Trust alleged that it relied on that representation, that Bankers Trust would not have a 10b-5 action against Kates?

MR. WEINER: Our position is that Bankers Trust Company does not need to proceed against him in 10b-5. At the time he pledged the collateral--

Q Could it?

MR. WEINER: Our position, Your Honor, is that it

does not need that. He would have executed a note at that time as well as the pledge of collateral. And we could proceed against him on the note.

Q Could you proceed against him on the note under 10b-5?

MR. WEINER: No, we would not need that. We could proceed against him in state court.

Q Could you proceed against him by virtue of the fraudulent representation in connection with the pledge by virtue of 10b-5?

MR. WEINER: Our position is we do not need that as a remedy.

Q I was not asking you whether you needed it. I was asking whether it would be available if your management changed and the new management thought you did need it.

Q Is not your position simply that there would be no sale under the circumstances?

MR. WEINER: That is correct. There is no sale.

Q So, the answer is no.

Q That is all I was trying to find out.

MR. WEINER: The loan was in the process of being--do you have any other questions, Mr. Justice Rehnquist?

Q Not right now, no.

MR. WEINER: The loan was in the process of being repaid. In 1971 a dispute arose between Kates, the pledgor,

and Equity National, the issuer of the stock. Bankers was informed of the dispute by Equity National who asked that the stock be returned to them. They then contacted Kates, and Kates's attorneys advised Bankers not to return the collateral, but he was entitled to return of the collateral upon repayment of the indebtedness.

Bankers then informed Equity National that it was obligated to the return of the collateral to its borrower, Kates, upon repayment of the indebtedness. And it might consider talking to Equity National if it were indemnified. Equity National did nothing.

A year later negotations began between Kates, Arnold, and Fowler with respect to the Equity National stock as well as a block of odd a hundred thousand shares of Merck stock. And at that time Kates wanted to have these transactions handled together. Bankers did not introduce Kates to Arnold and Fowler and had no relationship there.

On February 24, 1972 a contract of sale was entered into between Kates, Arnold and Fowler with respect to the Equity National stock and with respect to the Merck stock.

Q There was a Mr. Kupferman somewhere in here too.

MR. WEINER: No, he comes in later in the picture. He is much later in the picture, Your Honor.

Q That particular sale you would concede is a sale within the meaning of the statute?

MR. WEINER: The sale between --surely.

Q Kates to Arnold and Fowler.

MR. WEINER: Kates to Arnold and Fowler is a sale.

Q The pledges were not in connection with that sale.

MR. WEINER: That is correct, sir.

Q The release of the pledge was not--

MR. WEINER: That is correct, sir.

In that contract the closing was scheduled for February 29th. On February 29th apparently Arnold and Fowler did not have the $156,000 but Fowler gave Kates and additional $10,000 to get an extension of time. He received a four or five day odd extension of time for this thing, and again this was unknown to Bankers.

Unbenkownst to Bankers, Mallis had some dealings with Mr. Arnold on or about March 1st. Arnold told Mallis of the deal, and he said someone could make some money if they would loan him the funds for which he would be able to consummate the transaction, he was going to make $400,000 out of $480,00 odd thousand.

Arnold suggested that he participate, and then in his affidavits, Mr. Mallis states that it was suggested also by Mr. Murfitt of Franklin National Bank that Mr. Murfitt told Mallis that Kates enjoyed a good reputation in the business world and that his securities appeared worthwhile and few if any restrictions were okayed.

Then there was an agreement by Mallis and Kupferman to borrow monies from Franklin and loan the money to Arnold and Fowler. Bankers again was totally unaware of this, Bankers was not present at any of these transactions with Mallis and Kupferman. On the morning of March 3rd, Mallis and Kupferman went into the offices of Franklin National Bank in the suburbs. They signed the necessary documents, and then Mallis was told by Murfitt no need to be present. He expected the transaction to be paid by the sale of a hundred thousand shares of Merck & Company stock.

The pledge transaction was a usurious contract because Dr. Mallis at the time he loaned these gentlemen $156,000 was going to make a, quote, "profit" of $50,000 within 30 days. Arithmetically computed, that comes to 383 percent. And this was raised by Mr. Fowler in the state court action.

The critical fact here is that no one alleges that Bankers Trust nor any of its representatives, including its attorneys, did anything either by action or non-action until the closing on the afternoon of March 3rd. Bankers did not introduce Kates to Arnold and Fowler. Bankers did not even know the existence of Mallis and Kupferman until after the closing and the beginning of the lawsuits.

Q Mr. Weiner, would it make any difference if the bank had introduced the parties or known all these details? Would that have any relevance to the legal issue?

MR. WEINER: It does not have any real relevance to the issue.

Q Then why do we dwell on those facts?

MR. WEINER: But they gave the in-connection here, the in-connection-with argument, sir.

Q Only for purposes of our decision, we would have to assume that Bankers Trust committed some kind of fraud but it is not in connection with the sale of the--

MR. WEINER: That is correct, sir.

Bankers' only function at the collateral was to return collateral to its debtor, Kates, upon repayment of the indebtedness as it was required to do under the New York Uniform Commercial Code.

At the closing, Arnold asked Kates for an affidavit on behalf of the respondents, Mallis and Kupferman. On the basis of information furnished by Fowler, he moved that there was a problem between Equity National, Kates, and Arnold. Fowler had contacted the president of Equity National, and he told Arnold of this. That is in the depositions in the state court which we just obtained. And Arnold accepted an affidavit from Kates saying that there were no restrictions.

At that time, Bankers had no knowledge with respect to these transactions. The stock was redeemed by Mr. Kates, and it was returned to the Kateses. Indeed, at the closing a check was offered to Bankers Trust Company made payable to

Bankers Trust Company and Kates. Bankers Trust Company refused to touch that check because Bankers Trust said, "I am not privy to any of these transactions."

