



10-1974

## Blue Chip Stamps v. Manor Drug Stores

Lewis F. Powell Jr.

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Grant  
11/8

358  
(Rule 10(b)(5)  
& Sec Act §)

Resps, who are neither purchasers or  
~~or~~ sellers of securities, or investors,  
~~are~~ were held entitled to sue Petr.  
under 10(b)(5) for preventing them  
from becoming purchasers by  
issuing an overly-pessimistic  
prospectus.

Petr had been required to  
divest some of its shares to  
~~retail~~ retailers who used its  
stamps.

Preliminary Memo

Conf. of Nov. 8, 1974  
List 3, Sheet ~~E~~3

No. 74-124

BLUE CHIP STAMPS  
V.  
MANOR DRUG STORES

Cert. to CA 9  
(Browning, Choy, Hufstedler  
dissenting)  
Federal/Civil (Securities)

Petr elected  
not to buy &  
stock went up.  
Conflict with  
Timery  
Birnbaum

Summary: This case presents the question of the continuing  
viability of Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.),  
cert. denied, 343 U.S. 905 (1952) which limited the plaintiff class  
in Rule 10(b)(5) damage actions to actual purchasers or sellers of  
securities in the transaction called into question. Resps in the  
immediate case were required to be offered certain shares of Blue  
Chip as part of a plan of reorganization incorporated in an

Grant  
JK

antitrust consent decree. Because of an allegedly misleading over-  
pessimistic prospectus, they did not purchase the offered shares.  
They later filed suit in USDC, seeking the difference between the  
offering price of the shares and their asserted fair market value.  
They presented three theories: liability of petrs under 10(b)(5);  
liability under §12 of the 1933 Securities Act [15 U.S.C. §77L];  
and liability of petr to them under the consent decree as its third  
party beneficiaries. The complaint was dismissed for failure to  
state a claim by USDC [Kelleher] because of the literal inappli-  
cability of §12, the wording of the consent decree, and the failure  
to satisfy the Birnbaum standing requirement for Rule 10(b)(5). A  
panel of the 9th Circuit reversed holding that resps did have 10(b)  
(5) standing (without passing on the remaining claims) over a  
vigorous dissent by Judge Hufstedler and the 9th Circuit denied  
rehearing en banc with five judges dissenting. Petr now renews  
his Birnbaum argument before this Court.

Facts: Blue Chip Stamp is a company engaged in providing and  
redeeming trading stamps used by retail stores. Until 1967, it was  
90% owned by eight large chain grocery corporations (also petrs  
here and defendants below) who used its stamps. A number of other  
small retailers also used the stamps but owned none of Blue Chip's  
stock. An antitrust consent decree entered in that year between  
the Government and the petrs provided for a reorganization of Blue  
Chip in order to reduce the % of its shares held by the big retailers



and increase the % of shares held by smaller retailers. The decree provided that (after a change of name reorganization was consummated) Blue Chip was to make an offering of 621,000 shares (43% of the company) first to the small retailers with any unpurchased shares being offered to others. The number of shares offered to each small retailer was proportional to his prior stamp usage. The offering was in package units with each package costing \$100 and consisting of three shares of common stock and one \$100 completely subordinated debenture. Resps allege that the actual fair market value of this package was \$315.

Some 60% of the offering was purchased by small retailers. The remaining 40% was not and resps as class representatives of the non-accepting retailers seek some \$20 million dollars in damages, representing the aggregate of the difference between the offering price of the non-accepted shares and the allegedly higher fair market value of the non-accepted shares at the time of sale. The gravamen of resps' complaint is that the prospectus distributed in connection with the offering (as required by §4 of the 1933 Securities Act) was materially misleading in its over-pessimistic description of Blue Chip and its prospects. For example, the prospectus listed as potential contingent liabilities some \$29 million in pending legal claims against Blue Chip although the company and its control shareholders knew that many of these claims were frivolous and in fact later settled these claims for

slightly over \$1 million.

Rule 10(b)(5), adopted pursuant to §10(b) of the 1934 Securities Exchange Act and similar in language to that section, provides in pertinent part that "it shall be unlawful for any person, directly or indirectly, . . . (a) to employ any device, scheme, or artifice to defraud, . . . in connection with the purchase or sale of any security."

Q { Contention: The sole question presented in this petition is whether the CA erred in holding that the resps, who neither purchased nor sold securities, had the requisite standing to maintain a damage action under Rule 10(b)(5).

The CA majority [Pet. at A1-A11] reasoned that the purpose of the statute and rule were to insure a well informed body of investors so that the absence of a purchase or sale by a named plaintiff was irrelevant to the rule's objective, noting for example that the SEC in an amicus brief in this case called for total abandonment of Birnbaum's purchaser/seller standing requirement. Various cases for example allowed plaintiffs, who could not maintain a damage action because of failure to meet the purchaser/seller rule, to maintain an action for injunctive relief. To the extent that the standing rule remains applicable, it does so only where other factors not presented in the instant case are present. Normally where the plaintiff has neither purchased nor sold, it is impossible for him to prove either that he would have done so if the misleading conduct had not occurred



or at what price and when he would have done so. Thus the purchaser/seller "standing" rule is only a shorthand for saying that on the alleged facts there is a failure of proof on both causality and loss. Where a prior contractual relationship such as an option exists, the "standing" rule does not apply since there is objective proof of an intent to purchase or sell and a measure of damages may be determined.

Here the consent decree was the "functional equivalent" of a prior contractual arrangement since it specified a discrete group of offerees and a fixed price. It provides objective evidence of both causality and damages and hence the "standing" requirement simply doesn't apply.

Judge Hufstedler didn't agree. The decision conflicts <sup>with</sup> those of every other circuit applying the purchaser/seller standing rule and seeks to use a legal fiction to expand the reach of 10(b)(5). While decisions do recognize that plaintiffs holding contractual obligations to purchase/sell (such as options or puts) do have standing even in the absence of an executed purchase or sale, they do so because the statute itself [15 U.S.C. §78c(a)] says that "the terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire". A consent decree of course is not such a contract under this Court's decisions. It creates no rights of enforcement in either the potential purchaser or the potential seller under a long line of this Court's decisions. If the standing rule exists, then the presence or absence of proof of causation or damages is irrelevant

to whether or not it is met. Although injunctive relief has been granted to non-Birnbaum plaintiffs, this is because preventive relief ought not be denied where the fraud hasn't been consummated and because this form of relief doesn't involve the staggering exposures to liability involved in damage suits by non-purchasers and non-sellers. There is no logical distinction between these non-purchaser offerees and any others in a public offering. At the heart of the majority's decision is a misunderstanding of the role of standing in the federal system. It is not a form of snap judgement on the nature of the plaintiff's proof but rather a confinement of remedy to that class of persons whom Congress intended to have it. The loosening or elimination of the purchaser/seller rule may incrementally increase disclosure but it will certainly generate additional federal litigation, impose draconian damages on offerors drastically increasing the cost of marketing securities, invite strike suits, and drastically unsettle the market through adding new, and unknown risk factors. If the decision of the majority applies only to this discrete group of offerees, then it is simply bad law since there is no meaningful distinction between them and other non-purchasers. It is more likely that this decision reaches all non-purchasers who may now await market developments without risk, claiming deception caused non-buying if the value of the securities proves more promising than the offeror's glum predictions or claiming that deception caused non-selling if a rosy prospectus is followed by a market decline.



The USDC mechanically applied Birnbaum's purchaser/seller rule. Petrs generally repeat the CA dissent. They point out that the 2d, 3rd, 5th, 6th, and 8th Circuits apply Birnbaum while the 7th Circuit followed the 9th Circuit's lead in Eason v. General Motors Acceptance Corp., 490 F.2d 654 (7th Cir. 1973), cert. denied, 42 U.S.L.W. 3595 (April 22, 1974) (Burger, C.J., Douglas and White, J.J. dissenting from denial; Powell, J. not participating). They further argue that even Eason is distinguishable since the fraud alleged there was in connection with a transfer of securities whereas here there was no transfer and resps aren't purchasers, sellers, or investors. They point out that many cases have held that there are no derivative individual rights from an anti-trust consent decree. [Pet. at 19-22]. Finally, they argue that the decision conflicts with the entire policy of the 1933 and 1934 Acts which was to encourage disclosure of all possible adverse aspects of a company in order to preclude "puffing" of securities.

Resps argue that the instant decision is not in conflict with Birnbaum since only a purely mechanistic application of Birnbaum would have denied them standing. Because of their right or entitlement to purchase the shares under the consent decree, they stand in the same position as an option holder. They valiantly seek to distinguish many cases applying the Birnbaum rule and rely on Eason.

Discussion: The status of the Birnbaum doctrine in light of this decision and that in Eason is perhaps the most fundamental



unsettled question in the federal securities area. This decision constitutes a thinly veiled overruling of the doctrine in the 9th Circuit as Judge Hufstedler points out and replaces the purchaser/seller rule with an inquiry into the quantum of available evidence on causation and damages. Because the federal securities laws apply largely to issuers listed on national exchanges, whose shares are sold interstate, and because of the extremely important ramifications of the elimination of the rule, the current conflicting decisions create grave and unfair business uncertainties.

For example, §§ 11 and 12 of the 1933 Act, taken together with Birnbaum under R. 10(b)(5), have meant that only actual purchasers of newly offered shares could recover for inaccuracies in a prospectus. Such purchasers of course have nothing to recover if the prospectus was over-gloomy and the company does better than the prospectus indicates. The result has been consistently over-pessimistic prospectuses as a hedge against potential liability. Exit Birnbaum and in comes the disappointed non-purchaser offeree with a 10(b)(5) cause of action.

The opinions in the case fully articulate the factors going either way and the status of this rule ought to be decided by the Court.

There is a response.

10/29/74

O'Neill

Ops in Pet.

BLUE CHIP STAMPS, ET AL., Petitioners  
vs.

MANOR DRUG STORES, ETC.

8/15/74 Cert. filed.

Birnbaum  
case

Granted

[illegible]



BENCH MEMORANDUM

TO: Mr. Justice Powell  
FROM: Penny Clark

DATE: March 18, 1975

No. 74-124 Blue Chip Stamps v. Manor Drug Stores

The issue in this case is whether § 10(b) of the Securities Exchange Act of 1934 and the SEC's Rule 10b-5 afford a cause of action for damages to a person who alleges that fraudulent misrepresentations within the definition of that rule caused him not to buy a security that he could have purchased. This is not an issue of standing, although it is usually described in those terms. It has nothing to do with Article III; it is solely an issue of the scope of the 10b-5 cause of action. This Court has never endorsed the Birnbaum rule and is writing on a clean slate.

I see two steps in the analysis of the issue: first, whether a person fraudulently induced not to buy a security is within the scope of protection of the securities acts; second, even if he is, whether the class of injuries is so speculative that, as a matter of policy, the Court should deny recovery in damages.

Question one. The SEC's amicus brief takes the position that the securities acts were intended to protect all investors from misrepresentation in connection with all securities transactions. Petitioner takes a narrower view

asserting that the securities acts are primarily designed to prevent "puffing", and that overemphasis of negative factors in a prospectus does not violate the policies of the acts. This seems too narrow a view of the securities acts. Section 10(b) and Rule 10b-5 have no such restrictions: they prohibit all misrepresentations and fraudulent silences in connection with securities transactions, whatever the effect on investors or potential investors. I can easily imagine a fraudulent scheme in which a bad guy trying to obtain control of a corporation would put out false information to dissuade other potential investors from purchasing, or to induce current stockholders to sell their holdings. I think both classes of investors are within the umbrella of the securities acts' protection. I would therefore shift the burden of the analysis to the second question.

Question two. As a general proposition, I think it cannot be denied that the class of claims by persons dissuaded from buying securities is more speculative than the class of claims by persons who were induced to buy, to sell, or to hold securities they already owned. All of these categories include a certain number of speculative problems: "what I would have done if I had known the truth" is always difficult of proof. The issues are even more speculative in class actions. Nonetheless, if there is an actual purchase or sale, there is a point of reference for measuring damages. And if the plaintiff claims that he held securities that would have



sold but for the defendant's fraud, we at least know how many shares he owned. Even when there is only a contract for sale or purchase of securities, the plaintiff's claim that he was induced not to honor the contract <sup>(or exercise the option)</sup> has some ring of certainty.

In a case like Blue Chip Stamps, however, the only certain factor is the maximum subscription each plaintiff was offered.

(And most cases of claimants who were persuaded not to buy will lack even that benchmark.) To prove injury, the plaintiff should have to establish that he intended to buy a certain number of shares, that he had or could have obtained the money to purchase them, and that the defendant's misrepresentation induced him not to buy the stock. If he should establish all this, there is still a question whether his injury - loss of a speculative chance of gain - should be cognizable in damages.

✓ The claimant has suffered no out-of-pocket loss. In Blue Chip Stamps, the respondents ask the difference between the "bargain" price of the offering and the market value of the securities as of the time they were offered. This measures the respondents' loss of an expectation, however, and even at that is more certain than the expectation loss of most persons who would claim they were fraudulently dissuaded from purchasing a security. In sum, the category of claims that Blue Chip Stamps represents is more speculative than other categories of actions under Rule 10b-5. One can reasonably expect that far more of these suits would be started than won, especially if the plaintiffs are required to sustain an appropriately severe burden of proof.

