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Recent Developments

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RECENT DEVELOPMENTS

SECURITIES REGULATION — TENDER OFFERS — STANDING TO SUE — PURCHASER-SELLER REQUIREMENT — CORPORATION MAKING A TENDER OFFER HAS STANDING UNDER THE SECURITIES AND EXCHANGE ACT OF 1934 TO SEEK DAMAGES AND INJUNCTIVE RELIEF AGAINST ANYONE UNLAWFULLY OPPOSING ITS OFFER DESPITE THE FACT THAT IT WAS NOT DECEIVED IN ITS OWN PURCHASES.

Crane Co. v. Westinghouse Air Brake Co. (2d Cir. 1969)

The Crane Company proposed a merger of Crane and Westinghouse Air Brake Company and began to purchase Air Brake stock. Air Brake rebuffed the offer, but Crane continued to purchase Air Brake shares. Blyth and Co., investment bankers and representatives of American Standard, Inc., Crane's largest competitor, indicated to Air Brake that Standard would be interested in helping Air Brake resist the Crane takeover attempt and later proposed a merger of Air Brake into Standard by exchanging Air Brake stock for Standard's securities worth approximately $50 per share. At that time Air Brake stock was quoted at about $36 per share on the New York Stock Exchange [hereinafter referred to as NYSE]. Air Brake directors agreed to the merger on substantially the same terms as those proposed by Blyth and, after informing the Air Brake shareholders of the terms of the agreement and obtaining their approval, Air Brake stock rose to $44 per share. During the week of April 8, 1968, Crane mailed to Air Brake stockholders its offer, which would expire on April 19, to exchange Crane stock and debentures worth $50 for each share of Air Brake stock. During the week of April 10, 1968, Standard purchased substantial amounts of Air Brake stock on the NYSE and the price of the stock rose to $49 per share. On the day Crane's tender offer was to expire, Standard purchased 170,000 shares of Air Brake on the NYSE at an average price of $49.50 per share and sold 100,000 shares “off the market” to Investors Diversified Services and 20,000 shares on the market at a negotiated price to Dillion Read at an average price of $44.50 per share, thereby taking an apparent loss of more than $500,000 on its purchases and sales for the day. Crane failed to gain enough shares of Air Brake and the merger of Air Brake into Standard became effective, the former Air Brake stock being converted into a new issue of Standard convertible preferred stock. Crane later sold this convertible preferred stock under the threat of a divestiture action to be brought by Standard under the antitrust laws.

Crane brought an action against Standard and Blyth under sections 9 and 10 of the Securities Exchange Act of 1934 and rules 10b–6 and 10b–5
promulgated thereunder, alleging that Blyth, on Standard's behalf, manipulated and rigged the price of Air Brake stock on the NYSE for the purpose of deterring tenders of Air Brake stock under the Crane exchange offer. The District Court entered judgment dismissing the complaint. The Court of Appeals for the Second Circuit reversed and remanded to the District Court for appropriate remedies holding, inter alia, that Standard violated: (1) section 9(a) (2) of the Securities Exchange Act of 1934 by entering into a series of transactions for the purpose of inducing Crane to sell its Air Brake stock and (2) section 10(b) of the Exchange Act and rule 10b-5 promulgated thereunder, because its failure to disclose its manipulation operated as a fraud or deceit on Crane in connection with the purchase and sale of securities. 4

Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969).

1. Section 9(a) (2), makes it unlawful:
To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.
Liability for a violation of section 9(a)(2) is provided for in section 9(e) which states in part that:
Any person who willfully participates in any act or transaction in violation of subsection (a), (b) or (c) of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction.

2. Section 10 provides in part that:
It shall be unlawful for any person, directly or indirectly by the use of any means of 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.

3. Rule 10b-5 provides that:
It shall be unlawful for any person, directly or indirectly by the use of any means of instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud,
(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
in connection with the purchase or sale of any security.

4. The Second Circuit affirmed the dismissal of the proxy violation claims. Certain alleged nondisclosures in a proxy statement of a merger target company did not violate the Exchange Act since the facts forming the basis of the allegations were adequately discussed in the document, and there was no misstatement or omission that would influence a stockholder's vote. The court found that the alleged falsity of a management affirmation in the proxy statement that due consideration was given the offer was unsupported by the evidence.
A tender offer is a practice whereby an offeror solicits the stock of a target company through an offer, made directly to the shareholders of the target company, to purchase all or a large portion of the stock of the target company for a fixed price — usually representing a premium over the market price — for cash or securities of the offeror. In recent years this technique has been widely used, often following the breakdown of negotiation between the companies concerning a merger, consolidation or sale of assets, to acquire control of the target company. The reasons for its increased use are numerous. The cash or stock (exchange offer) tender offer, unlike other methods for gaining control of a corporation over the heads of a hostile management such as the proxy battle or the gradual purchase of shares in the open market, affords the offering corporation a direct approach to the shareholders and a reasonable chance for success with speed, secrecy and relatively low costs. However, when the mana-

5. See, e.g., Brudney, A Note on Chilling Tender Solicitations, 21 Rutgers L. Rev. 609 (1967); Fleischer & Mundheim, Corporate Acquisition By Tender Offer, 115 U. Pa. L. Rev. 317 (1967); Hamilton, Some Reflections on Cash Tender Offer Legislation, 15 N.Y.L.F. 269 (1969); Comment, Economic Realities of Cash Tender Offers, 20 Me. L. Rev. 237 (1968); Comment, Regulation of Contested Cash Tender Offers, 46 Texas L. Rev. 915 (1968); Comment, The Regulation of Corporate Tender Offers Under Federal Securities Law: A New Challenge for Rule 10b-5, 33 U. Chi. L. Rev. 359 (1966). The bidder will often attempt to acquire a substantial position in the target company's stock prior to announcing its tender offer. See Hamilton, supra at 272. The mechanics of the offer consist of the publication of the offer in various newspapers, or by mail to individual shareholders where possible, stating that the offeror will purchase a specified number of shares of the target corporation at a stated price for a designated period of time and indicating where an offering letter and letter of transmittal may be obtained. The offering letter will outline the terms of the offer, give instructions for tendering the shares, and specify the conditions under which the offeror will be obligated to purchase the shares, the number of shares it is required to accept, and whether the shares will be accepted on a first-come, first-served or pro rata basis. The letter of transmittal, which is drafted for the shareholders' use in transmitting their shares to a designated depository (usually a bank) contains the formal terms of the agreement between the parties and instructions for compliance. See Fleischer & Mundheim, supra at 335-37; Hamilton, supra at 271-72; Kennedy, Tender Movement, 23 Bus. Law. 1091-92; Comment, Regulation of Contested Cash Tender Offers, 46 Texas L. Rev. 915, 915-16 (1968). Tender offers may also be made by a corporation to acquire its own stock. See Loomis, Purchases by a Corporation of Its Own Securities, 22 THE RECORD 275 (1967); Zilber, Corporate Tender Offers for Their Own Stock: Some Legal and Financial Considerations, 33 U. Cin. L. Rev. 315 (1964); Comment, Rule 10b-5 And Purchase By A Corporation Of Its Own Shares, 61 Nw. U. L. Rev. 307 (1966); Comment, The Regulation of Corporate Tender Offers Under Federal Securities Law: A New Challenge for Rule 10b-5, 33 U. Chi. L. Rev. 359 (1966).

6. In 1960, there were $186 million in cash tender offers and $435 million of stock tender offers (exchange offers). By 1965, the value of such offers had increased to $951 million and $558 million, respectively. Hayes & Taussig, Tactics of Cash Take-Over Bids, 43 Harv. Bus. Rev. 135, 136 (March-April 1967). Thereafter, the value of tender offers have increased even more markedly. From July 29, 1968 to February 28, 1969, 54 cash tender offers were filed with the SEC involving $1.424 billion and 104 offerings of securities were filed in exchange offers valued at approximately $9 billion. Hamilton, supra note 5, at 270 n.2. See Hearings on Problems in the Securities Industry Before the Subcomm. on Sec. of the Senate Comm. On Banking and Currency, 91st Cong., 1st Sess. at 13-14 (1969).

7. See Hamilton, supra note 5, at 272; Kennedy, supra note 5, at 1094.

agement of the target corporation opposes the tender offer, it may be a powerful opponent to the offeror since it has all the resources of the target corporation at its disposal to defend the existing corporate policy. It can take any one or several of the following measures: (1) communicate its opposition to the offer to the shareholders; (2) raise the dividend; (3) split the stock; (4) increase the outstanding stock; (5) attempt

9. Fleischer & Mundheim, supra note 5, at 331-32. See Bradshaw, Defensive Tactics Employed By Incumbent Managements in Contesting Tender Offers, 21 STAN. L. REV. 1105, 1106 (1969): "Tender offers frequently give rise to fierce opposition by the target corporation's incumbent management, since management's job or independent control of the enterprise may ride on the outcome of a tender offer." Bradshaw, id. at 1105.

10. By analogy to the proxy contest, it would seem that the management will be afforded access to the corporate treasury for the purpose of opposing the tender offer where the expenditures are to defend the existing corporate policy while such would not be the case where expenditures were solely to retain the present management. See Bradshaw, supra note 9, at 1114 n.49; Fleischer & Mundheim, supra note 5, at 321 & n.18. See Campbell v. Lowe's, Inc., 36 Del. Ch. 563, 134 A.2d 852 (1957). Management, however, is invariably able to frame its defense in matters of policy and, therefore, will almost always have access to corporate funds. See Bradshaw, supra note 9, at 1114 n.49; Fleischer & Mundheim, supra note 5, at 321 & n.18.

11. Management exhortations to shareholders not to tender their shares may be accomplished by the publication of an open letter to the shareholders in news media or, as management possesses the shareholder list, the mailing of personal letters to the shareholders. See Bradshaw, supra note 9, at 1112; Fleischer & Mundheim, supra note 5, at 360. The standard arguments are: (1) that the offerors must think the company's shares are a good investment at the tender price and so the present shareholders should retain their investment; (2) that the board of directors and management consider the offer inadequate and that none of the directors or principal officers intend to tender their shares; (3) that the tender offer is a taxable transaction; (4) that any current problems are temporary and management expects increased sales and earnings; (5) where applicable, that the tender price is less than the book value of the corporation's shares or its recent market price; and (6) that the future potential of the shareholder's investment greatly outweighs the short-term gain to be achieved by the acceptance of the offer from outsiders who want to "raid" the corporation and oust the duly-elected board of directors. See Bradshaw, supra note 9, at 1113; Schmults & Kelly, Cash Take-Over Bids — Defense Tactics, 23 BUS. LAW. 115, 121-24 (1967).

12. The prospect of increased dividend income, which tends to increase the shareholder's opinion of the value of their investment, may induce shareholders against tendering their stock, raise the price of the stock thereby reducing the attractiveness of the tender price and may tend to insure that the market price of the company's stock will remain at or near the level to which it rises after the tender offer. See Bradshaw, supra note 9, at 1120; Hayes & Taussig, supra note 6, at 143; Schmults & Kelly, supra note 11, at 117-18.

