OFFICIAL TRANSCRIPT

PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: KEITH R. GOLLUST, ET AL., Petitioner

v. IRA L. MENDELL, ETC., ET AL

CASE NO: 90-659

PLACE: Washington, D.C.

DATE: April 15, 1991

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IN THE SUPREME COURT OF THE UNITED STATES

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KEITH R. GOLLUST, ET AL., :

Petitioners :

v. : No. 90-659

IRA L. MENDELL, ETC., ET AL. :

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Washington, D.C.

Monday, April 15, 1991

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 12:59 p.m.

APPEARANCES:

EDWIN B. MISHKIN, ESQ., New York, New York; on behalf of the Petitioners.

IRVING MALCHMAN, ESQ., New York, New York; on behalf of the Respondents.

JAMES R. DOTY, ESQ., General Counsel, Securities and Exchange Commission, Washington, D.C.; on behalf of SEC, as amicus curiae, in support of Respondents.

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P R O C E E D I N G S

(12:59 p.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument now in Number 90-659, Keith R. Gollust v. Ira L. Mendell.

Mr. Mishkin.

ORAL ARGUMENT OF EDWIN B. MISHKIN

ON BEHALF OF THE PETITIONERS

MR. MISHKIN: Thank you, Mr. Chief Justice, and may it please the Court:

The issue in this case is whether a plaintiff can maintain an action under section 16(b) of the Securities Exchange Act of 1934 after ceasing to own any securities of the issuer on whose behalf the action was instituted.

Briefly stated, the facts are as follows. The respondent, then a shareholder of Viacom International, Inc., brought this action under section 16(b) against the petitioners in January of 1987. In June of 1987 Viacom International was acquired in a merger transaction in which the respondent and other public shareholders of International received in exchange for their shares in International a combination of cash and a small amount of securities in the acquiring corporation, which became the parent company of Viacom International, which in turn became a wholly owned subsidiary of the new parent.

The transaction was an arm's length transaction between independent parties. It was approved by stockholder vote. The petitioners had nothing to do with the merger either in form or the substance of the merger.

QUESTION: But you really don't think that matters anyway? I mean, as far as your legal principle that you're urging upon us is concerned that wouldn't make a difference?

MR. MISHKIN: Justice Scalia, that is correct. I point it out because in the opinion of the court of appeals below there was some suggestion that there was something suspicious in the timing. In fact there was nothing suspicious in the timing. If the Court looks to the record in this case it is clear -- nor has the respondent argued or alleged otherwise -- that this merger was begun by a series of events including a leveraged buyout proposal made by the management long before this suit was filed. The merger was a culmination of those events. I point that out simply as a matter of fact.

The analysis of this case should begin with the statute. The statute says that an action may be instituted by the issuer or by the owner of any security. of the issuer in the name and on behalf of the issuer. The statute does not state that a former owner of an issue or securities can sue. Indeed neither the SEC nor the

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respondent now seem to be saying that a former owner can sue in the first instance, although that --

QUESTION: Well, Mr. Mishkin, in this case wasn't the plaintiff an owner at the time the suit was initiated?

MR. MISHKIN: That's correct, Justice O'Connor.

QUESTION: So all we have to resolve is whether it's now moot or he has lost standing? What is it?

MR. MISHKIN: What the Court is -- must resolve is whether a former shareholder, having commenced an action, loses standing when he ceases to be an owner of the securities of the issuer. The further contention is made in this case that -- by the SEC and the respondent, that a former share owner may lose standing in some cases but somehow not in this case, because in this case the SEC takes the position and the respondent takes the position that because the shareholder, originally a shareholder of the issuer, has wound up a shareholder of the parent corporation, that an exception should be made to the statute to cover this particular set of affairs.

QUESTION: Mr. Mishkin --

QUESTION: Well, is that strictly speaking an exception to the statute? I mean, the language of the statute just says a -- an act -- a suit to recover such profit may be instituted by the owner of any security of

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the issuer. Now, this suit was instituted by an owner of the security, was it not?

MR. MISHKIN: That's correct. And that distinction now seems to have become, belatedly in this Court, the linchpin of the SEC's position. In the court below that was not the distinction on which the SEC or any party relied. But in any event, if taken literally, if you follow that position literally, what it would mean is that a shareholder can buy stock immediately before bringing an action, which he can now. He can go to the clerk's office, file his complaint, call his broker on the way out of the clerk's office, and thereafter maintain his action and point to the words of the statute that said "may be instituted."

QUESTION: Well, wouldn't ordinary principles of mootness come into play there? Here you have a plaintiff who can be said to have a continuing financial interest.

MR. MISHKIN: I think, Your Honor, the question of mootness might come into play in appropriate cases, but what we're dealing with is a question of statutory construction. It's quite plain that section 16(b) does not intend, or was not intended by the Congress to go to the full length of the constitutional article III jurisdiction of this Court. Congress didn't simply say what we have done is we have created a statute that said

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somebody could get inside the courthouse door, and whatever happens to him thereafter we're going to leave up to the courts to decide under constitutional mootness standards.