Against the problems of recognizing such a speculative category of claims are the policies that prompted a private cause of action under 10b-5 in the first place: the inadequacy of the SEC's investigative and enforcement resources, and the potential for reinforcement by private suits enforcing the obligations imposed by the securities acts. Some of the civil remedies expressly included in the statutes seem to have such an enforcement purpose; not all are strictly compensatory. The SEC says that private enforcement is helpful. Amicus participation in this case, however, is not the only method open to it for broadening the range of private enforcement: the SEC's rulemaking power is probably broad enough to justify changing Rule 10b-5 to eliminate any "purchaser-seller" limitation. Perhaps the rulemakers and the litigators have a different set of priorities.

Recommendation: I see two alternatives: to hold that persons dissuaded from buying securities may have a cause of action under 10b-5 if they meet an appropriate burden of proof on reliance and injury; or to hold that there is no cause of action. The practical difference between the two choices is whether these cases will be dismissed for failure to state a claim or whether they will go to summary judgment or trial. My inclination is to deny the cause of action - not on the basis of the mechanical "purchaser-seller" rule, but because the claimed injury is too speculative to be



cognizable in an action for damages. I think wholly different considerations should apply if the issue is availability of injunctive relief, and I would not embrace the purchaser-seller rule as a general proposition but would await further litigation in other factual settings.

P.C.

ss

No. 74-124 BLUE CHIP STAMPS v. MANOR DRUG

Argued 3/24/75

Simbaum doctrine (10 lb)(5)



Ryan (Respe)

SEC is arguing for total  
invalidation of Beinbaum Rule  
— Ryan says his clients can  
win on peculiar facts of this  
case. Unique facts.

(White noted that we deal  
with statutory language —  
not necessarily facts)

White suggests we might remand  
to CA 9 to consider Beinbaum  
rule — but, as Stewart, noted  
CA 9 has approved rule in  
Int. Clements.

Statements in "negative prospectus"  
were false.

A TT in 10(b)5 suit would  
have had to read fraud. (But  
then raises quest. as to class  
action)

Kreps (cont.)

Imp.  
question

How many private investors  
who did 'nt purchase may  
sue? Issuers could be  
sued for far more than total  
proceeds of issue.

J. White asked if CAG rejected  
the Berman Rule. ~~Kreps~~ Kreps  
answers that "analytically" the  
CAG repudiated Rule - &  
Hopstetter agrees. Majority  
"wrote around it" by the "functional  
equivalent" concept.

Can't <sup>CAG</sup> reconcile Mount Clement  
case - in terms of its rationale  
- with op. of majority in this case.

Rehnquist suggests that Stewart's  
op. in Airtrack is relevant

Consider potential investor who has  
\$1,000 to invest & considers stocks  
A, B, & C. If he buys A, & B & C go up  
has he been damaged.

xxx  
Resps have a ~~remedy~~ remedy & a suit  
pending in Calif Cts



Blue Chip Stamps - 74-124

Kreps (for Pett.) Good Argument

Resp. never owned; never purchased & never sold any of these securities.

SEC suggests two <sup>limitations</sup> qualifications

(1) Stricter burden of proof

(But this would still leave ~~any~~ any issuer subj. to strike suits — & burden of proof would not come into play until trial).

(2) allow vicarious liab. w/ corp. only when it benefits from the alleged fraud. (Congress has not imposed vicarious liability).

→ In this case, Resp. watched market rise for 2 yrs before filing complaint.

Both of these "limitations" are illusory.

Nysen (Cont.)

Ferber (for SEC)

Urgent repudiation of Bierbaum Rule.

"Standing" is only issue.

Bierbaum issue is here & is presented by this case.

CA9 rule is that Bierbaum Rule is law of circuit, but the panel in this case carved out an exception.

Bierbaum issue was before & decided by DC

Rule makes no sense. It is arbitrary.

Brennan asked if SEC had ever asked Congress to change Rule - it has been with us ~~for~~ for 20 yrs. Answer was "No".

(over)



# Kreps (Rebuttal)

(2000)

1. The first point is that the data is not representative of the population.

2. The second point is that the data is not representative of the population.

3. The third point is that the data is not representative of the population.

4. The fourth point is that the data is not representative of the population.

5. The fifth point is that the data is not representative of the population.

6. The sixth point is that the data is not representative of the population.

7. The seventh point is that the data is not representative of the population.

8. The eighth point is that the data is not representative of the population.

9. The ninth point is that the data is not representative of the population.

10. The tenth point is that the data is not representative of the population.

11. The eleventh point is that the data is not representative of the population.

12. The twelfth point is that the data is not representative of the population.

13. The thirteenth point is that the data is not representative of the population.

14. The fourteenth point is that the data is not representative of the population.

15. The fifteenth point is that the data is not representative of the population.

16. The sixteenth point is that the data is not representative of the population.

17. The seventeenth point is that the data is not representative of the population.

18. The eighteenth point is that the data is not representative of the population.

19. The nineteenth point is that the data is not representative of the population.

20. The twentieth point is that the data is not representative of the population.

(2000)



Burnbaum

Blue Chip  
(74-124)

{not a "standing" case in Art III sense. statutory & policy quest.

Language of 10(b) - & 10(b)5 is focused on a purchase & sales transaction.

Indeed, this is focus of Sec. Acts. The problem which caused Congress to act in 1933 related to frauds perpetrated on buyers of securities, new issues & then the national exchanges.

1934 Act defines "purchase" & "sale" as including contract

The non-buyer - absent some option or ctt right to buy - was never a concern of Congress.

Since Birnbaum (1952) <sup>Arthur Dean - comment</sup> (Hard, Hard & Chert) the "purchase-seller" rule has been the law. Settled rule in CA 2, 3, 5, 6 & 8 & 9<sup>th</sup>. Only CA 7 (Eason) <sup>suggested to reject</sup> ~~has rejected~~ it, & CA 5 - after considering Eason - has reaffirmed "purchase-seller" rule in damage suits (injunctive relief may be different)

CA 9 decision in this case stands alone in its rationale. (Its holding - despite opinion arguing "functional equivalent" - is flatly contrary to Rule).

Judicially created

Private causes of action under 10(b) are wholly judicial creation. Thus, policy consideration must be considered in extending standing (who may) to sue. J. Hupstedly has <sup>well</sup> summarized the probable adverse consequences of abandoning purchase-seller rule. A-20.

CA 1 & 2 "P" offerings (not Reg-exempt) to stockholders are usually under priced



Browning ducked Birnbaum  
by holding consent decree  
the functional eq. of a  
purchase-sale transaction.

Not willing to construe 10(b)  
to allow non-buyers to  
sue whenever a stock goes  
up.

Need not face Birnbaum

Out

Brennan, J. Affirm

There was a 10(b) violation.

Browning was right —  
the functional equivalent  
rationale is OK.

Need not address

Birnbaum. Can accept  
it arguendo & could this  
case not within it.

This is close to a  
ctt to purchase.

Stewart, J. Reverse

Agree that Birnbaum  
rule is sound &  
would adopt it.

There is also a question  
whether this case comes  
within an exception  
to Rule? Patten  
thinks not — not w/in  
any exception <sup>that is</sup> yet  
established & would  
go beyond any  
exception presently  
recognized.

Reverie

Must ask  
first what right  
Resp. has to be in  
court. Right is  
only an implied  
right - this suggests  
caution in extending  
right.

Brenbaum is  
reasonable construction  
of statute.

→ Let Congress  
~~act~~ change 10(b) - not us.  
\* This is odd-ball  
case, could join an  
affirmance if Ct. approves  
Brenbaum

Powell, J. Reverie

See my notes.

Agrees generally with Brennan  
~~Agrees~~ For Brenbaum  
~~but~~

affirm

Blackmun, J. Affirm

Willing to cast Brenbaum  
aside.

This is unusual case  
- can write narrowly  
Agree with Brennan.

Rehnquist, J. Reverie . . . . .

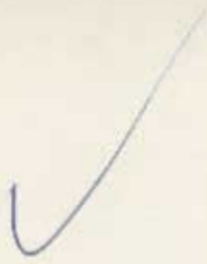
Can't live with  
Brenning's rule .



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

CHAMBERS OF  
JUSTICE HARRY A. BLACKMUN

May 9, 1975



Re: No. 74-124 - Blue Chip Stamps v. Manor Drug Stores

Dear Bill:

In due course I shall be writing a dissenting opinion for  
this case.

Sincerely,

Mr. Justice Rehnquist

cc: The Conference

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

CHAMBERS OF  
JUSTICE THURGOOD MARSHALL

May 12, 1975

Re: No. 74-124 -- Blue Chip Stamps v. Manor Drug Stores

Dear Bill:

I shall wait to see Harry's dissent.

Sincerely,

*TM.*  
T.M.

Mr. Justice Rehnquist

cc: The Conference



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

CHAMBERS OF  
JUSTICE POTTER STEWART

May 12, 1975

74-124 - Blue Chip Stamps, et al.  
v. Manor Drug Stores, Etc.

Dear Bill,

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

Sincerely yours,

P.S.

Mr. Justice Rehnquist

Copies to the Conference

May 13, 1975

No. 74-124 Blue Chip Stamps v.  
Manor Drug Stores

Dear Bill:

Please join me.

Sincerely,

Mr. Justice Rehnquist

lfp/ss

cc: The Conference

Bill: In view of my special interest in this subject, I  
may write a short concurring opinion emphasizing  
the statutory language.

L.F.P., Jr.



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

CHAMBERS OF  
JUSTICE BYRON R. WHITE

May 16, 1975



Re: No. 74-124 - Blue Chip Stamps v. Manor  
Drug Stores

Dear Bill:

Please join me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Byron", located below the word "Sincerely,".

Mr. Justice Rehnquist

Copies to Conference

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

CHAMBERS OF  
JUSTICE WM. J. BRENNAN, JR.

May 27, 1975

✓

RE: No. 74-124 Blue Chip Stamps v. Manor Drug  
Stores, etc.

Dear Harry:

Please join me in your fine dissent.

Sincerely,

*Bul*

Mr. Justice Blackmun

cc: The Conference



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

CHAMBERS OF  
THE CHIEF JUSTICE



May 29, 1975

Re: No. 74-124 - Blue Chip Stamps v. Manor Drug Stores

Dear Bill:

Please join me.

Regards,

A handwritten signature in blue ink, consisting of the letters 'H', 'S', and 'B' in a stylized, cursive-like font.


Mr. Justice Rehnquist

Copies to the Conference

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

CHAMBERS OF  
JUSTICE THURGOOD MARSHALL

June 2, 1975



Re: No. 74-124, Blue Chip Stamps v. Manor Drug Stores

Dear Lewis:

Please join me.

Sincerely,

*J.M.*  
T.M.

Mr. Justice Powell

cc: The Conference





June 4, 1975

No. 74-124 Blue Chip Stamps v.  
Manor Drug Stores, Etc.

Dear Potter:

Thank you for joining my concurring opinion. You may recall our conversation about the majority being charged with "callousness toward the investing public". I enclose a second draft of my concurring opinion, in which I respond to Harry's charges.

I have not yet circulated this draft, and would appreciate your views.

Sincerely,

Mr. Justice Stewart

lfp/ss



*Penny - Please add to next circulation*  
Supreme Court of the United States  
Washington, D. C. 20543

CHAMBERS OF  
JUSTICE POTTER STEWART

June 4, 1975

Re: No. 74-124, Blue Chip Stamps v. Manor Drug  
Stores

Dear Lewis,

I should appreciate your adding my name to your  
concurring opinion in this case.

Sincerely yours,

*P.S.*

Mr. Justice Powell

Copies to the Conference

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

CHAMBERS OF  
JUSTICE POTTER STEWART

June 5, 1975

No. 74-124 - Blue Chip Stamps v. Manor  
Drug Stores, Etc.

Dear Lewis,

I think Part II in your amended con-  
curring opinion is fine, and gladly join it.  
I have noted in pencil on page 1 of the en-  
closed copy an extremely minor suggestion.

Sincerely yours,

P.S.

Mr. Justice Powell





Compton  
declined  
to change - 8

Reverts - RB-2  
to include "offers" - RB-31; RB-2

Is this stock listed?  
If so compare market  
prices - time of suit, each  
year since?

Take heart! We're not  
the only verbose  
securities "experts" on  
this Court!

1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 74-124

Blue Chip Stamps et al.,  
Petitioners,  
v.  
Manor Drug Stores, Etc.

On Writ of Certiorari to the  
United States Court of Ap-  
peals for the Ninth Circuit.

[May —, 1975]

MR. JUSTICE REHNQUIST delivered the opinion of the  
Court.

This case requires us to consider whether the offerees  
of a stock offering, made pursuant to an antitrust consent  
decree and registered under the Securities Act of 1933, 15  
U. S. C. § 77a et seq. ("the 1933 Act"), may maintain a  
private cause of action for money damages where they  
allege that the offeror has violated the provisions of Rule  
10b-5 of the Securities and Exchange Commission, but  
where they have neither purchased nor sold any of the  
offered shares. See *Birnbaum v. Newport Steel Corp.*,  
193 F. 2d 461 (CA2), cert. denied, 343 U. S. 956 (1952).

