Semerenko v. Cendant Corp.: The Third Circuit Clarifies the Securities Exchange Commission's Rule 10B-5 in the Context of Public Misrepresentations

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SEMerenko v. Cendant Corp.: The Third Circuit Clarifies the Securities Exchange Commission's Rule 10b-5 in the Context of Public Misrepresentations

I. Introduction

Congress enacted the Securities Exchange Act of 1934 (the "1934 Act") to protect investors from fraudulent practices in the securities markets.1 Section 10b2 and the related Securities Exchange Commission (the "SEC") Rule 10b-53 accomplish Congress' intent by prohibiting the use of

1. See Basic Inc. v. Levinson, 485 U.S. 224, 230 (1988) (citing S. Rep. No. 73-792, at 1-5 (1934)). "The 1934 Act was designed to prevent investors against manipulation of stock prices."); Randzanower v. Touche Ross & Co., 426 U.S. 148, 155 (1976) (quoting H.R. Rep. No. 94-229, at 91 (1975)); ("The primary purpose of the Securities Exchange Act was . . . '[t]o provide fair and honest mechanisms for the pricing of securities [and] to assure that dealing in securities is fair and without undue preferences or advantages among investors . . . .'"); Blue Chips Stamps v. Manor Drug Stores, 421 U.S. 723, 728 (1975) (quoting Securities Exchange Act of 1934, 15 U.S.C. § 78a et seq.) (describing that 1934 Act was promulgated "to provide for the regulation of securities exchanges and 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"); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) ("One of . . . [the central purposes [of the 1934 Act] is to protect investors through the requirement of full disclosure by issuers of securities . . . "); see also In re Ames Dep't Stores, Inc. Stock Litig., 991 F.2d 958, 963 (2d Cir. 1993) noting 1934 Act's purpose of protecting investors from fraud); SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968) (stating that "obvious purposes of the Act [are] to protect the investing public and to secure fair dealing in the securities markets"); Julia K. Cronin et al., Securities Fraud, 38 AM. CRIM. L. REV. 1277, 1278 (2001) (discussing Congress' efforts "to ensure vigorous market competition by mandating full and fair disclosure of all material information in the marketplace"); Hal Morris, Note, Another Day Comes—Misappropriation as an Alternate Basis for Section 10(b) Liability, 61 CHI.-KENT L. REV. 693, 695 (1985) (discussing historical context in which 1934 Act was promulgated).

2. 15 U.S.C. § 78j(b) (1994). Section 10b of the 1934 Act reads as follows: 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.

Id. (emphasis added).

3. 17 C.F.R. § 240.10b-5 (1999). SEC Rule 10b-5 states: 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 security 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

(1171)
fraudulent schemes, devices, misstatements or omissions “in connection with” the purchase or sale of a security. The “in connection with” requirement defines the nexus litigants must show between the prohibited act and the purchase or sale of a security in order to pursue an action under Rule 10b-5.

The language of Section 10b and Rule 10b-5 does not attach a fixed and precise meaning to the “in connection with” requirement. The majority of Rule 10b-5’s jurisprudence construes the “in connection with” requirement;...

Id.


5. See, e.g., Saxe v. E.F. Hutton & Co., 789 F.2d 105, 109 (2d Cir. 1986) (dismissing case for failure to meet Rule 10b-5’s “in connection with” requirement and stating that “[a]ny fraud that may have occurred in the reinvestment of [the] funds... was merely incidental to the sale of [the] securities and, therefore, was not ‘in connection with’ the sale of a security to bring it within the protective ambit of Rule 10b-5’); Vigilant Ins. Co. v. C. & F. Brokerage Servs., 751 F. Supp. 496, 499 (S.D.N.Y. 1990) (dismissing plaintiffs’ Rule 10b-5 claim for “failure to allege the requisite ‘connection’ with ‘the purchase or sale’ of a security’); see also Barbara Black, The Second Circuit’s Approach to the “In Connection With” Requirement of Rule 10b-5, 53 BROOK. L. REV. 539, 541 (1987) (discussing dismissal of actions under 10b-5 for failure to meet rule’s “in connection with” requirement); C. Edward Fletcher, III, The “In Connection With” Requirement of Rule 10b-5, 16 PEPP. L. REV. 913, 915-16, 22 (1998) (likening “in connection with” requirement to that of “linchpin” between fraudulent act and sale or purchase of security and delineating importance of “in connection with” requirement as threshold requirement to stating cause of action under Rule 10b-5).

6. See 15 U.S.C. § 78j(b) (1994) (providing language of statute); 17 C.F.R. § 240.10b-5 (1999) (providing language of SEC Rule 10b-5 promulgated under 15 U.S.C. § 78j(b) (1994)). The expansive amount of case law struggling to interpret the seemingly straightforward “in connection with” requirement brings to light the ambiguity present in the rule’s construction. See In re Ames Dep’t Stores, Inc. Stock Litig., 991 F.2d 953, 964-69 (2d Cir. 1993) (discussing evolution of case law regarding 10b-5’s “in connection with” requirement and recognizing that confusion evidenced within case law is in part caused by numerous factual situations under which Rule 10b-5 actions arise); see also Fletcher, supra note 5, at 929 (discussing confusion prominent in case law and contributing such confusion to “the explosive growth of 10b-5 to cover vastly different types of transactions”); Francesca Muratori, The Boundaries of the “In Connection With” Requirement of Rule 10b-5: Should Advertising Be Actionable as Securities Fraud?, 56 BUS. LAW. 1057, 1057-58 (2001) (noting judicial uncertainty in area of Rule 10b-5).

There is an on-going debate, however, as to the drafter’s reasoning for promulgating such an ambiguous and seemingly expansive rule. Compare Fletcher, supra note 5, at 915 (“The rule is drafted in a manner seemingly calculated to produce disputes over its interpretation; if that is what the drafters intended, their wishes have been long fulfilled.”), with Muratori, supra, at 1057 (discussing belief that drafters never intended rule to be subject of such judicial uncertainty).
requirement broadly, as to insure the protection of investors. Conversely, some scholars endorse a narrower reading of the "in connection with" requirement, as to insure that the floodgates to Rule 10b-5 litigation are not opened.

The United States Court of Appeals for the Third Circuit recently reconsidered the contours of Rule 10b-5's "in connection with" requirement. In Semerenko v. Cendant Corp., the court applied a broad "material and public dissemination" approach to the Rule. Under this approach, the Third Circuit held that the fraud alleged need only be "disseminated to the public in a medium upon which a reasonable investor would rely, and . . . material when disseminated." Some commentators suggest that this broad approach demonstrates a departure from the circuit's prior "in connection with" jurisprudence. To what extent the Third Circuit abandoned its prior precedent is, however, debatable given that the Semerenko court limited its holding to situations where the alleged fraud concerns public misrepresentations.

This Casebrief reviews the Third Circuit's interpretation of Rule 10b-5's "in connection with" requirement. Part II provides a general examination of the court's requirement.

7. See Melvin Aron Eisenberg, Corporations and Other Business Organizations, Cases and Materials 821 (8th ed. 2000) (discussing that minimal nexus between violation of Rule 10b-5 and purchase or sale of security is needed but noting that courts interpret "in connection with" requirement broadly; see also Muratori, supra note 6, at 1057-58 (discussing fact that broad interpretation is advocated by many commentators). For a further discussion of the broad interpretation of Rule 10b-5's "in connection with" requirement, see infra notes 74-85 and accompanying text.

8. See Muratori, supra note 6, at 1058 ("[some scholars counter the broad approach insisting that] under an amorphous reading—one that invariably invites class action abuses—public companies face an indiscernible boundary between what does and does not violate the prohibition."); see also Joseph M. McLaughlin, Understanding Directors' and Officers' Liability, N.Y. L.J., Sept. 26, 2000, at 1 (advocating narrow "investment value" approach for determining contours of "in connection with" requirement). For a further discussion of the narrow approaches, see infra notes 68-73 and accompanying text.


10. 223 F.3d 165 (3d Cir. 2000).