What the statute says is that a shareholder should be a shareholder of the issuer. It was very plain. And the question is did it -- means to say thereafter anybody can continue suit so long as they maintain, no matter how indirect, an interest. For example, suppose the plaintiff in this case was a holder of some debt, not a security at all, but a creditor. I suppose -- of the parent corporation, or suppose that we had a grandparent corporation, twice removed. You can pose any number of circumstances. And the question that I think that the Court should not get itself into is going through the varieties of corporate forms in deciding that under certain circumstances a plaintiff should not lose standing --

QUESTION: No, but Mr. Mishkin, the question -- you're right. The question in this case is whether a shareholder of a parent of a wholly-owned subsidiary continues to have standing when he did have standing at the time he instituted the suit. That's the only issue here, isn't it? And what in the statute says he loses standing?

MR. MISHKIN: Well, Your Honor, I think as I was --

QUESTION: You're worried about a lot of other cases, not this one.

MR. MISHKIN: No, what I think I'm saying is that if a shareholder turns around and sells his --

QUESTION: But he didn't do that.

MR. MISHKIN: He didn't do that. If --

QUESTION: What in the statute defeats his right to continue an action that was properly instituted?

MR. MISHKIN: I think it's inherently in the concept of a section 16(b) and a derivative action, because the courts have said in both contexts, in section 16(b) and in shareholder derivative actions generally, of which this is a variation, that a shareholder must be a shareholder of the issuer corporation, and not a shareholder of some parent or indirect subsidiary.

QUESTION: Well, that's what's in the 16(b) context. The Second Circuit has said that repeatedly, but we have never said that.

MR. MISHKIN: That's correct.

QUESTION: And the statutory language doesn't say that.

MR. MISHKIN: The Seventh Circuit has said that. The Ninth Circuit has said. This Court has not addressed

this issue previously.

QUESTION: And the statute doesn't say that.

MR. MISHKIN: Your Honor, the statute uses the term "issuer."

QUESTION: Referring to the point of instituting the suit.

MR. MISHKIN: Well, if the -- I don't think what the Congress intended to do was to state that a shareholder need -- his standing may be tested or need be tested only at the instant the suit is filed. That would make of the standing requirement the sort of empty formality that the SEC claims that our position is.

QUESTION: Well, Mr. Mishkin, in diversity cases do we look at diversity of the parties as of the initiation of the lawsuit, and if it disappears later do we say there is no standing?

MR. MISHKIN: No, Justice O'Connor, you look at it --

QUESTION: Or the amount in controversy cases?

MR. MISHKIN: No, those are questions that go to when a court's jurisdiction hatches to a lawsuit and it doesn't reinvestigate its jurisdiction as a case proceeds. But this is, as Your Honor's previous question indicated, more analogous to constitutional requirements of mootness or case of controversy where the court does in fact

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examine whether a case continues to be a viable controversy --

QUESTION: Well, it's entirely, it's entirely possible that a case filed under this 16(b) section could later become moot, I suppose. So our question, as Justice Stevens pointed out, is whether this case has mooted out.

MR. MISHKIN: Well, I think this case is mooted out insofar as the statutory words are concerned. And it is a question of what Congress intended. We are not maintaining that the plaintiff has not maintained -- does not have -- if it were a question of whether he had constitutional standing, that he would have lost constitutional standing. What our argument is is that you look at the statute and you determine what it is the statute intended, the sort of interest that a plaintiff would have.

And it seems to me that the Commission and the respondent are both saying look, we recognize that the word "instituted" doesn't mean that you look at it only at the instant the lawsuit is brought. The SEC, for example, has attempted to engage in rulemaking in this area and to establish distinctions among shareholders who have lost their -- lost shares. And what the SEC has said, that in certain instances a shareholder who has lost his shares by virtue of a merger continues to have standing, and certain

instances doesn't continue to have standing. If the SEC believed that the word instituted was all you needed to look at, then it wouldn't have had to adopt any such rules.

And indeed, in its 1989 rule proposal where it did include a requirement that a shareholder had brought the action before a merger resulted in the loss of his shares, the SEC only applied those proposed rules to a merger situation. It didn't apply it to a situation where there was a reverse stock split. It didn't apply it to a situation where a shareholder was confronted with a cash tender offer that would be followed by a back end merger, and said if he tendered in the first stage he wouldn't lose standing.

As far as I can understand the Commission's position he would lose standing. What difference is there between a shareholder who tenders in the first step and a shareholder who accepts the merger price? What difference is there between a shareholder who excepts an exchange offer, which is not exempted by their proposed rule? So I think that the Commission has clearly and implicitly accepted the idea that this statute is not to be looked at at the instant the plaintiff walks out of the courthouse after filing his complaint and says --

QUESTION: I wish you had given us some examples

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of other Federal statutes. I am sure there are a lot of other Federal statutes that are framed this way: any person who thus and such may bring suit, or suit may be brought by, which again has an initiation flavor.

MR. MISHKIN: Well, I think that the Commission actually identified a statute which, somehow, inexplicably to me, they cited it in their favor which indicated the statute provided that a lawsuit could be instituted against a certain -- Secretary of a Government agency, and went on to provide that even if that, the identity of that Secretary changed, the action could be maintained. It seems to me that Congress was recognizing that if the word "instituted" meant, in that instance, that you looked at the lawsuit, at the inception of it and forget about what happens thereafter, they would not have adopted any further terminology.

I think what the Congress is doing where it uses the word "instituted," and it does so in other instances, I think in section 36(b) of the Investment Company Act which the Court had before it in the Daily Income Fund against Fox case was another such example, although litigation has not arisen under it that raises this question.

QUESTION: Is the plaintiff's only motive in a case like this to increase the -- increase indirectly and

incrementally the value of his own shares?