I

In 1963 the United States filed a civil antitrust action  
against Blue Chip Stamp Company ("Old Blue Chip"),  
a company in the business of providing trading stamps to  
retailers, and nine retailers who owned 90% of its shares.  
In 1967 the action was terminated by the entry of a con-  
sent decree. *United States v. Blue Chip Stamp Co.*, 272  
F. Supp. 432 (CD Cal. 1967), aff'd sub nom. *Thrifty  
Shoppers Script Co. v. United States*, 389 U. S. 580

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

From: Rehnquist, J.

Circulated: 5-9-1975

Recirculated: \_\_\_\_\_

Reviewed  
L.F.P.  
5/10/75

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result -

but  
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~~meanders~~  
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about in  
a most  
unlawy-like  
manner!

Why so  
many apologies  
for following  
Birnbaum?  
See pp 12, 14, 18, 24

Why not  
rely more  
heavily on  
the  
"purchase  
or sale"  
language of  
10(b) &  
10(b) 5?  
(see pp 4, 5),

and on legislation history (9)?



2 BLUE CHIP STAMPS *v.* MANOR DRUG STORES

(1968).<sup>1</sup> The decree contemplated a plan of reorganization whereby Old Blue Chip was to be merged into a newly formed corporation "New Blue Chip." The holdings of the majority shareholders of Old Blue Chip were to be reduced, and New Blue Chip, one of the petitioners here, was required under the plan to offer a substantial number of its shares of common stock to retailers who had used the stamp service in the past but who were not shareholders in the old company. Under the terms of the plan, the offering to nonshareholder users was to be proportional to past stamp usage and the shares were to be offered in units consisting of common stock and debentures.

The reorganization plan was carried out, the offering was registered with the SEC as required by the 1933 Act, and a prospectus was distributed to all offerees as required by § 5 of that Act, 15 U. S. C. § 77e. Somewhat more than 50% of the offered units were actually purchased. In 1970, two years after the offering, respondent, a former user of the stamp service and therefore an offeree of the 1968 offering, filed this suit in the United States District Court for the Central District of California. Defendants below and petitioners here are Old and New Blue Chip, eight of the nine majority shareholders of Old Blue Chip, and the directors of New Blue Chip (collectively called "Blue Chip").

Respondent's complaint alleged, *inter alia*, that the prospectus prepared and distributed by Blue Chip in connection with the offering was materially misleading in its overly pessimistic appraisal of Blue Chip's status and

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<sup>1</sup> Neither respondent nor any of the members of his alleged class were parties to the antitrust action. The antitrust decree itself provided no plan for the reorganization of Old Blue Chip but instead merely directed the parties to the consent decree to present to the court such a plan. Appendix, at 27, 31.



future prospects. It alleged that Blue Chip intentionally made the prospectus overly pessimistic in order to discourage respondent and other members of the allegedly large class whom it represents from accepting what was intended to be a bargain offer, so that the rejected shares might later be offered to the public at a higher price. The complaint alleged that class members because of and in reliance on the false and misleading prospectus failed to purchase the offered units. Respondent therefore sought on behalf of the alleged class some \$21,400,000 in damages representing the lost opportunity to purchase the units; the right to purchase the previously rejected units at the 1968 price, and in addition, it sought some \$25,000,000 in exemplary damages.

The only portion of the litigation thus initiated which is before us is whether respondent may base its action on Rule 10 (b) (5) of the Securities and Exchange Commission without having either bought or sold the shares described in the allegedly misleading prospectus. The District Court dismissed respondent's complaint for failure to state a claim upon which relief might be granted.<sup>2</sup> On appeal to the United States Court of Appeals for the Ninth Circuit, respondent pressed only his asserted claim under Rule 10b-5, and a divided panel of the Court of Appeals sustained his position and reversed the District Court.<sup>3</sup> After the Ninth Circuit denied rehearing en banc, we granted Blue Chip's petition for certiorari. — U. S. —. Our consideration of the correctness of the determination of the Court of Appeals requires us to consider what limitations there are on the class of plaintiffs who may maintain a private cause of action for money damages for violation of Rule 10b-5, and whether respondent was within that class.

<sup>2</sup> The District Court opinion is reported at 339 F. Supp. 35.

<sup>3</sup> The Court of Appeals opinion is reported at 492 F. 2d 136.

were they?

## II

During the early days of the "New Deal," Congress enacted two landmark statutes regulating securities. The Securities Act of 1933, 48 Stat. 74, as amended, 15 U. S. C. § 77a *et seq.*, was described as "an Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." The "Securities Exchange Act of 1934," 48 Stat. 881, as amended, 15 U. S. C. § 78a *et seq.*, was described as an Act "to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes."

The various sections of the Act of 1933 dealt at some length with the required contents of registration statements and prospectuses, and expressly provided for private civil causes of action. Section 11 (a) gave a right of action by reason of a false registration statement to "any person acquiring" the security, and § 12 of that Act gave a right to sue the seller of a security who had engaged in proscribed practices with respect to prospectuses and communication to "the person purchasing the said security from him."

The Act of 1934 was divided into two titles. Title I was denominated "regulation of securities exchanges," and Title II was denominated "amendments to Securities Act of 1933." Section 10 of the Act of 1934 made it "unlawful for any person . . . (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 neces-

10(b)



## BLUE CHIP STAMPS v. MANOR DRUG STORES 5

sary or appropriate in the public interest or for the protection of investors." The "Commission" referred to in the section was the Securities and Exchange Commission created by § 4 (a) of the Act of 1934. Section 29 of that Act provided that "every contract made in violation of any provision of this Title or of any rule or regulation thereunder" should be void.

In 1942, acting under the authority granted to it by § 10 (b) of the Act of 1934, the Commission promulgated Rule 10b-5, providing as follows:

"§ 240.10b-5 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 or would operate as a fraud or deceit upon any person,

"in connection with the purchase or sale of any security."

Section 10 (b) of the 1934 Act does not by its terms provide an express civil remedy for its violation. Nor does the history of this provision provide any indication that Congress considered the problem of private suits under it at the time of its passage. See, e. g., Note, Implied Liability Under the Securities Exchange Act, 61 Harv. L. Rev. 859, 861 (1948); A. Bromberg, Securities

*10(b) does  
not provide  
a civil  
remedy*



## 8 BLUE CHIP STAMPS v. MANOR DRUG STORES

Law: Fraud—SEC Rule 10b-5 § 2.2, at 300-340 (1968); S. Rep. No. 792, 73d Cong., 2d Sess., p. 5-6 (1934). Similarly there is no indication that the Commission in adopting Rule 10b-5 considered the question of private civil remedies under this provision. SEC Securities Exchange Act Release No. 3230 (1942); Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967); *Birnbaum v. Newport Steel Corp.*, *supra*, 193 F. 2d, at 463; 3 L. Loss, Securities Regulation, at 1469 n. 87 (1961).

Despite the contrast between the provisions of Rule 10b-5 and the numerous carefully drawn express civil remedies provided in both the Acts of 1933 and 1934,<sup>4</sup> it was held in 1946 by the United States District Court for the Eastern District of Pennsylvania that there was an implied private right of action under the Rule. *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (1946). This Court had no occasion to deal with the subject until 20-odd years later, and at that time we confirmed with virtually no discussion the overwhelming consensus of the district courts and courts of appeals that such a cause of action did exist. *Superintendent of Insurance v. Bankers Life and Casualty Co.*, 404 U. S. 6, 13 n. 9 (1971); *Affiliated Ute Citizens v. United States*, 406 U. S. 128, 150-154 (1972). Such a conclusion was, of course, entirely consistent with the Court's recognition in *J. I. Case Corp. v. Borak*, 377 U. S. 426, 432 (1964), that private enforcement of Commission rules may "[provide] a necessary supplement to Commission action."

Within a few years after the seminal *Kardon* decision,

<sup>4</sup> See, e. g., § 11 of the 1933 Act, 15 U. S. C. § 77k; § 12 of the 1933 Act, 15 U. S. C. § 77l; § 15 of the 1933 Act, 15 U. S. C. § 77o; § 9 of the 1934 Act, 15 U. S. C. § 78e; § 16 of the 1934 Act, 15 U. S. C. § 78p; § 18 of the 1934 Act, 15 U. S. C. § 78r; § 20 of the 1934 Act, 15 U. S. C. § 78t.

Implied  
right to sue

the Court of Appeals for the Second Circuit concluded that the plaintiff class for purposes of a private damage action under § 10 (b) and Rule 10b-5 was limited to actual purchasers and sellers of securities. *Birnbaum v. Newport Steel Corp.*, *supra*.

The Court of Appeals in this case did not repudiate *Birnbaum*; indeed, another panel of that court (in an opinion by Judge Ely) had but a short time earlier affirmed the rule of that case. *Mount Clemmons Industries v. Bell*, 464 F. 2d 339 (CA9 1972). But in this case a majority of the Court of Appeals found that the facts warranted an exception to the *Birnbaum* rule. For the reasons hereinafter stated, we are of the opinion that *Birnbaum* was rightly decided, and that it bars respondent from maintaining this suit under Rule 10b-5.

### III

The panel which decided *Birnbaum* consisted of Chief Judge Swan and Judges Learned Hand and Augustus Hand; the opinion was written by the latter. Since both § 10 (b) and Rule 10b-5 proscribed only fraud "in connection with the purchase or sale" of securities, and since the history of § 10 (b) revealed no congressional intention to extend a private civil remedy for money damages to other than defrauded purchasers or sellers of securities, in contrast to the express civil remedy provided by § 16 (b) of the 1934 Act, the court concluded that the plaintiff class in a Rule 10b-5 action was limited to actual purchasers and sellers. 193 F. 2d 461, 463-464.

Just as this Court had no occasion to consider the validity of the *Kardon* holding that there was a private cause of action under Rule 10b-5 until 20-odd years later, nearly the same period of time has gone by between the *Birnbaum* decision and our consideration of the case now before us. As with *Kardon*, virtually all lower

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Ely found  
an exception  
to Birnbaum



## 8 BLUE CHIP STAMPS v. MANOR DRUG STORES

federal courts facing the issue in the hundreds of reported cases presenting this question over the past quarter century have reaffirmed Birnbaum's conclusion that the plaintiff class for purposes of § 10 (b) and Rule 10b-5 private damage action is limited to purchasers and sellers of securities. See 6 L. Loss, Securities Regulation, at 3617. See, e. g., *Haberman v. Murchison*, 468 F. 2d 1305, 1311 (CA2 1972); *Landry v. FDIC*, 486 F. 2d 139, 156-157 (CA3 1973), cert. denied, 416 U. S. 960 (1974); *Sargent v. Genesco*, 492 F. 2d 750, 763 (CA5 1974); *Simmons v. Wolfson*, 428 F. 2d 455, 456 (CA6 1970), cert. denied, 400 U. S. 999 (1971); *City National Bank v. Vanderboom*, 422 F. 2d 221, 227-228 (CA8), cert. denied, 399 U. S. 905 (1970); *Mount Clemens Industries, Inc. v. Bell*, 464 F. 2d 339 (CA9 1972); *Jensen v. Voyles*, 393 F. 2d 131, 133 (CA10 1967). Compare *Eason v. General Motors Acceptance Corp.*, 490 F. 2d 654 (CA7 1973), cert. denied, 416 U. S. 960 (1974), with *Dasho v. Susquehanna Corp.*, 380 F. 2d 262 (CA7), cert. denied, 389 U. S. 977 (1967).

In 1957 and again in 1959, the Securities and Exchange Commission sought from Congress amendment of § 10 (b) to change its wording from "in connection with the purchase or sale of any security" to "in connection with the purchase or sale of, or any attempt to purchase or sell, any security." (Emphasis added.) 103 Cong. Rec. 11636 (1957); SEC Legislation, Hearings before Subcom. of Sen. Com. on Banking & Currency on S. 1178-1182, 86th Cong., 1st Sess., 367-368 (1959); S. 2545, 85th Cong., 1st Sess. (1957); S. 1179, 86th Cong., 1st Sess. (1959). In the words of a memorandum submitted by the Commission to a congressional committee, the purpose of the proposed change was "to make section 10 (b) also applicable to manipulative activities in connection with any attempt to purchase or sell any

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## BLUE CHIP STAMPS v. MANOR DRUG STORES 9

security." Hearings on S. 1178-1182, *supra*, at 331. Opposition to the amendment was based on fears of the extension of civil liability under § 10 (b) that it would cause. *Id.*, at 368. Neither change was adopted by Congress.

The longstanding acceptance by the courts, coupled with Congress' failure to reject *Birnbaum's* reasonable interpretation of the wording of § 10 (b), wording which is directed towards injury suffered "in connection with the purchase and sale" of securities, argues significantly in favor of acceptance of the *Birnbaum* rule by this Court. *Blau v. Lehman*, 368 U. S. 403, 413 (1962).

Available extrinsic evidence from the texts of the 1933 and 1934 Acts as to the congressional scheme in this regard, though not conclusive, also tends to support the result reached by the *Birnbaum* court. The wording of § 10 (b) directed at fraud "in connection with the purchase or sale" of securities stands in contrast with the parallel antifraud provision of the 1933 Act, § 17 (a), 15 U. S. C. § 77q,<sup>6</sup> reaching fraud "in the offer or sale"

<sup>6</sup> § 17 (a) of the 1933 Act provides in wording virtually identical to that of Rule 10b-5 with the exception of the italicized portion that:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

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

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." (Emphasis added.)