11. See id. at 176 (adopting and defining materiality and public dissemination requirement).

12. Id.


14. See Semerenko, 223 F.3d at 176 ("We conclude that the materiality and public dissemination approach should apply in this case") (emphasis added). The court further noted that, "[t]he light of the law of this circuit... the scope of the 'in connection with' requirement must be determined on a case-by-case basis..." Id. at 175.
tion of Section 10b and Rule 10b-5 focusing on the evolution of the statute and the rule’s “in connection with” requirement. Part III analyzes the Third Circuit’s interpretation of Rule 10b-5 as developed prior to Semerenko. This discussion provides the backdrop for Part III’s detailed discussion of the Third Circuit’s Semerenko decision. Finally, Part IV discusses the implications of Semerenko on the circuit’s “in connection with” jurisprudence. This section concludes with advice for practitioners to consider when confronted with an “in connection with” issue.

II. History and Evolution of Section 10b and Rule 10b-5’s “In Connection With” Requirement

In response to fraudulent and deceptive practices in the securities market, Congress enacted the 1934 Act. Section 10b of the 1934 Act is the Act’s general anti-fraud provision. The statute, however, is not self-executing. Section 10b, by its terms, requires the SEC to prescribe implementing rules. To implement the statute, the SEC promulgated Rule 10b-5, Rule 10b-5, in turn, deems it unlawful to use any fraudulent scheme, device, misstatement or omission “in connection with” the purchase or sale of a security. Rule 10b-5 is the “cornerstone” of the security law’s antifraud provisions. The activities prohibited by the rule include: (1) activities involving a corporation’s issuance of misleading in-

15. For a further discussion of Section 10b and the evolution of Rule 10b-5’s “in connection with” requirement, see infra notes 21-65 and accompanying text.

16. For a further discussion of the Third Circuit’s interpretation of Rule 10b-5 as developed prior to Semerenko, see infra notes 86-110 and accompanying text.

17. For a further discussion of the Third Circuit Court of Appeals’ decision in Semerenko, see infra notes 111-47 and accompanying text.

18. For a further discussion of the implications of Semerenko on the circuit’s “in connection with” jurisprudence, see infra notes 148-64 and accompanying text.

19. For a further discussion regarding advice for practitioners to consider when confronted with an “in connection with” issue, see infra notes 148-64 and accompanying text.

20. For a further discussion of Congress’ purpose in enacting the 1934 Act, see supra note 1 and accompanying text.


22. See 15 U.S.C. § 78j(b) (1994) (prohibiting use of “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") (emphasis added).


24. See id. (providing language of Rule 10b-5).

25. See Morris, supra note 1, at 695 (citing Section 10b and Rule 10b-5 as 1934 Act’s “primary anti-fraud provisions” and “cornerstones of the SEC’s enforcement program to combat fraudulent trading”); see also SODERQUIST & GABALDON, SECURITIES LAW 135 (1998) (discussing development of Section 10b and Rule 10b-5 since their respective enactment and noting that over time Rule 10b-5 “clearly occupies the preeminent position among the antifraud provisions in the securities laws”).
formation to the public;\textsuperscript{26} (2) a corporation's silence despite a duty to disclose;\textsuperscript{27} (3) tipping;\textsuperscript{28} (4) insider trading;\textsuperscript{29} and (5) market manipulation and certain other forms of conduct in connection with the purchase or sale of a security.\textsuperscript{30}

A. The Elements and Defenses of the Rule 10b-5 Private Cause of Action

Rule 10b-5 provides no express private right of action.\textsuperscript{31} Beginning with the 1946 case of \textit{Kardon v. National Gypsum Co.},\textsuperscript{32} however, the lower courts have found that an implied right of action exists under the Rule.\textsuperscript{33} To state a private cause of action under Rule 10b-5, a plaintiff must show six elements.\textsuperscript{34} First, the plaintiffs must show that a defendant made a

\begin{itemize}
\item \textsuperscript{26} See, e.g., Semerenko v. Cendant Corp., 223 F.3d 165, 176-80 (3d Cir. 2000) (determining contours of "in connection with" requirement in case concerning public misrepresentations); McGann v. Ernst & Young, 102 F.3d 390, 392-93 (9th Cir. 1996) (same); \textit{In re Ames Dep't Stores, Inc. Stock Litig.}, 991 F.2d 953, 965 (2d Cir. 1993) (same); SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 847-54 (2d Cir. 1968) (adding "reasonably certain" test into judicial vernacular); \textit{In re Leslie Fay Cos. Sec. Litig.}, 871 F. Supp. 686, 697-98 (S.D.N.Y. 1995) (determining contours of "in connection with" requirement in case concerning public misrepresentations).
\item \textsuperscript{27} See, e.g., Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988) (discussing Rule 10b-5 liability based on corporation's silence despite duty to disclose and noting that "[t]o be actionable, of course, a statement must also be misleading. Silence, absent a duty to disclose, is not misleading under Rule 10b-5").
\item The Court in \textit{O'Hagan} found that:
Under the 'traditional' or 'classical theory' of insider trading liability, a violation of §10(b) and Rule 10b-5 occurs when a corporate insider trades in his corporation's securities on the basis of material, confidential information he has obtained by reason of his position. Such trading qualifies as a 'deceptive device' because there is a relationship of trust and confidence between the corporation's shareholders and the insider that gives rise to a duty to disclose or abstain from trading. \textit{O'Hagan} at 642; see also SODERQUIST & GABALDON, supra note 25, at 135 (listing activities most commonly litigated under Rule 10b-5 and noting that insider trading is rule's best known use).
\item \textsuperscript{30} See, e.g., Corsair Capital Partners, L.P. v. Wedbush Morgan Sec., Inc., No. 00-56397, 2001 U.S. App. LEXIS 27117, at *5 (9th Cir. Dec. 4, 2001) (noting that "market manipulation carries with it liability under Rule 10b-5" and remanding case to lower court to decide issue of market manipulation); GFL Advantage Fund, Ltd. v. Colkitt, 272 F.3d 189, 207 (3d Cir. 2001) (dismissing Rule 10b-5 complaint for failure to state claim of securities fraud and market manipulation).
\item \textsuperscript{31} See 17 C.F.R. § 240.10b-5 (1999) (providing no private cause of action).
\item \textsuperscript{32} 69 F. Supp. 512 (E.D. Pa. 1946).
\item \textsuperscript{33} See id. at 513-15 (finding implied right of action under Section 10b); see also Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) (confirming private right of action under Section 10b).
\item \textsuperscript{34} See Semerenko v. Cendant Corp., 223 F.3d 165, 174 (3d Cir. 2000) (citing \textit{Weiner v. Quaker Oats Co.}, 129 F.3d 310, 315 (3d Cir. 1997)) (discussing elements necessary to state claim under Rule 10b-5).
\end{itemize}
misrepresentative or fraudulent statement.\(^{35}\) Second, a plaintiff must show that the statement was material.\(^ {36}\) Third, a plaintiff must show that the defendant acted with scienter.\(^ {37}\) Fourth, the defendant must have made the statement in question "in connection with" the purchase or sale of a security.\(^ {38}\) Fifth, a plaintiff must show that it relied upon the misrepresentative or fraudulent statement.\(^ {39}\) Sixth, a plaintiff must show that such reliance led to its injury.\(^ {40}\)

**B. The Evolution of Rule 10b-5's "In Connection With" Requirement**

Since the Kardon court's implied finding of a private cause of action, interpretation of Rule 10b-5's "in connection with" requirement has undergone considerable transformation.\(^ {41}\) Beginning in the 1960s, use of Rule 10b-5 as a private cause of action flourished, reaching its "heyday" in the mid-1970s.\(^ {42}\) The United States Court of Appeals for the Second Circuit's 1968 decision in *SEC v. Texas Gulf Sulphur Co.*,\(^ {43}\) followed in 1971 by the United States Supreme Court's decision in *Superintendent of Insurance of the State of N.Y. v. Bankers Life & Casualty Co.*,\(^ {44}\) spurred Rule 10b-5 litigation by expanding the scope of the "in connection with requirement."\(^ {45}\)

In *Texas Gulf*, the Second Circuit found that Texas Gulf Sulphur's misleading press releases were "in connection with" the sale of a security.\(^ {46}\)

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35. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976) (defining manipulative as "virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities").