MR. MISHKIN: That was the intention that the Congress had in mind by vesting a plaintiff with standing to bring an action. And the legislative history makes that clear. There are repeated references to the fact that a shareholder or a security owner is given standing to maintain the action because indeed that shareholder has a financial interest in achieving a result, even if it's an indirect financial interest as a shareholder of the company.

So the idea that somebody should be a stranger to the corporation and be permitted to proceed simply because he was originally a shareholder and thereafter ceased to be one is foreign to this statute.

QUESTION: But what's the incentive? It doesn't seem to me like there would be much incentive to a small shareholder. Do you get attorneys' fees?

MR. MISHKIN: The way I think the statute has operated or worked out over the years in practice, most shareholders indeed have the interest of their lawyers. I think in this instance we have such a circumstance, where in fact a shareholder brought a lawsuit after the court held that the shareholder had no standing. He went out at the recommendation or suggestion of his lawyer and bought some notes or some junk bonds that happened to be

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thereafter issued by the named subsidiary in order to maintain standing.

QUESTION: But how does the lawyer benefit if the statute doesn't provide for attorneys' fees?

MR. MISHKIN: Well, the courts regularly award lawyers -- plaintiffs' lawyers attorneys' fees in these circumstances.

QUESTION: Under the common fund theory?

MR. MISHKIN: Yes. Yes. And clearly, as a practical matter in most of these cases the principal interest is that of an attorney, not of a shareholder. But the statute itself when it was constructed, and it was, it is a statute, let us all recognize, is a statute that is devoted to certain formal requirements.

This Court has recognized the statute is a strict liability statute, that it sometimes operates harshly. Although it is aimed at preventing the misuse of inside information, in fact there is no inquiry into whether the defendant did abuse or use inside information. It catches people who are not in fact insiders, never have been, such as my clients, in a particular company, because they meet a certain statutory threshold that is arbitrarily fixed.

This Court has had a number of occasions to address the inflexibility and artificiality of some of the

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provisions of this statute. In one of the early cases that this Court has had, Blau against Lehman, Lehman Brothers was regularly trading the securities of a, what I believe was a client of Lehman Brothers, and a partner, a fairly significant partner of Lehman Brothers, Mr. Thomas, was on the board of the issuer company. And the Court refused, this Court refused to hold that Lehman Brothers as an entity was a director through Mr. Thomas. That conclusion I don't think was self-evident to the bar before this Court's reading of the statute, and I think the Court took into account that this statute is a inflexible statute that imposes requirements that are not necessarily going to produce just results to particular defendants or to particular plaintiffs.

Similar approaches have been taken by the Court in every case that this Court has had, I believe, involving section 16(b). In the Foremost-McKesson case that was before this Court we had a situation, or the Court had a situation, of a shareholder who acquired more than 10 percent of the shares, and the question -- and therefore would ordinarily be a statutory insider, and the question is when do you become an insider.

And you can arrange your purchases so that if, for example, you wanted to get 16 percent of the stock, you could do that consistently with the statute, to be

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within the statute or be without the statute. For example, you could acquire up to 9.9 percent and then look for a block of another 8 percent. And if you acquired your 16 or 17 percent that way, when you sold that block you would have no statutory liability, as a result of a decision of this Court.

The SEC, I don't think -- I think opposed that result in this Court, but the Court said look, we're dealing with a statute that is a very inflexible one. It imposes rather strict requirements and harsh requirements, sometimes unjust, and we're going to read the words not in an expansive, not in a broad manner as the SEC there and as the SEC here has contended, but in a rather narrow fashion, because we recognize that it sometimes can produce undesirable results. We're going to apply the words Congress wrote in the manner in which Congress intended that they be.

This Court thereafter had a case, the Reliance Electric case, in which somebody who did own more than 10 percent of the shares decided he would sell those shares in two pieces rather than one. The first piece got him from some 14 percent to 9.8 percent, and he paid his profit back to the corporation on those shares. Then he sold all of the shares and paid no part of the profit back.

The issue came to this Court as wasn't that a device, wasn't that some avoidance scheme, isn't that wrong. And the Court said, you know, under this statute we're going to enforce it the way it was written and let the SEC, who argued to the contrary in that case, do what they should do if it's a problem with this statute, if there's a hole. We, the Court, are not going to tinker with the statute. Go to the proper forum to do so, which is the Congress of the United States.

And so the Court in cases thereafter has also applied a narrow, not a broad construction of the statute so that --

QUESTION: But Mr. Mishkin, isn't it true that all those cases -- I'm not sure the words narrow and broad are correct -- all those cases gave a very technical, literal reading to the statute. And if we just read this statute literally it only focuses on the time the case is instituted.

MR. MISHKIN: Well, I think if you read this statute literally you also -- I mean, look, every statute drawn by Congress requires some degree of interpretation. One of the common characteristics I suppose we have as lawyers is that we read words and recognize that they don't always say the exact -- have the exact meaning that one draws from a very strict reading of it. So the word

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"institute" has got to be construed in the context in which Congress passed this statute. It was riding against the back drop of derivative actions.

Now, derivative action principles that go back over a century in this Court, which has laid down the basic principles, and they say that a shareholder -- you have to be a shareholder of a corporation to bring an action. Now that has been construed by State courts and by Federal courts as meaning that you need to own your shares throughout the litigation, not that you should only have your shares at the outset. What is the point of the Congress ever adopting such a requirement if it was to be a formality that would be forgotten the moment the plaintiff leaves the clerk's office? Of course the court had -- the Congress had in mind a continuing interest. And the SEC has recognized that in its own rulemaking.