We express, of course, no opinion on whether § 17 (a) in light of the express civil remedies of the 1933 Act gives rise to an implied

Congress  
declined  
to expand  
10 (b)

yes

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of securities. Cf. § 5 of the 1933 Act, 15 U. S. C. 77e. When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly. Cf. § 16 (b) of the 1934 Act, 15 U. S. C. § 78p.

Section 28 (a) of the 1934 Act, 15 U. S. C. § 77bb, which limits recovery in any private damage action brought under the 1934 Act to "actual damages," likewise provides some support for the purchaser-seller rule. See, e. g., A. Bromberg, *Securities Law: Fraud—SEC—Rule 10b-5* § 8.8, at 221 (1968). While the damages suffered by purchasers and sellers pursuing a § 10 (b) cause of action may on occasion be difficult to ascertain, *Affiliated Ute Citizens v. United States*, *supra*, at 155, in the main such purchasers and sellers at least seek to base recovery on a demonstrable number of shares traded. In contrast, a putative plaintiff, who neither purchases nor sells securities but sues instead for intangible economic injury such as loss of a noncontractual opportunity to buy or sell, is more likely to be seeking a largely conjectural and speculative recovery in which the number of shares involved will depend on the plaintiff's subjective hypothesis. Cf. *Estate Counseling Service v. Merrill, Lynch, Pierce, Fenner & Smith*, 303 F. 2d 527, 533 (CA10 1962); *Levine v. Seilon, Inc.*, 439 F. 2d 328, 335 (CA2 1971); *Wolf v. Frank*, 477 F. 2d 467, 478 (CA2 1973).

One of the justifications advanced for implication of a cause of action under § 10 (b) lies in § 29 (b) of the 1934 Act, 15 U. S. C. § 78cc, providing that a contract

cause of action. Compare *Greater Iowa Corp. v. McLendon*, 378 F. 2d 783, 788, 791 (CA8 1967), with *Fishman v. Raytheon Mfg. Corp.*, 188 F. 2d 783, 787 (CA2 1951). See, e. g., *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833, 867 (CA2 1968) (Opinion of Friendly, J., concurring), cert. denied, 394 U. S. 976 (1969); 3 L. Loeb, *Securities Regulation* 1785 (1961).



## BLUE CHIP STAMPS v. MANOR DRUG STORES 11

made in violation of any provision of the 1934 Act is voidable at the option of the deceived party.<sup>6</sup> See, e. g., *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (ED Pa. 1946); *Slavin v. Germantown Fire Insurance Co.*, 174 F. 2d 799, 815 (CA3 1949); *Fischman v. Raytheon Manufacturing Co.*, 188 F. 2d 783, 787 n. 4 (CA2 1951); A. Bromberg, *Securities Regulation: Fraud—SEC Rule 10b-5 § 2.4 (1)(b)* (1968). But that justification is absent when there is no actual purchase or sale of securities, or a contract to do so, affected or tainted by a violation of § 10 (b). Cf. *Mount Clemens Industries, Inc. v. Bell*, *supra*.

The principal express nonderivative private civil remedies, created by Congress contemporaneously with the passage of § 10 (b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities. Thus § 11 (a) of the 1933 Act confines the cause of action it grants to "any person acquiring the security" while the remedy granted by § 12 of that Act is limited to the "person purchasing the said security." Section 9 of the

<sup>6</sup> § 20 (b) of the 1934 Act provides in part:

"Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void, (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation. . . ."

Cf. *Decker v. Independent Sharee Corp.*, 311 U. S. 282 (1940).



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1934 Act, prohibiting a variety of fraudulent and manipulative devices, limits the express civil remedy provided for its violation to "any person who shall purchase or sell any security" in a transaction affected by a violation of the provision. Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . ." It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.

Having said all this, we would by no means be understood as suggesting that we are able to divine any express or even clearly implied "intent of Congress" in determining whether a claim under Rule 10b-5 should be limited to purchasers and sellers under the Act. When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn. Such growth may be quite consistent with the congressional enactment and with the role of the federal judiciary in interpreting it, see *J. I. Case v. Borak*, *supra*, but it would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 foreordained the present state of the law with respect to Rule 10b-5. It is therefore proper that we consider, in addition to the factors already discussed, what may be described as policy considerations when we come to flesh out the portions of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance.

Three principal classes of potential plaintiffs are pres-

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No

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3 classes

ently barred by the *Birnbaum* rule. First are potential purchasers of shares, either in a new offering or on the Nation's post-distribution trading markets, who allege that they decided not to purchase because of an unduly gloomy representation or the omission of favorable material which made the issuer appear to be a less favorable investment vehicle than it actually was. Second are actual shareholders in the issuer who allege that they decided not to sell their shares because of an unduly rosy representation or a failure to disclose unfavorable material. Third are shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5. It has been held that shareholder members of the second and third of these classes may frequently be able to circumvent the *Birnbaum* limitation through bringing a derivative action on behalf of the corporate issuer if the latter is itself a purchaser or seller of securities. See, e. g., *Schoenbaum v. Firstbrook*, 405 F. 2d 215, 219 (CA2 1968), cert. denied *sub nom. Manley v. Schoenbaum*, 395 U. S. 908 (1969). But the first of these classes, of which respondent is a member, can not claim the benefit of such a rule.

A great majority of the many commentators on the issue before us have taken the view that the *Birnbaum* limitation on the plaintiff class in a Rule 10b-5 action for damages is an arbitrary restriction which unreasonably prevents some deserving plaintiffs from recovering damages which have in fact been caused by violations of Rule 10b-5. See, e. g., *Lowenfels*, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 Va. Law Rev. 268 (1968). The Securities and Exchange Commission has filed an *amicus* brief in this case espousing that same view. We have no doubt that this is



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indeed a disadvantage of the *Birnbaum* rule,<sup>7</sup> and if it had no countervailing advantages it would be undesirable as a matter of policy, however much it might be supported by precedent and legislative history. But we are of the opinion that there are countervailing advantages to the *Birnbaum* rule, purely as a matter of policy, although those advantages are more difficult to articulate than is the disadvantage.

There has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general. This fact was recognized by Judge Browning in his opinion for the majority of the Court of Appeals in this case, 492 F. 2d 141, and by Judge Hufstедler in her dissenting opinion when she said:

"The purchaser-seller rule has maintained the balances built into the congressional scheme by permitting damage actions to be brought only by those persons whose active participation in the marketing transaction promises enforcement of the statute without undue risk of abuse of the litigation process and without distorting the securities market." 492 F. 2d 147.

<sup>7</sup> Obviously this disadvantage is attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law. Cf. § 28 of the Securities Exchange Act of 1934, 15 U. S. C. § 78bb. See *Iroquois Industries, Inc. v. Syracuse China Corp.*, 417 F. 2d 963, 969 (CA2 1969), cert. denied, 399 U. S. 909 (1970). Thus for example in *Birnbaum* itself, while the plaintiffs found themselves without federal remedies, the conduct alleged as the gravamen of the federal complaint later provided the basis for recovery in a cause of action based on state law. See 3 L. Loss, Securities Regulation 1489 (1961). And in the immediate case, respondent has filed a state court class action held in abeyance pending the outcome of this suit. *Manor Drug Stores v. Blue Chip Stamps*, No. C-5652 (Superior Court, County of Los Angeles, Cal.).

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Judge Friendly in commenting on another aspect of Rule 10b-5 litigation has referred to the possibility that unduly expansive imposition of civil liability "will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers . . ." *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833, 867 (CA2 1968) (concurring opinion). See also Boone and McGowan, Standing to Sue under Rule 10b-5, 49 Tex. L. Rev. 617, 648-649 (1971).

We believe that the concern expressed for the danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5 is founded in something more substantial than the common complaint of the many defendants who would prefer avoiding lawsuits entirely to either settling them or trying them. These concerns have two largely separate grounds.

The first of these concerns is that in the field of corporate law even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit. See, e. g., Sargent, The SEC and the Individual Investor: Restoring His Confidence in the Market, 60 Va. L. Rev. 533, 562-572 (1974); Dooley, The Effects of Civil Liability on Investment Banking and the New Issues Market, 58 Va. L. Rev. 777, 822-843 (1972).

Congress itself recognized the potential for nuisance or "strike" suits in this type of litigation, and in the 1934 Act amended § 11 of the 1933 Act to provide that:

"In any suit under this or any other section of this Title the Court may, in its discretion, require an undertaking for the payment of the costs of such

what !!

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suit, including reasonable attorneys' fees. . . ." (48 Stat. 881, 908.)

Senator Fletcher, Chairman of the Senate Banking and Finance Committee, in introducing Title II of the 1934 Act on the floor of the Senate, stated in explaining the amendment to § 11 (e) that "[t]his amendment is the most important of all." 78 Cong. Rec. 8669. Among its purposes was to provide "a defense against blackmail suits." *Ibid.*

Where Congress in those sections of the 1933 Act which expressly conferred a private cause of action for damages, adopted a provision uniformly regarded as designed to deter "strike" or nuisance actions, *Cohen v. Beneficial Loan Corp.*, 337 U. S. 541, 548-549, that fact alone justifies our consideration of such potential in determining the limits of the class of plaintiffs who may sue in an action wholly implied from the language of the 1934 Act.

The potential for possible abuse of the liberal discovery provisions of the federal rules may likewise exist in this type of case to a greater extent than they do in other litigation. The prospect of extensive deposition of the defendant's officers and associates and the concomitant opportunity for extensive discovery of business documents, is a common occurrence in this and similar types of litigation. To the extent that this process eventually produces relevant evidence which is useful in determining the merits of the claims asserted by the parties, it bears the imprimatur of the Federal Rules of Civil Procedure and of the many cases liberally interpreting them. But to the extent that it permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence, it is a social cost rather than a



## BLUE CHIP STAMPS v. MANOR DRUG STORES 17

benefit. Yet to broadly expand the class of plaintiffs who may sue under Rule 10b-5 would appear to encourage the least appealing aspect of the use of the discovery rules.

Without the *Birnbaum* rule, an action under § 10b-5 will turn largely on which oral version of a series of occurrences the jury may decide to credit, and therefore no matter how improbable the allegations of the plaintiff, the case will be virtually impossible to dispose of prior to trial other than by settlement. In the words of Judge Hufstедler's dissenting opinion in the Court of Appeals:

"The great ease with which plaintiffs can allege the requirements for the majority's standing rule and the greater difficulty that plaintiffs are going to have proving the allegations suggests that the majority's rule will allow a relatively high proportion of 'bad' cases into court. The risk of strike suits is particularly high in such cases; although they are difficult to prove at trial, they are even more difficult to dispose of before trial." 492 F. 2d, at 147 n. 9.

The *Birnbaum* rule, on the other hand, permits exclusion prior to trial of those plaintiffs who were not themselves purchasers or sellers of the stock in question. The fact of purchase of stock and the fact of sale of stock are generally matters which are verifiable by documentation, and do not depend upon oral recollection, so that failure to qualify under the *Birnbaum* rule is a matter that can normally be established by the defendant either on a motion to dismiss or on a motion for summary judgment.

Obviously there is no general legal principle that courts in fashioning substantive law should do so in a manner which makes it easier, rather than more difficult, for a defendant to obtain a summary judgment. But in this type of litigation, where the mere existence of an un-



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resolved lawsuit has settlement value to the plaintiff not only because of the possibility that he may prevail on the merits, an entirely legitimate component of settlement value, but because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proven so before trial, such a factor is not to be totally dismissed. The *Birnbaum* rule undoubtedly excludes plaintiffs who have in fact been damaged by violations of Rule 10b-5, and to that extent it is undesirable. But it also separates in a readily demonstrable manner the group of plaintiffs who actually purchased or actually sold, and whose version of the facts is therefore more likely to be believed by the trier of fact, from the vastly larger world of potential plaintiffs who might successfully allege a claim but could seldom succeed in proving it. And this fact is one of its advantages.

The second ground for fear of vexatious litigation is based on the concern that, given the generalized contours of liability, the abolition of the *Birnbaum* rule would throw open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony. We in no way disparage the worth and frequent high value of oral testimony when we say that dangers of its abuse appear to exist in this type of action to a peculiarly high degree. The brief of the Securities and Exchange Commission, while opposing the adoption of the *Birnbaum* rule by this Court, states that it agrees with petitioners "that the effect, if any, of a deceptive practice on someone who has neither purchased nor sold securities may be more difficult to demonstrate than is the effect on a purchaser or seller." Brief, pp. 24-25. The brief also points out that frivolous suits can be brought whatever the rules of standing, and reminds us of this Court's recognition "in a different

Why keep  
knocking  
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of course!

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context" that "the expense and annoyance of litigation is 'part of the social burden of living under government.'" *Petroleum Exploration, Inc. v. Public Service Comm'n*, 304 U. S. 209, 222. The Commission suggests that in particular cases additional requirements of corroboration of testimony and more limited measure of damages would correct the dangers of an expanded class of plaintiffs.

But the very necessity, or at least the desirability, of fashioning unique rules of corroboration and damages as a correlative to the abolition of the *Birnbaum* rule suggests that the rule itself may have something to be said for it.

