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MEASUREMENT OF DAMAGES IN PRIVATE ACTIONS UNDER RULE 10b-5

Securities Exchange Commission Rule 10b-5 proscribes fraudulent conduct in connection with the purchase or sale of securities by the use of the mails or any facility of a national securities exchange.1 Although the rule does not expressly provide a civil remedy the courts have held since 1946 that a party injured by its infraction may sue for damages.2 The number of private civil suits based on the rule has steadily increased. This note examines the methods by which courts compute damages in 10b-5 actions and compares these methods with the common law measures of recovery.3

1. Rule 10b-5 provides in full:

   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
   a) To employ any device, scheme, or artifice to defraud
   b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or
   c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (1967).


3. For purposes of the discussion which follows, it will be assumed that the elements of a cause of action under Rule 10b-5 have been made out by the plaintiff. For a general discussion of the requirements the plaintiff must meet in order to bring a successful 10b-5 action see A. Bromberg, SECURITIES REGULATION UNDER 10b-5 (1967); Note, Civil Liability under Section 10B and Rule 10B-5; A Suggestion for Replacing the Doctrine of Privity, 74 YALE L.J. 658 (1965).
I. MEASUREMENT OF DAMAGES IN THE SECURITIES ACT AND THE SECURITIES EXCHANGE ACT

Both the Securities Act of 1933 and the Securities Exchange Act of 1934 contain civil liability provisions that permit a defrauded investor to recover damages. Under the Securities Act liability is imposed only for misconduct in connection with the sale of a security. Anyone who offers or sells a security in violation of the registration or prospectus provisions of section 5 is liable in rescission or for damages under section 12(1). Section 12(2) imposes the same liability upon anyone who offers or sells any security, whether or not registered or excepted from registration, by means of a material misstatement. When the plaintiff in a section 12(1) or 12(2) action no longer has possession of the securities, courts have allowed as damages the substantial equivalent of those recoverable by rescission. The plaintiff can also recover the entire purchase price without deducting the defendant's selling commission. Civil liability under section 11(e) of the Securities Act for filing a false registration statement is non-punitive. The damages recoverable represent the purchase price of the security bought in reliance on a false registration statement.

Unlike the Securities Act, the Exchange Act contains no section specifically setting forth the manner in which to determine damages. For example, section 9(e) imposes liability for manipulations affecting registered securities but does not provide a measure of damages. Since no case has yet been decided for the plaintiff, the damage issue remains undetermined.

5. 3 Loss 1719.
8. In Cady v. Murphy, 113 F.2d 988 (1st Cir. 1940), the court held that the plaintiff could recover the difference between the purchase price and the plaintiff's resale price, plus interest and loss of any income or return of capital received on the security by the plaintiff.
9. Stadia Oil & Uranium Co. v. Wheelis, 251 F.2d 269, 276 (10th Cir. 1957); 3 Loss 1727.

The main obstacle to recovery under a section 9(e) action is a formidable causation problem. Not only are damages limited to those sustained as a result of the manipulation of the security registered on an exchange, but the plaintiff must also show that he bought or sold at a price affected by the manipulation. Separating ordinary market movements from movement due solely to the defendant's conduct is virtually impossible. See Rosenberg v. Hano, 121 F.2d 818 (3d Cir. 1941).
SEC Rule 10b-5\textsuperscript{12} is frequently employed as the substantive basis for determining damages in civil actions. Although Rule 10b-5 was patterned after section 17(a) of the Securities Act, it covers frauds perpetrated on sellers as well as buyers.\textsuperscript{13} It has become the general anti-fraud provision under the Exchange Act. Courts have relied upon a tort theory to justify use of 10b-5 as a basis for civil liability.\textsuperscript{14} This follows the Restatement of Torts, which provides for damages if a violation of a legislative enactment is the legal cause of harm to a plaintiff who is within the class of persons the statute was designed to protect.\textsuperscript{15}

