
The First Boston Corp. v. Chris-Craft Industries

Bangor Punta Corp. v. Chris-Craft Industries

In view of the complexity of this case, as to its facts and the questions presented, I will undertake no "summer memo." Rather, I will rely on the bench memo being prepared by one of my clerks.

The case is of unusual interest to persons subject to, or protected by, the Securities Acts. The several opinions of the DC and CA2 (contained in the joint appendix to the three petitions for certiorari), the briefs of the parties, and the amicus brief for the United States, present the facts, the issues and argue the law -- all at considerable length! Although the case may appear to be "overbriefed," there are actually three major cases in some respects and the damages awarded in the amount of nearly $26 million, plus interest, jointly and severally against the petitioners, is said to be the largest award of damages since
No. 75-353, et al

the Securities Acts were adopted in 1933 and '34. The briefs are of interest in view of some of the participating counsel: Sullivan and Cromwell (Arthur Dean and Judge Peck, with Louis Loss "of counsel"); Wilmer, Cutler and Pickering (with Charles Alan Wright on brief); Paul, Weiss, Rifkind, Wharton and Garrison (Simon Rifkind); and the Solicitor General.

If I should vote with the majority, there is a fair possibility -- I would guess -- that the opinion would be assigned to me in view of my having written several SEC cases. In view of the relevance of Ernst and Ernst to a central issue in this case, the Conference will expect me to take the lead in advising the Conference whether the standard of liability imposed by CA2 (see Judge Timber's opinion) is compatible with the standard we adopted in Ernst and Ernst. I believe -- subject to further consideration -- that the language of Section 10(b) and of Section 14(e) is sufficiently similar to justify the conclusion that the Ernst and Ernst holding with respect to § 10(b) will govern § 14(e). My preliminary impression is that CA2 (Judge Timbers) enunciated and applied a standard of liability considerably less severe than the scienter standard we adopted in Ernst and Ernst. But my clerk should consider this with special care.

In connection with the foregoing, the parties differ sharply as to the facts. Petitioners' briefs, relying primarily on findings by the district court as to the absence of any fraud or
intent to deceive, assert that at most the conduct for which liability was imposed constituted negligence. Respondent, however, reacts strongly to this position, asserting that the "undisputed facts . . . show scienter from start to finish" (Br. 63).

I would like to know, from my clerk's examination, exactly what the DC found as "facts" in this respect.

There are, of course, a number of other issues. We do not reach all of them -- indeed we may not reach any of them.-- if we conclude that CA2 applied the incorrect standard as to culpability. But if we are persuaded to clear that high "hurdle," a number of other questions of considerable importance remain in the case -- varying with the particular petitioner. Without attempting to identify even the more important ones, I do note that with respect to the liability of First Boston Corporation (and the imposition on it of three times the amount of damages that would be imposed under Section 11 of the 1933 Act, the SEC suggests a "remanding to the Court of Appeals for explicit consideration of the proper scope of its liability as an underwriter" (see note 12 to the SEC's brief, although this brief was filed prior to our granting cert).

A threshold question that we certainly must answer is whether there is an implied private federal cause of action for damages under the Williams Act (Section 14(e)) in favor of the loser in a contest to "take over" control of a third corporation. There is also the question, puzzling to me, whether damages may be
presumed without any proof.

In sum, I find the case (rather these cases) to present a number of difficult, fascinating and important issues. I will need lots of help.
To: Justice Powell
From: TAB
Re: Bangor Punta Bench Memo (Attached)

It is an odd problem to need to apologize for a memo being too long and for it being under-inclusive, but that is my problem with this memo. The memo is written to be read after re-reading the cert memo, which I have annotated in several respects. In general, I have tried to present additional facts at the point of discussing their legal significance, rather than in one section of the memo.

The discussion that I have had with other clerks who have worked on this case makes me think that CCI is likely to lose on the basis of there being no implied right of action under §14(e) for a tender offeror and on the basis that it was not a purchaser or seller of Bangor Punta securities as required by Rule 10b-6. I have tried to give a reasonably comprehensive discussion of all of the important issues, but, as you will see, questions that are farther down the chain of legal logic get less space. This is primarily a result of my feeling that the case will be decided on logically prior issues. If that feeling turns out to be wrong, I will need to give more attention to issues such as damages.