In considering the policy underlying the *Birnbaum* rule, it is not inappropriate to advert briefly to the tort of misrepresentation and deceit, to which a claim under § 10b-5 certainly has some relationship. Originally under the common law of England such an action was not available to one other than a party to a business transaction. That limitation was eliminated in *Pasley v. Freeman*, 3 Term Rep. 51, 100 Eng. Rep. 450 (1789). Under the earlier law the misrepresentation was generally required to be one of fact, rather than opinion, but that requirement, too, was gradually relaxed. Lord Bowen's famous comment in *Edgington v. Fitzmaurice*, that "the state of a man's mind is as much a fact as the state of his digestion," 1882, L. R. 29 Ch. Div. 359, suggests that this distinction, too, may have been somewhat arbitrary. And it has long been established in the ordinary case of deceit that a misrepresentation which leads to a refusal to purchase or to sell is actionable in just the same way as a representation which leads to the consummation of a purchase or sale. *Butler v. Watkins*, 9 Wall. 815 (1871). These aspects of the evolution of the tort of deceit and misrepresentation suggest a direction away from rules such as *Birnbaum*.

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But the typical fact situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b-5 is applicable. The plaintiff in *Butler, supra*, for example, claimed that he had held off the market a patented machine for tying cotton bales which he had developed by reason of the fraudulent representations of the defendant. But the report of the case leaves no doubt that the plaintiff and defendant met with one another in New Orleans, that one presented a draft agreement to the other, and that letters were exchanged relating to that agreement. Although the claim to damages was based on an allegedly fraudulently induced decision not to put the machines on the market, the plaintiff and the defendant had concededly been engaged in the course of business dealings with one another, and would presumably have recognized one another on the street had they met.

In today's universe of transactions governed by the Securities Exchange Act of 1934, privity of dealing or even personal contact between potential defendant and potential plaintiff is the exception and not the rule. The stock of issuers is listed on financial exchanges utilized by tens of millions of investors and corporate representations reach a potential audience, encompassing not only the diligent few who peruse filed corporate reports or the sizable number of subscribers to financial journals, but the readership of the Nation's daily newspapers. Obviously neither the fact that issuers or other potential defendants under Rule 10b-5 reach a large number of potential investors, or the fact that they are required by law to make their disclosures conform to certain standards, should in any way absolve them from liability for misconduct which is proscribed by Rule 10b-5.

But in the absence of the *Birnbaum* rule, it would be sufficient for a plaintiff to prove that he had failed to purchase or sell stock by reason of a defendant's violation

yes

of course



of Rule 10b-5. The manner in which the defendant's violation caused the plaintiff to fail to act could be as a result of the reading of a prospectus, as respondent claims here, but it could just as easily come as a result of a claimed reading of information contained in the financial pages of a local newspaper. Plaintiff's proof would not be that he purchased or sold stock, a fact which would be capable of documentary verification in most situations, but instead that he decided not to purchase or sell stock. Plaintiff's entire testimony could be dependent upon uncorroborated oral evidence of many of the crucial elements of his claim, and still be sufficient to go to the jury. The jury would not even have the benefit of weighing the plaintiff's version against the defendant's version, since the elements to which the plaintiff would testify would be in many cases totally unknown and unknowable to the defendant. The very real risk in permitting those in respondent's position to sue under Rule 10b-5 is that the door will be open to recovery of substantial damages on the part of one who offers only his own testimony to prove that he ever consulted a prospectus of the issuer, that he paid any attention to it, or that the representations contained in it damaged him.\*

\* The SEC, recognizing the necessity for limitations on non-purchaser, nonseller plaintiffs in the absence of the *Birnbaum* rule, suggests two such limitations to mitigate the practical adverse effects flowing from abolition of the rule. First it suggests requiring some corroborative evidence in addition to oral testimony tending to show that the investment decision of a plaintiff was affected by an omission or misrepresentation. SEC Brief, at 25-26. Apparently ownership of stock or receipt of a prospectus or press release would be sufficient corroborative evidence in the view of the SEC to reach the jury. We do not believe that such a requirement would adequately respond to the concerns in part underlying the *Birnbaum* rule. Ownership of stock or receipt of a prospectus says little about whether a plaintiff's investment decision was affected by a violation of Rule 10b-5 or whether a decision was even made. Second, the SEC would limit the vicarious liability

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The virtue of the *Birnbaum* rule, simply stated, in this situation, is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates. And their dealing in the security, whether by way of purchase or sale, will generally be an objectively demonstrable fact in an area of the law otherwise very much dependent upon oral testimony. As Judge Hufstedler said dissenting from the majority's opinion for the Court of Appeals in this case:

"The passive investor could always await market developments without any risk, claiming deception caused non-buying if the value of the securities proved more promising than the offeror's glum predictions and deception caused nonselling if a rosier prospectus was followed by a market decline. Meanwhile securities offerors would be hard pressed to find language for prospectuses that would be sufficiently neutral to avoid potential damage suits from bystanders." 492 F. 2d, at 148.

While much of the development of the law of deceit

of corporate issuers to nonpurchasers and nonsellers to situations where the corporate issuer has been unjustly enriched by a violation. We have no occasion to pass upon the compatibility of this limitation with § 20 (a) of the 1934 Act, 15 U. S. C. § 78t (a). We do not believe that this proposed limitation is relevant to the concerns underlying in part the *Birnbaum* rule as we have expressed them. We are not alone in feeling that the limitations proposed by the SEC are not adequate to deal with the adverse effects which would flow from abolition of the *Birnbaum* rule. See, e. g., *Vine v. Beneficial Finance Co.*, 374 F. 2d 627, 636 (CA2), cert. denied, 389 U. S. 970 (1967); *Iroquois Industries Inc. v. Syracuse China Corp.*, 417 F. 2d 963, 967 (CA2 1969), cert. denied, 399 U. S. 909 (1970); *Rekant v. Desser*, 425 F. 2d 872, 879 (CA5 1970); *GAF Corp. v. Milstein*, 453 F. 2d 709, 721 (CA2 1971), cert. denied, 406 U. S. 910 (1972); *Drachman v. Harvey*, 453 F. 2d 722, 736, 738 (CA2 1972) (in banc); *Mount Clements Industries, Inc. v. Bell*, 464 F. 2d 339, 341 (CA9 1972).



has been the elimination of artificial barriers to recovery on just claims, we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good. In *Ultramares Corp. v. Touche*, 255 N. Y. 170, 174 N. E. 441, Chief Judge Cardozo observed with respect to "a liability in an indeterminate amount for an indeterminate time to an indeterminate class" that:

"The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of the duty that exposes to these consequences." 174 N. E., at 444.

In *Herpich v. Wallace*, 430 F. 2d 792, 804-805 (CA5 1970), a case adopting the *Birnbaum* limitation on the class of plaintiffs who might bring an action for damages based on a violation of Rule 10b-5, Judge Ainsworth expressed concern similar to those expressed by Chief Judge Cardozo. Judge Stevens, writing in *Eason v. General Motors Acceptance Corp.*, CA7, 490 F. 2d 654, stated that court's view that these concerns were unduly emphasized, and went on to say that "We may not for that reason reject what we believe to be a correct interpretation of the statute or the rule." 490 F. 2d, at 660. He relied in part on the view that Rule 10b-5 should be interpreted, in keeping with this Court's repeated admonition, "not technically and restrictively, but flexibly to effectuate its remedial purposes." *Affiliated Ute Citizens v. United States*, 406 U. S. 128, 151 (1972).

We quite agree that if Congress had legislated the elements of a private cause of action for damages, the duty of the Judicial Branch would be to administer the law which Congress enacted; the judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about

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the wisdom of creating so expansive a liability. But as we have pointed out, we are not dealing here with the interpretation of the express language of § 10b or of Rule 10b-5 conferring a private cause of action. No language in either of those provisions speaks at all to the contours of a private cause of action for their violation. However flexibly we may construe the language of both provisions, nothing in such construction militates against the *Birnbaum* rule. We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited one way or another unless and until Congress addresses the question. Given the peculiar blend of legislative, administrative, and judicial history which now surrounds Rule 10b-5, we believe that practical factors to which we have adverted, and to which other courts have referred, are entitled to a good deal of weight.

Thus we conclude that what may be called considerations of policy, which we are free to weigh in deciding this case, are by no means entirely on one side of the scale. Taken together with the precedential support for the *Birnbaum* rule over a period of more than 20 years, and the consistency of that rule with what we can glean from the intent of Congress, they lead us to conclude that it is a sound rule and should be followed.

## IV

The majority of the Court of Appeals in this case expressed no disagreement with the general proposition that one asserting a claim for damages based on the violation of Rule 10b-5 must be either a purchaser or seller of securities. However, it noted that prior cases have held that persons owning contractual rights to buy or sell securities are not excluded by the *Birnbaum* rule. Relying on these cases, it concluded that respondent's status as an offeree pursuant to the terms of the

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consent decree served the same function, for purposes of delimiting the class of plaintiffs, as is normally performed by the requirement of a contractual relationship. 492 F. 2d, at 142.

The Court of Appeals recognized, and respondent concedes here,<sup>9</sup> that a well-settled line of authority from this Court establishes that a consent decree is not enforceable directly or in collateral proceedings by those who are not parties to it even though they were intended to be benefited by it. *United States v. Armour and Co.*, 402 U. S. 673 (1971); *Buckeye Co. v. Hocking Valley Co.*, 269 U. S. 42 (1925).<sup>10</sup>

A contract to purchase or sell securities is expressly defined by § 3 (a) of the 1934 Act, 15 U. S. C. § 78c (a),<sup>11</sup> as a purchase or sale of securities for the purposes of that Act. Unlike respondent, who had no contractual right or duty to purchase Blue Chip's securities, the holders of puts, calls, options and other contractual rights or duties to purchase or sell securities have been recognized as "purchasers" or "sellers" of securities for purposes of Rule 10b-5, not because of a judicial conclusion that they were similarly situated to "purchasers" or "sellers," but because the definitional provisions of the 1934 Act themselves grant them such a status.

Even if we were to accept the notion that the *Birn-*

<sup>9</sup> See Respondent's Brief, at 60.

<sup>10</sup> See n. 1, *supra*; 492 F. 2d, at 144 n. 3 (Opinion of Hufstедler, J., dissenting).

<sup>11</sup> Section 3 (a)(13) of the 1934 Act, 15 U. S. C. § 78c (a)(13) provides:

"The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

Section 3 (a)(14) of the 1934 Act, 15 U. S. C. § 78c (a)(14) provides:

"The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."



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*baum* rule could be circumvented on a case-by-case basis through particularized judicial inquiry into the facts surrounding a complaint, this respondent and the members of his alleged class would be unlikely candidates for such a judicially created exception. While the *Birnbaum* rule has been flexibly interpreted by lower federal courts,<sup>12</sup> we have been unable to locate a single decided case from any court in the 20-odd years of litigation since the *Birnbaum* decision which would support the right of persons who were in the position of respondent here to bring a private suit under Rule 10b-5. Respondent was not only not a buyer or seller of any security but it was not even a shareholder of the corporate petitioners.

As indicated, the 1934 Act, under which respondent seeks to assert a cause of action, is general in scope but chiefly concerned with the regulation of post-distribution trading on the Nation's stock exchanges and securities trading markets. The 1933 Act is a far narrower statute chiefly concerned with disclosure and fraud in connection with offerings of securities—primarily, as here, initial distributions of newly issued stock from corporate issuers. 1 L. Loss, *Securities Regulation* 130-131 (1961). Respondent, who derives no entitlement from the anti-trust consent decree and does not otherwise possess any contractual rights relating to the offered stock, stands in the same position as any other disappointed offeree of a stock offering registered under the 1933 Act who claims that an overly pessimistic prospectus, prepared and distributed as required by §§ 5, 10 of the 1933 Act, has caused it to allow its opportunity to purchase to pass.

<sup>12</sup> Our decision in *SEC v. National Securities, Inc.*, 393 U. S. 453 (1969), established that the purchaser-seller rule imposes no limitation on the standing of the SEC to bring actions for injunctive relief under § 10 (b) and Rule 10b-5.



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There is strong evidence that application of the *Birnbaum* rule to preclude suit by the disappointed offeree of a registered 1933 Act offering under Rule 10b-5 furthers the intention of Congress as expressed in the 1933 Act.<sup>24</sup> Congress left little doubt that its purpose in imposing the prospectus and registration requirements of the 1933 Act was to prevent "the high pressured salesmanship rather than careful counsel," causing inflated new issues, through direct limitation by the SEC of "the selling arguments hitherto employed." H. R. Rep. No. 85, 73d Cong., 1st Sess., 2, 8 (1933).

"Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction states one of the best arguments for the provision." *Id.*, at 8.

The SEC, in accord with the congressional purposes, specifically requires prominent emphasis be given in filed registration statements and prospectuses to material adverse contingencies. See, e. g., SEC Securities Act Release No. 4936, Guides for the Preparation and Filing of Registration Statements, p. 8, ¶ 6 (1968); *Universal Camera Corp.*, 19 S. E. C. 648, 654-656 (1945); Wheat and Blackstone, *Guideposts for a First Public Offering*, 15 Bus. Lawyer 539, 560-562 (1960).

<sup>24</sup> Blue Chip did not here present the question of whether an implied action under § 10 (b) of the 1934 Act and Rule 10b-5 will lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act. We therefore have no occasion to pass on this issue. Compare *Rosenberg v. Globe Aircraft Corp.*, 80 F. Supp. 123 (E.D. Pa. 1948), with *Thiele v. Shields*, 131 F. Supp. 416 (S.D.N.Y. 1955). Cf. 3 L. Loss, *Securities Regulation* 1787-1791 (1961); 6 L. Loss, *Securities Regulation*, at 3915-3917 (1969); A. Bromberg, *Securities Law: Fraud—Rule 10b-5*, § 2.4 (2) (1958).