13. Although stock splits do not change the proportional ownership of the corporation, they are generally favored by shareholders. The fact that many shareholders still regard stock splits as an extra dividend while others prefer to own more shares at a lower price coupled with the fact that the offering price (although it will be adjusted to account for the split) may appear to be less since it will involve fewer dollar premium per share, may induce shareholders not to tender their stock. Bradshaw, supra note 9, at 1120; Schmults & Kelly, supra note 11, at 118.

14. The purpose of this tactic is threefold: (1) it will dilute the stock interest acquired by the bidder; (2) it will make it more difficult and more expensive for the offeror to acquire the requisite number of shares to attain control and; (3) it will increase the bidder's financial risk by making its designated minimum number of shares to be purchased insufficient to give it control. See Bradshaw, supra note 9, at 1124-25; Schmults & Kelly, supra note 11, at 119-20. Where the bidder is obligated to purchase a minimum number of shares and that number does not provide control, in the absence of additional purchases which may not be financially possible, the bidder may have problems disposing of the shares without violating rules 10b-5 or 10b-6 under the Securities Exchange Act or turning over his profit to the target corporation under Section 16(h) of the same Act. Id. The target corporation, how-
to block the acquisition on the grounds that it will violate antitrust laws;\(^5\) (6) enlist the aid of banks to withdraw financing from the offeror\(^6\) and; (7) arrange a defensive merger.\(^7\) The target company or its allies could also go into the market and purchase shares being sought by the offeror.\(^8\) The purpose of such a course of action is to absorb the supply of securities which might otherwise be tendered\(^9\) and to raise the market price of the

ever, must be wary that its action does not violate the security laws or state corporation statutes. See Bradshaw, supra note 9, at 1125.

15. This response is ordinarily not possible since the offeror will investigate the possible antitrust implications of the acquisition of the target company before making the offer. See Schmults & Kelly, supra note 11, at 123. The incumbent management, however, can drastically alter these antitrust considerations by acquiring or merging with a third company. Id. See also Bradshaw, supra note 9, at 1124; Fleischer & Mundheim, supra note 5, at 322.

16. The besieged corporation may have strong allies, among them banks and other financial institutions, which could be persuaded to withhold financing needed by the bidder to effectuate the planned tender offer. See Fleischer & Mundheim, supra note 5, at 322.

17. A defensive merger may be a very successful tactic where the terms of the merger are roughly analogous to that of the tender offer since the exchange of the target company's shares for the securities of the surviving corporation are tax free to the shareholders whereas shareholder acceptance of the tender offer will result in immediate taxes on any gain. See Bradshaw, supra note 9, at 1126; Schmults & Kelly, supra note 11, at 132. Where such a plan of protective merger has been adopted, various problems arise for both the bidder and the target company under the proxy regulations of the Securities Exchange Act. See Bradshaw, supra note 9, at 1126; Fleischer & Mundheim, supra note 5, at 369-70; Schmults & Kelly, supra note 11, at 132-33.

18. Where the management causes the corporation to purchase its own shares, questions, analogous to the problem of the use of corporate funds to fight a tender offer or proxy battle, arise under state corporation statutes concerning the propriety of such purchases during a contest for control. Such action, however, has been justified on the theory that "a threat to control by an 'outsider' poses a question of 'corporate policy' in terms of conflicting views as between management and a large 'outsider' interest as to how the business should be conducted." Israels, Corporate Purchases of Its Own Shares—Are There New Overtones?, 50 CORNELL L.Q. 620, 623 (1965). This indicates that a corporation may not purchase its own shares to preserve the incumbent management's control but may do so where corporate policy is at stake. See, e.g., Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964); Kors v. Carey, 39 Del. Ch. 47, 158 A.2d 136 (1960); Martin v. Am. Potash and Chem. Corp., 33 Del. Ch. 234, 92 A.2d 295 (1952). See also Bradshaw, supra note 9, at 1123; Fleischer & Mundheim, supra note 5, at 364-68; Schmults & Kelly, supra note 11, at 124.

At the present time, there are no federal securities law restrictions upon corporate purchases of shares to perpetuate control absent deception or fraud. See Bradshaw, supra note 9, at 1123; Fleischer & Mundheim, supra note 5, at 365; Lockwood, Corporate Acquisitions and Actions Under Sections 10(b) and 14(f) of the Securities Exchange Act of 1934, 23 BUS. LAW. 365, 376-77 (1968). See also Ruckle v. Roto American Corp., 339 F.2d 24 (2d Cir. 1964) (injunctive relief granted where management concealed material facts in purchasing shares to retain control) ; O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964) (dismissing a complaint under rule 10b-5 where there was no allegation of deception in connection with corporate purchases to perpetuate control). Corporate purchases of its own stock, however, are now covered by section 13(e)(1), 15 U.S.C. § 78m(e)(1) (Supp. 1969), which gives specific authority to the SEC to promulgate rules concerning the target company's purchases during the tender offers. The applicable rules provide for notice to the SEC and to shareholders of the purchases, its purposes and the source of the funds. See Bradshaw, supra note 9, at 1123; Bromberg, Exchange Offers, 2 REV. OF SEC. REG. 605, 614 (1969); Bromberg, The Securities Law of Tender Offers, 15 N.Y.L.F. 462, 524-26 (1965); Schmults & Kelly, Disclosure in Connection With Cash Take-Over Bids: The New Regulations, 24 BUS. LAW. 19, 22-24 (1968).

19. Bradshaw, supra note 9, at 1119, 1121; Fleischer & Mundheim, supra note 5, at 364; Schmults & Kelly, supra note 11, at 147-25.
shares, thus reducing the premium over the market price and consequently making the tender less attractive.\textsuperscript{20}

The problem with such a plan, however, is that the disclosures made in connection with such purchases and the prices at which such purchases are made create the potential for securities law violations.\textsuperscript{21} Section 9(a)(2) proscribes a series of transactions creating actual or apparent active trading in a security, or raising or depressing the price of the security for the purpose of inducing its purchase or sale by others.\textsuperscript{22} Of course, any large purchase or sale of a security will have an effect on the market price of the security, but the effect itself does not create the violation.\textsuperscript{23} The gravamen of the violation of section 9(a)(2) is making the transactions with the intent to induce others, through the effect on market price, to buy and sell. The problem in finding a violation in this context, however, is that management-inspired purchases of stock are not made to induce others to buy or sell but are made to induce the shareholders not to sell (tender) by raising the market price to the level of the tender price.\textsuperscript{24}

Additionally, where management or its allies fail to disclose their purchases, they may be subject to liability under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 promulgated thereunder.\textsuperscript{25} Section 10(b) and rule 10b-5 essentially prohibit schemes to defraud, a material misrepresentation or omission, or a fraudulent course of business "in connection with the purchase and sale of any security."\textsuperscript{26} While there has been a tremendous growth of private rights under rule 10b-5,\textsuperscript{27} certain

\textsuperscript{20} Bradshaw, supra note 9, at 1119, 1121; Fleischer & Mundheim, supra note 5, at 364; Schmults & Kelly, supra note 11, at 124-25. The market price of the target company's shares will generally rise toward the tender offer price simply as a reaction to the offer. The management-inspired purchase of the target company's shares is designed to accentuate that price advance towards the tender offer price and, perhaps, to exceed it. Bradshaw, supra note 9, at 1119 n.75. It should be noted that stock splits and dividend increases, to a lesser degree, have the same effect. See notes 12 and 13 supra and accompanying text. Such management-inspired purchases may also have the purpose of increasing the amount of stock in friendly hands in order to fight a management change or merger after the offer or to decrease the liquid assets of the target company which may have prompted the offer. Bromberg, Exchange Offers, 2 Rev. of Securities Regulation 805, 814 (1969).


\textsuperscript{22} See note 1 supra.

\textsuperscript{23} Congress made this clear when it said:
Any extensive purchases or sales are bound to cause changes in the market price of the security, but mere knowledge on the part of the purchaser or seller that his transaction will have that effect is not sufficient to bring him within the scope of this provision.

\textsuperscript{24} This has led one commentator to state:
The specific anti-manipulation provisions of Exchange Act § 9 do not quite fit. For example, § 9(a)(2) would be violated if the purpose was to raise the price to induce others to sell. But the purpose here is to deter them from selling. Bromberg, supra note 20, at 814.

\textsuperscript{25} See Schmults & Kelly, supra note 11, at 124-25.

\textsuperscript{26} See notes 2 and 3 supra.

\textsuperscript{27} Despite the absence of express language granting a private cause of action under rule 10b-5, the District Court for the Eastern District of Pennsylvania inter-
concepts have been utilized to limit liability under its sweeping language. Courts have held that: (1) the plaintiff must have actually relied on the fraudulent statement or nondisclosure;28 (2) that a misrepresentation or nondisclosure must be material;29 (3) that the fraud actually causes the harm;30 (4) that the injury be foreseeable31 and; (5) where the fraud is a nondisclosure the defendant must be under a duty to speak,32 i.e., be an insider. Perhaps the most important and formidable obstacle for the offeror corporation to overcome in maintaining a 10b-5 action is the doc-

interpreted the rule to provide a private cause of action for defrauded sellers. Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946), and the Second Circuit later recognized a similar right for purchasers, Fishman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951). All circuits have now recognized that a private right of action exists under rule 10b-5. See, e.g., Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967); A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967); Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963).

28. Although rule 10b-5 does not expressly require reliance, the courts have regularly stated that the defrauded party must have actually relied upon the allegedly fraudulent statement. E.g., List v. Fashion Park, Inc., 340 F.2d 457, 462-63 (2d Cir. 1965), cert. denied, 382 U.S. 811 (1965). Such an assertion, however, is an oversimplification. The requirement of reliance is now indistinguishable from the requirement of causation which demands that the defendant's activity cause the plaintiff's damages. A. Bromberg, Securities Law: Fraud — SEC Rule 10b-5 § 8.6, p. 209 (1969).

This is particularly true in nondisclosure cases where reliance per se plays only a small role. The proper test, in this context, is whether the plaintiff would have acted differently if the defendant had disclosed the undisclosed fact. A. Bromberg, Securities Law: Fraud — SEC Rule 10b-5 § 8.6, p. 209. See List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir. 1965), cert. denied, 382 U.S. 811 (1965). Additionally, there is no requirement that the plaintiff himself rely on the nondisclosure or be personally defrauded so long as others relied or were defrauded and this caused injury to the plaintiff. See Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), cert. denied, 389 U.S. 970 (1967).


32. Not everyone who fails to disclose material information in open market transactions violates rule 10b-5 but only those who possess their information by reason of some access to the issuer. A. Bromberg, Securities Law: Fraud — SEC Rule 10b-5 § 8.2, p. 197 (1969). The obligation to disclose material facts before trading is based upon two factors:

[F]irst, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing. In re Cady, Roberts & Co., 40 SEC 907, 912 (1961). See SEC v. Texas Gulf Sulphur Co., 407 F.2d 833, 848 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

When a corporation has agreed to a protective merger with the target company, that corporation may possess inside information about the target company by virtue of their merger talks and this information may have to be disclosed under rule 10b-5 in connection with purchases of the target companies shares. Schmults & Kelly, supra note 11, at 133.
trine, first enunciated in Birnbaum v. Newport Steel Corp., that only a person who has been defrauded in connection with his own purchase or sale of securities has standing to enforce the federal rights granted by section 10(b) and rule 10b-5. Under this doctrine the offeror corporation would not have standing to sue because it has not been deceived in the purchase of securities.