For your convenience, an outline of the major divisions of the opinion follows, with page references.

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Standing of CCI to Sue Under § 14(e)

In Cort v. Ash, 422 U.S. 66 (1975), the Court has quite recently canvassed the relevant factors to be considered in the decision whether to imply a private cause of action. The decision by CA 2 to imply a private right of action under § 14(e) was made before the decision in Cort and, therefore, there is not a complete "fit" between the CA 2 decision and the Cort factors. Assuming Cort to control, the question is whether there is a fatal inconsistency. The factors mentioned by the Court in Cort, without the supporting citations, are as follows:

"First, is the plaintiff 'one of the class for whose especial benefit the statute was enacted,' that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?"

422 U.S. at 78.

Applying these factors in Cort, the Court refused to imply a private
cause of action in favor of a stockholder of a corporation which had allegedly violated a criminal statute against corporate political contributions.

For purposes of the instant case, the first of the factors mentioned in Cort is probably the most important. Before examining the arguments of the parties on that question, I note that the Court held that the first factor was not satisfied in that case. That conclusion did not, however, cause the Court to forego a consideration of the other factors. Having concluded that Congress' intention was to keep corporate money out of elections and that the intention to protect corporate shareholders was at best secondary, the Court went on to consider the other relevant factors, finding that they "all either are not helpful or militate against implying a private cause of action." 422 U.S. at 80. The point of this observation is that, although the first factor mentioned by the Court is obviously important, it does not have to be viewed as a necessary condition to an implied cause of action. This case might force the Court to face that issue.

A. Especial Benefit

The battle over the question of "especial benefit" belongs, in my opinion, to the petrs. The presentation of evidence and
argument on this point probably takes up more space in the briefs than the treatment of any other issue. It is not the type of dispute that easily lends itself to presentation in a bench memo, even a summer bench memo. I have read all of the briefs, including their footnotes, carefully and will set out my position and the reasons for it. Limitations of space and time preclude any extensive documentation at this stage.

Taking to heart the admonition that the starting point for the analysis of a statute is the language of the statute, I turn first to § 14(e) itself. Since it does not create an express private right of action, the statute, not surprisingly, does not yield an easy answer to this issue. An argument has been made from the language of the statute, although I do not find it persuasive. In the amicus brief in opposition to the granting of cert, the SG/SEC argued that the language of the Act proscribing, inter alia, deceptive practices "in connection with . . . any solicitation of security holders in opposition to [a tender offer]" showed a congressional intention to benefit tender offerors:

"Thus, by its express terms, the statute protects tender offerors against dishonest or unfair opposition or competition. In short, tender offerors, like shareholders and management of the target corporation, are within 'the class for whose especial benefit the statute was enacted.'" SG/SEC's Brief at 14-15.

The fact that a particular statute may inure to the advantage
of a class of persons does not necessarily indicate a congressional intention to benefit that class of persons. I find petrs' explanation of this language more convincing than that of resp. Petrs argue that the language was included to protect shareholders from deceptive practices by management or third parties acting in opposition to a tender offer. The language would provide a solid basis for implying a cause of action in favor of a shareholder who did not tender because of such a deceptive practice — a cause of action which, significantly, would not be available under Rule 10b-5 because of the purchaser/seller limitation. Petrs argue with some force that the above interpretation is what Judge Friendly was driving at in Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 940-941, when he commented.

"In effect this [§ 14(e)] applies Rule 10b-5 both to the offeror and to the opposition — very likely, except perhaps for any bearing it may have on the issue of standing, only a codification of existing case law."

That language from the Friendly opinion has been relied on by CA 2 (A-32) and CCI in support of an implied action for CCI.

Writing about the "in opposition" language of the Williams Act, Professor Bromberg found no congressional intention to benefit tender offerors:

"The primary beneficiaries are the security holders to whom the offer is made. There is nothing in the
I will return later to consider the policy arguments made by Professor Bromberg and others in favor of an implied action offerors.

