10-1976

Santa Fe Industries, Inc. v. Green

Lewis F. Powell Jr.

Grant

See my notes on 75-1660 and 75-1753

PRELIMINARY MEMO

Summer List 7, Sheet 2

No. 75-1782

Grant

AFW FABRIC CORP. Cert to CA 2
(Hays, Smith, con; Meskill)

v.

Gene

MARSHALL Federal/Civil Timely

I. SUMMARY: This is the case related to No. 75-1660 and 75-1753 on this list. Please read that memo first. The issues and arguments are the same. The difference is that in this case the DC denied a motion for a preliminary injunction to enjoin a merger to be effected under N. Y.'s long form merger statute. CA 2 rev'd holding that the injunction should issue. CA 2 summarized its holding as follows:

> "We hold that when controlling stockholders and directors of a publicly-held corporation cause it

> to expend corporate funds to force elimination of minority stockholders' equity participation for reasons not benefiting the corporation but rather serving only the interests of the controlling stockholders such conduct will be enjoined pursuant to Section 10(b) and Rule 10b-5 which prohibits "any act, practice, or course of business which operates or would operate as a fraud*** in connection with the purchase or sale of any security."

CA 2 also said,

> "In the present case the 'merger' itself constitutes a fraudulent scheme because it represents an attempt by the majority stockholders to utilize corporate funds for strictly personal benefit. ?? Under these circumstances it would surely be anomalous to hold that a cause of action is stated under § 10(b) and Rule 10b-5 when the fraudulent conduct in connection with a purchase or sale of securities includes deception but that similarly fraudulent practices carried out with prior disclosure to the helpless victim do not give rise to a Rule 10b-5 claim."

This looks like fraudulent intent

In this case the corporations involved were Concord, which had been closely held and went public in 1968 when its stock was high, and AFW which had been formed to effect a merger with Concord and buy back the publicly held stock when the price was low. Concord transferred its 68% of the stock in Concord to AFW. AFW made a tender offer of the remaining stock publicly held, explaining exactly what it intended to do. Under NY law, 68% of the voting stock is enough to approve a merger, but, unlike the Del. short form merger, prior notice is necessary.

2. DISCUSSION: Since this case presents a long form, instead of a short form merger, it would complement No. 75-1753.

There is a response.

Kovacic CA and DC ops in petn

7/23/76

LB

Court CA - 2

Argued ....., 19...

Submitted ....., 19...

Voted on ....., 19...

Assigned ....., 19...

Announced ....., 19...

No. 75-1782
(Vide 75-1660
& 75-1753)

AFW FABRIC CORP., ET AL., Petitioners

vs.

ARNOLD MARSHEL, ET AL.

6/8/76 - Cert.

There are
distinctions
- long form in
one & short form in
other. The merger has
been permanently enjoined
& John argue Nov motion
case

Relist
for
L.F.P.

	HOLD FOR	CERT. G	CERT. D	JURISDICTIONAL STATEMENT N	JURISDICTIONAL STATEMENT POST	JURISDICTIONAL STATEMENT DIS	JURISDICTIONAL STATEMENT AFF	MERITS REV	MERITS AFF	MOTION G	MOTION D	ABSENT	NOT VOTING
.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Stevens, J.													
Rehnquist, J.		✓											
Powell, J.		✓											
Blackmun, J.		✓											
Marshall, J.	✓												
White, J.	✓												
Stewart, J.			✓		or Hold								
Brennan, J.													
Burger, Ch. J.	✓		for Santa Fe										

PRELIMINARY MEMO

Summer List 7, Sheet 2

No. 75-1782

AFW FABRIC CORP. Cert to CA 2
(Hays, Smith, con; Meskill)

v.

MARSHALL Federal/Civil Timely

See Preliminary Memo in No. 75-1660.

PRELIMINARY MEMO

Summer List 7, Sheet 2

No. 75-1753

SANTA FE INDUSTRIES, INC.	Cert to CA 2 (Medina, Mansfield, con; Moore, dis.)	
v.		
GREEN	Federal/Civil	Timely

See Preliminary Memo in No. 75-1660.

Court CA - 2 ..... Voted on ....., 19...

Argued ....., 19... Assigned ....., 19... No. 75-1753

Submitted ....., 19... Announced ....., 19... (Vide 75-1660, 75-1782)

SANTA FE INDUSTRIES, INC., ET AL., Petitioners

vs.

S. WILLIAM GREEN, ET AL.

6/2/76 - Cert.

G.

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING
		G	D	N	POST	DIS	AFF	REV	AFF	G	D		
.....	.....	✓		.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Stevens, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Rehnquist, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Powell, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Blackmun, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Marshall, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
White, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Stewart, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Brennan, J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Burger, Ch. J.	.....	✓	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....

Justice Powell--

This is a brief memo on AFW, No. 75-1782 (the long form merger case), which has been relisted for the 10/8 conference.

The Court has already granted cert in No. 75-1753, Santa Fe, which raises the same 10-b-5 question as the instant case only in the context of a short form merger. There are presently three votes to grant in AFW: yourself, Justice Rehnquisrt, and Justice Blackmun. You asked for a brief memo on whether to vote to hold the case for Santa Fe.

FIRST: My first problem with the case is that I think Justice Stevens is correct in his conclusion that the case is moot. This case was an appeal to CA2 from the DC's denial of a preliminary injunction to enjoin a long form merger. CA2 reversed, holding that the injunction should issue. So the case would be here on cert from a decision of CA2 to grant a preliminary injunction. But one month after the announcement of the decision of CA2 in the instant case, a permanent injunction was entered (by "consent") against the challenged merger in state court. Respondent thus contends that the case is now moot. Petrs suggest that the respondents's claim for damages remains "viable" and constitutes a sufficient basis upon which to reject the suggestion of mootness. But as respondents points out, petrs will be liable in any event for the unnecessary expenses to which they have ~~put respondents which they~~ subjected Concord; the monies they expended in furtherance of a transaction which they have conceded to be without business purpose are recoverable by Concord whether or not petr's conduct violated the federal securities laws. Any other damages which petrs have in mind would surely have to await the outcome of a trial and are thus are too speculative to present a live controversy.

My own view of the mootness issue is that Justice Stevens is right. The case involves, at this stage, merely the ~~denial of~~ grant of ~~propriety of issuing~~ a preliminary injunction, a question mooted by the entry of a permanent injunction in state court.

SECOND: If you disagree on the mootness point, I still think this case is a grant rather than a ~~list~~ hold. The only difference between the long form merger case and the short form merger case is that (as I'm sure you already know!) the long form merger statutes require prior notice ~~and~~ to dissenting shareholders and an opportunity to seek premerger injunctive relief. CA2 regarded the unavailability of this additional remedy in the short form merger case (Santa Fe) as "further justification for the intervention of federal courts to remedy any fraudulent conduct." Thus, at least from CA2's point of view, if the Court ~~affirms in~~ reverses in Santa Fe, it should be clear that there is no ~~10b-5~~ 10-b-5 violation in the long form merger situation, since there are the added protections of notice and opportunity for premerger injunctive relief. But if the Court concludes that there is something to CA2's position in the short form merger situation, the question remains whether the long form merger situation is different. To some, that difference may be significant. For example, in his concurring opinion in the Sante Fe & short form case, Judge Mansfield noted that full advance disclosure of all relevant facts and the opportunity for premerger injunctive relief may be effective protection.