But I think once you get into the problem of under what circumstances do you permit somebody who was formerly a shareholder to continue to assume that position, that is, if he's a shareholder of a parent corporation, he lost his shares involuntarily in a merger, and so on, then I suggest that what the Court is being asked to do is to make policy decisions.

And I am not suggesting that those policy decisions are not real ones. The Commission has been

struggling with those policy decisions, and I think the problem with their struggle is that they keep coming up with different rules. I don't know if the Commission has the authority to correct it, but if they do it's because they are exercising not a judicial function but a quasi-legislative function.

This is a statute, I think, that has to be given a strict and a literal interpretation, but in accordance with the common sense with which it is -- that lies behind the words. And I don't think that the Congress intended to say well, "instituted" is to be applied and thereafter who cares whether the plaintiff continues to have any standing.

For example, suppose that you have a shareholder that is divested of his shares in an all-cash merger. The Commission originally and in its rules said well, we're going to continue standing for such a plaintiff.

They now say well, we'll do that only if he sued before the merger, consistently with the literalist reading of the word "instituted." But does that make any real sense? A shareholder who was cashed out in a merger, Your Honor, has no real constitutional jurisdiction, for that matter. The SEC in its rule would still have continued his standing. He certainly did not represent any body of shareholders.

And then suppose that such a person sought to settle a case. Would the court say well, you can go settle it, and who cares about the other shareholders? Maybe your lawyer will get, you know, a handsome reward, but you can turn away from this case. No. I think that the Congress had in mind a shareholder who had a certain relationship, a continuing relationship with the corporation for which he was suing and his co-shareholders. He is in essence a fiduciary or a trustee of this cause of action.

QUESTION: Well, how long would you say he had to keep the shares, as you read the word instituted in the statute?

MR. MISHKIN: Throughout the litigation, Your Honor. Throughout the entire course of the litigation. And there is really, you know -- and Your Honor, if there is to be some distinctions made, if we say that a shareholder should continue it throughout the trial and not at some later stage, it seems to me that is a tinkering or a supplementing of the statute in deciding that maybe there are nuances here that ought to be fixed. Maybe there are loop holes that ought to be plugged. But the SEC has been able to address itself to Congress before. And I must say this is a statute that is not only inflexible in its effect on people, but it has been --

when it was enacted in 1934, after all, it was the only statute that dealt with the subject of insider trading.

Now I'm not saying that you apply a different interpretive rule because the law has developed in other areas, but I do say then, and this Court has said in its adjudications in section 16(b) that there are other remedies that plaintiffs have if there is real insider trading going on. There is 10(b)(5) that has, as the Court knows, is a post-1934 developments, although section 10(b) was in the act. There is section 14(e) of the act and the regulations under that dealing with insider trading and tender offer situations.

There is the whole range of insider trading sanctions under the Insider Trading Act, where if you engage in insider -- illegal insider trading you can be subject in effect to quadruple penalties.

So that there is a whole panoply of remedies if we have a case in which a plaintiff is saying look, I have a real insider trading case. I'm being thrown out of court on a technicality. That's not this case and I don't think we need argue it, but the Court has recognized and taken some comfort from the fact that there are other remedies available in true insider trading cases.

Insofar as the issue of whether or not -- I think, Justice O'Connor, you had raised this question,

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whether or not a shareholder of a parent or a grandparent corporation has or should continue to have standing, whether he has a sufficient interest to permit that person to sue, the statute uses the term "issuer." It doesn't use the term "grandparent" or "parent." And indeed the term "issuer" is defined in the 1934 act in a narrow manner. The term "issuer" means the issuer of a security or the entity that proposes to issue a security. And that's Viacom International.

When Congress saw fit to broaden that definition to include a parent corporation it knew how to do that. In fact it did so a year earlier in the 1933 act, where the term issuer was defined for certain purposes as including a parent corporation. That is to say was included -- as including a person in control of an issuer.

QUESTION: Well, my question was really whether you thought that under ordinary principles of mootness it could be said that someone who ends up at the end of the day with stock in the parent can be said to have no financial interest.

MR. MISHKIN: I think that that is arguable, Justice O'Connor, but I am not urging that as the rule for this case. It is the -- if one goes to the full constitutional sweep of case or controversy it is conceivable that a shareholder of a parent or a

grandparent may have a sufficient interest to withstand constitutional attack. I think that may be a case-by-case review, and I am not here in this Court asking for the Court to make those distinctions.

What I am saying is that the Congress here did not intend to go to the full sweep of the constitutional case or controversy jurisdiction of this Court. And nor did it intend to leave to this Court's constitutional jurisdiction the question of who had standing and who is a proper plaintiff to commence and proceed with this action. That was a legislative determination made by the Congress. It is not or was not intended to be a determination to be made based on the constitutional authority of the United States courts.

The Congress clearly did not, in defining -- and it used the word "owner of a security of the issuer." And I think you've got to take into account all of those words. And the owner of a security of a parent corporation or a grandparent simply does not meet the statutory requirement.

Let me address one other point that Mr. Malchman has made that the SEC has not.

QUESTION: Would you be making the same argument if the corporation had been merged into the other?