Recent criticisms of the Birnbaum doctrine have initiated judicial modifications resulting in a more flexible application. These decisions have expanded two aspects of this doctrine including (1) the concept of purchaser or seller and (2) the scope of "in connection with" the purchase and sale of securities. The concept of purchaser or seller has been expanded to provide an "aborted seller" or a "constructive seller" with standing to sue under section 10(b). In A.T. Brod & Co. v. Perlow, 33 33. 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952). Accord, Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967); Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969); Greenstein v. Paul, 400 F.2d 580 (2d Cir. 1968); Chasin v. Mencher, 255 F. Supp. 545 (S.D.N.Y. 1965); O'Neill v. Maytag, 230 F. Supp. 235 (S.D.N.Y.), aff'd, 339 F.2d 764 (2d Cir. 1964); Cooper v. North Jersey Trust Co., 226 F. Supp. 972 (S.D.N.Y. 1964). In Birnbaum, Newport's minority shareholders brought a combined derivative and class action against the former controlling shareholder, alleging that he had rejected a merger offer which would have been profitable to all Newport shareholders, choosing instead to sell his stock at a premium to outsiders. The plaintiffs contended that this premium sale together with specific acts of fraud, consisting of misrepresentations to them to facilitate the transaction, constituted fraudulent practices in connection with the purchase and sale of securities within the meaning of section 10(b) and rule 10b-5. Dismissing the action, the Second Circuit held that section 10(b) "was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller." 34 34. 193 F.2d at 464 (emphasis added).

35. Where there is deception it is the shareholders rather than the offeror who has been deceived and therefore, when the deception is successful the defrauded shareholders will not tender their shares and the offeror will not be a purchaser in a fraudulent transaction.

36. Much of the criticism of the Birnbaum doctrine has come from the Securities and Exchange Commission. See Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969) (the SEC urged that the purchaser-seller requirement be abandoned); A.T. Brod & Co. v. Perlow, 375 F.2d 393, 387 (2d Cir. 1967) (the SEC contended that one need not be a purchaser or seller in order to sue under rule 10b-5); Vine v. Beneficial Fin. Co., 374 F.2d 627, 634, 636 (2d Cir.), cert. denied, 389 U.S. 970 (1967) (where the Commission argued that the plaintiff need not be a selling stockholder to sue under rule 10b-5, so long as the rule has been violated and plaintiff's stock lost value as a result). For other sources of criticism, see Lowenfels, The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5, 54 VA. L. REV. 268 (1968); Comment, The Purchaser-Seller Limitation to SEC Rule 10b-5, 53 CORNELL L. REV. 684 (1968); Comment, supra note 34, at 1178-79; Comment, The Decline of the Purchaser-Seller Requirement of Rule 10b-5, 14 VILL. L. REV. 499 (1969).


38. 375 F.2d 393 (2d Cir. 1967). The district court had dismissed the complaint on the ground that the type of fraud alleged was not encompassed by section 10(b) and rule 10b-5 since those provisions were intended to protect investors from frauds "usually associated with the sale or purchase of securities" and relating to the investment value of the securities sold or purchased. Id. at 396.
the Second Circuit granted standing to the plaintiff, a stockbroker, injured by an alleged fraudulent scheme in which the defendants had ordered securities intending to pay for them only if their value increased by the settlement date. Thus, an "aborted seller" — one whom has been defrauded in connection with a securities transaction which has not been completed — was permitted to bring a section 10(b) action even though he was not an actual seller of securities. In Vine v. Beneficial Finance Co., the Second Circuit further expanded the concept of purchaser-seller to include a "constructive" or "forced seller" — a party who has been the victim of a fraudulent merger and who has been forced to exchange his stock for the stock of the merged company without the volition normally present in a sale. In this case the plaintiff alleged a fraudulent scheme by which the defendant gained control over plaintiff's company and subsequently dissolved it by means of a short-form merger. Although the plaintiff neither accepted the offer to purchase his stock nor surrendered his stock pursuant to the short-form merger, the court considered him to be a "constructive" or "forced" seller since his only option was to exchange his stock for cash under the applicable corporate statute and therefore allowed his action for damages under rule 10b-5.

39. We believe that § 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. 375 F.2d at 397. See also Commerce Reporting Co. v. Puretec, Inc., 290 F. Supp. 715 (S.D.N.Y. 1968).

The SEC filed an amicus curiae brief contending that one need not be a purchaser or seller to sue under rule 10b-5. In referring to this argument, the court concluded: "[W]e need not consider that contention since plaintiff is clearly a purchaser of securities." 375 F.2d at 397 n.3.

40. 374 F.2d 627 (2d Cir.), cert. denied, 389 U.S. 970 (1967).

41. Various state statutes authorize a parent corporation which owns a specified percentage of the stock of a subsidiary to merge the subsidiary into the parent without any vote or appraisal rights for the stockholders of the parent, and with only a cash payment to the minority stockholders of the subsidiary.

42. The district court had dismissed the complaint holding that the plaintiff was not a seller within the meaning of rule 10b-5 since he had not accepted the offers and continued to hold the stock in the dissolved corporation. 252 F. Supp. 212 (S.D.N.Y. 1966).

43. 374 F.2d at 634-35. He is a forced seller because: the volition normally associated with a sale is absent when a stockholder exchanges his shares for stock in the surviving corporation and it is constructive since the exchange element of a sale is present and the shareholder has disposed of his shares, yet there actually has not been a sale.

Comment, supra note 37, at 508.

44. The Court stated that:

[1]n order to realize any value for his stock, appellant must exchange the shares for money from appellee, as a practical matter appellant must eventually become a party to a "sale," as that term has always been used. ... It is true that appellant still has his stock; if he turned it in ... it would be clearer that appellant is a seller. Assuming that this would not otherwise affect his right to sue under the Act and the Rule, requiring him to do so as a condition to suit seems a needless formality.

374 F.2d at 634 (citations omitted). The Securities and Exchange Commission, as amicus curiae, suggested that the plaintiff need not even have been a "forced" seller so long as he was conduct condemned by the rule and the plaintiff's stock lost value as a result. Id. at 636. See also Mader v. Armel, 402 F.2d 158 (6th Cir. 1968), cert. denied, 394 U.S. 930 (1969); Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir.), cert. denied, 389 U.S. 977 (1967); Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (D. Del. 1965).
In addition to enlargeting the concept of the purchaser and seller of securities, the scope of the “in connection with” aspect of the Birnbaum doctrine has been expanded to provide injunctive relief where the fraudulent practice merely affects the purchase or sale of securities. Thus, in Mutual Shares Corp. v. Genesco, Inc., the Second Circuit held that the plaintiffs who did not sell their stock in relation to defendant’s market manipulation could seek an injunction under rule 10b-5. However, despite these modifications, the Birnbaum doctrine has never been expressly overruled and no case has recognized the standing of an offeror corporation to sue for fraud committed by the target corporation or its allies in resisting the tender offer.

It was against this background that the Second Circuit, in the instant case, confronted two major issues. They are: (1) did the large scale purchases and concealed sales of stock of the target corporation by an ally of that corporation and the nondisclosure of these transactions violate the Securities Exchange Act and; (2) if so, did the offeror corporation have standing to sue under the Act.

Beginning its inquiry under section 9(a)(2), the Second Circuit stated that this section makes it unlawful to effect a series of transactions in any security when these transactions create actual or apparent active trading or they raise or depress the price of the security for the purpose of inducing its purchase or sale by others. Recognizing however, that

45. The inroads of this approach have been marked. Judge Bonsal of the Southern District of New York read Vine and Brod as seriously challenging, if not overruling the decision in Birnbaum. Entel v. Allen, 270 F. Supp. 60, 69 (S.D.N.Y. 1967). He commented that on the basis of those two cases “and the position taken by the SEC, it may well be that the purchaser-or-seller requirement of Birnbaum will not be followed when the question is next presented to the Court of Appeals.” Id. at 70. Based on this, the district court allowed plaintiffs to bring an action for damages before they were parties to an actual securities transaction. Judge Bonsal, however, clearly overread Vine and Brod as the two cases did not grant standing to sue to one who is not a defrauded purchaser or seller (at least in its broader meaning) and Entel has been correctly criticized. See Comment, The Purchaser-Seller Limitation to SEC Rule 10b-5, 53 CORNELL L. REV. 684, 692-93 (1968); Comment, supra note 37, at 513. But while Vine and Brod did not do away with the purchaser-seller requirement in a rule 10b-5 action, the cases do demonstrate a judicial willingness to be more sympathetic towards defrauded plaintiffs. Cf. Comment, The Purchaser-Seller Limitation to SEC Rule 10b-5, 53 CORNELL L. REV. 684, 690 (1968). The groundwork had thus been laid. In fact, the next time the Second Circuit was met with the standing issue the court stated that “this court has expressly left undecided the question whether one who is neither a purchaser nor a seller can attack a transaction under Rule 10b-5...” Symington Wayne Corp. v. Dresser Indus., Inc., 383 F.2d 840, 842 (2d Cir. 1967).

46. See Comment, supra note 37, at 504.
47. 384 F.2d 540 (2d Cir. 1967).
48. The court stated:

[W]e do not regard the fact that the plaintiffs have not sold their stock as controlling on the claim for injunctive relief. The complaint alleges a manipulative scheme which is still continuing. While doubtless the Commission could seek to halt such practices, present stockholders are also logical plaintiffs to play an important role in enforcement” of the Act in this way.

49. See Fleischer & Mundheim, supra note 8, at 360-61.
the Securities Exchange Act did not per se prohibit large scale buying or selling which raises the price of the security itself but only condemned transactions made with a manipulative motive and willfulness, the court indicated that the requisite purpose and willfullness could be inferred from the circumstances of the transactions. Judge Smith, writing for the court, found the manipulative purpose to be prima facie established because Standard, which had a direct pecuniary interest in the success of the tender offer, took active steps to raise the price of the Air Brake stock. The court further noted that the instant case presented "even more than the motive to manipulate and the requisite series of transactions" since not only did Standard dominate trading in Air Brake stock at price levels calculated to deter the shareholders from tendering their shares to Crane, but it concealed this course of action from the public for the purpose of defeating the tender offer to insure the success of its merger attempt with Air Brake. The failure to disclose this course of action distorted the information flowing from the market so that the Air Brake shareholders could only conclude that there was a large demand for their shares, and it was therefore unwise to tender their stock. Moreover, the Second Circuit found Standard's assertions that its purpose was to acquire shares to attain control and not to manipulate the market to be unconvincing in light of their massive purchases coupled with concealed sales. Finally, the court held that Crane had standing under section 9(a)(2) to maintain the action as it was a member of the class intended to be protected by the Securities Exchange Act. It reasoned that because Standard acted for the purpose of inducing the sale by Crane and, indeed, its conduct had the intended and inevitable effect of forcing Crane to become a seller within the meaning of this section.