36. See Semerenko, 223 F.3d at 176 (discussing materiality requirement).

37. See id. at 193 (granting certiorari to resolve question of "whether a private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the absence of any allegation of 'scienter' - intent to deceive, manipulate, or defraud" and concluding that there is no action under such facts).


40. See id. at (discussing interaction between reliance and injury element of Rule 10b-5).


42. See Soderquist & Gabaldon, *supra* note 25, at 135 (discussing history of Rule 10b-5 and noting that after *Kardon* decision until 1960s, "use of the rule grew slowly"); see also Fletcher, *supra* note 5, at 927 (labeling early 1970s as "heyday" of Rule 10b-5 litigation).

43. 401 F.2d 833 (2d Cir. 1968).

44. 404 U.S. 6 (1971).

45. See Soderquist & Gabaldon, *supra* note 25, at 135 (noting Texas Gulf's role in expanding use of Rule 10b-5). For a further discussion of *Texas Gulf*, *infra* notes 42, 46-48 and accompanying text. For a further discussion of *Bankers Life*, see *infra* notes 43, 49-51 and accompanying text.

46. See *Texas Gulf*, 401 F.2d at 860-62 (interpreting contours of "in connection with" requirement and applying contours to facts of case).
In so concluding, the Second Circuit introduced the “reasonably calculated” standard into judicial vernacular. This standard holds that the “in connection with” requirement is met “whenever assertions are made... in a manner reasonably calculated to influence the investing public... if such assertions are false or misleading or are so incomplete as to mislead... “

In 1971, the United States Supreme Court issued its only decision speaking directly to the “in connection with” requirement. In Bankers Life, the Court concluded that Section 10b’s “in connection with” requirement is to be read broadly. In so concluding, the Supreme Court held that the “in connection with” requirement is met when the deceptive practices, here a fraudulent bond selling and fund misappropriation scheme, “touch” the sale or purchase of a security.

Bankers Life’s ambiguously stated “touch” test sent a clear signal to the lower courts that the “in connection with” requirement was to be read broadly. The courts seized upon this signal and consistently read the “touch” test as a de minimis requirement. In the mid-1970s, however, the trend towards expanding the “in connection with” requirement was thwarted when the United States Supreme Court issued three opinions...

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47. See id. at (introducing “reasonably certain” concept).
48. Id. at 862.
49. See Bankers Life, 404 U.S. at 12 (defining contours of “in connection with” requirement broadly); see also Muratori, supra note 6, at 1060 (citing Bankers Life as United States Supreme Court’s only opinion specifically regarding “in connection with” requirement).
50. See Bankers Life, 404 U.S. at 11-12 (requiring broad reading of Rule 10b-5 to insure that “novel” and “atypical,” as well as standard and straightforward fraud would fall under scope of Section 10b and Rule 10b-5).
51. See id. at 12-13 (holding that corporation “suffered an injury as a result of deceptive practices touching its sale of securities as an investor,” and therefore, deceptive practices were “in connection with” sale of securities).
52. See Soderquist & Gabaldon, supra note 25, at 136 (“The looseness of the ‘touching’ formulation, and the almost summary way in which the Supreme Court disposed of the case, seemed to send a clear signal to lower courts that they were to continue to interpret [R]ule 10b-5 expansively.”); Fletcher, supra note 5, at 926 (“Most commentators agree that the almost cavalier way in which the Bankers Life Court reached its holding indicates a shift toward a more expansive reading of the ‘in connection with requirement...’”).
53. See Ketchum v. Green, 557 F.2d 1022, 1026 (3d Cir. 1977) (discussing implications of Bankers Life decision). The court stated that: Subsequent to Bankers Life, federal tribunals have tended to construe the “in connection with” element of 10(b) broadly. Such courts have focused on the language in the Bankers Life opinion which suggests that the protection of the statute is available when there are “deceptive practices touching [the] sale [or purchase] of securities...” Almost without exception, they have found compliance with the “connection” requirement even where fraudulent conduct is implicated only tangentially in a securities transaction.

Id. at 1026 (citing Jannes v. Microwave Communications, Inc., 461 F.2d 525, 529 (7th Cir. 1972) (footnote omitted); see also Fletcher, supra note 5, at 926 (finding that many courts read “touch” test as de minimis requirement).
narrowing the scope of the “touch” test.\textsuperscript{54} The most significant of these opinions regarding the “in connection with” requirement was \textit{Blue Chip Stamps v. Manor Drug Stores}.\textsuperscript{55}

In \textit{Blue Chip Stamps}, the United States Supreme Court was asked to extend Rule 10b-5’s “in connection with” requirement to fraudulent or misrepresentative statements in connection with offers.\textsuperscript{56} Here, the plaintiffs refused to purchase stock in Blue Chip Stamps alleging that Blue Chip Stamps “fraudulently and pessimistically misrepresented its financial condition.”\textsuperscript{57} The Court, however, refused to apply Rule 10b-5 to the defendants’ action even though there was an allegation of misrepresentation by Blue Chip Stamps and there was no question that Blue Chip Stamps sold securities.\textsuperscript{58} The Court instead held that under Section 10b, only a person who has actually purchased or sold stock has standing to bring a private action.\textsuperscript{59}

Commentators agree that the \textit{Blue Chip Stamps} line of cases decided by the United States Supreme Court in the mid-1970s implicitly rejected the \textit{Bankers Life} de minimis “touch” test by making it clear that “the ‘in connection with’ requirement requires more touching than simply a light caress.”\textsuperscript{60} As one commentator notes, “[t]he relatively narrow reading . . . the Supreme Court gave . . . to the 10b-5 . . . cause of action permits lower courts, in close cases, to decide that the ‘touching test’ is not met.”\textsuperscript{61} The various courts of appeals, in turn, have seized upon the opportunity to limit the overreaching breadth of the “touch” test in cases concerning less

\textsuperscript{54} See Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474 (1977) (determining requirements of Rule 10b-5 are not met when conduct at issue is neither manipulative nor deceptive and that proposed merger did not involve either manipulation or deception); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (granting certiorari to resolve question of “whether a private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the absence of any allegation of ‘scienter’—intent to deceive, manipulate, or defraud” and concluding that action will not lie and thereby adding scienter requirement to Rule 10b-5); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754-55 (1975) (holding that only actual purchasers or sellers of securities have standing to bring action under Rule 10b-5).

\textsuperscript{55} See \textit{Blue Chip Stamps}, 421 U.S. at 754-55 (holding that only actual purchasers or seller of securities have standing to bring action under Rule 10b-5).

\textsuperscript{56} See id. at 725-26 (discussing issue before Court).

\textsuperscript{57} See id. at (discussing plaintiffs’ allegations).

\textsuperscript{58} See id. at (discussing plaintiffs’ allegations).

\textsuperscript{59} See id. at 727, 754-55 (basing decision on policy concerns).

\textsuperscript{60} See Fletcher, supra note 5, at 927-28 (noting that Court rejected 10b-5 argument notwithstanding fact that there were allegations of misrepresentations and securities involved and thereby rejected any de minimis “touch” test); see also Soderquist & Gabaldon, supra note 25, at 136 (noting that after \textit{Bankers Life}, lower court interpreted Rule 10b-5 expansively until Supreme Court sent contrary signals in \textit{Blue Chips Stamps}).

\textsuperscript{61} Fletcher, supra note 5, at 927 (quoting A. Jacobs, \textit{Litigation and Practice Under Rule 10b-5} (2d ed. 1981)).
than straightforward fraud. Various views of the "in connection with" requirement subsequently have emerged.

C. Approaches Circuit Courts Employ in Attempting to Define the Contours of the "In Connection With" Requirement

The predominant approaches the circuit courts employ in attempting to define the contours of Rule 10b-5's "in connection with" requirement are divided into two broad categories. These categories are Rule 10b-5 violations involving "relatively private" [misrepresentations] . . . made by defendants to individual plaintiffs" ("private misrepresentations") and Rule 10b-5 violations made to the public at large ("public misrepresentations").