MR. MISHKIN: If Viacom International had not

been -- I'm sorry, if the securities of Viacom International were used in exchange so that the plaintiff in this case received securities in Viacom International, it was the succeeding corporation if you will rather than the subsidiary, I would not be making this argument because the statute would not permit me to make this argument, because the shares would then be owned by a shareholder of the issuer, Viacom International. If it was the corporation that resulted from the merger, then the original issuer in effect would have been the acquiring company, and I wouldn't have made the argument in the district court because this statute wouldn't permit me to.

The statute does make these formal distinctions. It makes it in the question of standing. It makes it in the substantive provisions of the statute. It is a very formal type of statute. Congress when it enacted it recognized that there were certain abuses that it was going to attempt to correct, not by leaving it to the courts to make adjudications as to people's intentions or bona fides or male fides. It was going to adopt a --

QUESTION: But you say if Viacom had been merged into the acquirer, you say you wouldn't be making this argument?

MR. MISHKIN: What I'm saying, Your Honor, is if

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Viacom were the corporation resulting from the merger, Viacom International, the issuer for whom Mr. Mendell's client is suing.

QUESTION: No. If Viacom is merged into another company.

MR. MISHKIN: Right.

QUESTION: And the succeeding corporation is no longer Viacom International.

MR. MISHKIN: And Viacom International has disappeared in that merger into --

QUESTION: Yes. Um-hum.

MR. MISHKIN: No, Your Honor, I would not be making the argument because the successor --

QUESTION: Well, the issuer is no longer in existence, and the stockholder can't possibly be holding stock in Viacom. Viacom is gone.

MR. MISHKIN: The question then becomes who is the issuer.

QUESTION: Exactly. So why wouldn't you be making the same argument?

MR. MISHKIN: And I think the courts have stated that where the issuer has disappeared in the merger into another company, the company that survives that merger has become the issuer, has succeeded to the rights of the issuer. In other words the section 16(b) cause of action,

like other causes of action, survives a merger. We're not contending that the cause of action is gone. The cause of action is there, and it can be asserted by a party withstanding to assert it.

QUESTION: I think you have adequately answered the question, Mr. Mishkin.

MR. MISHKIN: Thank you.

QUESTION: Thank you.

Mr. Malchman, we'll hear now from you.

ORAL ARGUMENT OF IRVING MALCHMAN

ON BEHALF OF THE RESPONDENTS

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

I'm going to proceed in a kind of disorganized manner because I have a couple of things I want to say right at the beginning. The first thing I want to do is ask, is answer Mr. Justice White's question. If the ABC Company is merged into the XYZ Company, the cases are clear that a stockholder -- any stockholder of the XYZ Company can sue under 16(b) for a transaction that took place in the stock of the ABC Company before --

QUESTION: Even though the stockholders of the XYZ Company are holding stock in a company that was never the issuer?

MR. MALCHMAN: That is correct, Your Honor, and

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there are two -- there are decisions to that effect. For example, Newmark v. --

QUESTION: Well, they may not be right.

MR. MALCHMAN: No, we were in the court of last resort, but I'm trying to answer your question. And the cases hold that in that situation the -- as I said, any shareholder of the XYZ Company could sue under 16(b) even though the XYZ Company is not the issuer and even though the plaintiff shareholder of the XYZ Company never owned stock of the issuer.

QUESTION: And your colleague on the other side seems to agree that he wouldn't be making an argument -- his argument up here if that were the situation.

MR. MALCHMAN: That's the way I heard it, Your Honor.

QUESTION: Um hum.

MR. MALCHMAN: Now, the next thing I would like to say out of order or out of sequence is that my opponent mentioned at least five or more times congressional intent. The intent of Congress -- let me back up. It is manifest from the face of section 16(b) itself that it was the intent of Congress to confer as broad standing upon a plaintiff shareholder who sues under 16(b) as possible. For example, the Congress said that any owner of a security, not stock, any owner of a security of the issuer

could sue under 16(b), which is much broader than the ordinary derivative action where one has to own stock of the company in question.

Second, the Congress provided --

QUESTION: Yes, but it doesn't say any owner of any security of a parent of the issuer, which could have been a little broader.

MR. MALCHMAN: If they thought of it they may have said it, Your Honor.

QUESTION: They might have thought it. It's not that hard to think of, is it?

MR. MALCHMAN: I beg your pardon?

QUESTION: Well -- never mind.

MR. MALCHMAN: So, as I said, it's palpable that the intent of Congress was to cast standing in as broad a compass as possible, and I gave the example that Congress didn't confine standing to stock owners. Also there is no requirement under 16(b) that the security owner owned a security contemporaneously at the time of the violation. And that is another rule in ordinary derivative actions which is not the case in 16(b).

Thirdly, Congress made it clear in 16(b) that the shareholder is not bound by the business judgment of the issuer not to sue, which of course is not the situation in ordinary derivative actions.

So, my submission to the Court is it's as if Congress had explicitly written in 16(b) that we want shareholder standing to be as broad as possible, and further that if Congress had been presented by this case when it enacted the statute it would surely have opted for standing.

Now, to return to the formal argument, the facts in this case are quite simple. First, the plaintiff owned the stock of the issuer at the time he commenced this 16(b) action, so that he satisfied the requirement of 16(b) that he be the owner of any security issuer at the time of institution of suit.