Sections 11 and 12 of the 1933 Act provide express civil remedies for misrepresentations and omissions in registration statements and prospectuses filed under the Act, as here charged, but restrict recovery to the offering price of shares actually purchased:

"To impose a greater responsibility would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public." H. R. Rep. No. 85, 73d Cong., 1st Sess., 9 (1933).

And in Title II of the Securities Exchange Act of 1934, 48 Stat. 905-908, the same act adopting § 10 (b), Congress amended § 11 of the 1933 Act to limit still further the express civil remedy it conferred. See generally James, Amendments to the Securities Act of 1933, 32 Mich. L. Rev. 1130, 1134 (1934). The additional congressional restrictions, contained in Title II of the 1934 Act, on the already limited express civil remedies provided by the 1933 Act for misrepresentations or omissions in a registration statement or prospectus reflected congressional concern over the impact of even these limited remedies on the new issues market. 78 Cong. Rec. 8668-8669. There is thus ample evidence that Congress did not intend to extend a private cause of action for money damages to the nonpurchasing offeree of a stock offering registered under the 1933 Act for loss of the opportunity to purchase due to an overly pessimistic prospectus.

Beyond the difficulties evident in an extension of standing to this respondent, we do not believe that the *Birnbaum* rule is merely a shorthand judgment on the nature of a particular plaintiff's proof. As a purely practical matter, it is doubtless true that respondent and the members of its class, as offerees and recipients of the prospectus of New Blue Chip, are a smaller class of



potential plaintiffs than would be all those who might conceivably assert that they obtained information violative of Rule 10b-5 and attributable to the issuer in the financial pages of their local newspaper. And since respondent likewise had a prior connection with some of petitioners as a result of using the trading stamps marketed by Old Blue Chip, and was intended to benefit from the provisions of the consent decree, there is doubtless more likelihood that its managers read and were damaged by the allegedly misleading statements in the prospectus than there would be in a case filed by a complete stranger to the corporation.

But respondents and the members of their class are neither "purchasers" nor "sellers," as those terms are defined in the 1934 Act, and therefore to the extent that their claim of standing to sue were recognized, it would mean that the lesser practical difficulties of corroborating at least some elements of their proof would be regarded as sufficient to avoid the *Birnbaum* rule. While we have noted that these practical difficulties, particularly in the case of a complete stranger to the corporation, support the retention of that rule, they are by no means the only factor which does so. The general adoption of the rule by other federal courts in the 20-odd years since it was pronounced, and the consistency of the rule with the statutes involved and their legislative history, are likewise bases for retaining the rule. Were we to agree with the Court of Appeals in this case, we would leave the *Birnbaum* rule open to endless case-by-case erosion depending on whether a particular group of plaintiffs were thought by the court in which the issue was being litigated to be sufficiently more discrete than the world of potential purchasers at large to justify an exception. We do not believe that such a shifting and highly fact-oriented disposition of the issue of who may bring



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a damage claim for violation of Rule 10b-5 is a satisfactory basis for a rule of liability imposed on the conduct of business transactions. Nor is it as consistent as a straightforward application of the *Birnbaum* rule with the other factors which support the retention of that rule. We therefore hold that respondent was not entitled to sue for violation of Rule 10b-5, and the judgment of the Court of Appeals is

*Reversed.*

MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case.

CHAMBERS DRAFT

SUPREME COURT OF THE UNITED STATES

No. 74-124

Blue Chip Stamps et al., Petitioners, v. Manor Drug Stores, Etc.	}	On Writ of Certiorari to the United States Court of Ap- peals for the Ninth Circuit.
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[May —, 1975]

MR. JUSTICE POWELL, concurring.

Although I concur in the opinion of the Court, I write to emphasize the significance of the texts of the Acts of 1933 and 1934 and especially the language of § 10 (b) and Rule 10b-5.

The starting point in every case involving construction of a statute is the language itself. The critical phrase in both the statute and the Rule is "in connection with the *purchase or sale* of any security." 15 U. S. C. § 78j (b); 17 CFR § 240.10b-5 (*italics added*). Section 3a (14) of the 1934 Act, 15 U. S. C. § 78o (a)(14), provides that the term "sale" shall "include any contract to sell or otherwise dispose of" securities. There is no hint in any provision of the Act that the term "sale," as used in § 10 (b), was intended—in addition to its long-established legal meaning—to include an "offer to sell." Respondent, nevertheless, would have us amend the controlling language in § 10 (b) to read:

"... in connection with the purchase or sale of, or an offer to sell, any security."

Before a court properly could consider taking such liberty with statutory language there should be, at least, unmistakable support in the history and structure of the legislation. None exists in this case.

## 2 BLUE CHIP STAMPS v. MANOR DRUG STORES

Nothing in the history of the Securities Acts supports any congressional intent to include mere offers in § 10 (b). Moreover, as the Court's opinion indicates, impressive extrinsic evidence in the texts of the two Acts indicates clearly that Congress selectively and carefully distinguished between offers, purchases and sales. Section 17 (a), the antifraud provision of the 1933 Act, 15 U. S. C. § 779 (a), for example, expressly includes "offer[s]" of securities within its terms while § 10 (b) and Rule 10b-5 of the 1934 Act do not. The 1933 Act also defines "offer to sell" as something distinct from a sale. § 2 (3), 15 U. S. C. § 77b (3).

If further evidence of congressional intent were needed, it may be found in the subsequent history of these Acts. As noted in the Court's opinion, the Securities and Exchange Commission unsuccessfully sought, in 1957 and again in 1959, to persuade Congress to broaden § 10 (b) by adding to the critical language: "or any attempt to purchase or sell" any security. See *ante*, p. 8.

This case involves no "purchase or sale" of securities.<sup>1</sup> Respondents were mere offerees, who instituted this suit some two years after the shares were issued and after the market price had soared. Having "missed the market" on a stock, they are hardly in a unique position. The capital that fuels our enterprise system comes from investors who have frequent opportunities to purchase, or not to purchase, securities being offered publicly. The market prices of new issues rarely remain static: almost invariably they go up or down, and they often fluctuate

<sup>1</sup> It is argued that the language "in connection with" justifies extending § 10 (b) to include offers which necessarily precede a purchase or sale. The short answer is that the statute requires a purchase or a sale of a security, and no offer was made to respondents in connection with either. Their complaint rests upon the absence of a sale to or purchase by them.



widely in market appraisal over a period far less than the two years during which respondents reflected on their lost opportunity. Most investors have unhappy memories of decisions not to buy stocks which later performed well.

The opinion of the Court, and the dissenting opinion of Judge Hufstедler in the Court of Appeals, correctly emphasize the subjective nature of the inevitable inquiry if the term "offer" were read into the Act and some arguable error could be found in an offering prospectus: "Would I have purchased this particular security at the time it was offered if I had known the correct facts?" Apart from the human temptation for the plaintiff to answer this question in a self-serving fashion, the offeror of the securities—defendant in the suit—is severely handicapped in challenging the predictable testimony.<sup>2</sup> The subjective issues would be even more speculative in the class actions that inevitably would follow if we held that offers to sell securities are covered by § 10 (b) and Rule 10b-5.

In this case respondents were clearly identifiable as offerees, as here the shares were offered to designated persons.<sup>3</sup> In the more customary public sale of securi-

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<sup>2</sup> Proving, after the fact, what "one would have done" encompasses a number of conjectural as well as subjective issues: would the offeree have bought at all; how many shares would he have bought; how long would he have held the shares; were there other "buys" on the market at the time that they may have been more attractive even had the offeree known the facts; did he in fact use his available funds (if any) more advantageously by purchasing something else.

<sup>3</sup> It is argued that the special facts of this case justify extending the benefit of § 10b-5 to these respondents, even if the statute ordinarily requires a purchase or a sale. But this resolution also would require judicial extension of the terms of the statute. The mere fact that securities are offered to a limited class of offerees

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ties, identification of those who in fact were bona fide offerees would present severe problems of proof. The law requires that offers to sell registered securities be made by means of an effective prospectus. § 5 (b), 15 U. S. C. § 77 (e)(b). Issues are usually marketed through underwriters and dealers, often including scores of investment banking and brokerage firms across the country. Copies of the prospectus may be widely distributed through the dealer group, and then passed hand-to-hand among countless persons whose identities cannot be known. If § 10 (b) were extended to embrace offers to sell, the number of persons claiming to have been offerees could be legion with respect to a security which subsequently proved to be a rewarding investment.

We are entitled to assume that the Congress, in enacting § 10 (b) and in subsequently declining to extend it, took into account these and similar considerations. The courts already have inferred a private cause of action that was not authorized by the legislation. In doing this, however, it was unnecessary to rewrite the precise language of § 10 (b) and Rule 10b-5. This is precisely what respondents—joined, surprisingly, by the SEC—sought in this case.<sup>4</sup> If such a far-reaching change is to

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may eliminate some of the problems of proof but it does not avoid the fatal objection that no offer of securities, absent a purchase or sale, is covered by the statute.

<sup>4</sup>It is more than curious that the SEC should seek this change in the 1934 Act by judicial action. The underlying philosophy of the 1933 Act was to promote "truth" in the marketing of securities to the public. The evil was the tendency of the seller to exaggerate, to "puff," and sometimes fraudulently to overstate the prospects and earning capabilities of the issuing corporation. The decade of the '1920's was marked by financings in which the buying public was oversold, if not actually misled, by the buoyant optimism of issuers and underwriters. The 1933 Act was intended to compel moderation and caution in selling prospectuses, and this is precisely the way that

be made, with unpredictable consequences upon the process of raising capital so necessary to our economic well-being, it is a matter for the Congress, not the courts.

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Act has been administered by the SEC for more than 40 years. Absolute factual accuracy with respect to a corporate enterprise is impossible, except with respect to certain hard facts (*e. g.*, some balance sheet items). The outcome of pending litigation, the effect of relatively new legislation, the possible enactment of adverse legislation, the expenditures needed to meet escalating environmental regulations, the likelihood and effect of new competition or of new technology and many similar matters of potential relevancy, must be addressed in registration statements and prospectuses. In administering the 1933 Act, the SEC traditionally and consistently has encouraged and often required offerors to take conservative postures in prospectuses, especially with respect to judgmental and unfavorable matters. If a different philosophy now were to be read into the 1934 Act, inviting litigation for arguably misleading understatement as well as for overstatement of the issuer's prospects, the hazard of "going to market"—already not inconsequential—would be immeasurably increased.



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~~CHAMBERS DRAFT~~

SUPREME COURT OF THE UNITED STATES

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Although I concur in the opinion of the Court, I write to emphasize the significance of the texts of the Acts of 1933 and 1934 and especially the language of § 10 (b) and Rule 10b-5.

The starting point in every case involving construction of a statute is the language itself. The critical phrase in both the statute and the ~~X~~ Rule is "in connection with the *purchase or sale* of any security." 15 U. S. C. § 78j (b); 17 CFR § 240.10b-5 (*italics added*). Section 3a (14) of the 1934 Act, 15 U. S. C. § 78o (a)(14), provides that the term "sale" shall "include any contract to sell or otherwise dispose of" securities. There is no hint in any provision of the Act that the term "sale," as used in § 10 (b), was intended—in addition to its long-established legal meaning—to include an "offer to sell." Respondent, nevertheless, would have us amend the controlling language in § 10 (b) to read:

"... in connection with the purchase or sale of, or an offer to sell, any security."

Before a court properly could consider taking such liberty with statutory language there should be, at least, unmistakable support in the history and structure of the legislation. None exists in this case.

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## 2 BLUE CHIP STAMPS v. MANOR DRUG STORES

Nothing in the history of the Securities Acts supports any congressional intent to include mere offers in § 10 (b). Moreover, as the Court's opinion indicates, impressive extrinsic evidence in the texts of the two Acts indicates clearly that Congress selectively and carefully distinguished between offers, purchases and sales. ~~Section~~ 17 (a), the antifraud provision of the 1933 Act, 15 U. S. C. § 77r (a), ~~for example~~, expressly includes "offer[s]" of securities within its terms while § 10 (b) and Rule 10b-5 of the ~~1934 Act~~ do not. The 1933 Act also defines "offer to sell" as something distinct from a sale. § 2 (3), 15 U. S. C. § 77b (3).

For example, §

of the 1934 Act

If further evidence of congressional intent were needed, it may be found in the subsequent history of these Acts. As noted in the Court's opinion, the Securities and Exchange Commission unsuccessfully sought, in 1957 and again in 1959, to persuade Congress to broaden § 10 (b) by adding to the critical language: "or any attempt to purchase or sell" any security. See *ante*, p. 8.

This case involves no "purchase or sale" of securities.<sup>1</sup> Respondents were mere offerees, who instituted this suit some two years after the shares were issued and after the market price had soared. Having "missed the market" on a stock, they are hardly in a unique position. The capital that fuels our enterprise system comes from investors who have frequent opportunities to purchase, or not to purchase, securities being offered publicly. The market prices of new issues rarely remain static: almost invariably they go up or down, and they often fluctuate

<sup>1</sup> It is argued that the language "in connection with" justifies extending § 10 (b) to include offers which necessarily precede a purchase or sale. The short answer is that the statute requires a purchase or a sale of a security, and no offer was made to respondents in connection with either. Their complaint rests upon the absence of a sale to or purchase by them.