\begin{itemize}
  \item 12. 17 C.F.R. § 240.10b-5 (1967). This rule permits both buyers and sellers to sue, freeing sellers from the restrictions of the Securities Act. Ellis v. Carter, 291 F.2d 270, 273 (9th Cir. 1961).
  \item 13. Section 17 of the Securities Act, 15 U.S.C. § 77q (1964), is virtually identical to Rule 10b-5 except that section 17 applies only to fraud in connection with the sale of securities. While it has seldom been used as a source of implied civil liability, courts have sustained the right to sue exclusively under this section. See, e.g., Newman v. Weinstein, CCH Fed. Sec. L. Rep. ¶ 91422 (S.D. Ill. 1964). See also Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 921-22 (1967) (remarks of Mr. Freeman).
  \item 15. Another possible basis for implying liability under 10b-5 is Section 29(b) of the Exchange Act which provides:
    \begin{quote}
    Every contract made in violation of any provision of this chapter or any rule or regulation thereunder, . . . the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void.
    \end{quote}
  \item 15. Restatement of Torts § 286 (1934). The section has since been revised to make optional the adoption of the legislative standard in lieu of the general reasonable man standard:
    \begin{quote}
    § 286 When Standard of Conduct Defined by Legislation or Regulation Will Be Adopted:
    The court may adopt as the standard of conduct of a reasonable man the requirements of a legislative enactment or an administrative regulation whose purpose is found to be exclusively or in part
    \begin{itemize}
      \item (a) to protect a class of persons which includes the one whose interest is invaded, and
      \item (b) to protect the particular interest which is invaded, and
      \item (c) to protect that interest against the kind of harm which has resulted, and
      \item (d) to protect that interest against the particular hazard from which the harm results.
    \end{itemize}
    Restatement (Second) of Torts § 286 (1965).
\end{itemize}
Since civil liability must be implied under 10b-5, the rule itself provides no guide for determining the measure of damages.16 The damages recoverable are limited by section 28(a) of the Exchange Act, which provides that "... no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of."17 This might be construed as a simple statement of the general rule prohibiting double recovery (i.e., recovery under both the common law and statutory remedies),18 but a number of recent cases have interpreted the section to prohibit punitive damages.19 Therefore, a plaintiff seeking exemplary damages must bring a common law count through pendent jurisdiction to a 10b-5 count.20 An intentional violation of Rule 10b-5 would seem, however, an appropriate occasion to impose punitive damages.21

II. MEASURES OF DAMAGES IN 10b-5 ACTIONS

As at common law, the plaintiff in a 10b-5 action has a choice of remedies: (1) he may reject the validity of the transaction by tendering back what he received from the defendant and sue for restitution of the consideration he gave in return; or (2) he may affirm the fraudulent transaction by retaining what he received and sue for damages to compensate for his losses.22 The law governing rescission and damages in 10b-5 actions is much in doubt. The remainder of this note is devoted to an examination of the 10b-5 cases in comparison with the common law remedies.

16. See note 2 supra and accompanying text.
18. 3 Loss 1474 n.105, 1624 n.5.
20. Since the claim for damages under 10b-5 and the common law claim for fraud and deceit involve the same operative facts, pendent jurisdiction is appropriate. See generally UMW v. Gibbs, 383 U.S. 715 (1966), noted in 80 HARV. L. REV. 220-24 (1966). It is possible that the application of pendent jurisdiction would permit the award in federal court of the common law measure of damages, including punitive damages.
22. See C. McCormick, supra note 21.
A. Rescission and Restitution

1. Common Law

At common law, a plaintiff could rescind a fraudulent sale by tendering the thing purchased if he was a buyer, or the purchase price if he was a seller, and demanding restitution of what he had given. This demand was enforceable by an action at law. He could also sue in equity, making the tender in his pleading and asking the court to rescind the sale and order restitution. In order to get rescission and restitution the plaintiff, after discovering the fraud, must do nothing to indicate an intent to affirm the sale; he must act promptly and have clean hands.

2. Rule 10b-5

In a rescission action brought under 10b-5, plaintiff alleges that he has already rescinded and is suing to enforce his demand for restitution at law. These cases have required clean hands and prompt action by the plaintiff. The requirement that plaintiff's rescission be prompt is especially important to avoid injustice in stock sales. The plaintiff's decision to affirm or rescind will depend upon whether the value of what he has given (money in the case of a plaintiff buyer, stock in the case of a plaintiff seller) is...
greater or less than the value of what he has received. Fluctuating stock values may make the defendant liable to restore something of much greater value than that which the plaintiff tenders. If the plaintiff can delay rescission he has an opportunity to speculate upon such fluctuations.