In addition to Crane's right as a forced seller under section 9(a)(2), the Second Circuit found that Crane had a right to relief under section 10(b) and rule 10b-5 because Standard's failure to disclose its manipulation operated as a fraud or deceit on Crane in connection with the purchase and sale of securities. The court noted that the prohibition against nondisclosure is based on the policy that all investors have relatively equal access to material information and that anyone who has access to information intended only for corporate purposes may not take advantage

51. 419 F.2d at 794. See notes 23 and 24 supra and accompanying text.
53. 419 F.2d at 795.
54. Id.
55. Id.
56. Id.
57. Id.
58. Id. at 794.
60. 419 F.2d at 795-96. The court clearly indicated that this was not a double violation of rule 10b-5 — one for the manipulation and one for the nondisclosure. Rather the transactions were manipulative in violation of § 9(a)(2), and the failure to disclose this manipulation constituted a violation of rule 10b-5. 419 F.2d at 796 n.11.
of it when it is unavailable to the investing public. Furthermore, it recognized that there is a duty to disclose information only when (1) the person is an insider, (2) the information is material and (3) the failure to disclose would be misleading and deceive the investing public.

In deciding that Standard was an insider with respect to the trading of Air Brake stock, the court considered four circumstances determinative. They were: (1) that Standard was acting in concert with Air Brake; (2) it regularly informed Air Brake's management of its transactions; (3) it was a major shareholder of Air Brake and; (4) its purchases were an integral part of the defense scheme. Similarly, the court found that the failure to disclose was misleading and that the undisclosed information was material. The primary method for the evaluation of an offer is from market performance in reaction to that offer. Such an evaluation was not possible in this case because the source of the market distortion was Standard's transactions, and they were not disclosed. Consequently, the market information reaching the shareholders was misleading. The undisclosed information was found to be material because a reasonable man in determining whether to accept the tender offer, would attach importance to the undisclosed fact that Standard bought large quantities of Air Brake stock while at the same time engaging in secret selling.

In concluding that Standard had violated rule 10b-5 by failing to disclose material inside information thereby deceiving the investing public, the court emphasized that it was immaterial that Crane was not in fact deceived because "it was entitled to the Act's protection not only against being deceived itself but also against deception of the investing public designed to prevent the public from entering into security transactions [with it]."

After finding that Standard had violated rule 10b-5, the question still remained whether Crane had standing to raise the issue, since it did not rely on the nondisclosure and was not a purchaser or seller in the manipulative transactions. The court, recognizing that other courts generally hold that reliance by the defrauded party is a necessary element for recovery under rule 10b-5, held that it is a minor element in non-disclosure cases and can be equated to causation. It stated that in non-disclosure cases "the test of 'reliance' is whether 'the misrepresentation is a substantial factor in determining the course of conduct which results in [the Plaintiff's] loss' ... and that '[w]hat must be shown is that"

62. 419 F.2d at 796.
63. Id. See note 32 supra.
64. 419 F.2d at 796.
65. Id. See note 29 supra.
66. 419 F.2d at 796.
67. Id. at 797. See notes 33-50 supra and accompanying text.
69. 419 F.2d at 797.
there was deception which misled [other] stockholders and that this was in fact the cause of plaintiff's claimed injury. 70

The final consideration relating to the question of standing was whether Crane, which was neither a purchaser nor seller in the fraudulent transactions, could attack Standard's conduct under rule 10b–5. 71 The court stressed that the purchase-sale requirement must be construed in light of the purpose of the Securities Exchange Act to prevent inequitable and unfair transactions 72 and that standing under the Act must be determined by considerations of what will best effectuate its legislative purpose. 73 In granting Crane standing to sue, the court concluded that this would effectuate the Congressional purpose "to protect the investing public from manipulation and deception by the use of devises which defrauded or misled investors in security transactions." 74

The significance of the decision in the instant case emerges from the fact that it is the first time a court has held that a corporation making a tender offer has standing under the antifraud provisions of the Securities Exchange Act to seek relief for manipulation and nondisclosure of that manipulation when the offeror has not been deceived in connection with its own purchases of stock. Previously, courts held that the offeror had no standing to seek relief because it was not a deceived purchaser or seller. This holding indicates a recognition by the Second Circuit that the extension of standing to an offeror which has a substantial interest in preventing the thwarting of its offer by unlawful opposition, would effectuate the general purpose of the Securities Exchange Act of preventing inequitable and unfair practices in the securities markets.

However, the court's extension of the purchaser-seller concept to include an undeceived tender offeror seems unclear in two respects. First, Judge Smith found that Crane had standing to bring the section 9(a)(2) claim because it was a forced seller. The rationale for this conclusion is that if the tender offer failed, Crane would be "forced" to sell because of the threat of a divestiture suit brought under the antitrust laws. 75 Yet, in the ordinary tender offer such antitrust problems are usually not present. It can be argued that the unsuccessful offeror will always be

71. 419 F.2d at 797. See notes 33–49 supra and accompanying text.
72. 419 F.2d at 798. See A.T. Brod. & Co. v. Perlow, 375 F.2d 393, 397 (2d Cir. 1967).
73. 419 F.2d at 798. See Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 946 (2d Cir. 1969).
74. 419 F.2d at 798.
75. After the effective date of the merger of Air Brake into Standard (Crane's largest competitor in the plumbing industry) Crane's 32 percent interest in Air Brake was converted into 740,311 shares of a new issue of Standard convertible preferred stock on June 13, 1968. Under the threat of a divestiture action to be brought by Standard under the antitrust laws, Crane sold all but 10,000 of its shares of Standard and later disposed of all but 1,000 of its remaining shares.
a forced seller in that such offers are made to acquire working control
over the target company and when this cannot be attained the offeror will
be "forced" to sell its stock.\footnote{76}

Secondly, it is not clear whether the Second Circuit has abandoned
its purchaser-seller requirement totally or whether it has done so only in
the context of tender offers. Subsequent to the instant case, Congress
enacted section 14(e) of the Securities Exchange Act of 1934 which
declares it "unlawful for any person" to make a misleading statement or
omission or to engage in fraudulent, deceptive or manipulative acts or
practices "in connection with any tender offer or request or invitation for
tenders, or any solicitation of security holders in opposition to or in favor
of any such offer, request, or invitation."\footnote{77} This language closely parallels
rule 10b-5 and it has been indicated that the two sections will be con-
strued as working together.\footnote{78} The primary difference between the two
sections is that section 14(e) omits the "in connection with the purchase
or sale of any security" phrase of rule 10b-5 and consequently seems to
undermine the buyer-seller requirement for standing to sue thereby pro-
tecting a larger class of plaintiffs.\footnote{79} While concededly it can be argued
that the offeror does not have standing under this section since its purpose
was to protect the security holders receiving the offer and that there is
nothing in the legislative history to suggest that Congress intended to
protect the offeror,\footnote{80} such a proposition does not seem logically valid. It
ignores the symmetry of obligations of the offeror and target companies
under sections 9 and 10 of the Exchange Act, the tremendous financial
interest of the offeror in protecting its offer from defeat by unlawful
tactics and the fact that the offeror's wealth and pecuniary interest make
it a logical party to insure that the shareholders are not damaged by the
fraudulent defense tactics of their corporation.\footnote{81} In light of these con-
siderations it would seem that the offeror should be accorded standing
under section 14(e) to seek relief against anyone unlawfully opposing its
offer.\footnote{82} The\textit{Crane} court clearly expressed its belief that an offeror does

76. See note 7 supra and accompanying text.

 provision of the Williams Bill, 82 Stat. 454 (1968), applies to exchange offers as
 well as cash tender offers. See Butler Aviation Int'l, Inc. v. Comprehensive Designers,
 Inc., \_\_ F.2d \_\_ (2d Cir. 1970).

78. See Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937
 (2d Cir. 1969). See also Krasik, Tender Offers: The Target Company's Duty

79. See Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937
 (2d Cir. 1969). See also Bromberg, The Securities Law of Tender Offers, 15 N.Y.L.F.
 462, 549 (1969); Krasik, supra note 78, at 458.

80. See Bradshaw, supra note 9, at 1121-22.

81. See Bromberg, supra note 79, at 554.

82. Two leading commentators have urged this to be the case. See Bromberg,
 supra note 79, at 554; Mundheim, supra note 8, at 956.
have standing under section 14(e)\(^{83}\) and may have, in a reflex action, accorded similar standing under 10b-5 in an analogous circumstance.

While the court may have only intended to relax the purchaser-seller requirement in the context of tender offers, it is submitted that it and other courts should abandon that limitation in all cases. The language of section 10(b) of the 1934 Act proscribes "any manipulative or deceptive devise 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."\(^{84}\) Likewise, rule 10b-5 condemns any fraud "in connection with the purchase or sale of any security."\(^{85}\) This broad language does not support a narrow limitation such as that enunciated in Birnbaum.\(^{86}\) The legislative history also does not support the view that only defrauded purchasers or sellers have private remedies under 10b-5.\(^{87}\) If Congress had intended such a restrictive limitation, it could have adopted more precise language to communicate such an intent.\(^{88}\)

In determining that an implied private cause of action was available under section 14(a)\(^{89}\) for violations of the Securities Exchange Act's proxy regulations, the Supreme Court found that while the language of the section "makes no specific reference to a private right of action, among its chief [Congressional] purposes is the 'the protection of investors,' which certainly implies the availability of judicial relief where necessary to achieve that result."\(^{90}\) The Supreme Court added that courts have a duty "to be alert to provide such remedies as are necessary to make effective the congressional purpose."\(^{91}\) Since section 10(b) was also passed for the protection of investors,\(^{92}\) it would seem to be within the congressional purpose to permit suit by any private party injured by its violation.\(^{93}\) Certainly, such an interpretation would be compatible with the SEC's rule-making power to act "in the public interest or for the protection of investors."\(^{94}\)

83. The court stated:
[T]he amendment to the Act adding section 14(e) . . . effective . . . subsequent to the events here in question, should serve to resolve any doubts about standing in the tender offer cases, even where an offeror is not . . . in the position of a forced seller.
419 F.2d at 798-99.
86. See Lowenfels, supra note 37, at 275; Krasik, supra note 78, at 457; Comment, The Purchaser-Seller Limitation to SEC Rule 10b-5, 53 CORNELL L. REV. 684, 698 (1968).
87. Comment, supra note 38, at 501.
91. Id. at 433.
93. See Comment, supra note 86, at 698; Comment, supra note 34, at 1178-79; Comment, supra note 88, at 622; Comment, supra note 37, at 501-02.
Additionally, since the purchaser-seller requirement has for the most part been eliminated in injunction cases, the refusal to allow a cause of action for damages seems illogical. Private investors who are the victims of fraudulent activities which affect their stockholdings may suffer clear and substantial losses despite their failure to sell. The loss of collateral, the foreclosure of business opportunities and possible margin calls resulting from the fraudulent depression of market prices seem to pervasively rebut arguments that the investor has suffered only paper losses. To require such an injured investor to sell before bringing suit would not only be a needless formality but would ignore the broad degree of federal rights which have developed under the federal securities laws and also would be inconsistent with the purpose of the Act. Practices which fraudulently depress the value of stockholdings are the type of activity which the Securities Exchange Act was designed to prohibit and such practices affect a class meant to be protected under the Act. Furthermore, the argument that the investor's monetary damages are difficult to prove should not preclude the potential plaintiff from attempting to prove them.