1. Private Misrepresentations

Private misrepresentations are misrepresentations made by defendants to individual plaintiffs. For example, a misrepresentation made by a brokerage house to a customer would constitute a private misrepresentation. In "private transaction" cases, the circuit courts primarily employ

62. See, e.g., Head v. Head, 759 F.2d 1172, 1175 (4th Cir. 1985) (seizing opportunity to redefine Bankers Life "touch" test in adopting "investment value" approach). In Head v. Head, the court reinterpreted the meaning of Bankers Life and stated:

The Bankers Life "de minimis touch test" might be read literally and expansively to make any securities transaction actionable under Rule 10b-5 so long as there was some deceptive practice remotely "touching" the transaction. But we think the test could not have been intended to be applied in so unlimited a way.

Id. at 1175; see Ketchum v. Green, 557 F.2d 1022, 1027 (3d Cir. 1977) (suggesting inadequacy of Bankers Life "touch" test and noting early trend to narrow breadth of test). For a discussion of the "investment value" approach adopted in Head, see infra notes 68-70 and accompanying text.

Ketchum serves as an early example of the trend towards narrowing the overly broad scope of Bankers Life's "touch" test. See id. at 1023-24 (adopting causation limitation). In Ketchum the court noted this early trend stating that, "[e]ven though the federal courts, by and large, have not felt compelled to engage in a searching exegesis respecting the 'connection' facet of § 10(b), a few judges have recognized that the teachings of Bankers Life are hardly refined or capable of facile application." Id. at 1027; see also Muratori, supra note 6, at 1061 (discussing lower courts "desire for more precision than the 'touch' test offers"). The courts desire this precision because of the "serious impact of a finding that the federal securities laws apply to particular behavior." Id. at 1061.

63. For a further discussion of various views, see infra notes 64-85 and accompanying text.

64. See Robert A. Prentice, Locating That "Indistinct" and "Virtually Nonexistent" Line Between Primary and Secondary Liability Under Section 10(b), 75 N.C. L. Rev. 691, 779 n.401 (1997) (consolidating different courts' approaches regarding "in connection with" requirement).

65. See McLaughlin, supra note 8, at 1 (providing example of private transaction).

66. See Peter v. Leisou, The Scope of Section 12(2) of the Securities Act of 1933: A Legal and Economic Analysis, 45 Emory L.J. 95, 110 (1996) (defining "private transac-
three approaches in defining the contours of the "in connection with" requirement.67 These approaches are "the value of the security approach" or the "investment value approach," "the causation approach," and the Bankers Life "touch" test approach.68

The narrowest view of the "in connection with" requirement finds that the requirement is satisfied only when the fraud or misrepresentation affects the underlying value of the security.69 This approach implicates statements concerning the value of the security, the quality of the security itself, the quality of the issuer, and other "attributes of ownership" that would influence a reasonable investor's decision regarding whether to buy or sell the security.70 The Second, Fourth and Seventh Circuits have articulated this view when the alleged fraud takes place in the context of a private transaction.71

67. See Muratori, supra note 6, at 1061-62 (discussing various tests); see also Prentice, supra note 64, at 779 n.401 (discussing different approaches and rating approaches on scale of most stringent to most liberal).

68. See McLaughlin, supra note 8, at 1 (naming various tests); see also Prentice, supra note 64, at 779 n.401 (discussing different approaches and rating approaches on scale of most stringent to most liberal).

69. See Prentice, supra note 64, at 779 n.401 (finding that "investment value" approach is narrowest view taken in defining contours of "in connection with" requirement); see also McLaughlin, supra note 8, at 1 (advocating "investment value" approach); Muratori, supra note 6, at 1061 (discussing "investment value" approach).

70. See McLaughlin, supra note 8, at 1 (discussing situations in which "investment value" approach applies).

71. See Gurwara v. Lyphomed Inc., 937 F.2d 380, 382 (7th Cir. 1991) (adopting "investment value" approach and dismissing action because misrepresentation was unrelated to value of involved security or consideration offered for security); Saxe v. E.F. Hutton & Co., Inc., 789 F.2d 105, 108 (2d Cir. 1986) (dismissing Rule 10b-5 complaint because private party "did not allege that appellees misled him concerning the value of the securities he sold or the consideration he received in return"); Head v. Head, 759 F.2d 1172, 1175-76 (4th Cir. 1985) (adopting "investment value" approach and precluding liability due to fact that alleged misrepresentations did not relate to underlying value of security); Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930, 943 (2d Cir. 1984) (dismissing 10b-5 action brought by creditors because there had been no misrepresentation as to value of pledged collateral and further noting "[t]he Act and Rule impose liability for a proscribed act in connection with the purchase or sale of a security; it is not sufficient to allege that a defendant has committed a proscribed act in a transaction of which the pledge of a security is a part").

The United States Court of Appeals for the Third Circuit has also looked to the "investment value" approach in defining the contours of the "in connection with" requirement. See Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939, 944-45 (3d Cir. 1985) (discussing and broadening scope of "investment value" approach). In so doing, the Third Circuit has broadened the narrow interpretation to include "misrepresentations beyond those implicating the investment value of a particular security," specifically, misrepresentations implicating the broader course of securities. See id. at 942 (discussing reasoning for holding in case). For a fur-
The nexus/causation approach, the predominant approach for both the Third and Fifth Circuits, is slightly more liberal than the value of the securities approach.\(^{72}\) This approach requires a sufficient “nexus” between the fraudulent misrepresentation and the investment decision so that the investment decision can be attributed to the misrepresentation.\(^{73}\) This approach is based on a consideration of whether the policy of “fostering investment activity without fear of fraud or deceit” underlying Section 10b and Rule 10b-5, is advanced by applying the rule to the fraudulent transaction at issue.\(^{74}\)

The Bankers Life “touch” test is the most “pro-plaintiff” approach.\(^{75}\) Courts employing the Banker Life “touch” test rely on the United States Supreme Court’s direction that Section 10b’s “in connection with” requirement is to be read broadly and read the “touch” test as a de minimis requirement.\(^{76}\) Most courts agree, however, that “[t]he ‘in connection with’ requirement will not support a Rule 10b-5 action for simply any wrongdoing that just happens to involve securities.”\(^{77}\) Therefore, reliance on Bankers Life has, in recent years, greatly diminished.\(^{78}\)

2. Public Misrepresentations

The second general approach concerns situations where the misrepresentations are “relatively public . . . and made by defendants to the market at large.”\(^{79}\) Unlike the division of approaches found in private misrepresentations, the lower courts ordinarily treat cases involving public

\(^{72}\) See Brown v. Ivie, 661 F.2d 62, 65 (5th Cir. 1981) (acknowledging need for causation and stating that “accepting the fraud as alleged, there is a direct connection between it and the execution of the . . . agreement obligating [the plaintiff to sell his stock for less than fair value]”); Ketchum v. Green, 557 F.2d 1022, 1027-29 (5th Cir. 1977) (adding causation requirement to Bankers Life “touch” test); see also Prentice, supra note 64, at 779 n.401 (defining “causation” approach as slightly more liberal).

\(^{73}\) See Muratori, supra note 6, at 1061-62 (discussing nexus required by courts employing “causation” approach).

\(^{74}\) See id. (discussing policy considerations underlying “causation” approach).

\(^{75}\) See Prentice, supra note 64, at 779 n.401 (citing “touch” test derived from Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 11-12 (1971), as most “pro-plaintiff” approach).

\(^{76}\) See Bankers Life at 11-12 (requiring broad reading of Rule 10b-5 to insure that “novel” and “atypical,” as well as standard and straightforward fraud fall under scope of Section 10b and Rule 10b-5); see also Jannes v. Microwave Communications, Inc., 461 F.2d 525, 529 (7th Cir. 1972) (citing Bankers Life’s de minimis “touch” test); Drachman v. Harvey, 453 F.2d 722, 736-38 (2d Cir. 1971) (same).

\(^{77}\) Thomas Lee Hazen, TREATISE ON THE LAW OF SECURITIES REGULATION, Volume II 472 (3d ed. 1995).

\(^{78}\) See id. (stating that “[i]t has thus been held that a de minimis ‘touch’ test is not sufficient to satisfy the ‘in connection with’ requirement”).