In addition to rescission, a plaintiff seller can compel the defendant to account for profits made on the stock which plaintiff is entitled to recover. In *Kardon v. National Gypsum Co.*, plaintiffs and defendants owned all the stock and constituted the entire board of directors of a corporation. The defendants, without notifying the plaintiffs of the negotiations, agreed to sell all the stock to a third party. After purchasing all the plaintiffs' stock, defendants consummated the sale. The federal district court held that the defendant directors' sale of their interest in the corporate assets was made outside the course of business and without disclosure to the shareholders. Under the rule of this case, proof that the defendant profited is not included in the plaintiff's burden. Plaintiff need only establish the breach of a duty of disclosure; the defendant is then made to account for his profits. The procedural advantage to the plaintiff is clear: while the duty of disclosure and its breach are often easily established, proving the size of defendant's profits may be a difficult task.

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30. 3 Loss 1793. Note that this general rule does not allow for any possible desire to speculate as to the stock's future performance. *Id.* at 1626-27.

31. In *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), the court indicated in dictum that, since a sale which violates Rule 10b-5 is declared void *ab initio* by 15 U.S.C. §78cc(b), it is treated as rescinded at its inception, so that plaintiff's delay in bringing his action at law for restitution following this "rescission" cannot be barred by laches. Laches can result only from delay prior to rescission, not by delaying the suit at law following rescission; under the artificial reasoning that the statute rescinded the transaction for the plaintiff, there would never be a delay prior to rescission. The only bar would then be the statute of limitations. Attributing this effect to Section 78cc(b) would, however, destroy the policy behind the rule of laches and allow plaintiff to speculate at will on the price fluctuations occurring throughout the period of limitations. It is clear that Section 78cc(b) does not *compel* plaintiff to seek restitution—that is, to adopt the position that he has rescinded the transaction. Plaintiff may sue for his losses at law upon the theory that he has affirmed the transaction. The *Myzel* reasoning would simply allow the plaintiff to gamble extensively with the defendant's money. *Compare* *Straley v. Universal Uranium Co.*, 289 F.2d 370 (9th Cir. 1961), discussing the comparable problem under the Securities Act of 1933.


34. Later cases have followed the holding of *Kardon*. In *Kane v. Central American Mining & Oil, Inc.*, 235 F. Supp. 559 (S.D.N.Y. 1964), an accounting was granted for money which had been misappropriated in connection with an issuance of the corporation's stock. In *Texas Continental Life Ins. Co. v. Bankers Bond Co.*, 187 F. Supp. 14 (W.D. Ky. 1960), *rev'd on other grounds*, 307 F.2d 242 (6th Cir. 1962), the court did not even require proof of common law fraud and deceit. The plaintiffs established their case by "showing that the defendants breached their duty by failing to make
Another court awarded restitution of profits to a defrauded seller without relying on the existence of a fiduciary duty. It held that if a defendant buyer realizes profits that were speculative, because not foreseeable at the time of the sale, “[i]t is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them.” The court recognized that this reasoning would not apply if there were extraordinary gains attributable to the defendant’s hard work, rather than general price rises, increased efficiency, or an improvement in the business cycle.

A major difficulty with restitution is that it bears little relation to the amount of harm done to the plaintiff since “[t]he injured party is entitled to require the perpetrator to disgorge gains made at the expense of the injured.” The object is not merely to compensate the plaintiff but also to deter the defendant by making him relinquish his profits on the sale of stock.

When the plaintiff elects to affirm the transaction and sue for damages, the recovery may be similar to restitutionary damages. In these cases, which involve defrauded sellers, the court simulates the amount of damages that would be awarded in restitution by allowing plaintiff to recover the defendant’s profits. The classic case allowing this restitutionary damage recovery under Rule 10b-5 is Speed v. Transamerica Corp. The defendants offered to buy at a price substantially above the market the holdings of the minority stockholders of Axton-Fischer Tobacco Corporation, a subsidiary of defendants’ corporation. The defendants did not disclose their plan to liquidate Axton-Fischer to take advantage of the increased inventory value of the tobacco. The plaintiffs sought to affirm the transaction by requesting disclosures and by withholding facts which in good conscience they should have revealed.