Secondly, in the merger by which the issuer became the wholly owned subsidiary of another company, that is the parent company, the plaintiff received stock as a result of the merger in the parent company, so that the plaintiff has a continuing financial interest to maintain a 16(b) action in this case.

And further, since plaintiff's 16(b) action had been commenced prior to the merger and was pending at the time of the merger, this case presents the possible danger of a restructuring intentionally designed to defeat section 16(b).

Now --

QUESTION: Well, if a financial interest in the

parent company is all you need, I don't suppose -- I suppose you would be making the same argument if he didn't bring -- begin his suit until after the merger?

MR. MALCHMAN: No, I wouldn't, Your Honor, but financial interest in the parent -- financial interest is just one-half of the situation. The other half of the situation, that he was an owner of a security of the issuer at the --

QUESTION: Of course, some of the arguments in brief would permit any holder of stock in the parent company to sue.

MR. MALCHMAN: I certainly don't, didn't intend to imply that, Your Honor.

QUESTION: A double derivative suit?

MR. MALCHMAN: Well, if I may, I'm going to come to that.

QUESTION: That's all right.

MR. MALCHMAN: All right. I don't want to be too disorganized.

So -- now all the other courts of appeals decisions in this area, and there are only four of them, all involved cash-out mergers, every single one of them, which presented a situation where the shareholder of the issuer who was cashed out no longer had a continuing financial interest in the 16(b) suit in question.

Moreover, in two of those four courts of appeals decisions, the plaintiff had never been a shareholder of the issuer. So the four other courts of appeals decisions in this area are totally inapposite here.

Now, if in this case the issuer had merged into the parent or the parent had acquired the assets of the issuer, plaintiff's 16(b) standing would be, would have been unimpaired. It is simply happenstance insofar as 16(b) considerations are concerned that the issuer became a subsidiary of the parent instead of merging into the parent or instead of its assets being purchased by the parent.

Now, I want to come to a kind of distinct point, and that is that the corporate distinction between the issuer and the parent in this case should be disregarded for the purposes of 16(b). The issuer -- the only asset of the issuer -- let me strike that, please. The only asset of the parent which was formed as a shell corporation to hold the issuer is the issuer. The parent holds and conducts the issuer's business through its wholly owned subsidiary, the issuer, so that the business reality is that the issuer's assets belong to the parent, including the issuer's 16(b) claim against defendants.

This Court, in cases that were cited -- are cited in my brief, have held that corporate form may be

disregarded where, as here, it produces an inequitable result such as the defeat of a statute of public policy, even to the extent of imposing liability upon the parent shareholders, and even though the parent was organized in good faith and was not a sham.

Now, on the point of the double derivative action, this 16(b) case is maintained not only as a single derivative action, but as a double derivative action whereby the plaintiff enforces derivatively the parent's derivative right to sue on behalf of the issuer under 16(b). The commentators, and that's Professor Laws and Professor Blumberg, state that there is no reason why under 16(b) double derivative actions should be singled out for nonmaintainability. That is there is no good reason why a double derivative action should not be maintainable in the context of 16(b).

In the double derivative action, a shareholder is enforcing the shareholder's -- the issuer's right to sue under 16(b). That is a shareholder is enforcing the parent's right to sue under 16(b), the parent's right as a shareholder of the, of the -- the parent's right as a shareholder of the issuer.

The Congress which drafted 16(b) would have welcomed the double derivative action if presented with the question.

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QUESTION: Why does the statute mention the single derivative action explicitly? I mean, if you didn't have to mention the double, presumably you wouldn't mention the single. I mean, the statute just could have said suit to recover may be instituted by the issuer, and then leave it to a derivative action to allow the single derivative action. If you follow me.

MR. MALCHMAN: Well --

QUESTION: Congress felt it necessary not to stop by just saying suit may be instituted by the issuer, which it could have said. In which case, I suppose you would be here arguing well, the stockholder of the issuer can sue by way of a derivative action.

But Congress didn't think that implication was enough, and therefore it went on to say not only the issuer, but the owner of any security of the issuer. Now I would have assumed if it wanted to go one step further it would have repeated that step again, or the owner of any security of the parent of an issuer.

MR. MALCHMAN: Mr. Justice Scalia, when one writes a statute one can't think of every possible situation --

QUESTION: That's my point. They tried to think of every possible situation. If they had just said the issuer your case would be a lot easier. They didn't say

the issuer. They said the issuer or a owner of a security of the issuer.

MR. MALCHMAN: But they said both. They said not only the shareholder of the issuer, but they said the issuer as well. So it's a double-barrelled provision.

I think I have finished. Thank you.

QUESTION: Thank you, Mr. Malchman.

Mr. Doty, we'll hear now from you.

ORAL ARGUMENT OF JAMES R. DOTY

ON BEHALF OF THE SEC,

AS AMICUS CURIAE, IN SUPPORT OF RESPONDENTS

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

The Securities and Exchange Commission believes that the guiding principle for determining standing under section 16(b) of the Exchange Act resides in the plain language of the statute and in Congress' purpose in enacting section 16(b) to create an express private right of action. As to this statute, it is the Commission's position first that the plain language of section 16(b) directs the maintenance of standing here as that language is unambiguous in its grant of standing to institute suit to a broad class of security holders. Nothing else in the language of section 16(b) or anywhere else in any other provision of the Exchange Act limits that grant of

standing or permits a gloss of a continuous ownership requirement on the statute.