\(^{79}\) Prentice, supra note 64, at 779 n.401.
misrepresentations in a consistent manner. In such cases, courts generally adopt the Texas Gulf "reasonably calculated" standard holding that the "in connection with' requirement is met when the affirmative misrepresentations are made in a setting reasonably calculated or reasonably expected to influence the investing public."

As evidenced by the brief overview of circuit court approaches, there is not a universal approach for determining when the "in connection with" requirement is satisfied nor is one possible. The "in connection with" determination is highly fact sensitive and therefore must be made on a case-by-case basis. Although the aforementioned approaches are considered the dominant approaches of the noted circuits, they are not the exclusive approaches. Rather, when the facts of the case necessitate, the lower courts indicate a readiness to rely on an "in connection with" approach different than one on which the circuit previously relied. The

80. See In re Ames Dep't Stores, Inc. Stock Litig., 991 F.2d 953, 966 (2d Cir. 1993) (contributing consistency threading throughout public misrepresentation cases to situations of blatant and straightforward fraud found in such cases and minimal analytical difficulties such fraud presents to courts); see also Prentice, supra note 64, at 779 n.401 (finding consistency in lower courts' interpretations of "in connection with" requirement when fraud alleged includes dissemination of information to public at large).

81. Prentice, supra note 64, at 779 n.401 (citing SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 862 (2d Cir. 1968); see also Semerenko v. Cendant Corp., 223 F.3d 165, 176 (3d Cir. 2000) (adopting Texas Gulf "reasonably calculated" standard in case of public misrepresentation); McGann v. Ernst & Young, 102 F.3d 390, 392-93 (9th Cir. 1996) (same); In re Ames, 991 F.2d at 965 (same); In re Leslie Fay Co., Inc. Sec. Litig., 871 F. Supp. 686, 697-98 (S.D.N.Y. 1995) (same).

82. See Fletcher, supra note 5, at 929 ("The doctrinally diffuse nature of 10b-5 makes it impossible to establish common principles for universal application of the 'in connection with' requirement.").

83. See Semerenko, 223 F.3d at 174 (noting law of circuit that scope of "in connection with" requirement must be determined on case-by-case basis); In re Ames, 991 F.2d at 962 (quoting Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930 (2d Cir. 1984) ("In cases near the borderline, courts have warned that 'it is important that the standard be fleshed out by a cautious case-by-case approach'...’); see also Muratori, supra note 6, at 1060 ("Because of the ambiguity of the 'touch' test, courts widely claim that the sufficiency of the 'in connection with' nexus must be made on a case-by-case basis.") (footnote omitted).


85. See McLaughlin, supra note 8, at 1 (noting how Second Circuit Court of Appeals applies "investment value" approach to private misrepresentations and Texas Gulf's "reasonably calculated" approach to cases concerning public misrepresentations). The Second Circuit's varying approaches are attributable to the fact that cases of public misrepresentation are often considered cases of typical, straightforward fraud. See In re Ames, 991 F.2d at 963 (considering fraud related to press releases issued to public as straightforward case of fraud). Unlike cases of "atypical fraud," cases of straightforward fraud pose minimal analytical difficulties. See id. at 966 (comparing analytical difficulties found in cases of atypical fraud, such as private misrepresentations "in which the defendants tricked the plaintiffs
history and present state of the "in connection with" requirement in the Third Circuit provides one such example.\textsuperscript{86}

III. THE THIRD CIRCUIT COURT OF APPEALS' APPROACH TO THE "IN CONNECTION WITH" REQUIREMENT

A. Third Circuit Precedent Prior to Semerenko v. Cendant Corp.

The Third Circuit's modern day "in connection with" jurisprudence dates back to the 1971 case \textit{Gottlieb v. Sandia American Corp.}\textsuperscript{87} \textit{Gottlieb} concerned the nondisclosure of information to shareholders regarding an asset acquisition.\textsuperscript{88} On review, the Third Circuit Court found "a sufficient nexus between the [nondisclosure of information to the shareholders] and the purchase" to meet the statutory test of Section 10b and Rule 10b-5.\textsuperscript{89} In so doing, the court adopted the "reasonably calculated" standard articulated in \textit{Texas Gulf}.\textsuperscript{90}

Shortly after the \textit{Gottlieb} decision, however, the United States Supreme Court decided \textit{Bankers Life}.\textsuperscript{91} Thereafter, the Third Circuit seemed into parting with their securities for no consideration at all" to minimal analytical difficulties found in cases in which "defendants are accused of defrauding the plaintiffs by misleading the general public as to the market value of securities they had issued").

\textsuperscript{86} For a discussion of the Third Circuit Court of Appeals' fact based approach to the "in connection with" requirement, see infra notes 110 and accompanying text.

\textsuperscript{87} 452 F.2d 510 (3d Cir. 1971).

\textsuperscript{88} \textit{See Gottlieb} 452 F.2d at 515 (discussing omission of material fact in financial statement). In \textit{Gottlieb}, the plaintiffs, stock and debenture holders of a corporation, were the target of a merger by Sandia American Corporation. \textit{See id.} (discussing facts of case). The plaintiffs alleged that Sandia American's indebtedness for a large sum of money to a third party was not reflected in the financial statement that Sandia American provided the plaintiffs during the negotiations nor otherwise communicated to them prior to the consummation of the agreement. \textit{See id.} (discussing plaintiffs' allegations). The plaintiffs alleged such withholding of information was a misrepresentation of the true value of Sandia American's stock at the time plaintiffs agreed to take it in exchange for their holdings in the acquired corporation. \textit{See id.} (discussing plaintiffs' allegations). The defendants, however, argued that the plaintiffs did not rely on the financial statements and, therefore, could not pursue litigation under Rule 10b-5. \textit{See id.} (discussing one prong of defendants' defense).

\textsuperscript{89} \textit{See id.} at 515-16 (discussing first lower court's finding that statements constituted actionable misrepresentations and further affirming lower court's finding that actionable misrepresentations were "in connection with" sale of Sandia American's stock).

\textsuperscript{90} \textit{See id.} at 516 (quoting and adopting standard articulated in \textit{Texas Gulf Sulphur Co.}). For a further discussion of \textit{Texas Gulf}, see supra notes 48-50 and accompanying text.

\textsuperscript{91} \textit{See Superintendent of Ins. v. Bankers Life & Cas. Co.}, 404 U.S. 6, 12 (1971) (deciding contours of "in connection with" requirement in November of 1971, 8 months after \textit{Gottlieb} was decided). The \textit{Gottlieb} decision does not conform with any of the aforementioned approaches. This is due to the fact that the aforementioned approaches are all derivatives of the \textit{Bankers Life} "touch" test. For a discussion of the approaches seeking to narrow the \textit{Bankers Life} "touch" test, see
ingly abandoned *Texas Gulf*’s “reasonably calculated” standard, citing instead the *Bankers Life* “touch” test. In the wake of *Blue Chip Stamps*, the Third Circuit qualified the “touch” test in adopting the causation approach.

1. **The Causation Approach: Ketchum v. Green**

   In *Ketchum v. Green*, the Third Circuit Court of Appeals held that in order to meet Rule 10b-5’s “in connection with” requirement there must be a certain degree of proximity between the securities transaction and the claimed fraud. In *Ketchum*, the defendants, directors and officers of a close corporation, allegedly conspired to remove from office the plaintiffs, two officers of the corporation, employees and shareholders. Under the corporation’s stock retirement agreement, the removed and terminated plaintiffs were forced to resell their stock to the corporation. The plaintiffs, however, alleged that the price of the forced redemption was inadequate and subsequently brought action under Rule 10b-5 on the theory that they were forced to tender their shares as a result of the defendants’ fraudulent scheme.

   On review, the major issue before the Third Circuit was whether the alleged misrepresentations were made “in connection with” the sub-

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**supra** notes 70-75 and accompanying text. *Gottlieb* is instrumental, however, as it cited as the case in which the Third Circuit adopted the *Texas Gulf* “reasonably calculated” standard. See Semerenko v. Cendant Corp., 223 F.3d 165, 176 n.5 (3d Cir. 2000) (“This court has adopted the standards articulated in *Texas Gulf Sulphur Co.* for determining whether the statutory requirements of [Section] 10b and Rule 10b-5 are satisfied.”) (citing *Gottlieb* v. *Sandia American Corp.*, 452 F.2d 510, 515-16 (3d Cir. 1971)).