36. Id. at 786.
37. Id. at 787. The defendant admitted in answers to interrogatories that following the purchase of the stock he did nothing different and worked no harder than he had before. This saved the court considerable difficulty by making it unnecessary to determine what portion of the stock’s increased value was generated by the defendant’s extraordinary individual efforts, rather than by normal market fluctuations. Similar causal problems are present in Section 9(e) of the Exchange Act; see note 11 supra.
40. The tobacco inventories were carried on the company’s books at $9,845,983.25 (lower of cost or market) but had a replacement value of $19,307,557.00.
compensatory damages measured by the difference between the purchase price and the value of the stock at the time of the sale (a tort or loss theory of recovery).\footnote{41} But the court awarded damages measured by what the defendant received rather than by what the plaintiff lost. A "reconstructed liquidation" was carried out to determine the difference between the price paid the plaintiffs and the amount they would have received on liquidation had they retained the stock. The court reasoned that restitutionary relief is based on the existence of a fiduciary duty,\footnote{42} but no such relationship was necessary in common law misrepresentation cases, and nothing peculiar to 10b-5 actions would seem to require it.

Defrauded investors should be able to retain their bargain and sue for damages. However, the plaintiff's conduct may make it inequitable to compel the defendant to return the benefits he has received. Factors that should be considered before restitution is granted are promptness of action, acts indicating affirmance of the contract, plaintiff's ability to restore the status quo, and the degree of the stock's increase in value attributable solely to extraordinary labor by the defendant.

\section*{B. Recovery of Actual Damages at Law}

\subsection*{1. Common Law}

At common law, the investor induced by fraud to purchase or sell stock could affirm the sale and sue in tort (deceit) to recover the losses caused by the fraud. The measure of damages theory was either tort (out-of-pocket loss) or warranty (loss-of-bargain). The out-of-pocket rule is applied in a minority of states.\footnote{43} It allows recovery of the difference between the actual value of what the injured party gave and what he received. In contrast with restitution damages, the plaintiff recovers what he has lost, rather than what the defendant has gained. The injured investor is given nothing for the loss of the benefit that he would have enjoyed had defendant's representations been true.

The loss-of-bargain rule, which applies only when the plaintiff is a \textit{buyer}, is applied by the majority of American jurisdictions.\footnote{44} It attempts to place

\footnotesize{
41. See Section B infra.


44. \textit{E.g.}, Morse v. Hutchins, 102 Mass. 439 (1869); Chapman v. Bible, 171 Mich. 663, 137 N.W. 533 (1912); Kendrick v. Ryus, 225 Mo. 150, 123 S.W. 937 (1910); \textit{see} Annot., 13 A.L.R.3d 875 (1967).
}
the injured buyer in the position he would have occupied had the defendant's representations been true. Thus, the loss-of-bargain measure of recovery includes the profit which the plaintiff reasonably expected to make on the purchase—the benefit of the bargain. Recoverable damages equal the difference between the actual value of the stock and the value it would have had if it had been as represented.

It is necessary, in order to apply either the loss-of-bargain or out-of-pocket measures of recovery to determine the actual value of the stock on the day it was sold. "Actual value" can be defined in three different ways. The most readily ascertainable measure is the market value at which the stock or similar stock is traded. This method is unsatisfactory, however, because market value is influenced by extrinsic factors such as world conditions and rumors having no relation to the soundness of the corporation or its business prospects. A second method is to analyze and value corporate earnings. The third approach is to assign a value to the stock based on

45. This approach assumes that the actual value of stock is equivalent to its market value. A number of factors must be considered before market value can be equated with actual value of the stock. Factors influencing the market price of a stock are the general trend of the stock market as a whole, the prospects for the industry and the economy in general, facts about the particular company, and inflation of the market price by rumors. Very important also is the nature of the market for the individual security. The difference between a stock's value in a "thin" market and one with active trading among a large group of buyers and sellers can be quite significant. The sale of a large block of stock can temporarily depress market quotations. Speculative selling or buying can also artificially influence the market price of a stock.

If there are no market quotations for the stock, as in a closely-held corporation or in a newly formed enterprise, market value must be either simulated or established by actual test through the sale or purchase of some shares. The concept of market value is sometimes stretched under these circumstances, since simulation is only an approximation of what might take place under actual conditions. Moreover, a few individual sales do not realistically approximate buying and selling behavior in the market place. Fair market value, a concept often employed by courts, depends upon a reasonably unhurried and arms-length bargain between interested parties, without coercion and without undue advantage to either side. Because such ideal conditions rarely exist, market value is not an absolute standard of actual value.

There are a number of circumstances in which book value of common stock is used in spite of its shortcomings. If market value does not exist and earnings approaches are difficult, book value is often used at a floor value. The best application of net asset or book value is in the initial and terminal stages of a company. See generally authorities cited note 47 infra.