In sum, it seems to me that the Court can't lose by taking both cases, and it can be argued that it might be helpful to decide in one action whether the long form/short form differences

are important on this issue.

Gene.

Court ..... Voted on ....., 19...

Argued ....., 19... Assigned ....., 19... No. 75-1782

Submitted ....., 19... Announced ....., 19...

AFW FABRIC CORP.

vs.

MARSHEL

RELIST for J. Powell

V & R
to consider
mootness

	HOLD FOR	CERT. G	CERT. D	JURISDICTIONAL STATEMENT N	JURISDICTIONAL STATEMENT POST	JURISDICTIONAL STATEMENT DIS	JURISDICTIONAL STATEMENT AFF	MERITS REV	MERITS AFF	MOTION G	MOTION D	ABSENT	NOT VOTING
Stevens, J.			Vacate & remand to consider mootness										
Rehnquist, J.			"										
Powell, J.			"										
Blackmun, J.			"										
Marshall, J.			"										
White, J.			"										
Stewart, J.			✓										
Brennan, J.			Vacate on mootness										
Burger, Ch. J.			✓										

EC/// 1/18/77

TO: MR. JUSTICE POWELL

FROM: Gene Comey

RE: No. 75-1753--Santa Fe Industries v. Green

BOBTAIL BENCH MEMO

The issue in this case is narrow but important: are "short-form" mergers designed to "freeze-out" minority shareholders violative of section 10 and Rule 10b-5 even where there is full disclosure of all material facts. [Both lower courts resolved the issue on the assumption that there were neither misrepresentations nor nondisclosures in the relevant information statement. Although resp now suggests in its brief that there were misrepresentations and nondisclosures, this Court should treat this as a "full and complete" disclosure case.] CA2 answered the question in the affirmative, suggesting that the "fraud" was "inherent in the merger itself."

On a fair reading of CA2's opinion, the essential element for a 10b-5 violation in these circumstances is the absence of a "valid corporate purpose." The opinion also seems to rely on two other facts: (1) the undervaluation--I should say "alleged undervaluation"--of the Kirby stock; and (2) the lack of notice or disclosure prior to the merger. But neither of these latter two factors appears to have been determinative. In the first place, CA2 reaffirmed Popkin v. Bishop, 464 F.2d 714 (CA2 1972), which impliedly held that undervaluation standing alone does not

violate 10b-5. Moreover, I can't see the relevance of the lack of prior disclosure, since CA2 had held only thirteen days before Green that a "long-form" merger designed to "freeze-out" minority interests was violative of 10b-5. [We granted cert in the long-form case, Marsha vacated the judgment, and remanded for consideration of mootness]. Finally, we have the statement from Green itself: "If there is no valid corporate purpose for the merger, then even the most brazen disclosure of that fact to the minority shareholders in no way mitigates the fraudulent conduct." Thus, the lack of a valid corporate purpose seems to be the key element for the 10b-5 violation.

The background for this holding needs to be highlighted. As you know, some 38 states have enacted "short-form merger" statutes, thus evidencing a legislative judgment that a minority shareholder's right to continued ownership of the company must be limited in order to facilitate mergers, and that "appraisal" should be the exclusive remedy for corportate mismanagement in this regard. To be sure, if the "information statement" supplied to the minority shareholders contains false, inaccurate, or deceptive information, a federal cause of action under Rule 10b-5 would be established.* But the issue here is whether in the absence of such misrepresentations or nondisclosures such a cause of action is established. In that regard, it is worth noting that the decision of CA2 rests upon notion of the "fiduciary duty" owed by majority stockholders to minority stockholders. Common law fiduciary duties have long been a

* See, e.g. Levine v. Biddle Sawyer Corp., 383 F. Supp. 618 (SDNY) (1974)

a matter of state law, and in the case of Delaware it is clear that the state has taken the position that "fiduciary duties" do not preclude short-form mergers.

The issue then is whether the federal statute precludes such mergers where there is no valid corporate purpose. Resolution of the issue must start, as you noted in Ernst and Ernst, with the language of the statute. The basic problem is one of determining congressional intent. The mere fact that state law does approve short form mergers is not controlling, since a congressional decision to subject short-form mergers to federal regulation would clearly pre-empt state legislation in the area. There is nothing to the argument that Congress could not as a constitutional matter declare illegal short form mergers that are accomplished without a valid corporate purpose. Whether Congress in fact did so is an entirely different question.

As to the language of the statute and the language of the Rule, I think the petitioners do a fairly good job of showing that "any manipulative or deceptive device or contrivance" does not include a "full disclosure" short-form merger. Such a merger certainly is not "manipulative," as that term was defined in Ernst: "conduct that was designed to deceive or defraud investors by controlling or artifically affecting the price of securities." And here there certainly was no decpetion. Unfortunately, as you noted in Ernst, there is not a great deal of legislative history on section 10b, and thus

the legislative materials are not of considerable help in defining the scope of the "federal fraud."

But the case law on 10b and 10b-5 is helpful. Though I have obviously not read all the cases, a recent note in the Harvard Law Review suggests--and I don't doubt its accuracy--that no appellate decision before Marshel (the "long from" case from CA2) and Green (the instant, short-form case) had permitted a 10b-5 claim without some element of misrepresentation or non-disclosure. Judge Moore's dissent examines some of the more prominent cases, and he also concludes that even a cursory review of the decisions indicates that a 10b-5 claim will not attach in the absence of deception or misrepresentation. See App. at 158a-163a. See also Superintendent of Ins. v. Banker's Life, 404 U.S. 6, [redacted] 12: "Congress by § 10b did not seek to regulate transactions which constitute no more than internal corporate mismanagement."

Given the absence of any clear indication that Congress intended to intrude into an [redacted] area primarily governmed by state law, and the subsequent cases of this Court and the lower [redacted] courts interpreting the scope of the "federal fraud" cause of action under section 10b, I would hesitate before affirming the decision of CA2. Indeed, the results of CA2's decision strongly suggest that the decision should be reversed. In the first place, the decision apparently authorizes the development of a new federal common law of fiduciary duty, and thus would relegate state regulation of corporate mismanagement to cases in [redacted] which the mismanagement is accomplished apart

This would revolutionize corporate law

from any securities [redacted] transaction. Second, both Blue Chip and Ernst and Ernst emphasized the [redacted] difficulty of conducting business under the constant threat of indeterminate liability. See 421 U.S. at 747-748, and 96 S. Ct. at 1391. After this decision you can no longer even rely on compliance with state statutory procedures. Third, the test suggested by CA2--valid corporate purpose--seems especially hard to apply in this context. On the one hand, the results of squeezing out the minority may be beneficial, as Judge Moore notes, and thus qualify as valid corporate purposes. But, on the other hand, to the extent that it is necessary to eliminate the majority to accomplish those benefits, there is an [redacted] "invalid" corporate purpose.

Purpose for welcome?

In the final analysis, it appears that the gravamen of this complaint is that the merger was "unfair." That may well be, but resolution of issues like that is for the states, at least that is how I understood the federal regulatory scheme up until this decision. In effect, the plaintiffs below would have us read section 10b to prohibit "any manipulative or deceptive or unfair device" If that is what Congress meant, which I doubt, it should have said so. [redacted] A manipulative ~~and~~ or deceptive device may produce unfair results, but not every procedure which produces allegedly unfair results is manipulative and deceptive.

Gene.

LFP/lab 12/27/76

December 27, 1976

No. 75-1753 Santa Fe Industries, Inc., et al. v.
S. William Green, et al.