Originally a state court of action was instituted against Bankers. That action was dismissed. The Court just said, "How could Bankers be liable when they did not know these people and had nothing to do with these people?" But at the same time that action was dismissed, a suit against Fowler and Arnold, who were still part of that action, alleging a breach of contract as well as fraud. Fowler and Arnold instituted third party actions on the breach of contract against Bankers. These actions are still pending in the state court. Indeed, the deposition of Mallis by Bankers is now scheduled for February 1, 1978. This is plainly an analogous situation to the Blue Chip case and Birnbaum whereby there is a remedy in state court. The cases are still pending in the state court, and there is no need for 10(b) or 10b-5 in this situation.

It is our position that a pledge of stock is not a sale within the meaning of the act. The plain language of the act in Blue Chip Stamps and Hochfelder, as pointed out by this Court there, stated that since we are dealing with a judicially created right, the Court must construe the statute narrowly, and the statute requires that there be a purchase or sale. A pledgor of stock is not a seller of stock. All

right, title, and interest remain in the pledgor. The pledgor has the right to the dividends. He has all voting rights. Any increase in value of the stock remains in the pledgor. And he has the right to dispose of the securities when and to whomever he wishes. A pledge is merely a security interest, and the pledgee, as is Bankers, must act in accordance with law. And the Uniform Commercial Code very carefully defines the duties and obligations of a pledgee in that situation.

Q Mr. Weiner, when you talk about the act, I take it you are talking about the Securities and Exchange Act of 1934.

MR. WEINER: That is correct, sir.

Q And yet I look at the complaint, and it seems--the action seems to have been brought under the Securities Act of 1933.

MR. WEINER: The action was originally instituted under the Securities Act of 1933. In fact, they even assert in that that the only obligation of Bankers was to return the collateral to Mr. Kates. Subsequent thereto, there were various attempts to amend the complaint, and they attempted to amend the complaint by making numerous affidavits to Judge Pollack. Judge Pollack treated these affidavits as if they were part of an amended complaint and treated this as if it were an action under the 1934 act and Rule 10b-5. And that is how it proceeded from Judge Pollack to the Court of Appeals.

Q And it is clear now all around, is it, that the complaint is under the '34 act--

MR. WEINER: That is correct. We are litigating it as--

Q --and Rule 10b-5?

MR. WEINER: --10b-5, Rule 10b-5 violations.

Q Promulgated under that statute.

MR. WEINER: Yes.

Q The complaint does not indicate that at all.

MR. WEINER: I know it does not.

Q Mr. Weiner, do you contend there is a difference in the meaning of the word "sale" between the '33 act and the '34 act?

MR. WEINER: Yes, there is. There is a very plain difference, sir. "Sale" in the '33 act is much broader than it is in the '34 act.

Q It uses the word "pledge," does it not?

MR. WEINER: No, it does not. They say otherwise dispose of an interest for value. We would prefer that that act also be construed as not including a pledge.

Q It is pretty hard to do so, would it not be?

MR. WEINER: Pardon?

Q It is pretty hard not to say a pledge is a disposition of an interest in a security.

MR. WEINER: The SEC, Allan Trupe, the Fairlie

general counsel--it was decided in our brief--refer to that definition, and they sort of indicate that a pledge was not a sale for purposes of the 1933 act.

Q But, in any event, we are dealing here with the '34 act and Rule 10b-5 promulgated thereunder.

MR. WEINER: We are dealing with the '34 act, sir, right.

Q And there is no statutory definition of sale; is that right?

MR. WEINER: There is none in the act, sir. It is just sale or purchase.

I am saving time for the Clearing House.

As this Court has stated in its recent decisions in Santa Fe, Piper, and Blue Chip Stamps, Congress in enacting the 1934 Securities Act did not intend to create a federal commercial law. Congress merely intended to regulate the sale and purchase of securities as an investment. Congress did not intend to get involved with blending the commercial paper situation in this area. Indeed, if we broadly construe purchase for 10b-5 purposes, as sought by the SEC and as found by the Second Circuit, would render an unmanageable flood of litigation. Whenever a loan goes into default, the debtor frequently will utilize any source to avoid and delay repayment of an obligation because, as this Court is aware, the federal rules are very extensive with respect to discovery, and summary

judgment is much more difficult to get in the federal courts than it is in the state court action. And the federal courts have a sufficient burden to handle litigation properly before it. They should not be and do not need to be involved in extensive litigation which is properly the subject of state court action.

If, as the SEC and Mallis assert, at any time a transaction touches securities, the transactions will be subject to the federal courts, the scope of 10(b) and 10b-5 would be extended far beyond what Congress intended. Congress plainly did not intend to include as part of the securities law the release of collateral from a pledge.

Although, as Justice Stevens asked, we do not believe that there was any misrepresentation--and there was no purchase--nonetheless, before an action can be instituted, the plaintiff must satisfy the statutory requirement in connection with between the alleged misrepresentation and the purchase or sale. There must be a nexus or causation between the defendant and the plaintiff. In this case there was no such nexus.

Bankers did not know of their existence. Bankers accepted the pledge of collateral in August, 1970. Its customer redeemed the collateral on March 3, 1972. The contract had been entered into to purchase the collateral on February 26th. And everything had been locked in long before there was any participation of Bankers at the closing. There is no

possible way of imposing upon Bankers a duty to make any disclosure when it did not even know these people's existence. Bankers was only a passive participant in a transaction organized by Arnold and Mallis.

The Court of Appeals sought to place a connecting link by finding that Bankers was a seller by release of the collateral and Mallis and Kupferman purchasers by virtue of the acceptance of the pledge. But this finding skips two intervening transactions. Bankers released the collateral to Kates. Kates had sold the stock to Arnold and Fowler. And Arnold and Fowler may have pledged the stock to Mallis and Kupferman. There was no real connection in this situation. A bank's release of its collateral to its debtor is plainly no representation of the value of the collateral to any third party nor of its bona fides to any unknown third party.

As Judge Cardoza stated in Ultra Morris and recognized by this Court in Blue Chip Stamps and Hochfelder, to hold Bankers Trust liable in this case would be to extend liability in an indeterminate amount, for an indeterminate time, to an indeterminate class. Congress did not so intend to expand the securities laws.

Q Do I correctly read the Second Circuit opinion as relying on cases that arose chiefly under the '33 act rather than the '34?

