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## Corporations - Securities Regulation - Violation of Proxy Regulations Gives Private Right of Action but Federal Courts Are Limited Regarding Remedy

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CORPORATIONS—SECURITIES REGULATION—VIOLATION OF PROXY  
REGULATIONS GIVES PRIVATE RIGHT OF ACTION BUT FEDERAL  
COURTS ARE LIMITED REGARDING REMEDY.

*Dann v. Studebaker-Packard Corp.* (6th Cir. 1961).

A shareholder brought an action against the Studebaker-Packard Corporation, alleging fraud upon the stockholders by arrangements between that corporation and the Curtiss-Wright Corporation which constituted a waste of corporate assets and resulted from fraudulent proxy solicitation in violation of § 14(a) of the Securities Exchange Act of 1934 and the proxy regulations of the Securities and Exchange Commission.<sup>1</sup> Plaintiff petitioned that the court declare the proxies void. He urged, further, that, if it were found that without the fraudulent proxies, the transactions in question between defendant corporation and the Curtiss-Wright Corporation had not been approved by two-thirds of the outstanding stock as required by the corporate laws of Michigan, the court should rescind those arrangements. The District Court for the Eastern District of Michigan dismissed the complaint. On appeal,<sup>2</sup> the Court of Appeals for the Sixth Circuit *held* that: (1) although § 14(a) did not specifically create a cause of action in a private individual such a right could be implied, since plaintiff was within the class intended to be protected; (2) the fact that plaintiff was not directly defrauded by the misleading proxy solicitation did not affect his standing to sue, since the right created by § 14(a) was the right to a fair corporate election; and (3) it was not within the jurisdiction of the federal court to grant a rescission of the corporate transactions, since such relief would entail questions which were essentially local in character; however, it was within the power of the federal court to grant a declaratory judgment declaring the solicitations fraudulent, the assumption being that petitioner would take the judgment into a state court for enforcement and relief in compliance with the federal court's decision. *Dann v. Studebaker-Packard Corp.*, 288 F.2d 201 (6th Cir. 1961).

1. Securities Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n(a) (1958): "It shall be unlawful for any person, by the use of the mails or by any other means . . . of interstate commerce . . . to solicit . . . any proxy . . . in respect of any security . . . registered on any national security exchange 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." Jurisdiction was also based upon § 27, 15 U.S.C. § 78aa (1958): "Jurisdiction of offenses and suits. The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."

2. The first appeal was dismissed, the order appealed from not being a final one. *Dann v. Studebaker-Packard Corp.*, 253 F.2d 28 (6th Cir. 1958). The district court allowed an amended complaint to be filed, and, upon dismissal of this complaint, plaintiff prosecuted the present appeal.

The question of a private cause of action stemming from a violation of § 14(a) of the Securities Exchange Act had never been conclusively determined prior to this case. However, the trend toward allowing such an action had been evident. In the *Joiner Leasing Corp.* case,<sup>3</sup> the United States Supreme Court disapproved a slavish following of the doctrine of *expressio unius est exclusio alterius* and urged a consideration of the entire context of all legislative enactments. Thereupon, the courts began to allow a private right of action for violation of certain federal statutes which did not specifically provide for such relief.<sup>4</sup> In *Baird v. Franklin*, the court dealt with a cause of action pleaded under § 10(b) and § 6(b) of the Securities Exchange Act.<sup>5</sup> The court quoted favorably from the *Joiner Leasing* decision and pointed out that the fact that the statute provides no machinery by which the individual right could proceed is immaterial. The defendant's plea that the *expressio unius* doctrine barred the plaintiff's claim was rejected. This case marked the beginning of the trend toward allowing private actions under the Securities Exchange Act. In *Mack v. Mishkin*,<sup>6</sup> the court stated in dictum that a private right of action could be inferred from § 14(a). This seems to be as close as the federal courts had come to determining the propriety of a private suit under § 14(a) prior to the present decision. There have been a few cases holding that no individual right of action arose under other federal statutes,<sup>7</sup>

3. *S.E.C. v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-01, 64 S. Ct. 120, 123-24 (1943). The action was brought under the Securities Act of 1933, § 5(a) and § 17(a) (2) and (3), 15 U.S.C. § 77e(a) and § 77q(a) (2) and (3) (1958). The case hinged upon the question whether sales of leasehold subdivisions by the acre were excluded from within the meaning of "security" in § 2(1) since sales of leasehold subdivisions by undivided shares were explicitly included. The Court held that the inclusion of the one did not necessarily exclude all others.