This is the case in which CA 2 (Medina for the court; Mansfield, concurring; and Moore dissenting) held, in effect, that Rule 10b(5) preempts state corporate law with respect to short form mergers. Moreover, CA 2 held, in effect, that the "freeze-out" of minority stockholders under the Delaware short form merger law, requiring no prior notice and no corporate purpose for the benefit of all shareholders, constitutes a fraud (i.e. a manipulative or deceptive device) under 10b(5). The holding of CA 2 is so sweeping that, if affirmed, it would create a substantial body of federal corporate law displacing traditional state corporate law. Thirty-eight of the fifty states have short form merger laws (which vary in certain respects), but CA 2's opinion - at least its rationale - is not limited to short form mergers.

In a rather unusual per curiam, CA 2 declined to review the case en banc because they deemed it of "such extraordinary importance that we are confident the Supreme Court" will grant certiorari."

Statement of the Case

A number of subsidiaries of the Santa Fe Railway Company are involved. But for purposes of understanding the case, and indeed for deciding it, we may assume the following: A subsidiary of Santa Fe [a predecessor of Santa Fe Resources, Inc. (Resources)], acquired 60% of the stock of Kirby Lumber Corp.(Kirby) in 1936. Over succeeding years, Santa Fe subsidiaries, including Resources, made additional purchases of Kirby stock. In 1967, pursuant to a tender offer at $65 per share, the predecessor of Resources increased its ownership of Kirby to 95%. A few additional purchases were thereafter made between 1968 and 1973 at prices ranging from $65 to $92.50 per share.

In 1974, and for the purpose of acquiring 100% of the Kirby stock, a short form merger under Delaware law was accomplished between a new subsidiary of Resources (FPI Products, Inc.) with Kirby. The merger plan provided for the payment of $150 per share to the holders of the 25,324 minority shares outstanding.

Section 253 of the Delaware Corporation Law, authorizing short form mergers, does not require consent of, or advance notice to, the minority stockholders. Notice of the merger is required, however, to be given within 10 days after its effective date, and dissatisfied stockholders are entitled to an appraisal of their shares in the Delaware Court of Chancery.

Respondents do not deny that the merger was accomplished

strictly in accordance with Delaware law. Moreover, notice of the merger was accompanied by a detailed "Information Statement" that - in addition to other facts - included an opinion by Morgan Stanley that the fair market value of the stock was $125 per share (although the highest actual sale price in the open market had been $92.50); an appraisal of Kirby's physical assets, which - assuming liquidation on the basis of that appraisal, and prior to taxes - reflected a value of about $700 per share; and also an appraisal of Kirby's oil and gas royalty interests.

Despite Morgan Stanley's appraisal of market value at $125 per share, dissenting stockholders were offered $150.

Respondents initially invoked their right of appraisal under Delaware law, but later purported to withdraw their demand for an appraisal and filed this suit in the federal court alleging 10b(5) violations.[1/]

Although respondents' brief (p. 26) now makes an unpersuasive contention that there were misrepresentations and nondisclosures in the information statement, the district court stated categorically that there were no allegations in the complaint of misstatements of fact or material omissions. (Petn. 25A, 26A). Both courts below proceeded on the assumption that there were no such allegations.

The case was decided on ~~summary judgment~~ motions to dismiss. The

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[1/] A number of other stockholders are presently seeking appraisal in proceedings now in progress in the Del. Ct. of Chancery.

DC's opinion summarizes plaintiff's allegations:

> "Plaintiffs' allegations have two distinct aspects. First, it is alleged that the means of effectuating this merger operated as a fraud on the minority shareholders in that the merger was consummated for the benefit of the majority shareholders, without any justifiable business purpose, except to freeze out the minority, and was effected without prior notice to the minority shareholders. Second, plaintiffs allege that the low valuation placed on their shares in the cash exchange offer segment of the merger transaction was in itself a fraud actionable under Rule 10b-5."

(Petn. 21a).

Opinion of DC

The DC granted the defendant's motion to dismiss for failure to state a claim.[2/] The DC emphasized that the case involves a merger of Delaware corporations, and that under Delaware law shareholders have no "vested right to remain shareholders"; minority shareholders may be "frozen out"; Delaware law does not require that the merger be effected for a business purpose; and the "statute reflects the public policy of Delaware with respect to the rights of splinter interests in corporations". In Stauffer v. Standard Brands, Inc., 187 A.2d 80, it was said:

> "The very purpose of the Delaware short form merger statute is to provide the parent corporation with a means of eliminating the minority stockholders' interest in the enterprise."

This is a traditional purpose

The district court accepted, for purposes of its decision,

2/ I was in error in stating above that the case was decided on a summary judgment motion.

respondents' claim that their shares were worth $722 rather than $150.[3/] The DC nevertheless found no cause of action asserted under Rule 10b(5). It noted that respondents' claim was based, not upon misstatements or the omission of material facts, but upon information provided by the corporate defendants themselves.

The DC continued as follows:

> "The complaint demonstrates merely that the parties to this action differ in their computation of the fair value of plaintiffs' shares. Whatever the information statement indicates about the fair value of plaintiffs' shares, the value of the physical assets "was discernible, as plaintiff[s] discerned it." Tanzer Economic Associates, Inc. v. Haynie, 388 F. Supp. 365, 369 (S.D.N.Y. 1974). See also, Spiegler v. Wills, 60 F.R.D. 681 (S.D. N.Y. 1973). The adequacy of the offering price, standing alone, does not demonstrate bad faith or overreaching on the part of the controlling interests. See Muschel v. Western Union Corporation, 310 A.2d 904 (Del.Ch. 1973)." Petn at 24a.
>
> * * *
>
> "It was for each shareholder to determine, on the basis of the information provided, whether the price offered was adequate or whether he should seek a judicial appraisal. The instant complaint fails to allege an omission, misstatement or fraudulent course of conduct that would have impeded a shareholder's judgment of the value of the offer. Cf. Levine v. Biddle Sawyer Corp., 383 F. Supp. 618 (S.D.N.Y. 1974)." Petn at 25a.

3/ The DC noted, however, that the use of "liquidation value of Kirby's physical assets as the sole basis for determining the true worth of shares owned by minority stockholders is at least questionable". (A view that I certainly share)

Opinion of CA 2

In a wide ranging opinion by Judge Medina (with some of his characteristically colorful language denouncing corporate manipulation), the majority opinion of CA 2 held that a cause of action is alleged under Rule 10b(5) where "a breach of fiduciary duty" is charged, even in the absence of misrepresentation or nondisclosure:

> "Our later review of the decisions of this Court on the subject of allegations under Rule 10b(5) of breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure will, we think, demonstrate that in such cases misrepresentation or lack of disclosure are not essential ingredients of the claim for relief by the minority. But, lest there by any lingering doubt on this point, we now hold that in such cases, including the one now before us, no allegation or proof of misrepresentation or nondisclosure is necessary." Petn at 36a.

flat holding

CA 2 went on to hold that Delaware law was not controlling. Although CA 2 referred to the federal remedy under the Securities Exchange Act as "supplementary to those provided by the States", its holding actually would nullify Delaware law as declared by the Delaware courts (summarized in the opinion of the DC).

CA 2, despite Delaware law to the contrary, found a federal "fiduciary duty to deal fairly with the minority" in a merger, and seemed to hold that offering a price of $150 for stock alleged to be worth $720 constitutes a fraud and breach of fiduciary duty even where there was a full disclosure of all relevant facts, and a remedy under Delaware law that was not found to be inadequate.