Despite the difficulty of determining whether the injured party has standing to seek relief in situations other than the tender offer, it is clear that the offeror, the target corporation and non-tendering shareholders have standing either under rule 10b-5 or section 14(e) to seek relief from fraud or deception committed in connection with a tender offer. While the subject of remedies is as yet unresolved in such situations, it would seem that applicable relief can include an injunction, monetary damages or rescission. In remanding to the district court for the determination of appropriate remedies, the Second Circuit, in the instant decision, advised that the "remedies may include damages, if any, prospective injunctive relief, as well as appropriate retrospective relief, [and possibly divestiture or separation] notwithstanding the consummation of the merger." A final ramification of the Crane decision relates to the potential liability of financial institutions such as mutual funds and brokerage firms that participate in contested takeover attempts. Such institutions are playing increasingly larger roles in such contests by buying substantial quantities of target companies' shares — a process known as warehouser.

95. E.g., Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967).
96. See Lowenfels, supra note 36, at 275-76; Comment, supra note 86, at 698-99; Comment, supra note 34, at 1185; Comment, supra note 37, at 511.
97. Lowenfels, supra note 36, at 276; Comment, supra note 86, at 698.
98. See Comment, supra note 86, at 698.
100. Lowenfels, supra note 36, at 275-76.
101. See note 92 supra and accompanying text.
103. Id.
104. See Comment, supra note 86, at 699; Comment, supra note 37, at 513.
105. See Bromberg, supra note 20, at 815. See also Hamilton, supra note 5, at 292.
106. 419 F.2d at 803-04.

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ing — either to obtain shares for the offeror or to assist the target company by reducing available stock and driving up its market price. In the context of this case, it would seem that a mutual fund which purchases shares of the target corporation in order to drive up the market price of its stock will be subject to a charge of market manipulation under section 9(a)(2) of the Securities Exchange Act. Additionally, such a fund would be potentially liable under section 10(b) and rule 10b-5 for failure to disclose such purchases. In light of these possibilities, it is unfortunate that the Crane court did not disclose the scope of the potential liability of Blyth & Co.

Since the Crane court is the first to hold that a corporation making a tender offer has standing under the Securities and Exchange Act of 1934 to seek damages and injunctive relief against anyone unlawfully opposing its offer and has recognized that the offering corporation has a large financial stake in the success of its offer, it would seem that the offeror should be further protected by the antifraud provisions of the Act and be able to seek remedies against illegal opposition. Furthermore, by finding that the legislative purpose of the Act is to prevent inequitable and unfair practices in the securities markets and that this purpose would be best effectuated by granting the offeror standing, the court may have signaled the long awaited demise of the purchaser-seller requirement which has precluded investors not deceived in the purchase or sale of their stock from obtaining relief for injury caused by fraudulent conduct. If these projections can be considered to be reasonable extensions of Crane, then it is truly a landmark decision.

Robert S. Kant

UNFAIR COMPETITION — PRICE DISCRIMINATION — SECTION 2(a) OF THE ROBINSON-PATMAN ACT NECESSITATES THAT A SUPPLIER BE HELD RESPONSIBLE WHEN ITS DISCRIMINATORY PRICES INJURE THE COMPETITOR OF A FOURTH LEVEL CUSTOMER.


Petitioner, Clyde A. Perkins, a large independent retailer of gasoline and oil, purchased goods directly from respondent — Standard Oil Co. of California. Perkins alleged that for a two year period Standard discrimi-


108. See Thomas, supra note 107, at 977.
nated against him by selling gasoline and oil to a wholesaler named Signal at a price substantially lower than the one given to him. Signal passed on this price difference through the sales to its distributor, Western Hyway,\(^1\) who further transferred them through their sales to a retailer named Regal.\(^2\) Regal, who was in direct competition with Perkins, was the final beneficiary of Standard's discriminatory pricing practices and consequently was able to undersell Perkins causing him to lose his market and ultimately sell his business at a loss.

Perkins brought a civil antitrust action in the United States District Court for the District of Oregon alleging injury resulting from price discrimination\(^3\) and seeking treble damages\(^4\) under section 2(a) of the Clayton Act as amended by the Robinson-Patman Act.\(^5\) The jury returned a verdict in his favor. On appeal, the Court of Appeals for the Ninth Circuit reversed and ordered a new trial. The court of appeals based its reversal on a finding that Regal was too remote in the chain of distribution to be considered a customer of Standard within the terms of the Act, thereby making Standard's acts not directly attributable to Perkins' injury.\(^6\) The United States Supreme Court granted certiorari\(^7\) and reversed the Ninth Circuit holding that, to effectuate the legislative intent of section 2(a) of the Robinson-Patman Act, a supplier must be held responsible when its discriminatory prices are passed down the chain of distribution directly causing injury to a competitor of the retailer receiving the lower prices. *Perkins v. Standard Oil Co.*, 395 U.S. 642 (1969).

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1. Western Hyway Oil Co. is a subsidiary of Signal. During the period of time when the alleged violation occurred Signal owned 60% of the stock in Western Hyway. *Standard Oil Co. v. Perkins*, 396 F.2d 809, 813-14 n.6 (9th Cir. 1968).

2. Western Hyway Oil Co. is the majority shareholder in Regal. During the two year period in question, Western Hyway owned 55% of the shares in Regal. *Id.* at 813 n.6.


Standard also sold directly to Branded Dealers at a lower price than it charged Perkins. These sales also constituted price discrimination. *Standard Oil Co. v. Perkins*, 396 F.2d 809 (9th Cir. 1968).

4. A civil treble damage action is provided for by section 4 of the Clayton Act, 15 U.S.C. § 15 (1964). It states in relevant part that: Any person who shall be injured in his business or property by reason of any thing forbidden in the antitrust laws . . . shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

5. Section 2(a) of the Robinson-Patman Act provides in pertinent part: It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchasers involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.


6. 396 F.2d 809, 812 (9th Cir. 1968).
The primary statutory prohibition against price discrimination is section 2 of the Clayton Act as amended by the Robinson-Patman Act.\(^8\) The Robinson-Patman Act was primarily designed to prevent large buyers from using their greater purchasing power to gain discriminatory price preferences over their smaller competitors.\(^9\) Traditionally, to be protected

\(^8\) 15 U.S.C. § 13 (1964). Protection under section 2(a) of the Act has been limited to two levels, primary and secondary, with unsuccessful attempts to extend protection to a third level.

Primary line injury is discriminatory pricing practices between competing supplier-manufacturers. Although the main thrust of the Act was to curtail price discrimination upon the buyer of the secondary level, the Act has been extended to protect a supplier in primary competition with a discriminating supplier. A violation occurs when a geographically diversified supplier institutes a predatory price reduction in one area in an attempt to destroy competition. If the predatory price reduction is allowed to continue the competing supplier will be driven out of business. Hence, discrimination of this nature has been considered to be a violation of the Act. The injured supplier must show that he is in direct competition with the discriminating supplier and that the discriminating supplier instituted a predatory price reduction in an attempt to destroy competition. See FTC v. Anheuser-Busch, Inc., 363 U.S. 536 (1960); Moore v. Mead's Fine Bread Co., 348 U.S. 115 (1954). See generally Murray, Injury To Competition under the Robinson-Patman Act: Futility Revisited, 29 U. Pitt. L. Rev. 623 (1968); Sherwood, Robinson-Patman Act Primary Line Injury: Meanderings from Puerto Rico to Utah — and Beyond, 16 U.C.L.A. L. Rev. 304 (1969).

The majority of cases brought under the Act are concerned with competitive injury at the secondary or buyer level. These cases involve price discrimination between two direct purchasers, i.e., wholesalers of the same seller, where one purchaser is favored over the other. “[T]he essence of a secondary-line case is the injury to competing buyers from the same seller.” Bolick-Gillman Co. v. Continental Baking Co., 206 F. Supp. 151, 154 (D. Nev. 1961). Therefore, there must be two sales, one to each competing purchaser, at a different price. The injured purchaser must show the injury resulted from the price difference. E.g., FTC v. Morton Salt Co., 334 U.S. 37 (1948); E. Edelmann & Co. v. FTC, 239 F.2d 152 (7th Cir. 1956), cert. denied, 355 U.S. 941 (1958); Corn Prod. Ref. Co. v. FTC, 144 F.2d 211 (7th Cir. 1944), and 324 U.S. 726 (1945). See generally ANTITRUST DEVELOPMENT, 1955–1968, 124 (1968).

Third line injury arises out of a system of dual distribution, or when a supplier sells to both retailers and wholesalers. The injury occurs when the supplier favors the wholesaler over the direct-buying retailer. When the wholesaler passes the price advantage down the chain of distribution to the retail customers, these customers have a competitive advantage over their direct-buying retail competitors and injury results. To come within the scope of the Act the injury to the direct-buying retailer must be an actual reflection of the supplier’s discriminatory pricing practices. One further requirement is that the supplier must have knowledge of the injury to the direct-buying retailer.

Third level injury must be distinguished from the situation where the supplier favors the direct-buying retailer over the wholesaler and the customers of the wholesaler are the injured parties. The latter is a second line injury because the competitors of the direct-buying retailer are the injured parties, rather than a third line injury in which competitors of the retailer who purchased the goods at a price advantage from a wholesaler are injured. See F. Rowe, Price Discrimination Under The Robinson-Patman Act 195 (1962); F. Rowe, Price Discrimination Under The Robinson-Patman Act 43 (Supp. 1964).