4. *Texas and Pacific Ry. v. Rigsby*, 241 U.S. 33, 39-40, 36 S. Ct. 482 (1916), which involved a violation of the federal safety appliance acts; *Goldstein v. Groesbeck*, 142 F.2d 422, 427 (2d Cir. 1944), *cert. denied*, 323 U.S. 737, 65 S. Ct. 36 (1944), which was concerned with the Public Utility Holding Company Act of 1935. Note that there were deviations from the *expressio unius* rule even as early as *Zajkowski v. American Steel and Wire Co.*, 258 Fed. 9, 13 (6th Cir. 1918), which dealt with an Ohio statute which imposed a duty upon employers in certain industries to provide specific safety devices for their employees.

5. *Baird v. Franklin*, 141 F.2d 238 (2d Cir. 1944), *cert. denied*, 323 U.S. 737 (1944). The action was brought under the Securities Exchange Act of 1934, § 10(b) and § 6(b) 15 U.S.C., § 18j, 18f (1958). The former section prohibits the use of an instrument of interstate commerce, in connection with the purchase or sale of a security registered on a national security exchange, to transmit any manipulative or deceptive device in contravention of the rules of the Securities Exchange Commission. The latter section provides that no registration of a securities exchange shall be granted unless the rules of the exchange provide for disciplining of a member who conducts himself in a manner inconsistent with equitable principles of trade and declares that a willful violation of the Securities Exchange Act shall be considered conduct inconsistent with equitable principles of trade.

6. 172 F. Supp. 885 (S.D.N.Y. 1959). The holding of the court was that, upon the facts shown, an injunction would not be granted enjoining a certain management group from issuing allegedly fraudulent proxy solicitations, since complainants had not shown that they had a fair chance of success for the ultimate relief sought.

7. *E.g.*, *Massachusetts Universalist Convention v. Hildreth and Rogers Co.*, 183 F.2d 497, 500 (1st Cir. 1950), which dealt with the rules of the Federal Communications Commission; *Crawford v. Pituch*, 91 F. Supp. 626 (W.D. Pa. 1950), which concerned a violation of the Housing and Rent Act of 1947, as amended in 1948.

but a private right has been almost universally upheld under the state "blue sky" laws.<sup>8</sup> Regarding the standing of a stockholder who has not himself been duped by the fraudulent solicitation, there had been very little judicial comment of any sort before the present decision. One federal case<sup>9</sup> indicated that one who had not been deceived had no right to contest the validity of the proxies as used for election purposes.<sup>10</sup> On the other hand, a few state courts, applying their own corporate law, have been more sympathetic toward a stockholder who has not been "taken in" by the defendant's misrepresentations. In considering the suit of a shareholder bringing an action under local corporate law, the New York Supreme Court held that the term "aggrieved member" should not be strictly construed.<sup>11</sup> The reason given was that: "Any stockholder or director may bring such proceeding, he being naturally affected in some way by an unfair or irregular election".<sup>12</sup> The court in the present case was also influenced by this intimate relationship between corporate shareholders.<sup>13</sup>

Regarding the courts' power to rescind corporate transactions already completed, it was held in *Howard v. Furst*<sup>14</sup> that the regulations of the Securities and Exchange Commission would not permit such relief to an individual, especially if the affairs of one outside the corporation would be affected. On the other hand, in the recently decided case of *Mack v. Mishkin*,<sup>15</sup> the court indicated in dictum that there was no reason why a private party could not have a corporate election set aside upon proof of a violation of the proxy rules of the Securities and Exchange Commission.<sup>16</sup> Professor Loss, commenting upon the fate of the proxy regula-

8. See, LOSS AND COWETT, BLUE SKY LAW, 155-160 (Student ed. 1958).

9. *Textron, Inc. v. American Woolen Co.*, 122 F. Supp. 305 (D.C. Mass. 1954).