Dissent of Judge Moore

Judge Moore, obviously in a state of some shock ~~by~~ as a result of his Brothers' decisions, commenced his opinion:

> "I strongly dissent from the use of their powers by two judges of one of the eleven judicial Circuits to override and nullify not only the corporate laws of Delaware with respect to short-form corporate mergers, but also, in effect, comparable laws in an additional thirty-seven States."

Judge Moore states -- with a good deal of reason -- that the majority opinion creates "an irrebutable presumption that the use of the short form merger law amounts to a fraud per se" wherever a dissenting stockholders avers that the price offered dissenters is grossly inadequate.

It seems to me that Judge Moore's opinion also lays to rest the uncritical assumption by the majority that the averment of "no corporate purpose" must be accepted as correct. Anyone familiar with corporate law is aware of the problems and disadvantages that accrue to the majority stockholder where a small minority interest is outstanding. Judge Moore summarized some of the benefits of 100% ownership as follows:

> "The short-form merger procedure permits a corporation to retreat from the public marketplace of securities trading and assume the status of a private company. "Going private", as the process has been popularly labeled, is being more and more frequently resorted to in today's recession economy. The benefits to a corporation are varied. Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state

disclosure laws; the removal of a pressure to pay dividends at the expense of long-term capital development or speculative capital investment -- these are some of the advantages which may enure to a corporation "going private". It is essential to underscore that all of the above-stated advantages accrue from the very act of eliminating the 10% shareholders who confer public status on the corporation. To say that such action is not a "valid business reason" (plaintiffs' complaint) or a "justifiable corporate purpose" (the majority holding) is to completely misapprehend the impact of the shift in status from publicly held corporation to private company. Benefit to the parent company is not incompatible with the notion of "justifiable corporate purpose"; it is a legitimate part of it. As one commentator has noted:

> One selfish motivation is often adverted to in connection with going private, but one wonders why that should be. Are only those corporate transactions to be favored which are not motivated by greed? Must we seek to do public good in order to avoid regulatory sanctions? The questions answer themselves. To observe that greed is a compelling motivation is merely to observe that we live in a free-enterprise society.

It should be obvious that minority shareholders are as similarly motivated as the majority owners, and that their concern is not the purported damage to the public of "going private" transactions -- the likelihood of which I seriously doubt -- but rather, the equally selfish desire to avoid taking a loss while "playing the market". Such a desire, I submit, is a wholly inadequate justification for according to the 10% a veto power over the will of the 90%. Even our political system does not require 100% consensus before the majority will may be implemented; in fact, such a thought would be completely inimical to the values inherent in our democratic philosophy. (Pet. at 82a)

Comments

With all respect, I think my friend Judge Medina's opinion is out of the "blue sky". As I agree with the DC and

much of Judge Moore's dissent, I will undertake no extended comment here.

As I said in my concurring opinion in Blue-Chip, the starting point is the language of the statute. Also as I noted in Ernst and Ernst, the language of § 10b -- not the language of Rule 10b(5) -- is controlling. As the title of § 10b indicates, it is concerned with "manipulative and deceptive devices". I would not have thought, until CA 2's opinion, that anyone would have deemed a merger to be such a device solely because the price offered dissenters was "grossly" below fair market value so long as there was no misstatement or omission of a material fact. The purpose of § 10b and Rule 10b(5) is to substitute full disclosure for the doctrine of Caveat Emptor. Affiliated Ute, 406 U.S. 128, 151; Blue Chips Stamps, 421 U.S. at 744.

Nor would I have thought that § 10b was intended to create a federal commonlaw of corporations contrary to valid state statutes.

L.F.P.

75-1753 SANTA FE v. GREEN Argued 1/18/77

Snape Oil

(Short form merger case)

Reverse - CA 2 would federalize corp. law.

Glendon (Petr - Santa Fe)

Statute ($10 b) requires manipulation + deceit.

12½ times earnings for previous year.

Kirby was a public company.

No. 75-1753, Santa Fe v. Green 1/21/77 LFP

Revenue 7-2

The Chief Justice Reverse

Agrees with dissent by Moore.

[redacted] Stevens, J.

Can't assume remedy is inadequate. Mansfield erred in going off on this assumption.

No violation of statute.

Brennan, J. Affirm

State appraisal procedure was wholly inadequate - Mansfield was right

Stewart, J. Reverse

Vice of Medina's op. was equating inadequate price with fraud or deceit. No false representations or omission of material fact

While there is adequate remedy is irrelevant (I agree)

White, J.

Reverse

No deceit or fraud.
No breach of fid. obligation under Del law.
Precisely what Del. law prescribed.

Marshall, J.

Affirm

Appraisal is inadequate. Agree with W.J.B.

Blackmun, J. Reverse

CA 2 went too far.
Investor is presumed to know Del. law.
No showing of inadequate remedy.

Powell, J. Reverse

§ 10b proscribes "any manipulative or deceptive device." Ernst & Ernst defined manipulation as conduct designed to deceive or defraud by artificially affecting the price of securities.
The merger here had no such purpose.
No was there any deceit as there was no misstatement or omission of material fact.
CA 2 based its decision on absence of valid corporate purpose. But under Del. law the purpose was valid. Absent federal preemption state law controls.

Rehnquist, J. Reverse

No deception or fraud in normal sense.

If there was unfairness, there was no deception or fraud here.

To: The Chief Justice
Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Powell
Mr. Justice Rehnquist
Mr. Justice Stevens

From: Mr. Justice White

Circulated: 3-10-77

1st DRAFT

Recirculated: _____

SUPREME COURT OF THE UNITED STATES

No. 75–1753

Santa Fe Industries, Inc., et al., Petitioners, v. S. William Green et al. | On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[March —, 1977]

Received 3/10

Excellent opinion, especially since it relies so heavily on Ernst + Ernst.

Join

MR. JUSTICE WHITE delivered the opinion of the Court.

The issue in this case involves the reach and coverage of § 10 (b) of the Securities Exchange Act of 1934 and Rule 10b–5 [1] thereunder in the context of a Delaware short-form

[1] Section 10 of the Securities Exchange Act of 1934, 15 U. S. C. § 78j, provides in relevant part:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

". . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b–5, 17 CFR § 240.10b–5, provides:

"Employment of manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates

merger transaction used by the majority stockholder of a corporation to eliminate the minority interest.

I

In 1936 petitioner Santa Fe Industries, Inc. ("Santa Fe") acquired control of 60% of the stock of Kirby Lumber Corporation ("Kirby"), a Delaware corporation. Through a series of purchases over the succeeding years, Santa Fe increased its control of Kirby's stock to 95%; the purchase prices during the period 1968–1973 ranged from $65 to $92.50 per share.[2] In 1974, wishing to acquire 100% ownership of Kirby, Santa Fe availed itself of § 253 of the Delaware Corporation Law, known as the "short form merger" statute. Section 253 permits a parent corporation owning at least 90% of the stock of a subsidiary to merge with that subsidiary, upon approval by the parent's board of directors, and to make payment in cash for the shares of the minority stockholders. The statute does not require the consent of, or advance notice to, the minority stockholders. However, notice of the merger must be given within 10 days after its effective date, and any stockholder who is dissatisfied with the terms of the merger may petition the Delaware Court of Chancery for a decree ordering the surviving corporation to pay him the fair value of his shares, as determined by a court-appointed appraiser subject to review by the court. Del. Gen. Corp. Law §§ 253 (d), 262.