9. The Robinson-Patman Act was enacted in response to the change in the nation’s economy. With the rise of the large chain stores it became obvious that through the use of their buying power they could effectively destroy the small independent wholesaler-retailer. In an attempt to preserve the traditional market structure — manufacturer-wholesaler-retailer — the Act declared it unlawful for a supplier to grant a price preference to one customer without granting the same price advantage to the competitors of that customer. In this manner the smaller independent was given an equal opportunity to compete with the large mass distributors or retailers. See FTC v. Henry Broch & Co., 363 U.S. 166 (1960); See also C. Edwards, The Price Discrimination Law 21–28 (1959); W. Patman, Complete Guide To The Robinson-Patman Act 1–10 (1963); Rowe, The Evolution of the Robinson-Patman Act: A Twenty-Year Perspective of Column, L. Rev. 1059 (1957).
by the discriminatory pricing section of the Act a direct-buying retailer must have been injured while in competition with another direct-buying retailer of the same supplier-manufacturer. 10 The effect of this condition was to limit the protection of the Act to second level injury. 11 Although section 2(a) of the Act expressly states that a direct-buying retailer in competition with a "customer," or one purchasing goods from a direct-buying "purchaser," i.e., wholesaler, is to be protected, the courts were reluctant to extend the Act to the competitors of a "customer." The courts limited the supplier's obligations under the Act to granting equal prices to its direct-buying purchasers in competition on the same distributional level. 12 This reluctance resulted in a denial of protection to the direct-buying retailer who was competitively injured by price preferences passed down to a retailer ("customer") by a favored wholesaler. Because the direct-buying retailer was injured while in competition with a "customer," or one who purchased goods through an intermediary, he was not protected. Hence, the third level injury was not recognized. Furthermore, the direct-buying retailer was also precluded from bringing an action against the supplier for the discriminatory prices granted to the wholesaler since the required element of competition for the same class of customers did not exist between the wholesaler and the direct-buying retailer. 13

10. To be protected by the Act one must be in competition on the same functional level with the customer who is granted the price advantage and show an injury to competition on its functional level as a result of the price advantage. Only if the customers are competing in the distribution of goods will the injured party be protected. See Tri-Valley Packing Ass'n v. FTC, 329 F.2d 694, 702 (9th Cir. 1964); Atlas Bldg. Prod. Co. v. Diamond Block & Gravel Co., 269 F.2d 950, 954-55 (10th Cir. 1959), cert. denied, 363 U.S. 843 (1960); Chicago Sugar Co. v. American Sugar Ref. Co., 176 F.2d 1, 7 (7th Cir. 1949), cert. denied, 338 U.S. 948 (1950); Ingram v. Phillips Petroleum Co., 259 F. Supp. 176, 182 (D.N.M. 1966); Secatore's, Inc. v. Esso Standard Oil Co., 171 F. Supp. 665, 667 (D. Mass. 1959); Champion Spark Plug Co., 50 F.T.C. 30, 40-41 (1953). See also W. Patman, supra note 9, at 60.

11. See note 8 supra.

12. Only the customers on the same distributional level would be in competition for the same class of customers. See cases and books cited note 9 supra. However, the courts have focused on the actuality of competition regardless of the functional labels. That is, if a wholesaler actually competes for the same class of customers as the retailer does he would be deemed to be in competition with the retailer. Therefore, if a wholesaler actually deals in a retail sales operation, he will be in competition with a retailer and if the supplier grants a price advantage to the wholesaler he will be liable for price discrimination. See FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 550 (1960); FTC v. Morton Salt Co., 334 U.S. 37, 49 (1948); See also C. Edwards, supra note 9, at 518-45 (1959); REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 160 (1955).

The necessary causal nexus\textsuperscript{14} between the price advantage to the wholesaler and the resulting injury to the direct-buying retailer when the discriminatory price was ultimately passed down to a "customer" of the wholesaler, was not recognized\textsuperscript{15} unless the direct-buying retailer could invoke the indirect-purchaser doctrine.\textsuperscript{16} This doctrine extended the coverage of the Act to a direct-buying retailer injured while competing with a retailer who bought its goods through an intermediary, if a course of direct dealing between the supplier and the retailer could be established.\textsuperscript{17} The primary criterion for establishing sufficient contacts between the supplier and the indirect purchasing retailer is that the supplier actually negotiate the terms of the sale directly with the retailer thus, by-passing the intermediary — wholesaler. However, since most retailers purchasing through wholesalers lacked the requisite supplier contacts to be considered indirect purchasers, their competitors were left unprotected.\textsuperscript{18}

While there had previously been attempts to extend the coverage of section 2(a) to grant protection to a competitor of one who received a

\textsuperscript{14} American Oil Co. v. FTC, 325 F.2d 101, 104 (7th Cir. 1963), cert. denied, 377 U.S. 954 (1964). The court stated that there must "be a causal relation between the price discrimination . . . and the factor relied upon as evidencing . . . substantial lessening of ability to compete on the part of the unfavored customers." See also Minneapolis-Honeywell Regulator Co. v. FTC, 191 F.2d 786, 792 (7th Cir. 1951), cert. denied, 344 U.S. 206 (1952).

\textsuperscript{15} Courts have refused to recognize the causal nexus because of intervening factors on the wholesale level, such as independent pricing tactics, cost of other goods, advertising and services. The price advantage must actually be passed down the chain of distribution and elements such as these interrupt the actual passing down, hence the causal link is broken. See Balian Ice Cream Co. v. Arden Farms Co., 231 F.2d 356, 367 (9th Cir. 1955), cert. denied, 350 U.S. 991 (1956); Minneapolis-Honeywell Regulator Co. v. FTC, 191 F.2d 786, 792 (7th Cir. 1951), cert. denied, 344 U.S. 206 (1952); Corn Prod. Ref. Co. v. FTC, 144 F.2d 211, 214-15 (7th Cir. 1944), aff'd, 324 U.S. 726 (1945); Alexander v. Texas Co., 165 F. Supp. 53, 58 (W.D. La. 1958).

\textsuperscript{16} The indirect purchaser doctrine provides that a retailer who purchases goods from a wholesaler may be regarded as a customer of the supplier for purposes of section 2(a), if the manufacturer has direct dealings with the retailer or controls the terms of the sale. E.g., Hiram Walker, Inc. v. A & S Tropical, Inc., 407 F.2d 4 (5th Cir. 1969); Purolator Prod., Inc. v. FTC, 352 F.2d 874 (7th Cir. 1965); Tri-Valley Packing Ass'n v. FTC, 329 F.2d 694, 709 (9th Cir. 1964); American News Co. v. FTC, 300 F.2d 104 (2d Cir. 1962), cert. denied, 371 U.S. 824 (1963); Checker Motors Corp. v. Chrysler Corp., 283 F. Supp. 876 (S.D.N.Y. 1968). See generally Note, Robinson-Patman Act — Price Discrimination — Indirect-Purchaser, 12 N.Y.L.F. 91 (1966).

\textsuperscript{17} In American News Co. v. FTC, 300 F.2d 104, 109 (2d Cir.), cert. denied, 371 U.S. 824 (1962), the court stated: If the manufacturer deals with a retailer through the intermediary of wheelers, dealers, or jobbers, the retailer may nevertheless be a "customer" or "purchaser" of the manufacturer, if the latter deals directly with the retailers and controls the terms upon which he buys. See E. Edelmann & Co. v. FTC, 239 F.2d 152 (7th Cir. 1956), cert. denied, 355 U.S. 941 (1958); General Motors Corp., 50 F.T.C. 54 (1953); Champion Spark Plug Co., 50 F.T.C. 30 (1950). Contra, Klein v. Lionel Corp., 237 F.2d 13 (3d Cir. 1956) (disallowed the use of the doctrine in civil actions); Baim & Blank, Inc. v. Philco Corp., 148 F. Supp. 541 (E.D.N.Y. 1957). In Baim & Blank, the court regarded privity between the buyer and seller as a prequisite to bring a suit under the Act, stating that one must be an actual purchaser to be protected.

\textsuperscript{18} E.g., National Lead Co. v. FTC, 227 F.2d 825, 829 (7th Cir. 1955), rev'd on other grounds, 352 U.S. 419 (1957). The court required such a high degree of control that the wholesaler had to be a mere tool of the supplier. See also F. Rowe, (Supp. 1964), supra note 8, at 90.
discriminatory price passed down from a wholesaler, they were unsuccessful. The courts had viewed any extension of section 2(a) protection to "third level" injury as being incompatible with other antitrust laws. The rationale for this position was that to require a supplier to guard against a wholesaler passing on the price difference he received would foster price uniformity and rigidity, and require the supplier to exercise restraints on the wholesaler's right to complete dominion over the goods he had purchased, which is contrary to the tenets of the Sherman Act. The fact that a supplier could not control the resale price of his wholesaler without violating the Sherman Act served as a rebuttal to any charges of "third level" price discrimination.

19. Standard Oil Co. v. FTC, 41 F.T.C. 263 (1945), approved, Standard Oil Co. v. FTC, 173 F.2d 210 (7th Cir. 1949), rev'd on other grounds, 340 U.S. 231 (1951), the Commission redrafted its order and the case was again decided, 49 F.T.C. 923 (1953), set aside, 233 F.2d 649 (7th Cir. 1956), aff'd, 355 U.S. 396 (1958). Standard sold gasoline to four jobbers at prices lower than it sold to its own direct buyers of retail gas. The FTC alleged that because of the lower prices granted to the jobbers who passed it on to their customers the direct buying retail dealer's customers were competitively injured. The FTC's cease and desist order allowed Standard to continue the lower price only if the jobbers did not undersell Standard. When the case reached the Supreme Court in 1951, the issue of the validity of the order was not reached because the Court ruled against the Commission on the merits. When the case reached the Court for the second time in 1958, the FTC had withdrawn the element pertaining to third level injury. With the concession by the FTC in this case, effective protection for a customer on the third level seemed non-existent.

20. See Automatic Canteen Co. v. FTC, 346 U.S. 61, 74 (1953). The Supreme Court expressed concern over the interaction of the Robinson-Patman and the Sherman Acts. The Court determined that the broad goal of the Sherman Act to maintain a competitive price structure was controlling. Courts have also viewed the Robinson-Patman Act as vague and general in its wording and therefore have refused to attempt to harmonize it with the Sherman Act. See FTC v. Motion Picture Advertising Service Co., 344 U.S. 392, 405-06 (1953) (dissenting opinion of Mr. Justice Frankfurter) (the Robinson-Patman Act and the Sherman Act are not altogether harmonious); Ruberoid v. FTC, 189 F.2d 893, 894-95 (2d Cir. 1951), aff'd, 343 U.S. 470, 463, 492 (1952) (dissenting opinion of Mr. Justice Jackson) (the Act is vague and cannot be translated with assurance into any detailed guide).


22. Standard Oil Co. v. FTC, 340 U.S. 231, 248-49 (1951). The Court recognized the basic incompatibility of the Sherman Act and the Robinson-Patman Act stating: The heart of our national economic policy long has been faith in the value of competition. . . . We need not now reconcile, in its entirety the economic theory which underlies the Robinson-Patman Act with that of the Sherman and Clayton Acts. It is enough to say that Congress did not seek by the Robinson-Patman Act either to abolish competition or so radically to curtail it that a seller would have no substantial right of self-defense against a price raid by a competitor. See Adelman, Effective Competition and the Antitrust Laws, 61 HARV. L. REV. 1289, 1327-50 (1948).