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widely in market appraisal over a period far less than the two years during which respondents reflected on their lost opportunity. Most investors have unhappy memories of decisions not to buy stocks which later performed well.

The opinion of the Court, and the dissenting opinion of Judge Hufstедler in the Court of Appeals, correctly emphasize the subjective nature of the inevitable inquiry if the term "offer" were read into the Act and some arguable error could be found in an offering prospectus: "Would I have purchased this particular security at the time it was offered if I had known the correct facts?" Apart from the human temptation for the plaintiff to answer this question in a self-serving fashion, the offeror of the securities—defendant in the suit—is severely handicapped in challenging the predictable testimony.<sup>2</sup> The subjective issues would be even more speculative in the class actions that inevitably would follow if we held that offers to sell securities are covered by § 10 (b) and Rule 10b-5.

In this case respondents were clearly identifiable as offerees, as here the shares were offered to designated persons.<sup>3</sup> In the more customary public sale of securi-

<sup>2</sup> Proving, after the fact, what "one would have done" encompasses a number of conjectural as well as subjective issues: would the offeree have bought at all; how many shares would he have bought; how long would he have held the shares; were there other "buys" on the market at the time that ~~they~~ may have been more attractive even had the offeree known the facts; did he in fact use his available funds (if any) more advantageously by purchasing something else.

<sup>3</sup> It is argued that the special facts of this case justify extending the benefit of § 10b-5 to these respondents, even if the statute ordinarily requires a purchase or a sale. But this resolution also would require judicial extension of the terms of the statute. The mere fact that securities are offered to a limited class of offerees



## 4 BLUE CHIP STAMPS v. MANOR DRUG STORES

1933 Act

ties, identification of those who in fact were bona fide offerees would present severe problems of proof. The ~~law~~ requires that offers to sell registered securities be made by means of an effective prospectus. § 5 (b), 15 U. S. C. § 77 (e)(b). Issues are usually marketed through underwriters and dealers, often including scores of investment banking and brokerage firms across the country. Copies of the prospectus may be widely distributed through the dealer group, and then passed hand-to-hand among countless persons whose identities cannot be known. If § 10 (b) were extended to embrace offers to sell, the number of persons claiming to have been offerees could be legion with respect to ~~a security which~~ <sup>any</sup> ~~subsequently proved to be a rewarding investment.~~ <sup>that</sup>

We are entitled to assume that the Congress, in enacting § 10 (b) and in subsequently declining to extend it, took into account these and similar considerations. The courts already have inferred a private cause of action that was not authorized by the legislation. In doing this, however, it was unnecessary to rewrite the precise language of § 10 (b) and Rule 10b-5. This is ~~precisely~~ <sup>exactly</sup> what respondents—joined, surprisingly, by the SEC—sought in this case.<sup>4</sup> If such a far-reaching change is to

may eliminate some of the problems of proof but it does not avoid the fatal objection that no offer of securities, absent a purchase or sale, is covered by the statute.

It is more than curious that the SEC should seek this change in the 1934 Act by judicial action. The underlying philosophy of the 1933 Act was to promote "truth" in the marketing of securities to the public. The evil was the tendency of the seller to exaggerate, to "puff," and sometimes fraudulently to overstate the prospects and earning capabilities of the issuing corporation. The decade of the 1920's was marked by financings in which the buying public was oversold, if not actually misled, by the buoyant optimism of issuers and underwriters. The 1933 Act was intended to compel moderation and caution in selling prospectuses, and this is precisely the way that

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be made, with unpredictable consequences upon the process of raising capital so necessary to our economic well-being, it is a matter for the Congress, not the courts.

Act has been administered by the SEC for more than 40 years. Absolute factual accuracy with respect to a corporate enterprise is impossible, except with respect to certain hard facts (*e. g.*, some balance sheet items). The outcome of pending litigation, the effect of relatively new legislation, the possible enactment of adverse legislation, the expenditures needed to meet escalating environmental regulations, the likelihood and effect of new competition or of new technology and many similar matters of potential relevancy, must be addressed in registration statements and prospectuses. In administering the 1933 Act, the SEC traditionally and consistently has encouraged and often required offerors to take conservative postures in prospectuses, especially with respect to judgmental and unfavorable matters. If a different philosophy now were to be read into the 1934 Act, inviting litigation for arguably misleading understatement as well as for overstatement of the issuer's prospects, the hazard of "going to market"—already not inconsequential—would be immeasurably increased.

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MAY 20 1975

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**SUPREME COURT OF THE UNITED STATES**

**No. 74-124**

Blue Chip Stamps et al., Petitioners, v. Manor Drug Stores, Etc.	}	On Writ of Certiorari to the United States Court of Ap- peals for the Ninth Circuit.
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[May —, 1975]

MR. JUSTICE POWELL, concurring.

Although I concur in the opinion of the Court, I write to emphasize the significance of the texts of the Acts of 1933 and 1934 and especially the language of § 10 (b) and Rule 10b-5.

The starting point in every case involving construction of a statute is the language itself. The critical phrase in both the statute and the rule is "in connection with the *purchase or sale* of any security." 15 U. S. C. § 78j (b); 17 CFR § 240.10b-5 (*italics added*). Section 3a (14) of the 1934 Act, 15 U. S. C. § 78o (a) (14), provides that the term "sale" shall "include any contract to sell or otherwise dispose of" securities. There is no hint in any provision of the Act that the term "sale," as used in § 10 (b), was intended—in addition to its long-established legal meaning—to include an "offer to sell." Respondent, nevertheless, would have us amend the controlling language in § 10 (b) to read:

"... in connection with the purchase or sale of, or an offer to sell, any security."

Before a court properly could consider taking such liberty with statutory language there should be, at least, unmistakable support in the history and structure of the legislation. None exists in this case.

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Nothing in the history of the Securities Acts supports any congressional intent to include mere offers in § 10 (b). Moreover, as the Court's opinion indicates, impressive extrinsic evidence in the texts of the two Acts indicates clearly that Congress selectively and carefully distinguished between offers, purchases and sales. For example, § 17 (a), the antifraud provision of the 1933 Act, 15 U. S. C. § 77q (a), expressly includes "offer[s]" of securities within its terms while § 10 (b) of the 1934 Act and Rule 10b-5 do not. The 1933 Act also defines "offer to sell" as something distinct from a sale. § 2 (3), 15 U. S. C. § 77b (3).

If further evidence of congressional intent were needed, it may be found in the subsequent history of these Acts. As noted in the Court's opinion, the Securities and Exchange Commission unsuccessfully sought, in 1957 and again in 1959, to persuade Congress to broaden § 10 (b) by adding to the critical language: "or any attempt to purchase or sell" any security. See *ante*, p. 8.

This case involves no "purchase or sale" of securities.<sup>2</sup> Respondents were mere offerees, who instituted this suit some two years after the shares were issued and after the market price had soared. Having "missed the market" on a stock, they are hardly in a unique position. The capital that fuels our enterprise system comes from investors who have frequent opportunities to purchase, or not to purchase, securities being offered publicly. The market prices of new issues rarely remain static: almost invariably they go up or down, and they often fluctuate

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## BLUE CHIP STAMPS v. MANOR DRUG STORES 5

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I

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## BLUE CHIP STAMPS v. MANOR DRUG STORES 5

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## II

MR. JUSTICE BLACKMUN's dissent charges the Court with "a preternatural solicitude for corporate well being and a seeming callousness toward the investing public." Our task in this case is to construe a statute. In my view, the answer is plainly compelled by the language as well as the legislative history of the Securities Acts. But even if the language is not "plain" to all, I would have thought none could doubt that the statute can be read fairly to support the result the Court reaches. Indeed, if one takes a different view—and imputes callousness to all who disagree—he must attribute a lack of legal and social perception to the scores of federal judges who have followed *Birnbaum* for two decades.

The dissenting opinion also charges the Court with paying "no heed to the unremedied wrong" arising from the type of "fraud" that may result from reaffirmance

for more than 40 years. Precise factual accuracy with respect to a corporate enterprise is frequently impossible, except with respect to hard facts. The outcome of pending litigation, the effect of relatively new legislation, the possible enactment of adverse legislation, the cost of projected construction or of entering new markets, the expenditures needed to meet changing environmental regulations, the likelihood and effect of new competition or of new technology, and many similar matters of potential relevancy must be addressed in registration statements and prospectuses. In administering the 1933 Act, the SEC traditionally and consistently has encouraged and often required offerors to take conservative postures in prospectuses, especially with respect to judgmental and possibly unfavorable matters. If a different philosophy now were to be read into the 1934 Act, inviting litigation for arguably misleading understatement as well as for overstatement of the issuer's prospects, the hazard of "going to market"—already not inconsequential—would be immeasurably increased.



of the *Birnbaum* rule. If an issue of statutory construction is to be decided on the basis of assuring a *federal* remedy—in addition to state remedies—for every perceived fraud, at least we should strike a balance between the opportunities for fraud presented by the contending views. It may well be conceded that *Birnbaum* does allow some fraud to go unremedied under the federal Securities Acts. But the construction advocated by the dissent could result in wider opportunities for fraud. As the Court's opinion makes plain, abandoning the *Birnbaum* construction in favor of the rule urged by the dissent would invite any person who failed to purchase a newly offered security that subsequently enjoyed substantial market appreciation to file a claim alleging that the offering prospectus understated the company's potential. The number of possible plaintiffs with respect to a public offering would be virtually unlimited. As noted above (Part I, n. 2), an honest offeror could be confronted with subjective claims by plaintiffs who had neither purchased its securities nor seriously considered the investment. It frequently would be impossible to refute a plaintiff's assertion that he relied on the prospectus, or even that he made a decision not to buy the offered securities. A rule allowing this type of open-ended litigation would itself be an invitation to fraud.<sup>5</sup>

<sup>5</sup> The dissent also charges that we are callous toward the "investing public"—a term it does not define. It would have been more accurate, perhaps, to have spoken of the noninvesting public, because the Court's decision does not abandon the investing public. The great majority of registered issues of securities are offered by established corporations that have shares outstanding and held by members of the investing public. The types of suits that the dissent would encourage could result in large damage claims, costly litigation, generous settlements to avoid such cost, and often—where the litigation runs its course—in large verdicts. The shareholders of the defendant corporations—the "investing public"—would ultimately



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bear the burden of this litigation, including the fraudulent suits that would not be screened out by the dissent's bare requirement of a "logical nexus between the alleged fraud and the sale or purchase of a security."

Dissent <sup>implies</sup> ~~applying~~  
that test should be  
whether there was a  
fraud in any sale  
of securities

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

From: Blackburn, J.

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## SUPREME COURT OF THE UNITED STATES

No. 74-124

Blue Chip Stamps et al.,  
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v.  
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On Writ of Certiorari to the  
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[June —, 1975]

MR. JUSTICE BLACKBURN, dissenting.

Today the Court graves into stone *Birnbaum's*<sup>1</sup> arbitrary principle of standing. For this task the Court, unfortunately, chooses to utilize three blunt chisels: (1) reliance on the legislative history of the 1933 and 1934 Securities Acts, conceded as inconclusive in this particular context; (2) acceptance as precedent of two decades of lower court decisions following a doctrine, never before examined here, that was pronounced by a justifiably esteemed panel of that Court of Appeals regarded as the "Mother Court" in this area of the law,<sup>2</sup> but under entirely different circumstances; and (3) resort to utter pragmatism and a conjectural assertion of "policy considerations" deemed to arise in distinguishing the meritorious Rule 10b-5 suit from the meretricious one. In so doing, the Court exhibits a preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public quite out of keeping, it seems to me, with our own traditions and the intent of the securities laws. See *Affiliated Ute*

<sup>1</sup> *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (CA2), cert. denied, 343 U. S. 956 (1952).

<sup>2</sup> Just this Term, however, we did not view with such tender regard another decision by the very same panel. See *United States v. Feola*, — U. S. — (1975), and its treatment of an analogy advanced in *United States v. Crimmins*, 123 F. 2d 271 (CA2 1941).

Does not address policy ~~reconsideration~~  
all CA callous?

## 2 BLUE CHIP STAMPS v. MANOR DRUG STORES

*Citizens v. United States*, 406 U. S. 128, 151 (1972); *Supt. of Insurance v. Bankers Life & Cas. Co.*, 404 U. S. 6, 12 (1971); *SEC v. National Securities, Inc.*, 393 U. S. 453, 463 (1969); *Tcherepnin v. Knight*, 389 U. S. 332, 336 (1967); *SEC v. Capital Gains Bureau*, 375 U. S. 180, 195 (1963).

The plaintiffs' complaint—and that is all that is before us now—raises disturbing claims of fraud. It alleges that the directors of "New Blue Chip" and the majority shareholders of "Old Blue Chip" engaged in a deceptive and manipulative scheme designed to subvert the intent of the 1967 antitrust consent decree and to enhance the value of their own shares in a subsequent offering. Although the complaint is too long to reproduce here, see App. 4-22, the plaintiffs, in short, contend that the much-negotiated plan of reorganization of Old Blue Chip, pursuant to the decree and approved by the district court, was intended to compensate former retailer-users of Blue Chip stamps for damages suffered as a result of the antitrust violations. Accordingly, the majority shareholders were to be divested of 55% of their interest; Old Blue Chip was to be merged into a new company; and 55% of the common shares of the new company were to be offered to the former users on a pro rata basis, determined by the quantity of stamps issued to each of these nonshareholding users during a designated period. Some 621,000-shares were thus to be offered in units, each consisting of three shares of common and a \$100 debenture, in return for \$101 cash.