10. It is quite possible that this court would not have permitted a suit even by one who had been duped. By stressing that defendants would have won even if the questioned proxies were voted against them, the court implied that since injunctive relief was not available complainant had lost his right.

11. In the Matter of R. Hoe and Co., 137 N.Y.S.2d 142 (Sup. Ct. 1954), *aff'd mem.*, 285 App. Div. 927, 139 N.Y.S.2d 883 (1955) *aff'd mem.* 309 N.Y. 719, 128 N.E.2d 420 (1955). Plaintiff was suing under N.Y. GEN. CORP. LAW § 25.

12. In the Matter of R. Hoe and Co., 137 N.Y.S.2d 142, 147 (Sup. Ct. 1954).

13. See, *Dann v. Studebaker-Packard Corp.*, 288 F.2d 201, 208 (1961), where the court quotes favorably from the Congressional reports on the bill to enact the Securities Exchange Act.

14. 140 F. Supp. 507 (S.D.N.Y. 1956), *aff'd*, 238 F.2d 790 (2d Cir. 1956), *cert. denied*, 353 U.S. 937 (1957). The transaction involved was a sale of the corporate assets to one outside the corporation. The court distinguished such a transaction from one involving purely internal affairs. However, the rationale of the court in denying the right to rescission to an individual would also go to prohibit any private right of action.

15. 172 F. Supp. 885 (S.D.N.Y. 1959).

16. See, LOSS, SECURITIES REGULATION, 551-52 (Student ed. 1951): "In other words, if the Commission does not discover that its rules have been violated in time to enjoin the unlawful solicitation or the use of the proxies, there seems to be no reason why it should not sue in appropriate circumstances to undo the action taken by means of the proxies which have been unlawfully solicited". Although Professor Loss is concerned with possible action by the Securities Exchange Commission, there is no reason why the rationale should not apply equally as well to a suit by an individual.

tions in the courts,<sup>17</sup> agrees wholeheartedly with this latter view. In reviewing the willingness of the courts to enjoin the consummation of action which had been authorized through fraudulent proxy solicitation, he argues that the fact that the courts have gone this far without express statutory authority indicates that the further step of actually rescinding completed arrangements goes to the court's discretion and involves a balancing of the equities rather than a jurisdictional question. However, the court, in the present case, rejected this view and, instead, limited the remedies available in the federal courts so as to permit consideration only of the validity of the solicited proxies and not of their consequent effects.

The conclusion of the court regarding the standing of an individual to maintain a private action under the Securities and Exchange Commission's regulations — and this, even if he, himself, has not been defrauded by the solicitation — is based on sound legal precedent and seems to follow the legislative intent in enacting the statute. The problems which arise from the court's decision stem not from allowing a private shareholder, and even one who has not been personally misled, a private remedy under § 14(a) of the Securities Exchange Act,<sup>18</sup> but in disclaiming jurisdiction to consider the retrospective relief demanded. Now, in order for a petitioner to obtain such relief (if it is available at all), he will be forced either to bring an original action in a state court contending violation of a locally created right or to commence his action in the federal courts, secure a declaratory judgment regarding the validity of the proxies, and then sue upon this judgment in the state court. If the action is initiated in the state court upon a theory of fraud or upon some similar basis, and complainant meets the required standards of proof which each state demands, he may be able to obtain some relief. Of course, he must be careful that the antecedents for the action are not based entirely upon the rules of the Securities and Exchange Commission, lest the suit come within § 27 of the Securities Exchange Act, thus excluding it from a state court's consideration. If the state court were to determine that the cause of action was brought to enforce a right directly created by the Securities Exchange Act, and that it did not spring from the common law of tort, it might disclaim all jurisdiction to consider such a question.<sup>19</sup> If plain-

17. Loss, *The SEC Proxy Rules in The Courts*, 73 HARV. L. REV. 1041, 1079 (1960).

18. The validity of such an action becomes even clearer if we keep in mind that the right to be protected is the right to full and fair disclosures in corporate elections. Professor Loss' analysis is also enlightening: "The remedy is based . . . on the premise that either side in a contested solicitation has a legitimate interest, in view of the statutory purpose, to cry 'foul' against the other". Loss, *The SEC Proxy Rules in The Courts*, 73 HARV. L. REV. 1041, 1059 (1960).