MR. WEINER: That is correct, sir.

Q But there is a much broader definition of "sale."

MR. WEINER: That is correct, sir. Gentile and Guild Films were both '33 act cases, and they were both enforcement actions. In fact, this Court in National Securities stated that there is a distinction between a 10b-5 action and an enforcement action. And that is what the Second Circuit did.

Thank you.

MR. CHIEF JUSTICE BURGER: Mr. Warden.

ORAL ARGUMENT OF JOHN L. WARDEN, ESQ.,

ON BEHALF OF THE NEW YORK CLEARING HOUSE ASSOCIATION, AS AMICUS CURIAE

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

The principal proposition that is decisive in this case is the fact that the words "purchase" and "sale" used in the 1934 act are ordinary words and under the teachings of this Court must therefore be accorded their commonly accepted meanings. Those commonly accepted meanings do not include pledge transactions, that is, the pledging of securities or other property or the release of a pledge. Purchase and sale involve the transfer of ownership for consideration. A pledge does not transfer ownership or a general property interest in the pledge property.

I might say at this point in response to Mr. Justice Stewart's question earlier about the statutory definition,

that does include pledge. That is in the Public Utility Holding Company Act of 1935. And its inclusion there, we submit, shows that when Congress wants to impose upon a common word such as "purchase" or "sale" an artificial or special meaning to avoid repetition of a lengthy number of terms in order to achieve the purposes of the statute, it knows perfectly well how to do so.

There is no indication in the legislative history or otherwise that either the 1933 act or the 1934 act was intended to regulate credit transactions in the ordinary course of business on a face-to-face basis. As Professor Loss has pointed out in criticizing even the Guild Films decision under the '33 act, federal law was not required to deal with individual loan transactions.

What Congress was concerned about was the regulation of primary and secondary public securities markets of this country. The statutes as drafted of course cover personally negotiated purchases and sales, a point made by the SEC in its brief. And that is quite true. The statutes as drafted, both of them, do cover that. That indicates that Congress did not attempt to draw the line between public trading in securities and private purchases and sales of securities. But it did deal with purchases and sales, not with regulation of credit transactions.

The Court of Appeals and the SEC in its brief have

suggested that the ordinary meaning of purchase and sale should be disregarded because of the statutory definition which says sale includes a contract to sell or otherwise dispose of. There is nothing in the legislative history that indicates that the addition of the words "or otherwise dispose of" was intended to take away the very core of the meaning of the word "sell." In fact, as we point out in our brief, a strict definition of the word "sell," as obtained at that time, involved the transfer of ownership for a price paid in money. And the words "or otherwise dispose of" tend the definition of the word "sell" to an exchange or barter transaction or, as this case held in SEC v. National Securities, a statutory merger where there is in fact an exchange of ownership but not for consideration in money.

To attempt to read anything more into those words without any warrant in the legislative history is to engage in construction by speculation.

Q Do you think there has to be a transfer of title, so to speak, transfer of ownership?

MR. WARDEN: Mr. Justice Stewart, I think that it would probably be sufficient if there were a purchase and sale in the ordinary informal sense--that is, if I said to someone, "I will sell you a part interest in the 100 shares of General Motors that I own," and he said, "Fine, I will pay you a thousand dollars for that" and I took it, I think that would be

a purchase or sale within the meaning of the statute. I do not think that transfer on the books as a transfer agent or turning the shares in to get two-fifty share certificates would be required.

Q Mr. Warden, what about the phrase "in connection with"?

MR. WARDEN: Your Honor, I do not think that anything that was done or alleged to have been done by Bankers Trust in this case is in connection with the transaction of which the plaintiffs complain. That transaction, as Mr. Weiner pointed out, was entirely arranged before this closing occurred in the offices of Bankers Trust.

I might point out that that aspect of the case is one of the aspects of the case that has raised very serious concern in the banking community because it is quite a common thing for banks, which after all maintain conference rooms for the purposes of closing, to afford the use of those rooms to their customers for the conduct of transactions. And if that brings one's activities into disputes that otherwise do not involve the bank, what you have is an inhibition on the banks making facilities available to people, which does not serve the public interest in any way.

Q Mr. Warden, is that quite correct? I understood Mr. Weiner to agree that we must assume that the bank is charged with a fraud here, and we have to accept that for

purposes of the case. That is something more than making a conference room available, is it not?

MR. WARDEN: It is not quite clear for me in this record--I happen to agree with Mr. Justice Stewart that the facts in this case are rather hard to understand. It is not quite clear what it is that supposedly constituted that misrepresentation or how it was in connection with the transaction of which these plaintiffs complain, Mr. Justice Stevens, in that it is clear from the facts--and there are more facts here than there are in most motion-to-dismiss situations, there were a lot of affidavits and there was a state court record--that the transaction was entirely arranged by the cases with Fowler and Arnold and that Fowler and Arnold found these plaintiffs and that Bankers Trust Company had never heard of them. And then the closing occurred, and it is alleged that some unknown kind of misrepresentation was made at that closing, but the closing was a ministerial proceeding.

Q Stop right there. Wait a minute. Is it not alleged--and do we not have to assume it for the purpose of decision--it may not be proved ultimately--that at the closing Bankers Trust made a fraudulent misrepresentation? Let us assume that for purposes of decision.

MR. WARDEN: That is what the Court of Appeals decision--

Q So, that is different from just making a

conference room available.

MR. WARDEN: That is what the Court of--no, but I think that does indicate, Your Honor--you are quite right. That is what the Court of Appeals decision says, and this Court must assume it. But I do not think that that is entirely different from the point I was making because talk of that kind is pretty cheap and once they are in the conference room and these transactions occur and instruments are passed across the table, it is very easy for someone to allege--and this allegation, by the way, three years after the state court complaint was dismissed, the allegation of misrepresentation made in this case is made on information three years after their case has been thrown out of the state court.

Q Mr. Warden, it may be a very weak case, but that has nothing to do with the legal question we are supposed to decide.