23. See ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY ANTITRUST LAWS 132 (1955). The Committee endorsed the Supreme Court's view that the Sherman Act was controlling. It stated that: We agree that the "heart of our national economic policy has long been faith in the value of competition." For more than six decades the Sherman Act has guided our industrial organization and economic thought. . . . Hence we accept the views expressed by the Supreme Court, accommodating all legal restrictions on the distribution process to dominant Sherman Act policies.
In *FTC v. Fred Meyer, Inc.*\textsuperscript{24} the Supreme Court, while considering discriminatory practices in the granting of promotional allowances under section 2(d) of the Act,\textsuperscript{25} for the first time extended the classification of supplier's customers to include a retailer who purchases through a wholesaler. In this case, the Court found that the prior definition of "customer," which was limited only to those who purchase directly from the supplier, was untenable in light of the legislative intent to protect small buyers.\textsuperscript{26} Furthermore, the *Fred Meyer* decision marked the first time that a court had recognized that the Robinson-Patman Act's protection against a supplier's discriminatory pricing practices should be extended to different distributional levels.\textsuperscript{27}

In the instant case the Supreme Court was confronted, for the first time, with a "fourth level" injury. A "fourth level" injury exists when a discriminatory price is granted by a supplier (first level) to a wholesaler (second level) who in turn passes it on to a distributor (third level) who then passes it to a retailer (fourth level). The primary question before the Court in the instant case was whether Perkins as a competitor of a preferred fourth level customer has a cause of action against Standard Oil, as the supplier that granted discriminatory prices, which were passed down the chain of distribution to ultimately cause competitive injury.\textsuperscript{28} In holding that a cause of action exists, the Court rejected the traditional definition of the term customer and affirmed its holding in *Fred Meyer.*\textsuperscript{29}

\textsuperscript{24} 390 U.S. 341 (1968). Fred Meyer, Inc., operated a large supermarket chain that purchased goods directly from a supplier-manufacturer. The manufacturer granted Fred Meyer special promotional allowances that were not made available either to wholesalers or small retailers who purchased through the wholesalers. The Supreme Court held that the allowances had to be made available to retailers who purchased through the wholesalers.

\textsuperscript{25} Promotional allowances under section 2(d) of the Act are payments, discounts, rebates, allowances or advertising services granted to a purchaser. It is unlawful to grant any promotional allowance to a customer unless a proportionately equal allowance is made available to all competitors of that customer. 15 U.S.C. § 13(d) (1964).

\textsuperscript{26} See note 30 infra.

\textsuperscript{27} *Krug v. International Tel. & Tel. Corp.*, 142 F. Supp. 230 (D.N.J. 1956). The *Krug* court adopted a broader construction of the word competition and allowed wholesalers to bring an action for price favoritism towards a direct buying retailer. The court felt that the small retailer who purchases through wholesalers would be afforded greater protection because the benefit the wholesaler receives will be passed on to the retailer. This seems to be the only time the courts have allowed recovery for anything but horizontal competition. Normally, retailers compete with other retailers, and wholesalers with other wholesalers, consequently the redefinition of competition did not provide added protection of the small retailer.

\textsuperscript{28} While there is an additional intermediary in the distributional chain, the criteria involved in the instant decision is the same for both the third and fourth levels of competitive injury. Fourth level injury is merely third level injury once removed.

\textsuperscript{29} 395 U.S. at 647. In deciding who is to be considered a customer the Court made specific reference to FTC v. Fred Meyer, 390 U.S. 341, 349, 352, where the issue of who is a customer under section 2(d) was decided. In *Fred Meyer,* the Supreme Court held that a customer that purchases through a wholesaler while in competition with a direct buying retailer must be granted proportionately equivalent promotional allowances. In referring to the definition that a customer must be a direct buyer, the Court stated:

[A] narrow definition of customer ... becomes wholly untenable when viewed in light of the central purpose of section 2(d) and the economic realities with which the framers were concerned. Concerning that the Robinson-Patman amendments by no means represent an exemplar of legislative clarity, we cannot, in the
Its finding that the protection of a direct-buying retailer in competition with retailers who purchase goods through intermediates is essential to the effectuation of the broad goals of the Act \(^{80}\) emphasized that the failure to protect the injured party merely because it is in competition with a fourth level customer is an artificial and unwarranted limitation. \(^{81}\) To hold otherwise would mean that a price advantage granted by a supplier to a wholesaler could be passed down the chain of distribution to a third or fourth level customer, thereby permitting these customers to undersell the direct-buying retailers without violating the Act. This would deprive the direct-buying retailer of the Act's protection which he would receive if a similar injury were caused by a competing direct-buying retailer receiving discriminatory prices. \(^{82}\) Additionally, the holding in \textit{Perkins} that a fourth level buyer is a customer of the supplier removes the need for the application of the indirect-purchaser doctrine to third or fourth level customers. \(^{83}\) A direct-buying retailer competing with preferred re-

absence of an unmistakable directive, construe the Act in a manner counter to the broad goals which Congress intended it to effectuate.

The Court further stated that:

\ldots [s]maller retailers whose only access to suppliers is through independent wholesalers would not be entitled to this protection. Such a result would be diametrically opposed to Congress' clearly stated intent to improve the competitive position of the small retailers.\ldots

The Court in the instant case reasoned that section 2(a) is closely analogous to 2(d) and found it untenable to construe "customer" more narrowly in section 2(a) than in section 2(d). \textit{See generally Comment, Supplier Compliance With Section 2(d) of the Robinson-Patman Act — An Examination of the Fred Meyer Guides}, 15 Vill. L. Rev. 443 (1970); 37 Cinc. L. Rev. 635 (1968); 82 Harv. L. Rev. 265 (1968); 47 Texas L. Rev. 167 (1968).


The purpose of this proposed legislation is to restore, so far as possible, equality of opportunity in business by strengthening antitrust laws and by protecting trade and commerce against unfair trade practices and unlawful price discrimination, and also against restraint and monopoly for the better protection of consumers, workers, and independent producers, manufacturers, merchants, and other businessmen.

31. \textit{Id.} at 647.

32. \textit{Id.} at 648.

33. It is clear with the redefinition of the term customer that the need to invoke the protection of the indirect-purchaser doctrine has been eliminated under the instant facts. However, the indirect-purchaser doctrine could still provide protection for parties injured by harmful pricing practices of a supplier. For example, if a supplier sells goods to all purchasers at the same price it will normally be insulated from any action against itself because there is no "difference" in price and therefore, no price discrimination. \textit{See note 51 infra.} Although the direct-buying purchasers will receive equal prices, the customers of the wholesalers will be forced to pay a higher price than their direct-buying retailer competitors. If a customer could invoke the indirect-purchaser doctrine the supplier could be held liable for price discrimination. By invoking the indirect-purchaser doctrine a retailer purchasing goods from a wholesaler normally defined as a "customer" would be considered to be a "purchaser" of the supplier, because of supplier contacts. Therefore, the injured retailer could show that there was a price difference between two purchasers of the supplier thus making the supplier guilty of price discrimination.

The case of Klein v. Lionel Corp., 138 F. Supp. 560 (D. Del.), \textit{aff'd}, 237 F.2d 13 (3d Cir. 1956), presents a fact situation substantially similar to that proposed in the aforementioned example. Plaintiff, a retailer, purchased goods from a wholesaler. The competitors of the plaintiff bought goods directly from the supplier at a price equal to that paid by the wholesalers. Because plaintiff purchased goods from a wholesaler, he paid a higher price than that paid by its direct-buying com-
tailers on the third or fourth levels of distribution now has a cause of action against the supplier who grants discriminatory prices to its wholesalers which are subsequently passed down the distributional chain. 34

After an examination of the language and purpose of the Act and determining that a cause of action existed, the Court found that a supplier must be held responsible for the injury that is proximately caused by an unjustified price advantage, notwithstanding the level of distribution of the party receiving the benefit of the discriminatory pricing. 35 By so holding the Court effectively eliminated all unjustified cost-differences that were formerly granted to wholesalers. However, the decision in Perkins does not appear to effect those cost-justified price differences in the form of functional discounts. 36 A functional discount is a price reduction granted to a customer for marketing services that it undertakes, such as receiving

petitors. Plaintiff brought suit alleging a violation of the Robinson-Patman Act because he paid a higher price than his competitors. The court rejected plaintiffs claim basing its holding on the fact that there was not a difference in price between two purchasers of the supplier. The court stated:

The plaintiff, in order to show he comes within the designation of "purchaser," seizes upon the words "or with a customer of either of them" as found in the statute. I think the use of this language for the given purpose is inappropriate. The Act prohibits discrimination in price between two purchasers from the seller. This discrimination, however, by the Act is made actionable where the effect of it is to lessen competition with any person who grants or knowingly receives the benefit of such discrimination or "with the customer of either of them." Id. at 563.

The court thereby made it completely clear that there must be a price difference between two "purchasers," hence it rejected plaintiff's cause of action because he was a "customer" and there was no price discrimination between two purchasers. If the plaintiff in the Klein case could have employed the indirect-purchaser doctrine he could have been protected under the Act. Hence, the doctrine still maintains some validity. See generally Comment, supra note 14, at 646.

34. In the instant case Standard did not have any contacts with Regal; once the goods were transferred to Signal, Standard did not take part in the pricing of the goods. However, in a separate opinion, Mr. Justice Marshall expressed the view that the Court should limit the holding to the facts of the case, focusing on the fact that Signal was the parent corporation, owning shares in Hyway, which in turn owned shares in Regal. Therefore, the scope of the case should be limited to situations where the favored customer is a subsidiary of the wholesaler. Under these facts, Standard in effect would have had contacts with Regal, because Signal and Regal would be considered one and the same. In this way, the problems raised by extending the term "customer" to include one who purchases through two intermediaries would not arise. However, the majority opinion does not emphasize the fact that there was a community of interest between the parties in the chain of distribution and treats them as if they were completely independent. Therefore, it does not appear that the case will be limited to situations where there is a community of interest between the parties on the distributional ladder. 395 U.S. 642.

35. Id. at 649 (1969).

36. Id. at 648. By focusing on the two ends of the distributional ladder — the initial discrimination and the ultimate injury — the Court disregarded the possibility of independent pricing tactics by the intermediates. Therefore, it would seem that the internal decisions of the intermediates could possibly no longer act as a rebuttal to a charge of price discrimination. This conclusion presupposes a difference in price to different direct-buying purchasers and that the price discrimination is the proximate cause of the competitive injury.

37. See note 15 supra. 15 U.S.C. § 13 (1964). The Act does not expressly provide for functional discounts, however, they are valid if they fall within one of the defenses provided in the Act, such as, savings in cost or no competitive effect. See generally Comment, "The Tyranny of Labels: A Study of Functional Discounts Under the Robinson-Patman Act," 60 Harv. L. Rev. 371, 380 (1947).
large quantities of goods,\(^{38}\) or storing and breaking down goods for distribution,\(^{39}\) thereby saving the supplier the cost of carrying on the additional operations.\(^{40}\) Any price difference resulting from a supplier's granting of a functional discount to a wholesaler would not violate the Act because the price difference is merely a reflection of actual savings to the supplier.\(^{41}\) If injury does result from the functional discount being passed down the distributional chain, the supplier will not be held liable because the price difference is justified and there is no discriminatory action to form a causal link between the supplier and the injured direct-buying retailer.\(^{42}\)

In the instant case, the facts show that Standard knew the price advantages were being passed down the chain of distribution and that they were being used to injure competition.\(^{43}\) However, it is questionable whether the Court will require actual knowledge in subsequent litigation. By choosing to distribute its goods through a dual distributorship the supplier is aware that its unjustified price advantages to wholesalers can be passed down the chain of distribution to cause injury. The Court's extension of the term "customer" to include a fourth level buyer creates

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38. By receiving large quantities of goods, the supplier is not forced to make many deliveries to the buyer's place of business, therefore, there is a savings in transportation costs. Hamburg Bros., Inc., 54 F.T.C. 1450 (1958); Sylvania Elec. Prod., Inc., 51 F.T.C. 282 (1954); Kraft-Phenix Cheese Corp., 25 F.T.C. 537 (1937).


