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Michael A. Warner
University of Michigan Law School

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SECURITIES REGULATION—APPLICABILITY OF EXCHANGE ACT SECTION 10(b) TO TRANSACTION EFFECTED BY MEANS OF INTRASTATE TELEPHONE CALL—Plaintiff alleged that he had been defrauded in a sale of securities to the defendant. Plaintiff attempted to invoke section 10(b) of the Securities Exchange Act of 1934, which prohibits various fraudulent practices in securities trading.¹ In order to state a cause of action under 10(b), it was necessary for plaintiff to allege that a means or instrumentality of interstate commerce had been used directly or indirectly in connection with the sale. The sale in this case had been effected through telephone conversations over wires located within the city of Philadelphia. However, the wires carrying the calls could be used for interstate as well as intrastate calls. On defendant's motion for summary judgment, *held*, motion granted. The character of the telephone as an instrumentality of commerce should be determined by the use to which it is put, and Congress did not intend to include the use of a telephone for an intrastate call within the phrase "use of any means or instrumentality of interstate commerce." *Rosen v. Albern Color Research, Inc.*, 218 F. Supp. 473 (E.D. Pa. 1963). In a case decided within one week of the *Rosen* case, the opposite result was reached on similar facts, the court's theory being that a telephone is by nature an instrumentality of interstate commerce; thus any use of the telephone satisfies the requirements of section 10(b).² *Nemitz v. Cunny*, 221 F. Supp. 571 (N.D. Ill. 1963).

The issue of whether the use of a telephone for an intrastate call comes within the wording of a federal statute has arisen in only one other situation. Under section 605 of the Federal Communications Act of 1934 (which prohibits the interception and publishing of the contents of any telephone communication),³ evidence acquired by wire-tapping intrastate phone conversations is excluded from a federal prosecution.⁴ The wiretap situation, however, is distinguishable from the principal cases. Since section 605 refers to "any communication," the language is easily read to cover intrastate communication. Furthermore, since the purpose of the Communications Act is specifically to regulate the actual use of interstate communication, section 605 should extend to intrastate phone calls in the interest of protecting interstate commerce; once a tap is on a wire, both interstate and intrastate calls are intercepted indiscriminately. No such problem of

¹ "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 48 Stat. 891 (1934), 15 U.S.C. § 78j(b) (1958) [hereinafter cited as Exchange Act].

² The court also held that the statute, so interpreted, is constitutional.

³ 48 Stat. 1103 (1934), 47 U.S.C. § 605 (1958).

⁴ *Weiss v. United States*, 308 U.S. 321, 331 (1939). It has also been established that criminal liability can arise from such an interception. *Lipinski v. United States*, 251 F.2d 53 (10th Cir. 1958).

discriminating between interstate and intrastate calls arises in relation to section 10(b) of the Exchange Act.

The Exchange Act was aimed at the control of securities trading and speculation in all forms, with the emphasis on compelling full disclosure of corporate and exchange affairs through various registration and reporting requirements.⁵ Section 10(b) seems to have been intended as a catch-all provision.⁶ The courts have therefore adopted a policy of interpreting the text of 10(b) "as far as the meaning of the words fairly permits" in order to fulfill the "dominating general purpose" of the act.⁷

In line with this policy of judicial expansion, the courts have inferred a civil action in section 10(b), despite the absence of express authorization in the statute.⁸ Section 10(b) has not been limited by the boundaries of common-law fraud, but a higher duty of disclosure has been demanded.⁹ Recently, the requirement of privity between the parties has been relaxed,¹⁰ and a cause of action in favor of a corporation has been inferred.¹¹ The courts have required only a slight connection between the fraud and the telephone call, with no requirement that the misrepresentation be made in the telephone conversation itself.¹² Finally, isolated, face-to-face transactions outside the organized securities market have been held covered, provided the interstate commerce requirements were met.¹³ The judicial history chronicled above clearly demonstrates a policy in favor of extensive regulation of securities frauds.¹⁴ Perhaps this policy will be controlling if the intent of Congress in using the phrase "instrumentality of interstate commerce" cannot be established. It would seem that Congress would have used language expressly covering all transactions which it could constitutionally regulate unless the words "instrumentality of interstate commerce"

⁵ See Exchange Act § 2, 48 Stat. 881 (1934), 15 U.S.C. § 78b (1958); H.R. REP. NO. 1383, 73d Cong., 2d Sess. (1934); S. REP. NO. 792, 73d Cong., 2d Sess. (1934).