MR. WARDEN: Proceeding from there, we do have to decide whether the misrepresentation was in any way in connection with. What is that misrepresentation and how could it be in connection with? Either Bankers Trust would have to be considered a seller--and the Court of Appeals handled that problem by saying that the release of the pledge was a sale and with no further explication at all. And all the release of a pledge is is the performance of a duty imposed on the bank by law upon payment of the loan. Or somehow there would

have to be a finding that Bankers Trust was an aider and abettor, and this Court has expressly reserved in Blue Chip Stamps the question of whether there is any civil liability for aiding and abetting under 10b-5. One or the other of those bridges would have to be crossed in order to make this misrepresentation that this Court must assume existed--I quite agree.

Q Are not all those matters that were to be resolved at a later stage in the proceeding, Justice Stevens suggested?

MR. WARDEN: Your Honor, I think that they are both questions of law. Whether a release of a pledge is a sale under 10(b) is a question of law. And I submit that the answer to that is no it is not. And whether there is civil liability for aiding and abetting under 10b-5 is a question of law. Then if that question is answered in the affirmative, the plaintiff would be free to attempt to prove the aiding and abetting.

Q In other words, I take it what you are saying is that if the Court of Appeals had read the 1934 act definitions, they would have arrived at this result as a matter of law.

MR. WARDEN: That is correct, Your Honor.

Q And no one would have to delve into the facts.

MR. WARDEN: That is correct, Mr. Chief Justice. It is our position that these statutes on their face and in the history were not passed to regulate credit transactions, and

that a loan, whether or not secured by stock or other property remains a loan and is not, as the SEC contends, an investment in securities. Thank you.

MR. CHIEF JUSTICE BURGER: Mr. Hauser.

ORAL ARGUMENT OF NOEL W. HAUSER, ESQ.,

ON BEHALF OF THE RESPONDENTS

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

As counsel to the respondents, I have agreed to share my argument time with the general counsel to the SEC. And he will generally argue that the pledge of stock is the equivalent of a sale for the purposes of the Securities and Exchange Act of 1934 and that therefore the respondents have standing as pledgees to sue.

The appellants, it seems to me, have spent most of their argument time in arguing against the position taken by the SEC in their brief, amicus curiae to this Court. I, on the other hand, represent some people who are out $156,000 as a result of what I consider to be egregious fraud.

In view of the fact that some of the members of the Court apparently have had some problem in obtaining the facts from this record, which comes about because Judge Pollack dismissed the complaint before any discovery and even in advance of a motion to dismiss.

Q He denied leave to amend, did he not?

MR. HAUSER: He denied leave to amend. He permitted no opportunity to discover any facts which would allow the opportunity to discover the jurisdictional basis.

Q You cannot file a motion for discovery until you have received permission to file your amended complaint.

MR. HAUSER: That is correct.

Q And he denied leave to amend.

MR. HAUSER: He denied that leave.

Q So, you cannot complain about the lack of discovery.

MR. HAUSER: I can complain about it in this respect. In Woodward against the Bank of Dallas, which is cited by the briefs by the parties to this Court, the District Court in a similar situation, a pledge situation, and held twice before the trial that dismissal in a pledge situation of a 10b-5 case would be premature because the plaintiff might be able to prove enough facts to spell out the requisit staying to sue as required by Rule 10b-5. And eventually when the case did reach the Fifth Circuit, I think it was, the Court dismissed the complaint but not on the basis that there was not any jurisdiction. They expressly found there was jurisdiction where stock had been pledged to a bank; dismissed it on the ground that the bank's knowledge of what had occurred with respect to a fraud was insufficient to impose liability upon them. We were denied that opportunity.

Q This gigantic fraud before you were talking about, how much of that is involved in the litigation now pending in the New York State courts?

MR. HAUSER: The amount that the plaintiffs are out at this time is $156,000, plus five years interest. As regards their action in the state court, it has been dismissed as against Bankers Trust Company. They have no claim against Bankers Trust Company now. The only thing they have is a claim against the so-called buyers of record, Arnold and Fowler, who are deceit, breach of contract, malpractice, whatever else they could think of. Those parties in their turn have asserted a third party claim against Bankers Trust Company. But the plaintiffs do not have Bankers Trust Company as a direct defendant in that action.

There are restrictions on the transferability of the stocks in question, and they were spelled out on the certificates themselves. They are made a part of the record at pages 34 and 38. Bankers was advised by hand-delivered letter from the issuer of the securities, Equity National Industries, in March of 1971 that these stocks were worthless. At that time they held the stock as collateral, having received it from Jerome Kates.

They received a second letter from the issuer in April of 1971. They knew they were in trouble with this stock and Kates because they went so far as to reduce their claim

to judgment on July 20, 1971--

Q When you say they knew they were in trouble, you mean they knew that the pledge they had taken in security was very likely worthless?

MR. HAUSER: Absolutely. I do not think it is a common experience on the part of banks which have made loans to reduce their claims to judgment where they hold collateral. But in this case they did so. On July 20, 1971, judgment was entered in favor of Bankers and against Jerome Kates and Judith Kates who had pledged the stock to the bank.

In February of 1972 the issuer commenced an action in the District Court. And on March 3, 1972, a closing took place. Bankers says--and there is no support for it in the record--that they were served with a summons and complaint which had been filed a month before in the District Court on March 10, 1973, one week to the day after the closing. In the state court action they thereafter made the representation to the court that they believed on the closing that the stock was valuable. They certainly made that same representation in the closing room where my clients, through the representative of the Franklin National Bank, expended the sum of $156,000.

Q Is that in the record?

MR. HAUSER: Yes.

Q I mean, the fact that they made the representation, or is it just alleged?

MR. HAUSER: No, the plaintiffs have an affidavit as part of the record there. It appears as part of the record that an affirmative representation was made by a representative of the Bankers Trust Company. I understand that this Court is not bound by facts which are not in the record, but for whatever it is worth, I can make the affirmative representation that I have an affidavit in my own file to that effect.

Q Is the affidavit in the record?

MR. HAUSER: The affidavit was not obtained until after the record was filed in this Court.

Q You mean their affidavit was not before Judge Pollack?

MR. HAUSER: The plaintiffs' affidavit was before Judge Pollack.