46. The earnings approach capitalizes the earnings of an investment at a suitable rate of discount. The technique is expressed by the formula:

\[
\text{Share Value} = \frac{\text{Past earnings per share}}{\text{Rate of capitalization}}
\]

The procedure reduces to two basic problems: (1) finding a reliable expression of earnings attributable to the common market, and (2) finding the appropriate rate of
the value of corporate assets.47 These latter two methods are unsatisfactory in that they rely on the purely subjective estimates and predictions of the analyst.

capitalization which the investor will accept as an expression of the relative desirability of the earnings stream under the uncertainties surrounding it.

Earnings per share are the residue of operating, accounting, and financing decisions as well as of the economic climate in the industry and country. In calculating earnings per share, one attempts to forecast a company's future experience, extrapolated and adjusted from past history. Since it is impossible to predict precisely a company's earnings, it is necessary to employ reasonable assumptions based on all available information. Clearly, it is impossible to weigh and analyze every piece of datum, and shortcuts are normally taken. For example, it is a common procedure to compute a range of possible earnings and even to make a probability assessment of the likely outcomes to obtain as accurate a figure as possible.

Part of the uncertainty surrounding earnings estimates is the discretion given to management in the accounting for operations. Such choices as the capitalization or write-off of research expenditures, the recognition of installment contracts, depreciation methods, differences in tax and accounting treatments of revenues and expenses and resulting deferred taxes cloud the earnings concept. Thus, there is considerable risk in extrapolation from past figures without recognizing the pitfalls involved.

Once a reasonable earnings figure or range of earnings has been derived, a reasonable rate of capitalization must be found to represent the value of the earnings stream. Here, it is necessary to inject the investor's judgment of what he considers a fair compensation for the risk to which he is exposed in holding the common stock. In general, the greater the uncertainty (and, therefore, the risk in holding the stock), the greater will be the rate of capitalization and the smaller will be the value of the investment represented by the earnings. A rough guide to a selection of the proper rate is to some extent the experience prevailing in the industry and an analysis of the enterprises closely resembling the company. Since differences in management, resources, and products are impossible to duplicate exactly, an approximation must suffice. See generally J. Bonbright, Valuation of Property (1937); J. Cleandenin, Introduction to Investments ch. 4 (3d ed. 1960); B. Graham, Security Analysis ch. 32 (4th ed. 1962); E. Helfert, Valuation: Concepts & Practice (1966); R. Johnson, Financial Management chs. 18, 19 (1962).

47. This method assumes that assets recorded on the books of the corporation, less claims by creditors and preferred stockholders, represent a fair value of the common stockholders' equity. This assumption is dangerous unless there is a close correlation between the economic value of the assets and the economic value of the stock. Only in unusual circumstances will there be a reasonable relationship between recorded asset values and the stock they represent. These unusual circumstances are present when a corporation is being formed, when stock is issued for tangible and intangible assets, and when a corporation is being dissolved and liquidated. Between these points there will be a divergence of recorded asset values and the value of the stock, because accounting adjustments, changes in price level, technological progress, and economic conditions force a continuous reappraisal of asset values that is normally not reflected in the balance sheet of the corporation. The only way to arrive at reasonable stock values through an asset approach is to examine all corporate assets, revalue them in the light of changed conditions, adjust for the fact that intangibles such as entrepreneurship, reputation, and trademarks of a going company make the value of the total worth more than the sum of the individual parts, and then divide the residual value after deducting creditors' claims and the claims of preferred stockholders, among the common stock-
2. Rule 10b-5

Plaintiffs can recover actual damages for Rule 10b-5 violations, but not punitive damages. Courts have exercised considerable discretion in determining actual damages. They have tailored the amount of recovery to fit the particular circumstances of each case and have not strictly adhered to the common law rules of recovery.

Of all the common law measures of damages, the tort or out-of-pocket measure of actual damages has been most used in 10b-5 suits. This measure limits plaintiff's recovery to the difference in value between what he gave and what he received, calculated at the date of the fraudulent transaction. It eliminates any possibility of recovery for differences in the value of the stock caused by circumstances other than the fraudulent inducement to buy or sell which cause the stock value to fluctuate subsequent to the transaction. However, for a plaintiff seller this measure precludes the recovery of profits that plaintiff might reasonably have made had he been constantly in possession of the stock. The recent case of Myzel v. Fields suggests a modification of the tort measure to correct this shortcoming. Myzel involved a closely held corporation in which plaintiff's stock had no market value. Defendant insiders, through Myzel, purchased stock from the various plaintiffs over a three-year period, paying prices which ranged between $30 and $40 per share. In making the purchases, Myzel concealed information concerning the corporation's improved business outlook and misrepresented facts to give plaintiffs the impression that its prospects were dim. Following holders. In view of the information normally available and the difficulty of making the required adjustments, an attempt to arrive at actual value by the asset valuation method is futile.