Santa Fe obtained independent appraisals of the physical assets of Kirby—land, timber, buildings, and machinery—and of Kirby's oil, gas, and mineral interests. These appraisals, together with other financial information, were submitted

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or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

[2] Appendix 33a (merger information statement, considered by parties and court below as part of the amended complaint). Santa Fe controlled Kirby through its wholly owned subsidiary, Santa Fe Natural Resources, which owned the Kirby stock.

to Morgan Stanley & Company ("Morgan Stanley"), an investment banking firm retained to appraise the fair market value of Kirby stock. Kirby's physical assets were appraised at $320 million (amounting to $640 for each of the 500,000 shares); Kirby's stock was valued by Morgan Stanley at $125 per share. Under the terms of the merger, minority stockholders were offered $150 per share.

The provisions of the short-form merger statute were fully complied with.[3] The minority stockholders of Kirby were notified the day after the merger became effective and were advised of their right to obtain an appraisal in Delaware court if dissatisfied with the offer of $150 per share. They also received an information statement containing, in addition to the relevant financial data about Kirby, the appraisals of the value of Kirby's assets and the Morgan Stanley appraisal concluding that the fair market value of the stock was $125 per share.

Respondents, minority stockholders of Kirby, objected to the terms of the merger, but did not file a petition in the Delaware Court of Chancery.[4] Instead, they brought this action in federal court on behalf of the corporation and other minority stockholders, seeking to set aside the merger or to recover what they claimed to be the fair value of their shares. The amended complaint asserted that based on the fair market

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[3] The merger became effective on July 31, 1974, and was accomplished in the following way. A new corporation, Forest Products, Inc., was organized as a Delaware corporation. The Kirby stock, together with cash, was transferred from Santa Fe's wholly owned subsidiary (see n. 2, *supra*) to Forest Products in exchange for all of the Forest Products stock. The new corporation was then merged into Kirby, with Kirby as the surviving corporation. The cash transferred to Forest Products was used to make the purchase offer for the Kirby shares not owned by the Santa Fe subsidiary.

[4] On August 21, 1974, respondents petitioned for an appraisal of their Kirby stock, but they withdrew that petition on September 9 and the next day commenced this lawsuit.

value of Kirby's physical assets as revealed by the appraisal included in the Information Statement sent to minority shareholders, Kirby's stock was worth at least $772 per share.[5] The compaint alleged further that the merger took place without prior notice to minority stockholders; that the purpose of the merger was to appropriate the difference between the "conceded pro rata of value of the physical assets" and the $150 per share offered—to "freez[e] out the minority stockholders at a wholly inadequate price," app. 103a. 100a; and that Santa Fe, knowing the appraised value of the physical assets, obtained a "fraudulent appraisal" of the stock from Morgan Stanley and offered $25 above that appraisal "in order to lull the minority stockholders into erroneously believing that [Santa Fe was] generous." App. 103a. This course of conduct was alleged to be "a violation of Rule 10b–5 because defendants employed a 'device, scheme or artifice to defraud' and engaged in an 'act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.'" *Ibid.*[6] Morgan Stanley assertedly participated in the fraud as an accessory by submitting its appraisal of

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[5] The figure of $772 per share was calculated as follows:
"The difference of $311,000,000 ($822 per share) between the fair market value of Kirby's land and timber, alone, as per the defendants' own appraisal thereof at $320,000,000 and the $9,000,000 book value of said land and timber, added to the $150 per share, yields a pro rata share of the value of the physical assets of Kirby of at least $772 per share. The value of the stock was at least the pro rata value of the physical assets." App. 102a.

[6] The complaint also alleged a breach of fiduciary duty under state law and asserted that the federal court had both diversity and pendant jurisdiction over this claim. The District Court found an absence of complete diversity of citizenship between the plaintiffs and defendants because of the defendant Morgan Stanley and refused to exercise pendant jurisdiction because it held that the complaint failed to state a claim under the federal securities laws. 391 F. Supp., at 855.

$125 per share although knowing the appraised value of the physical assets.

The District Court dismissed the complaint for failure to state a claim upon which relief could be granted. 391 F. Supp. 849 (SDNY 1975). As the District Court understood the complaint, respondents' case rested on two distinct grounds. First, the federal law was assertedly violated because the merger was for the sole purpose of eliminating the minority from the company and therefore lacked any justifiable business purpose and because the merger was undertaken without prior notice to the minority shareholders. Second, the low valuation placed on the shares in the cash exchange offer was itself said to be a fraud actionable under Rule 10b–5. In rejecting the first ground for recovery, the District Court observed that Delaware law required neither a business purpose for a short-form merger nor prior notice to the minority shareholders whom the statute contemplated would be removed from the company, and that Rule 10b–5 did not override these provisions of state corporate law by independently placing a duty on the majority not to merge without prior notice and without a justifiable business purpose.

As for the claim that actionable fraud inhered in the allegedly gross undervaluation of the minority shares, the District Court observed that respondents valued their shares at a minimum of $772 per share based "on the pro rata value of Kirby's physical assets." *Id.*, at 853. Accepting this valuation for purposes of the motion to dismiss, the District Court further noted that, as revealed by the complaint, the physical asset appraisal, along with other information relevant to Morgan Stanley's valuation of the shares, had been included with the Information Statement sent to respondents within the time required by state law. It reasoned that if "full and fair disclosure is made, transactions eliminating a minority interest are beyond the purview of Rule 10b–5," and concluded that "the complaint fail[ed] to allege an omission,

misstatement or fraudulent course of conduct that would have impeded a shareholder's judgment of the value of the offer." *Id.*, at 854. The complaint therefore failed to state a claim and was dismissed.[7]

A divided Court of Appeals for the Second Circuit reversed. 533 F. 2d 1283 (1976). It first agreed that there was a double aspect to the case: first, the claim that gross undervaluation of the minority stock itself violated Rule 10b–5; and second, that "without any misrepresentation or failure to disclose relevant facts, the merger constituted a violation of Rule 10b–5" because it was accomplished without any corporate business purpose and without prior notice to the minority stockholders. *Id.*, at 1285. As to the first aspect of the case, the Court of Appeals did not disturb the District Court's conclusion that the complaint did not allege a material misrepresentation or nondisclosure with respect to the value of the stock; and the court declined to rule that a gross undervaluation itself would suffice to make out a Rule 10b–5 case. With respect to the second aspect of the case, however, the court fundamentally disagreed with the District Court as to the reach and coverage of Rule 10b–5. The Court of Appeals' view was that, although the Rule plainly reached material misrepresentations and nondisclosures in connection with the purchase or sale of securities, neither misrepresentation or nondisclosure was a necessary element of a Rule 10b–5 action; the rule reached "breaches of fiduciary duty by a

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[7] The District Court also based its holding on the alternative ground that the injuries alleged in the complaint were not causally related to any deception by the majority shareholder.

"Assuming *arguendo* that the merger information statement did not constitute adequate disclosure, the amended complaint does not demonstrate a causal connection between the alleged deception and plaintiffs' damages. Plaintiffs did not tender their shares for cancellation and payment pursuant to this merger plan. . . . From the outset, plaintiffs recognized the alleged deception and did not rely upon it." 391 F. Supp., at 855.

majority against minority shareholders without any charge of misrepresentation or lack of disclosure." *Id.*, at 1287.[8] The court went on to hold that the complaint taken as a whole stated a cause of action under the Rule:

> "We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware short form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement." *Id.*, at 1291; see *id.*, at 1289.[9]

We granted the petition for certiorari challenging this holding because of the importance of the issue involved to the administration of the federal securities laws. 428 U. S. — (1976). We reverse.