It is the plaintiffs' pleaded position that this offer to the former users was intended by the antitrust court and the Government to be a "bargain," since the then reasonable market value of each unit was actually \$315. The plaintiffs alleged, however, that the offering shareholders had no intention of complying in good faith with

Knight

units



the terms of the consent decree and of permitting the former users of Blue Chip stamps to obtain the bargain offering. Rather, they conspired to dissuade the offerees from purchasing the units by including substantially misleading and negative information in the prospectus under the heading "Items of Special Interest." The prospectus contained the following statements, allegedly false and allegedly made to deter the plaintiffs from purchasing the units: (1) that "[n]et income for the current fiscal year will be adversely affected by payments aggregating \$8,486,000 made since March 2, 1968, in settlement of claims" against New Blue Chip; (2) that net income "would be adversely affected by a substantial decrease in the use of the Company's trading stamp service"; (3) that net income "would be adversely affected by a sale of one-third of the Company's trading stamp business in California"; (4) that "Claims or Causes of Action (as defined) against the Company, including prayers for treble damages, now aggregate approximately \$29,000,000"; and (5) that, based upon "statistical evaluations," "the Company presently estimates that 97.5% of all stamps issued will ultimately be redeemed." App. 56.

Plaintiffs alleged that these negative statements were known, or should have been known, by the defendants to be false since, for example, the \$29,000,000 in purported legal claims were settled for less than \$1,000,000 only three months later, and, as an historical fact, less than 90% of all trading stamps are redeemed. Importantly, when the defendants offered their own shares for sale to the public a year later, the prospectus issued at that time made no reference to these factors even though, to the extent that they were relevant on the date of the first prospectus, one year earlier, they would have been equally relevant on the date of the second. As a result

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of the defendants' negative statements, plaintiffs claim that they were dissuaded from exercising their option to purchase Blue Chip shares and that they were damaged accordingly.

From a reading of the complaint in relation to the language of § 10 (b) of the 1934 Act and of Rule 10b-5, it is manifest that plaintiffs have alleged the use of a deceptive scheme "in connection with the purchase or sale of any security." To my mind, the word "sale" ordinarily and naturally may be understood to mean not only a single, individualized act transferring property from one party to another, but also the generalized event of public disposal of property through advertisement, auction, or some other market mechanism. Here, there is an obvious, indeed a court-ordered, "sale" of securities in the special offering of New Blue Chip shares and debentures to former users. Yet the Court denies these plaintiffs the right to maintain a suit under Rule 10b-5 because they do not fit into the mechanistic categories of either "purchaser" or "seller." This, surely, is anomaly, for the very purpose of the alleged scheme was to inhibit these plaintiffs from ever acquiring the status of "purchaser." Faced with this abnormal divergence from the usual pattern of securities frauds, the Court pays no heed to the unremedied wrong or to the portmanteau nature of § 10 (b).

The broad purpose and scope of the Securities Exchange Act of 1934 are manifest. Senator Fletcher, Chairman of the Senate Committee on Banking and Currency, in introducing S. 2693, the bill that became the 1934 Act, reviewed the general purposes of the legislation:

"Manipulators who have in the past had a comparatively free hand to befuddle and fool the public and to extract from the public millions of dollars

*Because  
Congress  
left it so  
for good  
reason*

*Has nothing  
to do with  
this case*



through stock-exchange operations are to be curbed and deprived of the opportunity to grow fat on the savings of the average man and woman of America. Under this bill the securities exchanges will not only have the appearance of an open marketplace for investors but will be truly open to them, free from the hectic operations and dangerous practices which in the past have enabled a handful of men to operate with stacked cards against the general body of outside investors. For example, besides forbidding fraudulent practices and unwholesome manipulation by professional market operators, the bill seeks to deprive corporate directors, corporate officers, and other corporate insiders of the opportunity to play the stocks of their companies against the interests of the stockholders of their companies." 78 Cong. Rec. 2271 (1934).

The Senator went on to describe the function of each of the many provisions of the bill, including § 9 (c) which, without significant alteration, became § 10 (b) of the Act. He said, as to this section, in terms that surely are broad:

"The Commission is also given power to forbid any other devices in connection with security transactions which it finds detrimental to the public interest or to the proper protection of investors." *Ibid.*

Similarly, the broad scope of the identical provision in the House version of the bill was emphasized by one of the principal draftsmen, in testimony before the House Committee on Interstate and Foreign Commerce. Summing up § 9 (c), he stated:

"Subsection (c) says, 'Thou shalt not devise any other cunning devices.' . . . Of course subsection (c) is a catch-all clause to prevent manipulative



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devices[.] I do not think there is any objection to that kind of clause. The Commission should have the authority to deal with new manipulative devices." Testimony of Thomas G. Corcoran, Hearing on H. R. 7852 and H. R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess., 115 (1934).

In adopting Rule 10b-5 in 1942, the Securities and Exchange Commission issued a press release stating: "The new rule closes a loophole in the protections against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase." SEC Release No. 3230 (May 21, 1942). To say specifically that certain types of fraud are within Rule 10b-5, of course, is not to say that others are necessarily excluded. That this is so is confirmed by the apparently casual origins of the Rule, as recalled by a former SEC staff attorney in remarks made at a conference on federal securities laws several years ago:

"It was one day in the year 1943, I believe. I was sitting in my office in the S. E. C. building in Philadelphia and I received a call from Jim Treanor who was then the Director of the Trading and Exchange Division. He said, 'I have just been on the telephone with Paul Rowen,' who was then the S. E. C. Regional Administrator in Boston, 'and he has told me about the president of some company in Boston who is going around buying up the stock of his company from his own shareholders at \$4.00 a share, and he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be \$2.00 a share for this coming year. Is there anything we can do about it?' So he came upstairs and I

*Irrelevant*

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called in my secretary and I looked at Section 10 (b) and I looked at Section 17, and I put them together, and the only discussion we had there was where 'in connection with the purchase or sale' should be, and we decided it should be at the end.

"We called the Commission and we got on the calendar, and I don't remember whether we got there that morning or after lunch. We passed a piece of paper around to all the commissioners. All the commissioners read the rule and they tossed it on the table, indicating approval. Nobody said anything except Summer Pike who said, 'Well,' he said, 'we are against fraud, aren't we?' That is how it happened." Remarks of Milton Freeman, Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967).

The question under both Rule 10b-5 and its parent statute, § 10 (b), is whether fraud was employed—and the language is critical—by "any person . . . in connection with the purchase or sale of any security." On the allegations here, the nexus between the asserted fraud and the conducting of a "sale" is obvious and inescapable, and no more should be required to sustain the plaintiffs' complaint against a motion to dismiss.

The fact situation in *Birnbaum* itself, of course, is far removed from that now before the Court, for there the fundament of the complaint was that the controlling shareholder had misrepresented the circumstances of an attractive merger offer and then, after rejecting the merger, had sold his controlling shares at a price double their then market value to a corporation formed by 10 manufacturers who wished control of a captive source's supply when there was a market shortage. The Second Circuit turned aside an effort by small shareholders to bring this claim of breach of fiduciary duty under Rule



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10b-5 by concluding that the Rule and § 10 (b) protected only those who had bought or had sold securities.

Many cases applying the *Birnbaum* doctrine and continuing critical comments from the academic world<sup>3</sup> followed in its wake, but until today the Court remained serenely above the fray.

To support its decision to adopt the *Birnbaum* doctrine, the Court points to the "longstanding acceptance by the courts" and to "Congress' failure to reject *Birnbaum's* reasonable interpretation of the wording of § 10 (b)." *Ante*, p. 9. In addition, the Court purports to find support in "extrinsic evidence from the texts of the 1933 and 1934 Acts," although it concedes this to be "not conclusive." *Ibid.* But the greater portion of the

<sup>3</sup> See, e. g., Lowenfels, The Demise of the *Birnbaum* Doctrine: A New Era for Rule 10b-5, 54 Va. L. Rev. 268 (1968); Boone & McGowan, Standing to Sue Under SEC Rule 10b-5, 49 Tex. L. Rev. 617 (1971); Whitaker, The *Birnbaum* Doctrine: An Assessment, 23 Ala. L. Rev. 543 (1971); Ruder, Current Developments in the Federal Law of Corporate Fiduciary Relations—Standing to Sue Under Rule 10b-5, 26 Bus. Law. 1289 (1971); Fuller, Another Demise of the *Birnbaum* Doctrine: "Tolls the Knell of Parting Day?", 25 Miami L. Rev. 131 (1970); Comment, Dumping *Birnbaum* to Force Analysis of the Standing Requirement under Rule 10b-5, 6 Loyola L. J. 230 (1975); Comment, Standing to Sue in 10b-5 Actions, 49 Notre D. Law. 1131 (1974); Comment, 10b-5 Standing Under *Birnbaum*: The Case of the Missing Remedy, 24 Hastings L. J. 1007 (1973); Comment, The Purchaser-Seller Requirement of Rule 10b-5 Re-evaluated, 44 Colo. L. Rev. 151 (1972); Comment, Inroads on the Necessity for a Consummated Purchase or Sale Under Rule 10b-5, 1969 Duke L. J. 349; Comment, The Decline of the Purchaser-Seller Requirement of Rule 10b-5, 14 Villanova L. Rev. 499 (1969); Comment, The Purchaser-Seller Limitation to SEC Rule 10b-5, 53 Cornell L. Rev. 684 (1968); Comment, The Purchaser-Seller Rule: An Archaic Tool for Determining Standing Under Rule 10b-5, 56 Geo. L. J. 1177 (1968). See Note, Limiting the Plaintiff Class: Rule 10b-5 and the Federal Securities Code, 72 Mich. L. Rev. 1396, 1412 (1974).



Court's opinion is devoted to its discussion of the "danger of vexatiousness," *ante*, p. 14, that accompanies litigation under Rule 10b-5 and that is said to be "different in degree and in kind from that which accompanies litigation in general." *Ibid.* It speaks of harm from the "very pendency of the law suit," *ante*, p. 15, something like the recognized dilemma of the physician sued for malpractice; of the "disruption of normal business activities which may accompany a law suit," *ante*, p. 18; and of "proof . . . which depend[s] almost entirely on oral testimony," *ibid.*, as if all these were unknown to lawsuits taking place in America's courthouses every day. In turning to, and being influenced by, these "policy considerations," *ante*, p. 12, or these "considerations of policy," *ante*, p. 24, the Court, in my view, unfortunately mires itself in speculation and conjecture not usually seen in its opinions. In order to support an interpretation that obviously narrows a provision of the securities laws designed to be a "catch-all," the Court takes alarm at the "practical difficulties," *ante*, p. 29, that would follow the removal of *Birnbaum's* barrier.

Certainly, this Court must be aware of the realities of life, but it is unwarranted for the Court to take a form of attenuated judicial notice of the motivations that defense counsel may have in settling a case, or of the difficulties that a plaintiff may have in proving his claim.

Perhaps it is true that more cases that come within the *Birnbaum* doctrine can be properly proved than those that fall outside it. But this is no reason for denying standing to sue to plaintiffs, such as those in this case, who allegedly are injured by novel forms of manipulation. We should be wary about heeding the seductive call of expediency and about substituting convenience and ease of processing for the more difficult task of separating the genuine claim from the unfounded one.

who said so

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Instead of the artificiality of *Birnbaum*, the essential test of a valid Rule 10b-5 claim, it seems to me, must be the showing of a logical nexus between the alleged fraud and the sale or purchase of a security. It is inconceivable that Congress could have intended a broad-ranging antifraud provision, such as § 10 (b), and, at the same time, have intended to impose, or be deemed to welcome, a mechanical overtone and requirement such as the *Birnbaum* doctrine. The facts of this case, if proved and accepted by the factfinder, surely are within the conduct that Congress intended to ban. Whether these particular plaintiffs, or any plaintiff, will be able eventually to carry the burdens of proving fraud and of proving reliance and damage—that is, causality and injury—is a matter that should not be left to speculations of “policy” of the kind now advanced in this forum so far removed from witnesses and evidence.

Finally, I am uneasy about the type of precedent the present decision establishes. Policy considerations can be applied and utilized in like fashion in other situations. The acceptance of this decisional route in this case may well come back to haunt us elsewhere before long. I would decide the case to fulfill the broad purpose that the language of the statutes and the legislative history dictate, and I would avoid the Court's pragmatic solution resting upon a 20-year-old, severely criticized doctrine enunciated for a factually distinct situation.

In short, I would abandon the *Birnbaum* doctrine as a rule of decision in favor of a more general test of nexus, just as the Seventh Circuit did in *Eason v. General Motors Acceptance Corp.*, 490 F. 2d 654, 661 (1973), cert. denied, 416 U. S. 960 (1974). I would not worry about any imagined inability of our federal trial and appellate courts to control the flooding of the types of cases that the Court fears might result. Nor would I yet be disturbed about dire consequences that a basically

not so

flooding



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pessimistic attitude foresees if the *Birnbaum* doctrine were allowed quietly to expire. Sensible standards of proof and of demonstrable damages would evolve and serve to protect the worthy and shut out the frivolous.