Q The plaintiffs' affidavit--

MR. HAUSER: Yes.

Q --was before Judge Pollack?

MR. HAUSER: Yes, it was.

Q Is it now included?

MR. HAUSER: It is included in the record for this Court.

Q Does that include a representation about the Bankers Trust representation?

MR. HAUSER: You mean in the complaint which we were not allowed to amend? The answer is no.

Q But the affidavit, that was before Judge Pollack?

MR. HAUSER: Yes, the affidavit alleges that--

Q Where is that?

MR. HAUSER: Page 110.

Q This is before Judge Pollack?

MR. HAUSER: Yes, sir. Yes, page 110.

Q What does it say and what are you referring to?

MR. HAUSER: I will quote the language exactly.

"We are informed by our attorneys and believe that we have a good and meritorious cause of action against the defendants Federal Deposit Insurance Corporation and European American Bank, as well as Franklin National Bank"--I will skip down to (b)--"against Bankers Trust Company which withheld vitally material information from us and our representatives and, as we are informed, actually misrepresented that the securities in question were genuine when in fact they were not."

Q Informed by whom?

MR. HAUSER: By the representatives--

Q This would not help me at all because I do not know a thing from this. We start off with "we are informed" and we end up with "we are informed."

MR. HAUSER: "Bankers Trust Company withheld vitally material information from us and our representatives."

Q I understood you to say that there was an affidavit which said positively that Bankers Trust said that this was good.

MR. HAUSER: Yes, sir.

Q Where is that here?

MR. HAUSER: Right here.

Q That is not information.

MR. HAUSER: Yes, it is.

Q That is no good.

MR. HAUSER: We were denied the opportunity, as I mentioned before, to amend our complaint so as to affirmatively allege it. We have not had that opportunity.

There are three reasons why this Court should affirm the District Court's--the Second Circuit's decision. In the first place, it is not at all clear, whatever the plaintiffs may have understood this transaction to have meant to them, they say that they were lenders. They understood that they were lenders. But the only document in the record which indicates what their relationship was with Arnold and Fowler appears at page 49 of the record, and I would call Your Honors attention to the language of the letter.

"Your participation in the purchase," says Mr. Arnold to Mr. Mallis. "You are advanced $156,000 towards the purchase price." "Your participation in the trade." "Your investment." And finally "you will be reimbursed."

A loan presupposes that it will be repaid. But nowhere in that letter does it say by whom.

I do not think that any member of this Court would grant summary judgment against Arnold and Fowler on the theory that he received the loan from Mallis or Kates. It seems to me that if they did not borrow the money, that neither Mallis nor Kates was a lender--and I think it is too early to conclude what their condition was. Certainly you cannot conclusively assume that they were lenders rather than participants in the trade.

Let us assume for a moment that they were lenders. If, as this Court has said, the starting point for the determination of standing to sue under Rule 10b-5 is the statute and the statute says that a form made--and I quote--"in connection with"--close quote--a sale is the trigger for a 10b-5 liability.

Of course there was a sale here. The reason that the case is perhaps a little confusing is because it is sandwiched in between the release of one pledge and the creation of another pledge. But the pledge to Mallis and Kupferman was simultaneous with the purchase by Arnold and Fowler, if indeed they were the purchasers. I draw your attention to the fact Arnold, when he signed the purchase agreement, signed it as attorney--that is, in a representative capacity.

There could have been no sale except for the fact that Mallis and Kupferman came with the money, through their representative of vourse, to a closing. At the closing their money was expended, and the sale took place.

Q Mr. Hauser, the sale you are describing now is the sale from Kates?

MR. HAUSER: Yes, sir.

Q And not from Bankers Trust.

MR. HAUSER: No, not from Bankers Trust. I do not claim that Bankers Trust was a seller, and I do not think that the--

Q You do not claim that the release of the pledge was a sale then?

MR. HAUSER: I do not believe that the mere release of a pledge is a sale, no.

Q So, you do not say Bankers Trust is a seller?

MR. HAUSER: I do not believe that Bankers Trust is a seller. Within the meaning of the act, I do not believe that they were the seller.

The next question is, Were the plaintiffs connected? They advanced at the closing 86 percent of the purchase price of this stock, and they received at the closing all of the thing sold. They were more connected than Arnold was because Arnold put up less than 24 percent of the purchase price. There could have been no sale without the use of their funds at

the closing. They were directly and intimately connected with the sale. To say that they were not imposed upon in connection with--in the words of the statute--a sale is to make a mockery of what the statute calls for.

Q Does not the Second Circuit opinion seem to be in some disagreement with you on whether the release of the pledge is a sale--

MR. HAUSER: Yes.

Q --or Bankers Trust--

MR. HAUSER: I do not think that--to the extent that the Second Circuit said that the release by Bankers of the pledge was a sale of stock, I do not think that it was necessary to their decision. I think that all that was required was a--

Q Do you think they thought it was?

MR. HAUSER: Do I think that they thought it was a sale?

Q Do you think that holding was essential to their decision?

MR. HAUSER: I do not think so. I think that they could have--that the decision would have been the same way strictly on the basis of a finding that plaintiffs were buyers within the meaning of the statute.

Q And that this release was in connection with the sale?

MR. HAUSER: Yes.

Q Your position then is that a fraudulent representation by someone who himself is not a seller is actionable under 10b-5?

MR. HAUSER: Absolutely.

Q It is necessary for you to claim, and for us to agree with you, that a pledge is a sale?

MR. HAUSER: No, I do not think so.

Q Because you say there was a sale that took place here and this release was in connection with the sale?

MR. HAUSER: Right. I say that if a sale occurs at the identical time as does the pledge, that the pledge is in connection with the sale. You cannot have a sale without a pledge.

Q How do you view the question of whether a pledge is a sale?

MR. HAUSER: How do I view whether a pledge is a sale?

Q Is a pledge a sale or not?

MR. HAUSER: I do not think that it is necessary for--

Q So, you disagree with the Court of Appeals again.