II

Section 10 (b) of the 1934 Act makes it "unlawful for any

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[8] The court concluded its discussion thus:
"Whether full disclosure has been made is not the crucial inquiry since it is the merger and the undervaluation which constituted fraud, and not whether or not the majority determines to lay bare their real motives. If there is no valid purpose for the merger, then even the most brazen disclosure of that fact to the minority shareholders in no way mitigates the fraudulent conduct." *Id.*, at 1292.

[9] The Court of Appeals affirmed, however, the dismissal of the complaint as against Morgan Stanley & Co. Morgan Stanley, as the Court of Appeals understood it, had not been charged with participating in the majority shareholders' breach of fiduciary duty; it had been involved only in evaluation of the stock and the compilation of its report with respect thereto. The complaint contained "no allegations that Morgan Stanley & Co. engaged in any misrepresentation or nondisclosure such as would support its liability to Rule 10b-5 (2)." *Id.*, at 1292.

person . . . to use or employ . . . any manipulative or deceptive device or contrivance in contravention of [SEC rules]"; Rule 10b–5, promulgated by the SEC under § 10 (b), prohibits, in addition to nondisclosure and misrepresentation, any "artifice to defraud" or any act "which operates or would operate as a fraud or deceit."[10] The court below construed the term "fraud" in Rule 10b–5 by adverting to the use of the term in several of this Court's decisions in contexts other than the 1934 Act and the related Securities Act of 1933, 15 U. S. C. § 77a *et seq.*[11] The Court of Appeals' approach to the interpretation of Rule 10b–5 is inconsistent with that taken by the Court last Term in *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185 (1976).

Ernst & Ernst makes clear that in deciding whether a complaint states a cause of action for "fraud" under Rule 10b–5, "we turn first to the language of § 10 (b), for '[t]he starting point in every case involving construction of a statute is the language itself.'" *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, 197 (1976), quoting *Blue Chips Stamps* v. *Manor Drug*

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[10] See n. 1, *supra*.

[11] The Court of Appeals quoted passages from *Pepper* v. *Litton*, 308 U. S. 295, 306–307, 311 (1939) (where this Court upheld the disallowance of a bankruptcy claim of a controlling stockholder who violated his fiduciary obligation to the other stockholders), and from 1 Story, Equity Jurisprudence § 187 (——); the Court also cited cases which quoted the passage from Justice Story's treatise—*Moore* v. *Crawford*, 130 U. S. 122, 128 (1889) (a diversity suit to compel execution of a deed held in constructive trust), and *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 194 (1963) (Investment Advisers Act of 1940 prohibits, as a "fraud or deceit upon any client," a registered investment adviser's failure to disclose to his clients his own financial interest in his recommendations). Although *Capital Gains* involved a statute in the securities field, the Court's references to fraud in the "equitable" sense of the term were premised on its recognition that Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers. See *id.*, at 191–192, 194. Moreover, the fraud that the SEC sought to enjoin in *Capital Gains* was, in fact, a nondisclosure.

Stores, 421 U. S. 723, 756 (POWELL, J., concurring). In holding that a cause of action under Rule 10b–5 does not lie for mere negligence, the Court began with the principle that "[a]scertainment of congressional intent with respect to the standard of liability created by a particular section of the [1933 and 1934] Acts must . . . rest primarily on the language of that section." 425 U. S., at 200–201, and then focused on the statutory language of § 10 (b)—"[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance.'" *Id.*, at 197. The same language and the same principle apply to this case.

To the extent that the Court of Appeals would rely on the use of the term "fraud" in Rule 10b–5 to bring within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction, its interpretation would, like the interpretation rejected by the Court in *Ernst & Ernst*, "add a gloss to the operative language of the statute quite different from its commonly accepted meaning." *Id.*, at 199. But as the Court there held, the language of the statute must control the interpretation of the Rule:

> "Rule 10b–5 was adopted pursuant to authority granted the [Securities Exchange] Commission under § 10 (b). The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.' . . . [The scope of the Rule] cannot exceed the power granted the Commission by Congress under § 10 (b)." *Id.*, at 212–214 (citations omitted).[12]

[12] The case for adhering to the language of the statute is even stronger here than in *Ernst & Ernst*, where the interpretation of Rule 10b–5 rejected by the Court was strongly urged by the Commission. See also *Piper* v. *Chris-Craft Industries, Inc.*, 45 U. S. L. W. 4182 (1977), and *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723 (1975) (rejecting interpretations of Rule 10b–5 urged by the SEC as *amicus curiae*). By

The language of § 10 (b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception. Nor have we been cited to any evidence in the legislative history that would support a departure from the language of the statute.[13] "When a statute speaks so specifically in terms of manipulation and deception, . . . and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute . . . ." *Id.*, at 214 (footnote omitted). Thus the claim of fraud and fiduciary breach in this complaint states a cause of action under any part of Rule 10b–5 only if the conduct alleged can be fairly viewed as "manipulative or deceptive" within the meaning of the statute.

III

It is our judgment that the transaction if carried out as alleged in the complaint, was neither deceptive nor manipulative and therefore did not violate either § 10 (b) of the Act or Rule 10b–5.

As we have indicated, the case comes to us on the premise that the complaint failed to allege a material misrepresentation or material failure to disclose. The finding of the Dis-

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contrast, the Commission apparently has not concluded that Rule 10b–5 should be used to reach "going private" transactions where the majority stockholder eliminates the minority at an allegedly unfair price. See SEC Securities Act Release No. 5567 (Feb. 6, 1975), CCH Federal Securities Law Reporter ¶ 80,104 (proposing Rules 13e–3A and 13e–3B dealing with "going private" transactions, pursuant to six sections of the 1934 Act including § 10 (b), but stating that the Commission "has reached no conclusions with respect to the proposed rules").

[13] As the Court noted in *Hochfelder*, "Neither the intended scope of § 10 (b) nor the reasons for the changes in its operative language are revealed explicitly in the legislative history of the 1934 Act, which deals primarily with other aspects of the legislation." 425 U. S., at 202. The only specific reference to § 10 in the Senate Report on the 1934 Act merely states that the section was "aimed at those manipulative and deceptive practices which have been demonstrated to fulfill no useful function." S. Rep. No. 792, 73d Cong., 2d Sess., 6 (1934).

trict Court, undisturbed by the Court of Appeals, was that there was no "omission" or "misstatement" in the accompanying the notice of merger. On the basis of the information provided, minority shareholders could either accept the price offered or reject it and seek an appraisal in the Delaware Court of Chancery. Their choice was fairly presented, and they were furnished with all relevant information on which to base their decision.[14]

We therefore find inapposite the cases relied upon by respondents and the court below, in which the breaches of fiduciary duty held violative of Rule 10b–5 included some element of deception.[15] Those cases forcefully reflect the prin-

[14] In addition to their principal argument that the complaint alleges a fraud under clauses (a) and (c) of Rule 10b–5, respondents also argue that the complaint alleges nondisclosure and misrepresentation in violation of clause (b) of the Rule. Their major contention in this respect is that the majority stockholder's failure to give the minority advance notice of the merger was a material nondisclosure, even though the Delaware short-form merger statute does not require such notice. Brief for Respondents, at 27. But respondents do not indicate how they might have acted differently had they had prior notice of the merger. Indeed, they accept the conclusion of both courts below that under Delaware law they could not have enjoined the merger because an appraisal proceeding is their sole remedy in the Delaware courts for any alleged unfairness in the terms of the merger. Thus the failure to give advance notice was not a material nondisclosure within the meaning of the statute or the Rule. Cf. *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U. S. 438 (1976).