49. See note 19 supra.


51. 386 F.2d 718 (8th Cir. 1967).
a merger five years later, the equivalent of each share sold by the plaintiffs was worth $9,000, and the value had been rising during the period. On the damages issue the trial court instructed the jury in the alternative: (1) at a minimum, plaintiffs were entitled to recover the difference between the price received from Myzel and the actual value of the stock at the time of the sale, the subsequent prosperity of the corporation to be considered in determining this actual value; (2) if any plaintiff would have sold to Myzel, but would have demanded a higher price had Myzel disclosed all the facts, that plaintiff's recovery was to be the difference between what he received from Myzel and the higher price; (3) if any plaintiff would have refused to sell had Myzel disclosed all the true facts, that plaintiff's recovery was to be the difference between the price paid by Myzel and the value of the stock at a reasonable time when plaintiff would have sold had he never been approached by Myzel. Under alternatives (2) and (3), the jury was required to predict each plaintiff's probable actions in selling or retaining the stock, based on the facts actually known to the plaintiff at the time and on his other investment prospects. In determining the value of the stock at any given time, the jury was to consider current book value, past and projected future earnings (based on an assessment of factors bearing on general business outlook), past dividend payments and prospects for future dividends. The Eighth Circuit Court of Appeals approved this instruction, noting that it did not rigidly restrict recovery to the conventional tort out-of-pocket measure (alternative 1) but allowed each plaintiff to recover the amount he would have obtained for the stock but for Myzel's fraudulent inducement to sell. This approach represents a considerable improvement over the modified tort measure of Section 11 of the Securities Act, which has recently been rejected.

Another modification of the tort measure approach recognizes circumstances arising after the date of a fraudulent sale as evidence of the value of the stock on that date. Thus, when the stock has no market value on the transaction date or when a plaintiff seller is induced to sell at the market price by concealment of facts indicating that the stock would soon have a greater value, the market price of the stock on the date of the fraudulent

52. See text accompanying note 10 supra.
53. Sarlie v. E.L. Bruce Co., 265 F. Supp. 371, 376 (S.D.N.Y. 1967). In Sarlie the court did not discuss its reasons for not employing a Section 11 recovery; however, it noted that the shares were sold both before discovery of the tort and before the commencement of the action. Therefore, valuation at either date would yield the same dollar value.
54. This may be due to the defendant's misrepresentations. See, e.g., Hindman v. First Nat'l Bank, 112 F. 931 (6th Cir.), cert. denied, 186 U.S. 483 (1902); Peek v. Deery, L.R., 37 Ch. Div. 541 (1887), rev'd on other grounds, 14 A.C. 337 (1889).
transaction would not be used. Instead, the plaintiff's recovery is the difference between what he received and the stock's fair value, which "is to be determined from all the pertinent circumstances both for a reasonable time before the sale and after it . . . If there can be no exact calculation . . . the wrongdoer cannot complain if a reasonable approximation is reached."

Ross v. Licht provides an example of the kinds of pertinent circumstances a court may consider as indices of value. Plaintiffs, stockholders in a closed corporation, offered to sell their stock to one of the defendants at $120 per share. The defendants did not accept plaintiffs' offer until they had formulated a plan of recapitalization for the company. The plan consisted of (1) a private sale by the corporation of 100 authorized but unissued shares and 22 1/2 treasury shares (the same kind of shares as those held by the plaintiffs) to the defendants at $300 per share, and (2) a 200-for-1 stock split coupled with a major public issue of the new shares at $3 per share. After implementation of part two of this plan, the holder of one of the old shares would hold 200 new shares selling at $3 each, or the equivalent of $600 per old share. The defendants bought plaintiffs' stock for $120 per share on May 4, and purchased the 122 1/2 shares at $300 each from the corporation on May 18. They kept these shares, which became worthless after the stock split and public issue, when the corporation went bankrupt. The defendants were held liable for failing to disclose their inside knowledge of the planned private and public sales. In calculating damages, the court ignored the book value of plaintiffs' stock at the date of sale, even though this was substantially higher than the $120 per share paid by the defendants. Instead, the court found that the most reliable indicator of the value of plaintiffs' stock on May 4 was the $300 per share which defendants, with their inside knowledge were willing to pay at the private sale on May 18. Thus, damages were assessed at $180 per share ($300 minus $120).