MR. HAUSER: I do not disagree with the Court of Appeals on that. I do not think that it is necessary to reach that conclusion as to whether every pledge ipso facto

constitutes a sale within the meaning of the Securities and Exchange Act.

Q You would not suggest that the Court of Appeals did not think it was necessary for its decision to hold that a pledge was a sale?

MR. HAUSER: I do think that the Court of Appeals so thought.

Q But you do not defend that conclusion?

MR. HAUSER: I do not necessarily defend that conclusion. I do know that somehow, somewhere--I do not know exactly when--where fraudulent securities are pledged to a pledgee, I know that somewhere there comes a time when the pledgee has standing to sue for violation of Rule 10b-5.

Mr. Justice Rehnquist asked a question during the course of Mr. Weiner's argument, What would happen if a note was given and stock given back in exchange? And Mr. Weiner--my time is up.

Q I would be interested to hear what you were going to say on that.

MR. HAUSER: And Mr. Weiner responded that there would not be any answer, that there is no--that there would be no occasion to go to a 10b-5 remedy. But suppose, for example, that the note itself was a forgery and the fellow had sent along his collateral and now denied liability although conceding that he had sold the stock for whatever purpose.

The bank would be foreclosed from serving on the debt but they would not be foreclosed from serving on the 10b-5, and it is not a farfetched possibility.

Q Your position, I take it, is that you can rely on the sale from Arnold to Mallis and the misrepresentation made by Bankers Trust was in connection with that.

MR. HAUSER: Positively, specifically.

Q That would protect the new pledgee or not? Could the new pledgee recover too?

MR. HAUSER: Yes. The plaintiffs are the new pledgees.

Q Yes, I know.

Q If they are the buyers. You said that you do not need to hold that they are buyers at all.

MR. HAUSER: I said that--

Q Let us assume that they are not buyers, that a pledge is not a sale or a purchase.

MR. HAUSER: Yes.

Q So, the new pledgee is not a buyer, and he did not get the stock from a seller. But Bankers is not a seller either, but it makes a misrepresentation in connection with a sale. The new pledgee can recover?

MR. HAUSER: Yes. I say that the sale which the pledgee generates with the use of his funds is sufficient to supply the statutory requirement of in-connection-with the sale.

Q That certainly is not the theory of the Court of Appeals, is it?

MR. HAUSER: No, I do not think it is.

MR. CHIEF JUSTICE BURGER: Mr. Pitt.

ORAL ARGUMENT OF HARVEY PITT, ESQ.

ON BEHALF OF THE SECURITIES AND EXCHANGE COMMISSION, AS AMICUS CURIAE

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

Q Do you think, Mr. Pitt, that the Court of Appeals stands independent of the analysis we have just been discussing?

MR. PITT: I think that the analysis of the Court of Appeals with respect to a pledge being a sale is correct. We take no position on whether the release of stock with respect to a natural fulfillment of the pledge agreement is a sale for purposes of the act. And, as the petitioners themselves argue, that was irrelevant to the--

Q You think the Court of Appeals did not need to say that?

MR. PITT: I think that the opinion stands analytically without that holding. It may well be that some of the judges on the Second Circuit were concerned about finding a completed transaction, a sale on a purchase. But I think, as our brief attempts to demonstrate, analytically there was a

sale with respect to the pledge transaction.

Q You think then that there is very little chance, if we were to disagree with the Court of Appeals on whether a release is a sale, there is very little chance that if we remanded it to them they would come out any other way than they did?

MR. PITT: I would agree with that. I would also say at this juncture that our concern is not with the release of securities after a pledge transaction, although there is a conceivable possibility that in some circumstances fraud may be induced in the holder of the collateral and that that might be actionable.

Q So, in your view, Bankers' liability rests on finding that if they made a misrepresentation, it was in connection with the sale, not that they were a seller?

MR. PITT: That is correct. I think that we have gotten away from privity. And, as I understand Mr. Justice Rehnquist's decision in the Blue Chip Stamps case, this Court specifically referred to the fact that 10b-5 has gone light years away--

Q What sale do you say their release was in connection with, the new pledge?

MR. PITT: If I may, Your Honor, not the release. The sale occurred when Arnold and Fowler pledged their stock to Mallis and Kupferman, and Bankers Trust affirmatively made

a misrepresentation to these plaintiffs--

Q So, it is in connection with the new pledge that you say they made a misrepresentation?

MR. PITT: That is correct, and that is all this Court need focus on, except in so far as it may be concerned about the motivation of Bankers Trust, as is alleged in the pleadings in the courts below.

Q So, we are not talking here at all about the pledge by Kates to Bankers Trust nor the release by Bankers Trust of the collateral.

MR. PITT: Definitely not. We are talking solely about the pledge from Mallis--I am sorry--from Arnold and Fowler to Mallis that was induced by Bankers Trust's affirmative misrepresentation as alleged in the papers in this Court pursuant to this cause.

Q Again it is quite a deviation from the Second Circuit's reasoning, is it not?

MR. PITT: Pardon?

Q Is this not quite a deviation from the reasoning of the Second Circuit?

MR. PITT: Your Honor, I believe that is precisely what the Second Circuit was holding with respect to that side of the transaction. That is the--

Q That is the pledge.

MR. PITT: That is the pledge. The Second Circuit

also felt--

Q The release to Kates by Bankers Trust of the collateral was a sale and said that.

MR. PITT: Yes. But analytically once Bankers Trust was satisfied as to the legal terms of its contract with Kates, it is arguable that that release should not be deemed a sale. That is not of concern in this case, and that is not an issue we think that is before this Court.

Q And then we have now a third theory to support 10b-5 liability, i.e., that Bankers Trust made a misrepresentation in connection with a sale from A to B, Bankers Trust being X. That is the theory being advanced by your brother, as I understood.

MR. PITT: If I have given the impression that there is yet a third theory, then I must apologize.

Q It is not you, it is your brother's, as I say, who--

MR. PITT: I believe that the theory that we have espoused is totally consistent with the Second Circuit's decision.

Q I do not know how you can say that we do not have before us the question of whether a release is a sale. The release of a pledge is a sale; the Second Circuit said it was. And if that were sustainable, you might get one result in this case; and if it was not, you might get another.