QUESTION: Mr. Doty, do you speak just for the SEC here or do you speak for the Government more generally? Is the Government willing to accept that position with respect to all statutes that, when they say somebody can institute suits with a certain characteristic they can continue it, whether they retain that characteristic or not?

MR. DOTY: Justice Scalia, I believe that in the context of this statute my statement as to the breadth of the grant of standing in this statutory context is one which the Government shares. As our brief notes, we in the Government recognize that, at some point in the determination of an interest in a lawsuit, article III considerations do arise, but we in the Government, in the Solicitor's General office, share the view that in this case plaintiff Mendell's continuing economic interest in the issuer and in the lawsuit which the security in its parent represents is entirely sufficient for purposes of article III.

QUESTION: I'm not talking about the sufficiency of -- I'm not talking about the article III point. I'm talking about the plain language point you were addressing.

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MR. DOTY: Yes.

QUESTION: For example, is the Government willing to accept that under the judicial review provision of the Federal Labor Management Relations Act, when it says any person aggrieved by any final order of the authority may institute an action for judicial review, that that person, even if the person later does not meet the aggrieved by any final order requirement which is somewhat above the article III minimum, that person may continue to maintain the suit nonetheless?

MR. DOTY: Justice Scalia, the Commission would not want to speak for the Government in these other contexts. We would not want to purport to be representing their position on these other statutes.

QUESTION: But plain language is plain language.

MR. DOTY: Plain language being plain language here, we rest strongly on the notion, or on the clear language of the statute that one who institutes the suit need only be a security holder. We believe that this, that the statutory purpose in enacting 16(b) in this case comports with that reading of the statute --

QUESTION: I expect that's a very common statute. I just, I just picked this up while we've been sitting here. I sent for the book and just flipped through it and came across the Federal Labor Management

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Relations Act. I suppose one can find scores of statutes that are framed that way. And if it indeed -- I like plain meaning. But if that is plain meaning, there are a lot of statutes that I think may have to be interpreted differently from what I have understood to be the practice.

MR. DOTY: Well, Your Honor, let me say this. This is a statute which, if the structure and the procedures of the statute are carefully examined, it is quite clear that Congress intended to legislate the elements of a private cause of action, including the procedures whereby a security holder went about getting that lawsuit before the courts. So this is not a case in which Congress has conferred on any private citizen or where the arguable language -- the arguable interpretation of the language could be that Congress had intended to confer on any concerned bystander the right to institute suit.

QUESTION: But you do agree, Mr. Doty, I guess, with Mr. Mishkin -- I mean with his statement of your position that it would be enough if the plaintiff had bought a share of stock the day before he filed his lawsuit and sold it the day afterwards, so far as what Congress demands in the way of standing?

MR. DOTY: We believe that as statutory standing

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for the purposes of 16(b), Mr. Chief Justice, that is correct. The defendants in this case are arguing that their right of continuous ownership, or this gloss of continuous ownership, is implicit in the statute. We think that one does not have -- one need not look to this implicit gloss in the statute, that the statute's policy is clear that it intended to authorize the instituting of suits by one who was an owner of a security --

QUESTION: And Congress was indifferent to what the plaintiff did with the security after he instituted the suit?

MR. DOTY: I think certainly Congress recognized that the policing power, the enforcement policy of the statute overcame what Mr. Mishkin has attempted to characterize as a common sense concern here. That Congress was comfortable with the notion that article III concepts of continuing interest in the outcome of litigation and the ability to vigorously advocate a position on behalf of a representation undertaken would be sufficient for the purposes of this statute. One must remember Congress was writing against a very dark tapestry of insider trading here in which the purpose was to get these suits brought and litigated.

QUESTION: Well, would you at least concede that in the situation the Chief Justice inquired about that the

cases become moot?

MR. DOTY: Justice O'Connor, we can easily see that cases may come before the Federal courts in which --

QUESTION: Well, I'm talking about the case where the plaintiff buys a share of stock on day 1, files suit on day 2, sells it on day 3.

MR. DOTY: We think that serious questions of an interest in the outcome and mootness would be --

QUESTION: Just serious questions?

MR. DOTY: -- would be addressed there. Yes, Your Honor. But we would -- the Commission would view that case as one which should be addressed by this Court in the full set of circumstances that it presents. One may imagine, for example, instances of fraud --

QUESTION: Well, I just wondered what the position of the SEC was. Is it moot or is it not?

MR. DOTY: Justice O'Connor, we do not have a position in the abstract on whether that case would necessarily be moot.

QUESTION: What's your position as General Counsel of the SEC on that question.

MR. DOTY: Your Honor, my own view of the statutory standing here is that the statutory standing in that case is clear that issues would be --

QUESTION: Has it become moot or not become moot

when the stock is sold, in your view?

MR. DOTY: It is possible that it is not moot. It is -- there are facts which could be developed which would not render that instance one of mootness.

QUESTION: We would have to presumably go through a brainstorming session on article III standing. Maybe -- maybe his aged mother owns a share and whether that would be enough of an interest would become a question in every case, in that this is the kind of a statute Congress has written. All you need is the interest they are concerned about at the outset of the suit, and after that any interest at all that possibly meets article III standing is going to be enough. I mean, it's possible to write a statute that way, but it seems like a very strange statute to me.