[15] The decisions of this Court relied upon by respondents all involved deceptive conduct as part of the Rule 10b–5 violation alleged. *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972) (misstatements of material fact used by bank employees in position of market maker to acquire stock at less than fair value); *Superintendent of Insurance of New York* v. *Bankers Life & Casualty Co.*, 404 U. S. 6, 9 (1971) ("seller of bonds was duped into believing that it, the seller, would receive the proceeds"). Cf. *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180 (1963) (injunction under Investment Advisers Act of 1940 to compel registered investment adviser to disclose to his clients his own financial interest in his recommendations).

We have been cited to a large number of cases in the Courts of Appeals,

ciple that "[s]ection 10 (b) must be read flexibly, not technically and restrictively" and that the statute provides a cause of action for any plaintiff who "suffer[s] an injury as a result of deceptive practices touching its sale [or purchase] of securities. . . ." *Superintendent of Insurance of New York* v. *Bankers Life & Casualty Co.*, 404 U. S. 6, 12–13 (1971). But the cases do not support the proposition,

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all of which involved an element of deception as part of the fiduciary misconduct held to violate Rule 10b–5. *E. g.*, *Schoenbaum* v. *Firstbrook*, 405 F. 2d 215, 220 (CA2 1968) (en banc), cert. denied, 395 U. S. 906 (1969) (majority stockholder and board of directors "were guilty of deceiving" the minority stockholders); *Drachman* v. *Harvey*, 453 F. 2d 736, 737 (CA2 1972) (en banc) (Rule 10b–5 violation alleged on facts found "indistinguishable" by panel from *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*); *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F. 2d 374 (CA2 1974), cert. denied, 421 U. S. 976 (1975) (scheme of market manipulation and merger on unfair terms, one aspect of which was misrepresentation); *Pappas* v. *Moss*, 393 F. 2d 865, 869 (CA3 1968) ("if a 'deception' is required in the present context [of § 10 (b) and Rule 10b–5], it is fairly found by viewing this fraud as though the 'independent' stockholders were standing in the place of the defrauded corporate entity," where the board of directors passed a resolution containing at least two material misrepresentations and authorizing the sale of corporate stock to the directors at a price below fair market value); *Shell* v. *Hensley*, 430 F. 2d 819, 825 (CA5 1970) (derivative suit alleging that corporate officers used misleading proxy materials and other reports to deceive shareholders regarding a bogus employment contract intended to conceal improper payments to the corporation president and regarding purchases by the corporation of certain securities at excessive prices); *Rekant* v. *Dresser*, 425 F. 2d 872, 882 (CA5 1970) (as part of scheme to cause corporation to issue treasury shares and a promissory note for grossly inadequate consideration, corporate officers deceived shareholders by making affirmative misrepresentations in the corporation's annual report and by failing to file any such report the next year). See Note, 89 Harv. L. Rev. 1917, 1926 (1976) (stating that no appellate decision before that of CA2 in this case and in *Marshel* v. *AFW Fabric Corp.*, 533 F. 2d 1277, vacated and remanded for a determination of mootness, 428 U. S. — (1976), "had permitted a 10b–5 claim without some element of misrepresentation or nondisclosure").

adopted by the Court of Appeals below and urged by respondents here, that a breach of fiduciary duty by majority stockholders, without any deception, misrepresentation, or nondisclosure, violates the statute and the Rule.

It is also readily apparent that the conduct alleged in the complaint was not "manipulative" within the meaning of the statute. Manipulation is "virtually a term of art when used in connection with securities markets." *Ernst & Ernst*, 425 U. S., at 199. The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity. See, *e. g.*, § 9 of the 1934 Act, 15 U. S. C. § 78 (i) (prohibiting specific manipulative practices); *Ernst & Ernst*, 425 U. S., at 195, 199 n. 21, 205; *Piper* v. *Chris-Craft Industries, Inc.*, 45 U. S. L. W. 4182, 4193 (1977) (Rule 10b–6, also promulgated under § 10 (b), is "an antimanipulative provision designed to protect the orderliness of the securities market during distributions of stock" and "to prevent stimulative trading by an issuer in its own securities in order to create an unnatural and unwarranted appearance of market activity"); 2 A. Bromberg, Securities Law: Fraud § 7.3 (1975); 2 L. Loss, Securities Regulation 1541–70 (1961); 6, *id.*, at 3755–3763 (1969). Section 10 (b)'s general prohibition of practices deemed by the SEC to be "manipulative"—in this technical sense of artificially affecting market activity in order to mislead investors—is fully consistent with the fundamental purpose of the 1934 Act "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*. . . ." *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 151 (1972), quoting *SEC* v. *Capital Gains Research Bureau, Inc.*, 376 U. S. 180, 186 (1963). Indeed, nondisclosure is usually an essential element in a manipulative scheme. 3 L. Loss, *supra*, at 1565. No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices. But we do not think it would have chosen this "term

of art" if it had meant to bring within the scope of § 10 (b) instances of coporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary.

IV

The language of the statute is, we think, "sufficiently clear in its context" to be dispositive here, *Ernst & Ernst*, 425 U. S., at 201; but even if it were not, there are additional considerations that weigh heavily against permitting a cause of action under Rule 10b–5 for the breach of corporate fiduciary duty alleged in this complaint. Congress did not expressly provide a private cause of action for violations of § 10 (b). Although we have recognized an implied cause of action under that section in some circumstances, *Superintendent of Insurance of New York* v. *Bankers Life and Casualty Co.*, *supra*, at 13 n. 9 (1971), we have also recognized that a private cause of action under the antifraud provisions of the Securities Exchange Act should not be implied where it is "unnecessary to ensure the fulfillment of Congress' purposes" in adopting the Act. *Piper* v. *Chris-Craft Industries*, 45 U. S. L. W., at 4193. Cf. *J. I. Case Co.* v. *Borak*, 377 U. S. 426, 431–433 (1964). As we noted earlier, p. ——, *supra*, the Court repeatedly has described the "fundamental purpose" of the Act as implementing a "philosopy of full disclosure"; once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute. Cf. *Mills* v. *Electric Auto-Lite Co.*, 396 U. S. 375, 381–385 (1970). As in *Cort* v. *Ash*, 422 U. S. 78, 80 (1975), we are reluctant to imply a private cause of action to serve what is "at best a subsidiary purpose" of the federal legislation.

An important element of the inquiry into the necessity for implying a private cause of action is "whether 'the cause of action [is] one traditionally relegated to state law. . . .'" *Piper* v. *Chris-Craft Industries, Inc.*, 45 U. S. L. W., at 4192.

quoting *Cort* v. *Ash*, 422 U. S., at 78. The Delaware Legislature has supplied minority shareholders with a cause of action in the Delaware Court of Chancery to recover the fair value of shares allegedly undervalued in a short-form merger. See p. 3, *supra*. Of course, the existence of a particular state law remedy is not dispositive of the question whether Congress meant to provide a federal remedy, but as in *Piper* and *Cort*, we conclude that "it is entirely appropriate in this instance to relegate respondent and others in his situation to whatever remedy is created by state law." 422 U. S., at 84; 45 U. S. L. W., at 4193.