92. See, e.g., Angelastro v. Prudential-Bache Sec., Inc., 764 F.2d 939, 944-45 (3d Cir. 1985) (discussing “in connection with” requirement and basing decision on qualified version of *Bankers Life* “touch” test); *Ketchum* v. *Green*, 557 F.2d 1022, 1027-29 (3d Cir. 1977) (defining contours of “in connection with” requirement and comparing factual situation at issue to that of *Bankers Life*).

93. See *Ketchum*, 557 F.2d at 1027-29 (adding causation element to “touch” test). For a further discussion of *Ketchum*, see infra notes 93-103 and accompanying text; see also Angelastro, 764 F.2d at 944-45 (citing *Ketchum* and adopting altered version of “value-based” approach). For a further discussion of Angelastro, see infra notes 104-10 and accompanying text. For a further discussion of *Blue Chip Stamps* and its impact on the contours of the *Bankers Life* de minimis “touch” test, see supra notes 57-65 and accompanying text.

94. 557 F.2d 1022 (3d Cir. 1977).

95. See id. at 1023 (specifying that court must “ascertain whether the factual matrix... satisfies the ‘in connection with’ clause of [Section] 10b... [and] Rule 10b-5 - a clause which requires for a cause of action that a misrepresentation be rendered in connection with a sale or purchase of a security”).

96. See id. at 1023-24 (discussing facts of case).

97. See id. at 1023-25 (discussing company’s stock retirement agreement under which former employees were required to sell their stock back to corporation at price determined by corporation).

98. See id. at 1023-24 (discussing plaintiffs’ theory for cause of action).
quent forced redemption of the plaintiffs' stock. In distinguishing the
situation put forth in *Ketchum* to that of *Bankers Life*, the court found that
unlike *Bankers Life*, where the deception was only one step away from a
securities deal, the deception in *Ketchum* was too far removed from the
ultimate redemption of the stock. The court emphasized that interven-
ning between the deception and the redemption of stock were numerous
events including the shareholders' vote and a subsequent meeting remov-
ing plaintiffs as officers and employees.

As such, the court determined that the degree of proximity was much
more attenuated than the degree of connection in *Bankers Life*. Based
on this determination the court held that the "in connection with" re-
quirement was not met. *Ketchum* therefore narrowed the *Bankers Life*
"touch" test by explicitly requiring a causal connection between the
claimed fraud and the purchase or sale of the security.

2. Finding an Exception to the Investment Value Approach: Angelastro v. 
Prudential-Bache Securities Inc.

In *Angelastro v. Prudential-Bache Security Inc.*, the Third Circuit con-
cidered whether "alleged misrepresentations and nondisclosures by a bro-
kerage firm regarding the credit terms of a margin account [fell] within
the ambit of Section 10b" and Rule 10b-5. On appeal, the main source of
dispute between the parties was whether alleged misrepresentations not
relating to the merits of a particular security but instead relating to a
broader course of dealing in securities satisfied Rule 10b-5's "in connection
with" requirement.

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99. See id. at 1023 (discussing issue on review).
100. See id. at 1028 (distinguishing situation present in *Ketchum* from *Bankers Life*).
101. See id. at 1028 (discussing intervening events and finding that alleged
misrepresentations and events leading to forced redemption of stock, here, adop-
tion of resolution terminating plaintiffs' status as company employees, were much
further removed than misrepresentation and sale of security in *Bankers Life*).
102. See id. at 1028-29 (distinguishing degree of connection in *Ketchum* from
that in *Bankers Life* and holding that there must be close connection between
fraudulent misrepresentation and sale or purchase of security).
103. See id. at 1027-28 ("It would appear, then, that the present case does
not constitute an instance in which misrepresentations were tendered 'in connection
with' a securities transaction. To the contrary, the purportedly deceptive practices
occurred, if at all, in connection with the struggle for control of the
corporation.").
(summarizing essential points of *Ketchum* and *Ketchum'*s role in Third Circuit Court
of Appeals' case law relating to "in connection with" requirement of Section 10
and Rule 10b-5).
105. 764 F.2d 999 (3d Cir. 1985).
106. Id. at 941.
107. See id. at 942-45 (discussing defendants' arguments against Section 10
and Rule 10b-5 liability and responding to such arguments by discussing numerous
factual situations in which Section 10 and Rule 10b-5 have been applied).
The Third Circuit found that the defendants’ misrepresentations and nondisclosures satisfied Rule 10b-5’s requisite causal connection per Ketchum. Further, the court justified its holding by taking exception to the straight-forward “investment value” approach, specifically noting that “Rule 10b-5 also encompasses misrepresentations beyond those implicating the investment value of a particular security” and, therefore, includes misrepresentations related to a broader course of dealing in securities. The court qualified its broad holding, however, by reinforcing the importance of considering the “in connection with” requirement on a case-by-case basis. Notwithstanding the court’s caution, Angelastro indicates that the Third Circuit will view Rule 10b-5 broadly when the circumstances warrant such an interpretation.

B. Semerenko v. Cendant Corp.

1. Facts and Procedural History

In March of 1998, Cendant Corporation executed an agreement to purchase American Bankers Insurance Group (ABI) for approximately $3.1 billion, payable partly in cash and partly in Cendant stock. On April 15, 1998, Cendant publicly announced that it had discovered certain accounting irregularities and that it would therefore have to restate its annual and quarterly earning for the 1997 fiscal year. In the wake of this announcement, the price of ABI common stock dropped from $64 and 7/8 per share to $57 and 3/4 per share.

Despite such findings, Cendant publicly reaffirmed its commitment to completing the merger with ABI. On July 14, 1998, however, Cendant...
made a series of additional statements describing the company's progressively worsening financial situation and stated that the company's previous announcements were inaccurate as to the anticipated reduction of income.\textsuperscript{116} After the July 14, 1998 announcement, the price of ABI stock further dropped until Cendant again publicly reaffirmed its intention to continue the tender offer.\textsuperscript{117} Cendant's continued announcements regarding its intent to go forward with the merger, served to "buoy" the price of ABI common stock.\textsuperscript{118}

On August 13, 1998, Cendant announced the completion of its investigation into the company's accounting irregularities.\textsuperscript{119} In a press release, Cendant stated that it "would restate its earnings by $0.28 per share in 1997, $0.19 per share in 1996, and by $0.14 per share in 1995."\textsuperscript{120}

On September 29, 1998, Cendant announced that it had in fact lost $217.2 million in 1997, rather than earning the previously stated $55.5 million.\textsuperscript{121} In response to Cendant's announcement, AGI common stock then dropped to $43.00 per share.\textsuperscript{122} On October 13, 1998, Cendant and

(Elaborating upon specifics of announcements). The letter was published in the financial press and stated:

\begin{quote}
We are outraged that the apparent misdeeds of a small number of individuals within a limited part of our company has adversely affected the value of your investment—and ours—in Cendant. We are working together diligently to clear this matter up as soon as possible. We fully support the Audit Committee’s investigation and continue to believe that the strategic rationale and industrial logic of the... merger that created Cendant is as compelling as ever.

Cendant is strong, highly liquid, and extremely profitable. The vast majority of Cendant’s operating businesses and earnings are unaffected and the prospects for the Company's future growth and success are excellent.

We have reaffirmed our commitment to completing all pending acquisitions, [including] American Bankers...
\end{quote}

\textit{Id.}

Further, Cendant issued a press release on May 5, 1998, stating that "over eighty percent of the Company’s net income for the first quarter of 1988 came from Cendant business units not impacted by the potential accounting irregularities."\textsuperscript{123} \textit{Id.} at 170-71.

\textsuperscript{116} See \textit{id.} at 171 (noting disclosure that "reduction in income would be twice as much as previously announced").

\textsuperscript{117} See \textit{id.} (discussing impact of disclosure upon ABI stock price). Further, during the Audit Committee’s investigation, the Audit Committee discovered several accounting irregularities not previously disclosed. \textit{See id.} at 171 (discussing accounting irregularities and finding that such irregularities spanned over business units and fiscal years).