MR. DOTY: But, Justice Scalia, Congress has in fact made clear that it in fact intends to deal with the potential, the possibility for abuse in the misuse of inside information, and that to do that it has sought to confer standing on security holders to bring the lawsuits. It does not follow, in our view, that Congress necessarily was blind to the implications of eventual article III questions of mootness.

But this Court resolves those questions frequently and the cases, even in Justice O'Connor's

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hypothetical, the cases that could arise under this statute don't necessarily pose questions of mootness that are any more difficult than the questions this Court faces in other Federal contexts.

The mootness issue does arise from time to time, but in this case, in this case this plaintiff has no difficulty meeting that test of continuing economic interest. The corporation whose securities he now holds was formed for the purpose of this transaction. It engaged in no business activities until it engaged in the financing of this transaction. The issuer has been, so far as we can determine from the papers, the sole asset of this corporation.

So in many ways Mendell's interest in the parent is an indirect but very strong economic equivalent of the security of the issuer he originally held.

We would urge on the Court the plain language of 6 -- of section 16, but also the purposes for which the statute was originally adopted. And the argument which we feel that the defendants here are advancing to the Court, which is that on the basis of derivative analogies which we feel do not fairly apply that the Court carve out a statutory exception to the ability of a 16(b) plaintiff to continue to litigate his case.

We respectfully submit that there is nothing in

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the statute that warrants carving out that exception in this case and on these facts. The time and the place in which the Court should consider what the extent of an economic interest is that would satisfy or fail to satisfy article III considerations or mootness considerations should be reserved for another time.

The plaintiff -- the defendants, rather, in this case place great store by derivative analogies. Their only source for that purported analogy -- for that purported statutory gloss based on the analogy, is to the rules that govern derivative suits.

And we respectfully submit that those really are not appropriate here. If one examines the structure again of the statute, it is quite clear the derivative analogy simply does not apply. The opening words of section 16(b) state that it was adopted for the purpose of preventing the unfair use of information which may have been obtained. Now that stands, we would submit, in stark contrast to the compensatory or the indemnificatory natures of derivative actions.

Section 16(b) is manifestly broader. Creditor holders of securities and not merely shareholders can institute these suits. Directors cannot refuse a demand -- cannot by refusing demand terminate the suit. Where Congress intended that one hold the security for purposes

of being a defendant, it was quite clear in the statute that Congress intended one be a 10 percent holder of the security both at the time of the purchase and the time of the sale, which are being matched for the purposes of liability.

So Congress knew how to address questions of timing of security holdings when it considered that important for granting the requisites of the statute, when invoking the enforcement apparatus of the statute. And they did not do so with the maintenance requirement.

QUESTION: Mr. Doty, I suppose wisdom is to be welcomed whenever it comes, but this plain language point did not occur to the Commission when it issued its proposed rules on this area, right, and did not even occur to the Commission when litigating this case below. Am I correct that this is the first time, before this Court, that the Commission is arguing for this interpretation of the statute?

MR. DOTY: Well, with all respect, Justice Scalia, we believe our brief to the Second Circuit in fact makes the plain language argument, and we believe also that the Second Circuit opinion reaches the right result and contains the right reasons --

QUESTION: Did it make this plain language argument? I thought your position below was much more

sweeping than this -- that you, that it did not refer to a current owner. It mean -- it meant a present or former owner. Wasn't that your position below?

MR. DOTY: It is true -- I believe it is fair, Your Honor, that we have refined our argument in this Court, and we believe that is something which the appellate process permits --

QUESTION: I'll accept that. You --

(Laughter.)

MR. DOTY: With respect to our rules, however, I would only note that our rules were not an attempt to exhaust the area of standing. They were put out for comment. The fact that we have not adopted a rule on this area in our view does not deprive the Commission's position today as to the standing of this plaintiff of any merit or any validity. And we --

QUESTION: Mr. Doty, can I ask you how your plain language argument would work if the plaintiff was a shareholder when he gave notice to the -- he made a demand, and then before the 60-day period when the directors have a chance to respond to the demand the merger took place, and then he filed suit after the merger took place and was no longer a shareholder. Would he have standing?

MR. DOTY: Our footnote 11 in our brief, Justice

Stevens, recognizes the problems with that factual hypothetical. And with that situation and with Justice O'Connor's situation the Commission is principally concerned with questions of whether there have been coercion, fraud, unusual circumstances --

QUESTION: My question was what does your plain language argument do with that hypothetical? Does it come within or without the plain language as you read it?

MR. DOTY: That is -- that, we believe, is a case in which the security holder had, as I understand your hypothetical, he had standing. He would have been able to bring the suit --

QUESTION: Not at the time he instituted --

MR. DOTY: -- but the merger intervened.

QUESTION: The merger intervened between the demand and the filing of the suit.

MR. DOTY: Candidly, Your Honor, we believe that that is an area where the Commission's rulemaking authority could provide clarification and certainty, and it would be entitled to deference by this Court.

QUESTION: But you don't know what your point --

MR. DOTY: That was in fact the area of concern addressed by the rule of proposals. We pulled back from that because we had not --

QUESTION: Are you sure the Commission can issue

rules as to when suits are bringable in court? Is that an area of Commission rulemaking at all?

MR. DOTY: Your Honor, this Court has -- to this General Counsel's knowledge this Court has not considered that issue. And it is clearly one that would have to be considered.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Doty.

The case is submitted.

(Whereupon, at 1:58 p.m., the case in the above-entitled matter was submitted.)

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