MR. PITT: Analytically I would submit that that is irrelevant to the decision, and I would like to explain why.

Q I know. I think you have already submitted it.

MR. PITT: I would like to explain why, if I may. Before it occurred, in connection with the misrepresentation made to Mallis to pay over funds sufficient to accomplish the purchase and upon which he was induced to rely on the investment value of the securities that served as collateral for the loan transaction, if there was fraud--as this Court must assume, based on the procedural posture of this case--then Arnold and Fowler, in pledging the stock--I am sorry--Mallis and Kupferman in taking the stock were defrauded, based on the investment value of that stock. It matters not that prior to that transaction, Bankers Trust released the stock to Kates so that Kates could give it to Arnold and Fowler. That is really irrelevant to the fraud in this case.

Q Mr. Pitt, Bankers Trust--paragraph on page 110, do you have anything more than that to show its implication? Or are you also relying on this one paragraph about the informance?

MR. PITT: Your Honor, we are relying on 110. As I understand it--

Q And what else?

MR. PITT: No, on 110 as to the affirmative misrepresentations, yes.

Q And what else?

MR. PITT: What else? We are relying solely on the fact that as a motion to dismiss, this can be pleaded on information and belief.

Q All I am trying to get at is this is all we have.

MR. PITT: This is all, Your Honor.

Q This was a denial of a motion to amend, not a motion to dismiss, was it not?

MR. PITT: Your Honor, as I understand the procedures, what occurred here was that Judge Pollack instituted a motion to dismiss on his own suggestion and, in connection with that, refused to allow an amendment of the complaint.

However, in his decision dismissing the complaint, which is what he did, he indicated that he would deem the complaint most favorably alleged under Section 10(b) and Rule 10b-5. So, he effectively extrapolated all of the materials that are before this Court and deemed it to be an amendment and still dismissed it. But he denied formal leave to amend the complaint.

Q According to the Court of Appeals, there was no judgment in the District Court.

MR. PITT: Except a motion to dismiss.

Q A motion is not a judgment.

MR. PITT: I am sorry--except the dismissal of the

action.

Q They say every good case requires a mystery document. In this case the missing document is the judgment.

MR. PITT: That may be, Your Honor.

Q Mr. Pitt, I take it from what you have said that it would not have made any difference to your position whether there had ever been a pledge to Bankers and released by Bankers; is that correct?

MR. PITT: No. Although I think when this case is tried, one of the allegations that the plaintiffs appear to be making is that Bankers, realizing it had a defective set of securities as collateral, was anxious and deliberately misrepresented the value of that stock so it could get out of its bad transaction. In that sense, I think it might be relevant. But of course that is speculation at this juncture.

Q That goes to the merits of the case.

MR. PITT: And that is precisely what we have been hearing to some extent, I must say respectfully, from my brothers. The issue in this case--

Q The question here is whether or not there was a purchase or sale within the meaning of the act, the '34 act--

MR. PITT: That is correct.

Q --10b-5. And, as my Brother Powell suggests, that question is wholly interdependent of whether there had ever been a pledge by Kates to Bankers Trust.

MR. PITT: That is precisely our position.

Q Bankers Trust could have held the securities in safekeeping, not having ever received them under a pledge.

MR. PITT: Analytically that would not affect the allegation of fraud in this case. I quite agree. Indeed, if I may assert what we think the issue is, we would assert that when a person is deceived into parting with money in exchange for an interest in securities, that is precisely the type of situation to which the federal securities laws' anti-fraud protections were intended to apply.

Q But there has to be a sale.

MR. PITT: There must be a disposition of an interest which is a sale; that is correct.

Q And the pledge by Arnold to Mallis and Kupferman was a sale under your theory?

MR. PITT: Yes, it was. Yes, it was.

Q May I ask this, since I interrupted you: How long has the SEC taken the position you take here today that a pledge is a sale?

MR. PITT: We have taken that position since the late 1950s.

Q Have you issued any releases to that effect?

MR. PITT: We have filed a number of lawsuits. We have a number of cases which are set forth in our amicus brief before this Court. We have articulated that. In certain cases

we have exempted pledge transactions where they would otherwise be included within the definition of a sale. Indeed, the petitioners take comfort, surprisingly to us, from our Rule 16a-6 in which we specifically felt the need to exempt a pledge from the operative term "sale" for purposes of that rule so as not to encompass those pledges in that special limited circumstance. But otherwise we have taken this position consistently since the 1950s.

Q Is there anything in the legislative history of either act of '33 or '34 that supports your position that a pledge is a sale?

MR. PITT: If there is something specific on pledges, I must confess I am unaware of that. However--

Q The hearings that led up to those acts were very extensive, and they dealt with all sorts of problems relating to securities. It would be curious, I would have thought, not to have gotten into the business of lending money and putting up collateral if Congress had intended to deal with it.

MR. PITT: Your Honor, I had occasion before coming here today to review our amicus brief in the Superintendent of Insurance case where this Court expressly held that not only shareholders but creditors were specifically within the intendment of the Securities Exchange Act protections for anti-fraud. And in our brief we did cite legislative history

which was rather diffuse. I cannot tell you that there were express references to pledge transactions. But it talked about the value of securities held by banks, the value of securities held by insurance companies, the mass of loans that were utilized. And I would point out to the Court that Section 2 of the Securities Exchange Act talks about making and preserving the investment decision of investors reasonably complete and effective from anti-fraud provisions, so that I do not think there is any question that the Securities Exchange Act covers any situation in which there is an investment intent and an investment interest.

I think it would be anomalous to suggest that when someone puts up $156,000, largely on the reliance on the underlying value of securities, and then takes possession of those securities, that that does not constitute an investment decision that this Court in National Securities talked about in terms of the definition of sale and in Blue Chip talked about in terms of the limited coverage of some of the exemptions this Court has applied more recently.

Q Mr. Pitt, in that connection, this transaction is quite extraordinary. It is very rare that private individuals lend this sort of money. The Securities Acts were concerned primarily, I had thought, with protecting unsophisticated investors. Here we are dealing primarily with banks and lending institutions, by definition sophisticated

investors. The acts certainly were not designed primarily to protect them. I suppose you would agree with that.