\textsuperscript{118} See \textit{id.} (discussing effect of Cendant’s announcement of commitment to continue tender offer on ABI’s stock price).

\textsuperscript{119} See \textit{id.} (discussing Cendant’s announcement of completion of investigation, as announced in press release).

\textsuperscript{120} \textit{Id.}

\textsuperscript{121} See \textit{id.} (discussing further announcements of accounting irregularities).

\textsuperscript{122} See \textit{id.} at 171 (elaborating further on adverse effect Cendant’s announcements had on price of ABI common stock).
ABI terminated the merger agreement and Cendant subsequently paid ABI a $400 million breakup fee. In response to the agreement’s termination, the price of ABI common stock dropped to $35 and 1/2 per share.

On October 14, 1998, plaintiffs, P. Schoenfeld Asset Management LLC and a class of similarly situated investors (collectively “the Class”), filed a complaint in the United States District Court for the District of New Jersey under Section 10b and Rule 10b-5. The complaint alleged that Cendant and certain individual defendants made fraudulent misrepresentations in public statements regarding “Cendant’s financial condition, its willingness to complete the tender offer, and its willingness to complete the proposed merger.” According to the Class, these announcements artificially inflated the price of ABI common stock. As a result, the Class allegedly suffered harm when the inflated price of ABI stock crashed in response to Cendant’s public disclosure of the accounting irregularities, the misrepresentations regarding the completion of the merger and the ultimate termination of the merger agreement.

In response to the Class’ complaint, defendants filed, and the District Court for the District of New Jersey granted, a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. The Class appealed the district court’s decision. The Third Circuit Court of Appeals, on review, did not decide whether the alleged misrepresentations were “in connection with” the purchase of ABI common stock; rather, the court clarified the standard to determine whether such connection was present. Having clarified that standard, the court remanded the case to the district court for further proceedings concerning the materiality and

123. See id. (discussing announcement of termination of merger agreement).
124. See id. (discussing ultimate impact of termination of Cendant and ABI's merger agreement upon ABI stock price).
125. See id. at 169, 171 (discussing procedural posture of case). The “similarly situated investors” included “persons who purchased shares of ABI common stock during the course of the tender offer.” See id. at 169 (adding that class period ran from January 27, 1998 to October 13, 1998). The Class alleged that it was harmed by purchasing ABI common stock at an artificially inflated price and then suffering a corresponding loss when Cendant disclosed the misrepresentations to the public and the merger agreement was terminated. See id. at 169 (discussing plaintiffs' allegation that Cendant's misrepresentations artificially inflated price of ABI stock). For a discussion of the fluctuating price of ABI common stock during the class period, see infra notes 121-31 and accompanying text.
126. See id. at 171 (discussing Class' allegations). In addition to Cendant, the defendants to the action included Cendant’s former officers, directors and its accountant. See id. at 169 (identifying defendants).
127. See id. (discussing Class’ allegations).
128. See id. (discussing Class’ allegations).
129. See id. at 172 (finding, inter alia, “that the complaint failed to establish that the alleged misrepresentations were made ‘in connection with’ the Class’s purchases of ABI common stock”).
130. See id. at 169 (discussing Class’ appeal).
131. See id. at 177-78 (discussing limited nature of holding). The court stated:
public dissemination of Cendant's alleged misrepresentations, in accordance with the pronounced materiality and public dissemination approach.132

2. Defining the Contours of the "In Connection With" Requirement in the Context of Public Misrepresentations

In reversing and remanding the district court's opinion, the Third Circuit began its analysis by reviewing the circuit's prior cases addressing the "in connection with" requirement.133 From this review, specifically of Ketchum and Angelastro, the court distilled the two principal mainstays of the Third Circuit's "in connection with" jurisprudence.134 These principles are Ketchum's requirement that the "in connection with" language requires a casual connection between the claimed fraud and the purchase or the sale of a security, and the Angelastro court's finding that the "misrepresentations need not refer to a particular security."135

Ketchum and Angelastro, however, were factually dissimilar situations, each having been based on alleged Rule 10b-5 violations involving private misrepresentations.136 In contrast, the alleged violations in Semerenko concerned the issuance of false and misleading information to the public at large.137 Due to these factual dissimilarities, the Semerenko court was forced to look to the Second and Ninth Circuits for guidance on this issue of first impression in the Third Circuit.138

We do not resolve, however, whether the "in connection with" requirement is satisfied in the present case. Because the standard that we have set forth is different from the one applied by the district court, and because the parties have not been afforded a full opportunity to brief the issues of materiality and public dissemination, we will remand this matter to allow the district court to consider, in the first instance, the question whether the Class's [sic] complaint pleads sufficient facts to satisfy the requirements of Rule 12(b)(6).

Id.

132. See id. at (noting that "the issue of materiality typically presents a mixed question of law and fact, and that the delicate assessment of inferences is generally best left to the trier of fact").

133. See id. at 174-75, 176 n.5 (discussing facts and holdings of Ketchum and Angelastro, as well as relevance of Gottlieb in Third Circuit jurisprudence).

134. See id. at 175 (noting two points that Ketchum and Angelastro illustrate).

135. See id. ([T]he decisions in Ketchum and Angelastro are illustrative of the point that the 'in connection with' language requires a casual connection between the claimed fraud and the purchase or the sale of a security, and that the misrepresentations need not refer to a particular security . . . .").

136. See id. (noting that Ketchum presented "a claim based on allegations of internal corporate misconduct arising from a contest for the control of a closely held corporation" and that Angelastro "concern[ed] a fraudulent course of dealing by a brokerage firm").

137. See id. (stating that Semerenko "involves the public dissemination of allegedly misleading information into an efficient securities market").

138. See id. ("In light of the law of this circuit that the scope of the 'in connection with' requirement must be determined on a case-by-case basis, we are compelled to look elsewhere in deciding the standard that governs this matter.").
The Third Circuit based its holding on the broad “reasonably calculated” standard set forth in both the Second and Ninth Circuit Courts of Appeals. Furthermore, the court included in its approach an element of materiality, holding that the “class may establish the ‘in connection with’ element simply by showing that the misrepresentations in question were disseminated to the public in a medium upon which a reasonable investor would rely, and that they were material.” Further, under this standard, the court held that the Class of investors “is not required to establish that the defendants actually envisioned that members of the class would rely upon the alleged misrepresentations when making their investment decisions. Rather, it must only show that the alleged misrepresentations were reckless.”

In so holding, the Third Circuit provided a broad interpretation of Rule 10b-5’s “in connection with” requirement. The court found that this broad holding was justified given that the purpose underlying Section 10(b) and Rule 10-b-5 is “to ensure that investors obtain fair and full disclosure of material facts in connection with their decisions to purchase or sell securities.” According to the court, “[t]hat purpose is best satisfied by a rule that recognizes the realistic causal effect that material misrepresenta-

139. See id. at 176 (citing In re Ames Dep’t Stores, Inc. Stock Litig., 991 F.2d 953, 966 (2d Cir. 1993). The court relied on the Second Circuit’s decision in In re Ames Department Stores, Inc. Stock Litigation, where the Second Circuit applied the Texas Gulf “reasonably calculated” standard to a case “involving the public dissemination of false information in publicly filed offering documents, press releases and research reports.” Id. The Semerenko court also relied on McGann v. Ernst & Young, a case in which the Ninth Circuit found that dissemination of false information in a publicly filed annual report satisfied rule 10b-5’s “in connection with” requirement per Texas Gulf. See McGann v. Ernst & Young, 102 F.3d 390, 397 (9th Cir. 1996) (adopting standards articulated in Texas Gulf).

140. See Semerenko, 223 F.3d at 176 (adopting public dissemination approach of Second and Ninth Circuit based on standard articulated in Texas Gulf). The court also revisited its holding in Gottlieb, using that precedent to support its reliance on the standards articulated in Texas Gulf. See id. at 176 n.5 (citing Gottlieb v. Sandia American Corp., 452 F.2d 510, 515-16 (3d Cir. 1971)). According to one commentator, however:

The addition of the element of “materiality” to the element of “dissemination to the public in a medium upon which a reasonable investor would rely” to satisfy the “in connection with” requirement may be more semantic than substantive because the materiality of the misrepresentation is sine qua non of a 10b-5 violation whether it is viewed separately, or as a part of the “in connection with” requirement.