40. Other valid functional discounts might include elimination of functions, salesman, brokers, advertising, sales solicitation and assumption of credit risks. See W. Patman, supra note 9, at 76.


42. See Report of the Attorney General's National Committee To Study the Antitrust Laws at 208 (1955). The Committee recommended the following: [T]hat suppliers granting functional discounts either to single-function or to integrated buyers should not be held responsible for any consequence of their customers' pricing tactics. Price cutting at the resale level is not in fact, and should not be held in law, "the effect of" a differential that merely accords due recognition and reimbursement for actual marketing functions. The price cutting of a customer who receives this type of differential results from his own independent decision to lower price. . . . In any event, consequent injury or lack of injury should not be the supplier's legal concern.

However, some authorities take the position that once the supplier becomes aware that the functional discount is being used to injure competition it should be liable for subsequent injury to competition. See C. Austin, supra note 39, at 56.

43. The price advantage has to be passed down the chain of distribution, otherwise there would not be a price difference to competitors. The Court stated: "There was evidence that Signal received a lower price from Standard than did Perkins, that the price advantage was passed on, at least in part, to Regal, and that Regal was thereby able to undercut Perkins' price on gasoline." 395 U.S. at 649. By passing the price advantage down the chain of distribution, the causal nexus between the original price favoritism and the ultimate injury is established. The Court therefore rejected the view expressed by the court of appeals that Regal's receipt of the discriminatory price was too far removed on the chain of distribution to be directly attributed to Standard. It stated that as long as the injured retailer could establish that the price discrimination was the proximate cause of the injury, the supplier will be liable.
a legal duty upon a supplier not to exercise discriminatory pricing practices because the resulting injury will fall upon one of its customers.\textsuperscript{44} This coupled with the nature of an unjustified — non-functional — price advantage places the supplier in a position that is reasonably calculated to impute to him the knowledge that injury will result.\textsuperscript{45} Therefore, it seems reasonable to conclude that the intent of the Court in \textit{Perkins} was to eliminate \textit{all} unjustified cost differences. Thus, with the extension of the term "customer" to include fourth level buyer, once the supplier grants an unjustified price advantage resulting in injury, the element of knowledge will be imputed.

The decision in \textit{Perkins} seems to have significantly expanded a supplier's obligations under section 2(a). Once a supplier arbitrarily grants a lower price to a wholesaler than it gives to a direct-buying retailer, there exists the threat that the price advantage will be passed on to the customers of that wholesaler. This will make the supplier vulnerable to a charge of price discrimination.\textsuperscript{46} Therefore, it seems reasonable to conclude that the supplier must either stop all indiscriminate price advantages to its wholesalers or find some effective way of assuring that the price advantages received by them will not be passed on. Should a supplier decide to continue to offer its wholesalers a lower price, it might well be able to escape violating the Act by controlling the wholesaler's resale price, thus insuring the savings will not be passed on to cause third or fourth level competitive injury. However, in such a situation the supplier might find itself in direct conflict with the provisions of the Sherman Act.


\textsuperscript{45} In Standard Oil Co. v. FTC, 173 F.2d 210, 217 (1949), rev'd on other grounds, 340 U.S. 231 (1951), the court stated that the supplier had to actually be aware or be in a position reasonably calculated to impute the knowledge that an injury will result in order to be held responsible. It would seem that the interaction of the above factors would put the supplier on notice that the possibility of competitive injury exists.

\textsuperscript{46} Price differences are not per se illegal. It is not until competitive injury results that the violation occurs. See note 10 \textit{supra}. For example, it would appear that a supplier can lawfully sell goods at lower prices to its wholesalers than to its direct-buying retailers because these purchasers are not in competition with each other and that competitive injury will not result. However, by redefining the term customer, the Court has added a new dimension. When the price difference is passed down the chain of distribution to a competitor of the injured retailer, the supplier will now be liable because injury will result to competing customers of the supplier.

Furthermore, it should be made clear at this point that if Perkins had purchased the goods at a lower price than Signal and Regal was competitively injured as a result of the price difference, Regal would have a cause of action against Standard for price discrimination. Section 4 of the Clayton Act, \textit{(see note 3 \textit{supra})}, states that "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court." If Regal could prove there was a price difference he would have a cause of action against Standard. The action would normally be brought as injury by secondary line discrimination. \textit{See note 8 \textit{supra}.}
since it is well established that any agreement between a supplier and a wholesaler to set a wholesaler's resale price constitutes resale price maintenance in violation of that Act. Moreover, if a supplier threatens to refuse to do business with a wholesaler in an effort to force him to absorb the price difference, his actions may be interpreted as an attempt to set a minimum resale price in violation of the price-fixing provisions of the Sherman Act.

In order to escape liability and maintain a system of dual distribution a supplier might institute a policy of selling to all purchasers — direct-buying retailers and wholesalers — at the same price, thereby eliminating any possibility of being charged with price discrimination. However,

47. See, e.g., Interstate Circuit, Inc. v. United States, 306 U.S. 208, 227 (1939), wherein the Supreme Court reiterated the position that tacit agreements to control price are a violation of the Sherman Act because they are an unlawful conspiracy in restraint of trade. See also Dr. Miles Co. v. John Park & Sons, 220 U.S. 373 (1911).


Moreover, once the supplier sells its product to the wholesaler, it may not alienate its wholesaler's dominion over the goods in an attempt to stabilize or control pricing or restrict the parties with whom a wholesaler may deal. United States v. Arnold, Schwinn & Co., 388 U.S. 355 (1967), wherein the court stated that "[I]f the manufacturer parts with dominion over his product or transfers risk of loss to another, he may not reserve control over its destiny or the conditions of its resale." Id. at 379. See generally Pollock, Alternative Distribution Methods After Schwinn, 63 NW. U.L. REV. 595 (1968).

49. The supplier could legally refuse to sell to a wholesaler who undercut prices. However, if he does sell, the supplier can only suggest a resale price and then refuse to sell to the wholesaler who undercut it. But, as will be noted later, this is a tenuous procedure. See note 50 infra. However, in the absence of any purpose to create or maintain a monopoly, the Sherman Act does not restrict the right of manufacturers engaged in an entirely private business, freely to exercise his own discretion as to the parties with whom he will deal. See United States v. Colgate & Co., 250 U.S. 300, 307 (1918); Hartley & Parker, Inc. v. Florida Beverage Corp., 307 F.2d 916, 921 (5th Cir. 1962); Nafieh v. Ronson Art Metal Works, Inc., 218 F.2d 202, 206 (10th Cir. 1954); Standard Oil Co. v. FTC, 173 F.2d 209, 217 (7th Cir. 1949), rev'd on other grounds, 340 U.S. 231 (1951).

50. United States v. Parke-Davis & Co., 362 U.S. 29, 45 (1960). The Court stated:

Parke-Davis did not content itself with announcing its policy regarding retail prices and following this with a simple refusal to have business relations with any retailer who disregarded that policy. Instead Parke-Davis used the refusal to deal with the wholesalers in order to elicit their willingness to deny Parke-Davis products to retailers and thereby help gain the retailers adherence to its suggested minimum retail prices.

The action on the part of Parke-Davis was viewed as a violation of section 1 of the Sherman Act. Therefore, a supplier who refuses to deal with a customer because the customer will not comply with the supplier's suggested retail price could very well be violating the Sherman Act. See also Sidney Morris & Co. v. National Ass'n of Stationers, 40 F.2d 620 (7th Cir. 1940).

51. A one-price policy is a method of distribution whereby a supplier sells goods at the same price to all direct-buying purchasers independent of their functional level. In instances where all purchasers buy at the same price there is no "difference" and therefore no discrimination. Since the first part of section 2(a) is not violated, the supplier is not responsible for any competitive injury which may result. See Standard Oil v. FTC, 173 F.2d 209, 217 (1949). See also FTC v. Staley Mfg. Co., 324 U.S. 746 (1945); Bird & Son, Inc., 25 F.T.C. 548 (1937); Comment, The Tyranny of Labels — A Study of Functional Discounts Under the Robinson-Patman Act, 60 HARV. L. REV. 571, 588 (1947).
if a wholesaler and a direct-buying retailer receive the same price from a supplier, the wholesaler will have to sell to its customers at a higher price in order to make a profit. Therefore, retailers purchasing through a wholesaler will not receive the same price as their direct-buying competitor. Although this one-price policy will have the ultimate effect of competitive injury to small buyers, the supplier will not be liable because the injury is not attributable to discriminatory pricing tactics. Therefore, if suppliers generally adopt a one-price policy the intent of the Act to protect the small buyers may be frustrated.

Alternatively, the supplier could abandon the dual distributorship entirely by limiting its sales to one functional level. By selling to a single class of customers — wholesalers — at the same price, a supplier removes himself from any discriminatory pricing tactics performed by his wholesalers. Conversely, a supplier might vertically integrate forward by either taking over the function of the intermediates and then selling directly to all retailers, or by making the intermediates its agents. However, vertical integration would seem practically limited to a supplier with limited customer outlets.

In conclusion, the decision in Perkins seems to greatly extend the protection of section 2(a). By redefining the term customer to include a retailer who purchases goods through intermediates, the direct-buying retailer will no longer be unprotected from unjustified price advantages that are passed down to its competitors. By effectively eliminating all unjustified price advantages granted by a supplier, the Supreme Court has more fully achieved the Legislative purpose of protecting the small buyer. Although Perkins places an added burden on the supplier, it seems to be a reasonable one when balanced against the competitive injury caused by discriminatory pricing.

Michael J. Shepard

52. In Sano Petroleum Corp. v. American Oil Co., 187 F. Supp. 345, 353-54 (E.D.N.Y. 1960), it was held that:
Equality in price charged to different purchasers by the same seller is without the ban of section 2(a) and an injury to competition caused by such equality cannot serve to bring the conduct within the section.
Id. at 353-54.

53. See United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1966); United States v. General Elec. Co., 272 U.S. 476 (1936). The supplier could legally undertake this alternative without violating the Sherman Act if a true agency was established with the supplier maintaining dominion over the goods. However, it is doubtful that the wholesalers would be willing to give up their independent status. Alternatively, if the supplier integrated forward by taking over the wholesalers functions, its action could be construed as a conspiracy in restraint of trade against the intermediates. See Albrecht v. Herald Co., 390 U.S. 145 (1968). See generally Borowitz, Pricing Problems in Distributor and Franchise Systems, 38 U. CINC. L. REV. 258 (1969).

54. For example, if a supplier deals in a limited variety and quantity of goods and markets them through limited outlets, vertical integration would be possible. Because of the small number of customers, the supplier could easily re-organize and start retailing the goods itself, or deal with a small group of wholesalers establishing a true agency. However, if the supplier distributes large quantities of varied goods it would be impossible to organize a retailing operation and if he deals with a large number of customers the alternative of making all of customers agents is eliminated.