MR. PITT: If I may, I have two responses to that. First, of course, I guess this case is ample evidence of the fact that not only sophisticated investors find themselves in this position. But, more importantly, I think this question and your prior question focus on what the legitimate concern of the Securities and Exchange Commission is. And that concern deals with the fact that when securities are pledged, the next step is that those pledged securities can be foreclosed upon. They become distributed in the marketplace. The enforcement actions that we referred to have shown that organized crime and many individuals are using pledge transactions as a means to circumvent our rules. In addition--

Q If foreclose and if the securities have not been registered, they are subject to the provisions of the act of '33.

MR. PITT: Some of the cases we have had have had knowing schemes in that direction. Banks may be participants and not just victims. In addition, I think it fair to point out that although the banks this Court has been faced with today assert that they would not like the protections of this act, there are many cases in which banks themselves have sought the protections of Section 10(b) and Rule 10b-5 in these kinds of situations. There are smaller banks and there are larger

banks, but many of them, including the Exchange National Bank in a billion dollar transaction in an opinion written by Judge Friendly recently, where the protections of Section 10(b) and Rule 10b-5 were eagerly sought out by banking institutions.

Q This bank is not complaining about the protections of the act.

MR. PITT: I understood--

Q Banks in this situation are going to be defendants, not plaintiffs.

MR. PITT: In this particular situation I agree with Mr. Justice Powell that this is a very unusual situation where the bank is alleged to have made an affirmative misrepresentation. I grant you the record is weak, and I grant you the fact that on trial this case may not prove out at all. That is not our concern at this juncture.

Q I was taught in pleading that when you plead something like fraud, you be specific as you can.

MR. PITT: I was taught the same thing, Your Honor, and I wish this complaint had been more specific. But I would hope--

Q The Good Book says I stick to my teaching and you and have left yours. [Laughter]

MR. PITT: I hope not, Your Honor. I would suggest that if we are to make a statutory determination that can have

far-reaching ramifications not only for private litigants but for the government, the Commission in civil enforcement actions, and the Justice Department in criminal actions, that hopefully some poor pleading, if that is in fact the case here, will not upset an important statutory protection that we think needs--

Q Mr. Pitt, did I understand you to say to Mr. Justice Powell that there was not any case authority for your position?

MR. PITT: No, no. If I said that, I apologize. I thought I was asked whether there were specific references to pledge transactions in the legislative history. As to a specific reference to pledge transactions, there are--I am not aware of any. As to loan and credit agreements and the importance of providing the protections of the securities laws in this context, I think there is ample legislative history. Some of it is cited in our Superintendent of Insurance amicus brief before this Court. I think this Court's decision in Superintendent of Insurance amply supports that conclusion, particularly footnote eight on page 12 of the reported decision.

Q How long have the courts held that a pledge is a sale?

MR. PITT: Consistently, with one minor exception, since we commenced raising this issue, which started in the late 1950s. The Second, Fifth, Seventh, and Tenth Circuits have

all acknowledged that pledges are sales. In one case--

Q Under the '33 and '34 acts?

MR. PITT: Under both acts. In one case--I believe the Fifth Circuit had an erroneous interpretation of of a limitation as to when a pledge could be a sale. But it is my understanding that these circuits have held that at least as to the '33 act--and I am not sure but I think in one case as to the '34 act, the Dolnick case that we cite in which we alleged a 10b-5 violation, that under the '34 act as well.

If I may in that respect, this Court has said in Mr. Justice Marshall's opinion in National Securities, as well as in the Hochfelder decision, that the interpretation of the '33 and '34 acts should be construed in pari materia because they were both complementing ends toward a comprehensive scheme of regulation of the nation's securities trading activities.

MR. CHIEF JUSTICE BURGER: Thank you.

MR. WEINER: I thought I had a few minutes.

MR. CHIEF JUSTICE BURGER: Yes, you have about four minutes left.

REBUTTAL ARGUMENT OF JACK H. WEINER, ESQ.,

ON BEHALF OF THE PETITIONER

MR. WEINER: Your Honor, Mr. Pitt referred to the phrase "interest" in definition of sale. That is not in the 1934 act. That is in the 1933 act. The 1934 act very clearly

speaks about sale and other disposition, Your Honor. That is one point.

The second point that is important is that there is a substantial difference between buying stock to make a collateralized loan and making a collateralized loan. The lending factor, which we sought to stress earlier, is based on the general credit of the individual, and they are not looking at the value of collateral.

The Guild Films case, which is the first time that the SEC really pushed the question as to whether or not a pledge was a sale, was in 1960. Professor Loss refers to that case. And in that case there was a sham transaction. It was not a pure bona fide pledge, and they expanded the question therein.

One of the factors that is really very, very important here is that a lot has been stated about what is beyond the record. I would like to clarify some facts which have just come to our attention as a result of the state court action. We just completed the deposition of Mr. Fowler. In his examination, Mr. Fowler makes it clear, number one, he was aware of the conflict; and he and Arnold were fully aware of the conflict between Equity National Industries and the Kateses.

Q That is no part of what is before us now.

MR. WEINER: I recognize that, sir, but there have

been numerous allegations which are totally without merit, and I would like this Court to remember that.

Q All we have is the pleading, and all we have here is a fairly precise issue as to whether or not a pledge is a sale within the meaning of the '34 act.

MR. WEINER: And whether or not it was in connection.

Q What confused me was that you in your brief were talking about the pledge by Kates to Bankers Trust and the release of that pledge; and the SEC is talking about quite a different pledge. They are talking about the one that Arnold and Fowler made to Mallis and Kupferman of the Equity National stock.

MR. WEINER: Because the Court of Appeals speaks about our--

Q I know it does, and that is what makes this case factually confusing. But the single issue is a rather precise one and has nothing to do with the merits.

MR. WEINER: And whether or not it was in-connection-with also. That is a subsidiary question also, Your Honor.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

[The case was submitted at 2:15 o'clock p.m.]

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