141. Semerenko, 223 F.3d at 176 (citations omitted) (citing In re Advanta Corp. Sec. Litig., 180 F.3d 525, 535 (3d Cir. 1999); In re Ames Dep’t Stores, Inc. Stock Litig., 991 F.2d 953, 965 (2d Cir. 1993)).

142. See Duffy, supra note 13, at B5 (stating that Third Circuit adopted “broad reading of securities fraud laws”); McLaughlin, supra note 8, at 1 (labeling Third Circuit’s interpretation of “in connection with” requirement as “expansive”).

143. See Semerenko, 223 F.3d at 176 (3d Cir. 2000) (citing Angelastro v. Prudential-Bache Sec., Inc. 764 F.2d 939, 942 (3d Cir. 1985)).
tions, which raise the public’s interest in particular securities, tend to have on the investment decisions of market participants who trade in those securities."144 As the Second Circuit noted in *In re Ames Department Stores, Inc.*,145 "[t]he securities markets are highly sensitive to press releases and to information contained in all sorts of publicly released corporate documents, and the investor is foolish who would ignore such releases."146 Therefore, this broad approach, unlike the narrower private misrepresentation approaches, is necessary in public disclosure cases given the sensitivity of securities markets.147

IV. A GUIDE FOR PRACTITIONERS ON RULE 10b-5’s "IN CONNECTION WITH" REQUIREMENT

Although Rule 10b-5’s “in connection with” requirement is the source of much confusion among the lower courts, such confusion can be a key advantage for practitioners in the Third Circuit seeking to sustain a Rule 10b-5 action.148 Working under minimal guidance from the United States Supreme Court, the lower courts have sought to define the contours of the “in connection with” requirement in a manner that provides certainty, yet preserves flexibility to meet unusual circumstances.149 Such efforts have led to both “broad” and “stringent” interpretations of the nexus needed to meet Rule 10b-5’s “in connection with” requirement.150

Practitioners in the Third Circuit have the somewhat dubious advantage of the rule’s ambiguity in formulating an argument either for an expansive interpretation of the “in connection with” requirement or, conversely, a stringent interpretation.151 Practitioners seeking to bring and sustain a Rule 10b-5 action, in particular, must utilize the ambiguity

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144. *See id.* at 176 (citing *In re Ames Dep’t Stores, Inc.* Stock Litig., 991 F.2d 953, 966 (2d Cir. 1993)).
145. 991 F.2d 953 (2d Cir. 1993).
146. *Id.* at 965 (citing *Basic Inc. v. Levinson*, 485 U.S. 224 (1988)).
147. *See id.* (discussing effect of misleading press release on securities markets).
148. For a discussion of the confusion prevalent in the lower courts, *see supra* note 6 and accompanying text.
149. *See McLaughlin, supra* note 8, at 1 (discussing courts’ struggle in interpreting “in connection with” requirement).
151. For a further discussion of the stringent interpretations, *see supra* note 159 and accompanying text. Practitioners arguing for a stringent interpretation in the context of private misrepresentations must argue that *Ketchum’s* causation requirement is not met and therefore that the alleged misrepresentation is not “in connection with” the purchase or sale of the security. *See Ketchum v. Green*, 557 F.2d 1022, 1027-29 (3d Cir. 1977) (adopting causation limitation). This standard leaves room for some creative argument, as the *Ketchum* court did not specifically define the degree of causation required. *See id.* at 1027-29 (noting only that less attenuated degree of causation was required than was present in *Ketchum*).
present in the Rule's construction to their advantage in order to withstand a Rule 12(b)(6) motion to dismiss. Further, these practitioners should try to take advantage of the Third Circuit's willingness to look outside of its own precedents to those of other circuits.

For Third Circuit corporate practitioners and their corporate clients, Semerenko represents a cautionary warning. As experience in the Second Circuit indicates, the materiality and public dissemination approach "casts a wide net, particularly at the pleading stage." This "wide net" underscores the importance of "meticulous care and investigation attending the preparation and issuance of any public statements made by directors and officers," including press releases, letters to shareholders, quarterly reports and annual reports. Although such meticulous care may or may not be enough to avoid a private party's claim under Rule 10b-5, it may be enough to invoke the "bespeaks caution" doctrine, which in turn renders the plaintiffs claim regarding misleading forward-looking statements moot for lack of materiality.

Semerenko's "wide net" in cases regarding the dissemination of false and misleading information to the public, however, might not aid a practitioner in bringing a Rule 10b-5 claim concerning a private misrepresentation. In such cases, Third Circuit practitioners must continue to rely on

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152. For a further discussion of Rule 10b-5's requirement regarding the nexus litigants must show between the prohibited act and the purchase of sale of a security in order to pursue an action under Rule 10b-5, see supra note 5 and accompanying text.


154. See McLaughlin, supra note 8, at 1 (discussing effect of Second Circuit's expansive interpretation of "in connection with" requirement and advocating instead "investment value" approach).

155. See id. (noting importance of "meticulous care and investigation" when preparing public documents).

156. See Eisenberg, supra note 7, at 809 (discussing "bespeaks caution" doctrine. Not every misleading statement, gives rise to Rule 10b-5 liability. Id. The "bespeaks caution" doctrine allows a defendant to escape liability under Section 10b and Rule 10b-5 notwithstanding the issuance of a misleading statement. Id. Courts afford this defense only if the document containing the misleading forward-looking statement includes sufficient cautionary language. Id.


157. See Semerenko, at 175-80 (distinguishing case based on fact that situation involved public misrepresentations). The Semerenko court stated:

We conclude that the materiality and public dissemination approach should apply in this case. The purpose underlying § 10(b) and Rule 10b-5 is to ensure that investors obtain fair and full disclosure of material facts in connection with their decisions to purchase or sell securities. That purpose is best satisfied by a rule that recognizes the realistic causal effect that material misrepresentations, which raise the public's interest in par-
Ketchum's causation approach or Angelastro's more liberal quasi-investment value approach. If neither case is factually similar to the practitioner's case at bar, however, the practitioner again should not hesitate to look to the precedent of other circuits.

V. CONCLUSION

Commentators suggest that Semerenko announced a "new rule on shareholder lawsuits" or "dispelled much of the confusion in its jurisdiction." To the contrary, however, Semerenko can be viewed as falling neatly into the general tendency shared between the circuits in cases concerning public dissemination of fraudulent misrepresentations, as the court held that the "in connection" requirement is met when the affirmative misrepresentations are material and made in a setting reasonably calculated or reasonably expected to influence the investing public. The confusion invoked by the Rule's ambiguity, however, is still very much alive in and between all the circuits, specifically in cases of private misrepresentations. Indeed, this confusion is the only constant in defining the contours of the "in connection with" requirement. As such, practitioners arguing before the Third Circuit must utilize the leeway this confusion provides to their utmost advantage.

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particular securities, tend to have on the investment decisions of market participants who trade in those securities.

Id. at 176 (citations omitted).

The court further noted that, "[i]n light of the law of this circuit ... the scope of the 'in connection with' requirement must be determined on a case-by-case basis ..." Id. at 175.

158. For a discussion of Ketchum, see supra notes 95-105 and accompanying text. For a discussion of Angelastro, see supra note 156-12 and accompanying text.

159. See Semerenko, 223 F.3d at 175-76 (rejecting previous Third Circuit precedent as useful in factual situation at bar and looking instead to useful precedent in Second and Ninth Circuits).

160. See Duffy, supra note 13, at B5 (suggesting that Semerenko announced "new rule on shareholder lawsuits").

161. See McLaughlin, supra note 8, at 1 (suggesting that Semerenko decision serves to "dispel much confusion in its jurisdiction").

162. For a further discussion of the consistency found throughout the lower courts regarding public misrepresentations made "in connection with" the sale or purchase of a security, see supra note 81 and accompanying text.

163. For a further discussion of the confusion prevalent among the lower courts, see supra note 6 and accompanying text.

164. For a further discussion of how practitioners must use the confusion prevalent in the Third Circuit to their advantage, see supra note 162 and accompanying text.