⁶ See *Fratt v. Robinson*, 203 F.2d 627, 631 (9th Cir. 1953).

⁷ *Matheson v. Armbrust*, 284 F.2d 670, 674 (9th Cir. 1960), *cert. denied*, 365 U.S. 870 (1961).

⁸ *E.g.*, *Fratt v. Robinson*, 203 F.2d 627, 631-33 (9th Cir. 1953).

⁹ *Berko v. SEC*, 316 F.2d 137 (2d Cir. 1963); *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951).

¹⁰ *Cochran v. Channing Corp.*, 211 F. Supp. 239 (S.D.N.Y. 1962).

¹¹ *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963).

¹² *Matheson v. Armbrust*, 284 F.2d 670 (9th Cir. 1960), *cert. denied*, 365 U.S. 870 (1961).

¹³ *Matheson v. Armbrust*, *supra* note 12. In this case a telephone call was made from Portland, Oregon, to Pasco, Washington, requesting that the plaintiff return to Portland to resume negotiations. The plaintiff did return, misrepresentations by the defendant were made at face-to-face meetings, and a sale of the entire capital stock of a corporation resulted.

¹⁴ In general, the judicial extensions cited above have been looked upon with approval. See, *e.g.*, Cary, *Israels & Loss, Recent Developments in Securities Regulation*, 63 COLUM. L. REV. 856 (1963). Similarly liberal construction may be found in other securities fraud legislation. *E.g.*, *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) (Investment Advisers Act of 1940); *United States v. Ross*, 321 F.2d 61 (2d Cir. 1963) (Securities Act of 1933). *But see* *Ruder, Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 Nw. U.L. Rev. 627 (1963), arguing that the extension of 10(b) has been violative of congressional intent.

were intended to place some limitation on federal power over securities fraud,¹⁵ but an examination of the legislative history of the Exchange Act gives no hint as to what Congress might have meant. Therefore, Congress must have been confident that the words "use of any means or instrumentality of interstate commerce" had an established meaning.

The *Nemitz* court cited a number of cases in which the telegraph or telephone was held an instrument of interstate commerce.¹⁶ In all these decisions, however, the labeling of the telephone as an instrument of interstate commerce was based on or could have been based on a particular interstate transmission.¹⁷ Moreover, these cases specifically stated that it is a message passing over state lines which constitutes the interstate commerce,¹⁸ thus indicating that, in attaching the label "instrumentality of interstate commerce," these courts were thinking only in terms of interstate communication. The Federal Communications Act, enacted the same year as the Exchange Act, distinguishes between interstate and intrastate communication, expressly prohibiting any construction that would extend the provisions of the act to intrastate commerce.¹⁹ Analogously, resolution of the question whether to treat a railroad locomotive as an instrumentality of interstate commerce has depended upon its use in commerce.²⁰

Examination of analogous statutes further supports the conclusion that the use of a telephone for an intrastate call is not the use of an instrumentality of interstate commerce. Section 17(a), the general anti-fraud provision of the Securities Act of 1933,²¹ is very similar to section 10(b) of the Exchange Act. In fact, when section 10(b) was implemented by Rule 10b-5,²² the Securities and Exchange Commission used language virtually identical to that of 17(a) in listing the specific acts henceforth to be prohibited under 10(b), and stated that Rule 10b-5 was promulgated, *inter alia*, to close a loophole in 17(a) by making applicable to the purchaser of securities the same anti-fraud provisions which Congress had imposed on the seller of

¹⁵ The use of this language also indicates that Congress did not intend that the reach of 10(b) be as broad as the scope of Congress' constitutional power to regulate interstate commerce. If X, standing on one side of a state line, sells a security to Y, standing on the other side of the line, this would be a transaction in interstate commerce within Congress' constitutional power; however, it would not be a transaction effected by the use of the mails, a national securities exchange, or an instrumentality of interstate commerce so as to make 10(b) applicable.