The reasoning behind a holding that the complaint in this case alleged fraud under Rule 10b–5 could not be easily contained. It is difficult to imagine how a court could distinguish, for purposes of Rule 10b–5 fraud, between a majority stockholder's use of a short-form merger to eliminate the minority at an unfair price and the use of some other device, such as a long-form merger, tender offer, or liquidation, to achieve the same result; or indeed how a court could distinguish the abuses involved in these going private transactions from other types of fiduciary self-dealing involving transactions in securities. The result would be to bring within the Rule a wide variety of corporate conduct traditionally left to state regulation. In addition to posing a "danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b–5," *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723, 740 (1975), this extension of the federal securities laws would overlap and quite possibly interfere with state corporate law. Federal courts applying a "federal fiduciary principle" under Rule 10b–5 could be expected to depart from state fiduciary standards at least to the extent necessary to ensure uniformity within the federal system.[10] Absent a clear indication of con-

[10] For example, some States apparently require a "valid corporate purpose" for the elimination of the minority interest through short-form

gressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden. As the Court stated in *Cort* v. *Ash*, *supra*, "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." 422 U. S., at 84 (emphasis added).

We thus adhere to the position that "Congress by § 10 (b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement." *Superintendent of Insurance of New York* v. *Bankers Life & Casualty Co.*, 404 U. S., at 12. There may well be a need for uniform federal fiduciary standards to govern mergers such as that challenged in this complaint. But those standards should not be supplied by judicial extension of § 10 (b) and Rule 10b–5 to "cover the corporate universe." [17]

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merger, whereas other States do not. Compare *Bryan* v. *Brock & Blevins Co.*, 490 F. 2d 563 (CA5), cert. denied, 419 U. S. 844 (1974) (merger arranged by controlling stockholder for no "business purpose" except to eliminate 15% minority stockholder violated Georgia short-form merger statute) with *Stauffer* v. *Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A. 2d 78 (Sup. Ct. 1962) (Delaware short-form merger statute allows majority stockholder to eliminate the minority interest without any corporate purpose and subject only to an appraisal remedy). Thus to the extent that Rule 10b–5 is interpreted to require a valid corporate purpose for elimination of minority shareholders as well as a fair price for their shares, it would impose a stricter standard of fiduciary duty than that required by the law of some States.

[17] Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 Yale L. J. 663, 700 (1974) (footnote omitted). Professor Cary argues vigorously for comprehensive federal fiduciary standards, but urges a "frontal" attack by a new federal statute rather than an extension of Rule 10b–5. He writes, "It seems anomalous to jig-saw every kind of corporate dispute into the federal courts through the securities acts as they are

The judgment of the Court of Appeals is reversed and the case is remanded for further proceedings consistent with this opinion.

So ordered.

presently written." *Ibid.* See also Note, Going Private, 84 Yale L. J. 903 (1974) (proposing the application of traditional doctrines of substantive corporate law to problems of fairness raised by "going private" transaction such as short-form mergers).

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

March 10, 1977

Re: No. 75-1753, Santa Fe Industries
v. Green

Dear Byron,

I am glad to join your opinion for the Court in this case.

Sincerely yours,

P.S.
1.

Mr. Justice White

Copies to the Conference

March 11, 1977

No. 75-1753 Santa Fe Industries v. Green

Dear Byron:

Please join me.

Sincerely,

Mr. Justice White

lfp/ss

cc: The Conference

To: The Chief Justice
Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice White
Mr. Justice Marshall
Mr. Justice Blackmun
Mr. Justice Powell
Mr. Justice Rehnquist

75-1753 - Santa Fe Industries v. Green et al.

From: Mr. Justice Stevens

Circulated: 3/11/77

Recirculated: _____

MR. JUSTICE STEVENS, concurring in part.

Wow!

For the reasons stated by Mr. Justice Blackmun in his dissenting opinion in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 761,[1] and those stated in my dissent in Piper v. Chris-Craft Industries, 45 U.S.L.W. 4182, 4196 (U.S. Feb. 23, 1977), I believe both of those cases were incorrectly decided. I foresee some danger that Part IV of the Court's opinion in this case may incorrectly be read as extending the holdings of those cases. Moreover, the entire discussion in Part IV is unnecessary to the decision of this case. Accordingly, I join only Parts I, II, and III of the Court's opinion. I would also add further emphasis to the fact that the controlling stockholders in this case did not breach any duty owed to the minority shareholders because (a) there was complete disclosure of the relevant facts, and (b) the minority are entitled to receive the fair value of their shares.[2] The facts alleged in the complaint do not constitute "fraud" within the meaning of Rule 10b-5.

1/ See also Eason v. General Motors Acceptance Corp., 490 F.2d 564 (CA7 1973), cert. denied, 416 U.S. 960.

2/ The motivation for the merger is a matter of indifference to the minority stockholders because they retain no interest in the corporation after the merger is consummated.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

March 11, 1977

Re: No. 75-1753 - Santa Fe Industries, Inc. v. Green

Dear Thurgood:

You have a good point. I am adding the following sentence to footnote 12:

> "Because we are concerned here only with § 10(b), we intimate no view as to the Commission's authority to promulgate such rules under other sections of the Act."

Sincerely,

Byron

Mr. Justice Marshall

Copies to Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

March 11, 1977

Re: No. 75-1753, Santa Fe Industries, Inc. v. Green

Dear Byron:

Although I voted the other way at Conference, I am very close to joining your opinion. I am concerned, however, that Part IV of the opinion could be read to say that the SEC has no authority under existing law to deal with the kind of practices alleged in the complaint. Since at least one of the provisions on which the SEC's proposed rules are based, § 13(e), appears to be broader than § 10(b), I do not think we should express a view on the extent of the SEC's power. Could you see your way clear to amending footnote 12 so that it explicitly reserves the question of the Commission's authority to regulate "going private" under provisions other than § 10(b)?

Sincerely,

T.M.

Mr. Justice White

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

March 14, 1977

Re: 75-1753 Santa Fe Industries v. Green et al

Dear Byron:

I join.

Regards,

Mr. Justice White

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

March 15, 1977

Re: No. 75-1753 - Santa Fe Industries v. Green

Dear Byron:

Please join me.

Sincerely,

WHR

Mr. Justice White

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

March 16, 1977

RE: No. 75-1753 Santa Fe Industries v. Green

Dear Byron:

Would you please add the following at the foot of your opinion:

> "Mr. Justice Brennan dissents and would affirm for substantially the reasons stated in the majority and concurring opinions in the Court of Appeals, 533 F. 2d 1283 (1976)."

Sincerely,

Bill

Mr. Justice White

cc: The Conference

THE C. J.	W. J. B.	P. S.	B. R. W.	T. M.	H. A. B.	L. F. P.	W. H. R.	J. P. S.
			1/26/77					
on BLW 3/14/77	dissents 3/16/77	join BLW 3/10/77	1st draft 3/10/77 3rd draft 3/15/77 4th draft 3/17/77	join BLW 3/18/77	concurring in part typed draft 3/14/77 1st draft 3/16/77	join BLW 3/11/77	join BLW 3/15/77	Concurring opinion 3/11/77 typed draft 1st draft 3/14/77
				75-1753	Santa Fe Ind. v. Green			