19. *Remar v. Clayton Security Corp.*, 81 F. Supp. 1014, 1017 (D.C. Mass. 1949). There was involved an action brought under § 7(c) of the Securities Exchange Act of 1934, 15 U.S.C. § 78g(c) which prohibited a broker in securities who transacts business through the medium of a national securities exchange to extend credit to any customer in contravention of the rules which the Board of Governors of the Federal Reserve System prescribed or without certain collateral. The state courts

tiff decided to sue upon a declaratory judgment issued by a federal court,<sup>20</sup> or if, in an original action, he wished to bring in a federal declaratory judgment as evidence of a violation of some local law, he might find the court unwilling to accept such a judgment. Perhaps some state court *may* admit such a judgment as a guide in reaching its final decision, but there is certainly no obligation to do so. In the *Standard Power and Light* case,<sup>21</sup> the Delaware court posed this question: "Will a Delaware court in a Section 31<sup>22</sup> proceeding take cognizance of and grant relief for a violation of the Securities Exchange Act and rules and regulations promulgated thereunder?" The Court answered in the negative holding that § 27 of the Securities Exchange Act<sup>23</sup> precluded any such action. As far as some state courts are concerned a federal declaratory judgment may be all but meaningless. In any event, the standards of the state regarding the amount and type of relief available for similar causes of action will vary considerably. But the Securities Exchange Act, and particularly § 27, seem to be directly aimed at preventing such an uncertain enforcement of federal rights.<sup>24</sup> An obvious purpose in reserving exclusive jurisdiction over the enforcement of a certain right is to insure uniformity of relief to those who have been injured. Such a purpose would be defeated by leaving enforcement to the states.<sup>25</sup> Further, in

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may be very willing to apply the language of Judge Wyzanski regarding § 7(c) to § 14(a): "The issue is whether plaintiff's cause of action springs from the common law of tort, which merely takes as its standard of due care the Securities Exchange Act . . . or is brought to enforce a liability or duty directly created by the Securities Exchange Act. After some hesitation, I have concluded that, within the meaning of § 27, plaintiff is enforcing a liability created by the Securities Exchange Act . . . . Once the liability was created, its extent was to be measured by what is sometimes called a federal rather than a state common law."

20. The court, in the present case, issued the injunction in accord with the Federal Declaratory Judgment Act, 28 U.S.C. § 2201. Regarding the possibility of further relief, § 2202 states: "Further relief. Further necessary or proper relief based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against any adverse party whose rights have been determined by such judgment." It has been held that a federal court may, after issuing a declaratory judgment, grant coercive relief upon petition by the complainant. *Shumaker v. Utex Exploration Co.*, 157 F. Supp. 68, 77 (D. Utah 1957). In the present case, plaintiff's original plea was for coercive relief. It has also been held that the further relief referred to may go to the issuance of an injunction, but not to the extent of proving damages. *Automotive Equipment, Inc v. Triso Products Corp.*, 11 F. Supp. 292 (W.D.N.Y. 1935). It should be noted that both these cases refer to further relief on the federal level.

21. *Investment Assoc's, Inc. v. Standard Power and Light Corp.*, 29 Del. Ch. 225, 238-39, 48 A.2d 501, 508-09 (Ch. 1946), *aff'd*, 29 Del. Ch. 593, 606, 51 A.2d 572, 579 (Sup. Ct. 1947).

22. DEL. GEN. CORP. LAW § 31, which deals with the election of the directors of a corporation.

23. See note 1, *supra*.

24. Almost no Congressional discussion attended the insertion of the phrase 'exclusive jurisdiction' in the Securities Exchange Act. However, the cases arising in consequence of the Act have so interpreted the legislative meaning. *Remar v. Clayton Security Corp.*, *supra* note 19; *American Distilling Co. v. Brown*, 184 Misc. 431, 51 N.Y.S.2d 614 (Sup. Ct. 1944), *aff'd*, 295 N.Y. 36, 64 N.E.2d 347 (1945); *Investment Assoc's, Inc. v. Standard Power and Light Corp.*, *supra* note 21.

25. For a review of the multitude of problems in this area, see Loss, *The SEC Proxy Rules and State Laws*, 73 HARV. L. REV. 1249, 1253-78 (1960).