¹⁶ *E.g.*, *Fratt v. Robinson*, 203 F.2d 627, 631 (9th Cir. 1953) (action under 10(b) in which a telephone call was made across state lines); *Western Union Tel. Co. v. James*, 162 U.S. 650 (1896) (the leading case holding that the telegraph is an instrument of interstate commerce subject to federal authority).

¹⁷ *Ibid.*

¹⁸ *Western Union Tel. Co. v. Lenroot*, 323 U.S. 490, 502 (1944); *Western Union Tel. Co. v. James*, *supra* note 16.

¹⁹ Federal Communications Act § 2, 48 Stat. 1064 (1934), 47 U.S.C. § 152 (1958).

²⁰ *Minneapolis & St. L.R.R. v. Winters*, 242 U.S. 353, 357 (1917); *Conklin v. New York Cent. R.R.*, 238 N.Y. 570, 144 N.E. 895 (1924); *Ruck v. Chicago M. & S.P.R.R.*, 153 Wis. 158, 140 N.W. 1074 (1913).

²¹ Securities Act of 1933, § 17(a), 48 Stat. 84, as amended, 15 U.S.C. § 77q(a) (1958).

²² 17 C.F.R. § 240.10b-5 (1949) (formerly denominated Rule X-10B-5).

securities through section 17(a).²³ The courts, too, have held that sections 17(a) and 10(b) should be construed *in pari materia*.²⁴ The only other difference between the two sections is that 17(a) prohibits fraud by the use of "instruments of . . . communication *in* interstate commerce," rather than by the use of an "instrumentality of interstate commerce," and thus requires an interstate communication before a cause of action may be stated. (Emphasis added.) Aside from a possible desire for conciseness, there is no explanation of why this substitution was made. It would seem, however, that, just as the SEC and the courts have looked upon 17(a) and 10(b) as part of the same statutory scheme, Congress intended that the two sections cover the same degree of commerce.

The history of the "wire fraud" act demonstrates a similar interchangeable use of "in" and "of" by Congress. As part of the 1952 amendments to the Federal Communications Act, Congress added to the federal Criminal Code the wire fraud provision, which prohibits fraud in general by "means of interstate wire,"²⁵ thus presenting the same ambiguity as section 10(b) of the Exchange Act. Inadvertently, Congress had omitted the regulation of foreign communication from the 1952 act, and the statute was amended in 1956. However, in redrafting the statute, Congress without any explanation changed the language applicable to domestic communication to read: "by means of wire . . . *in* interstate commerce."²⁶ Furthermore, the House committee, in considering the 1956 amendment, seemed to assume that the 1952 act had applied solely to interstate communications.²⁷

When one considers the many transactions which take place daily within a city such as Philadelphia or New York with which a telephone conversation is somehow connected, the significance of extending the language of section 10(b) to include transactions effected by means of an intrastate telephone call is apparent. If 10(b) is so extended, nothing but strictly face-to-face transactions would remain exempt. Aside from policy considerations, the cases and statutes which involve the term "instrumentality of interstate commerce" indicate that the *Rosen* court correctly held that Congress did not intend to include the use of a telephone for an intrastate call within the phrase "use of an instrumentality of interstate commerce." The *Nemitz* court, however, in holding that a cause of action does arise under section 10(b), recognized the prevailing policy in favor of extensive securities regulation. Seemingly, there will be considerable disagreement as to the conclusiveness of the *Rosen* court's showing of congres-

²³ SEC Securities Exchange Act Release No. 3230, May 21, 1942.

²⁴ *Northern Trust Co. v. Essaness Theatres Corp.*, 103 F. Supp. 954, 964 (N.D. Ill. 1952).

²⁵ 18 U.S.C. § 1343 (1958).

²⁶ *Ibid.* (Emphasis added.)

²⁷ "[T]his bill amends . . . [§ 1343] which imposes penalties for schemes to defraud in interstate commerce through the use of wire, radio and television communication." H.R. REP. No. 2385, 84th Cong., 2d Sess. 1 (1956).

sional intent. Therefore, congressional clarification should be given before the confusion engendered by the section's ambiguous language spreads much further.

Michael A. Warner