In Pappas v. Moss, another recent decision, the court claimed to have examined "all the facts and circumstances of this case" but did not indi-

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57. On the date of the sale the book value of the common stock was computed to be at least $204.20 per share ($60,000 original capital plus $67,625.02 retained earnings divided by the 600 shares outstanding). Thus the book value was roughly 40% higher than the $120 sale price. Id.
59. Id. at 364.
cate how it computed the damages. The defendant officers and directors caused their corporation to sell its stock to a small group of private investors at discounts ranging from 38% to 45% per share. The corporation needed capital, and defendants thought it advantageous to require the investors to hold the purchased shares indefinitely as an investment in the corporation. The discounts were offered to induce the investors to agree to this. However, defendants also purchased shares for themselves at the same discounts, pretending that the investors had, as a condition to their own purchases, required these purchases by defendants (as an indication of confidence in the corporation). The court held that this was a fraud on the corporation entitling plaintiffs, who were suing derivatively, to recover. Defendants were liable for the difference between the discount at which they purchased the stock and a 20% discount. The court did not explain how the 20% figure was determined; it cryptically concluded that "a reasonable discount, under all the facts and circumstances of this case, was 20%." Courts may modify the usual measure of recovery when the defendant's inequitable conduct prevents the plaintiff from proving his damages under the conventional measure. In one case, Sarlie v. Bruce Co., the defendant purchaser's counterclaim for 10b-5 damages was upheld after plaintiff refused to submit to discovery. Defendant alleged that he had paid more than $30 per share for stock in a market manipulated by the plaintiff. He had resold the stock for $30 per share, but he claimed as damages the difference between the price in a manipulated and in a non-manipulated market. The defendant was not able to prove damages under this theory, because plaintiff's refusal to submit to discovery had deprived the defendant of his opportunity to obtain the necessary evidence of plaintiff's manipulation. Plaintiff contended that since the pleaded damages could not be proved, defendant was without relief, because the court was limited to awarding only pleaded damages in a default proceeding. The court rejected this and awarded defendant the difference between the price he had paid and the $30 he had received for the stock on resale. To permit Sarlie

<table>
<thead>
<tr>
<th>Date</th>
<th>Average Market Price</th>
<th>Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/28/61</td>
<td>$14 1/2</td>
<td>45%</td>
</tr>
<tr>
<td>12/29/61</td>
<td>$14 1/2</td>
<td>42%</td>
</tr>
<tr>
<td>1/2/62</td>
<td>$15 1/2</td>
<td>38%</td>
</tr>
</tbody>
</table>

60. The actual discounts as applied to the average market price on the respective dates of purchase were:

64. The court observed that Sarlie was not prejudiced by the tort measure of recovery because the purchaser agreed to base his damages on the excess over $30 per
[the plaintiff] to prevail on the theory it [sic] has advanced would be to give him a windfall to which in business morals and good conscience, he is not entitled.\textsuperscript{65} The court in effect, allowed a modified tort measure of damages, adopting the resale price in lieu of the price at the date of sale in an unmanipulated market, a modification made necessary by the plaintiff's default.

CONCLUSION

There is no law of damages under Rule 10b-5. Since \textit{Kardon v. National Gypsum Co.},\textsuperscript{66} there have been very few cases allowing recovery to the injured party in 10b-5 actions. Courts have taken an ad hoc approach, the initial reference point being the common law out-of-pocket loss measure of recovery. Beyond this, the courts have exercised discretion traditionally left to trial courts in finding damages appropriate to the facts of the case.\textsuperscript{67} This approach should be relied upon while the law of damages remains uncertain. As long as courts bear in mind the desirability of making the injured investor as nearly whole as possible, it is probable that any rational measure of damages will be upheld.

\begin{itemize}
  \item It could be determined that in an unmanipulated market the price would have been below $30 per share, so this measure was actually more favorable to Sarlie than the pleaded measure of recovery.
  \item 69 F. Supp 512 (E.D. Pa. 1946).
  \item See 5 A. CORBIN, CONTRACTS §§ 1020-22 (1964).
\end{itemize}