Turning to the legislative history, I am even more convinced that § 14(e) was not enacted for the "especial benefit" of tender offerors. In the early days of the bill that was to become § 14(e) there was, in fact, an intention to protect the target corporation "raiders." At that stage in the history of the statute, tender offerors were quite clearly the bad guys, and there was no intention to benefit them. The bill was modified in the face of (valid) objections that it was too one-sided and that tender offers provided a way to turn out entrenched and incompetent management. The modifications did make the legislation more favorable to tender offerors. Involved in this shift in attitude was the proposition that the legislation should achieve its purpose of protection shareholders -- from both of the contending sides of a contest -- without favoring one side or the other. As a result, some provisions which would have burdened tender offerors were rejected -- for example, a suggestion that there be an advance filing requirement for tender offers. This desire to protect the shareholders without favoring one side or the other produced a number of comments in the
legislative history about even-handedness. To my mind, those statements indicate nothing about a congressional intention to protect tender offerors by the enactment of § 14(e). Rather, they indicate a congressional awareness that the requirements of § 14(e) would have an impact on tender offer contestants and a congressional desire to protect the shareholders through § 14(e) without unduly advantaging either of the contestants. This is a far cry from legislation enacted for the benefit of tender offerors. In contrast to the strained and twisted evidence of an intention to benefit tender offerors, the evidence that Congress intended primarily -- and perhaps exclusively -- to benefit the stockholders who are the objects of tender offers is quite strong. For example, during the House hearings, Chairman Cohen of the SEC testified:

"I would like to emphasize and reemphasize that the purpose of the bill ... is a very simple one, solely to provide information to investors so that they can arrive at an informed investment decision. It is not designed to assist the offeror, nor designed to assist the management in resisting any plans put forward by the offeror. It is essentially based on the concept that the investor should have the information so that he can arrive at a decision. Hearings on H.R. 14475, S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 90th Cong., 2d Sess. 17 (1968).

After recognizing that the bill "might serve to help the takeover bidder in certain situations, because it would permit the Commission to deal effectively with certain practices which may be unfair and
which may be engaged in by what may be called an entrenched management." (Senate Hearings at 178 (emphasis added)), Mr. Cohen went on immediately to say:

"But the principal point is that we are not concerned with assisting or hurting either side. We are concerned with the investor who today is just a pawn in a form of industrial warfare. And that is all the argument here today is: Do you help one side, or do you help the other side? The investor is lost somewhere in the shuffle. This is our concern and our only concern." Id.

In speaking about the first factor, the Court in Cort used some language that might suggest a broader approach to the question of an implied cause of action:

"In those situations in which we have inferred a federal private cause of action not expressly provided, there has generally been a clearly articulated federal right in the plaintiff, e.g., Bivens v. Six Unknown Federal Narcotics Agents, supra, or a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard, e.g., J. I. Case Co. v. Borak, supra. 422 U.S. at 82. (emphasis added)."

The SEC's amicus brief relies on the language emphasized in the above quotation. The Williams Act establishes a pervasive legislative scheme governing the relationship between shareholders and contestants and solicitors in tender offer contests. Although the shareholders are the center of the legislative scheme, the web of requirements and prohibitions might be said to encompass all of the participants. BPC argues that the Act is only concerned with relationships that include as one of the two sides the shareholders.
The quoted language could be used to stretch Cort, if the Court were so inclined, but I doubt that the language was intended to have that result. The citation to Borak tends to limit the language to the situations where shareholders are involved, as does the fact that this is discussion under the category of "especial benefit." The broader interpretation of the language tends to dilute the force of the "especial benefit" factor.

CCI argues that the 1970 amendment of the Williams Act represents an implicit endorsement of the view of courts and commentators that the Act would confer standing on tender offerors because of Congress' failure to disclaim those views. First, this type of argument is a good material for a brief, but of limited significance for a decision maker in the absence of fairly explicit legislative endorsement. Second, although I have not had a chance to check anywhere nearly all of the articles and cases, the ones I have checked indicate that CCI cites with a considerable amount of advocates' license. Although there was dicta, there were no square holdings on this proposition in 1970 by the CAs, and Bromberg was far from certain that offerors would be entitled to sue, although he did seem to think that it would be a good thing if they could.

In Klaus v. Hi-Shear Corp., 528 F.2d 225 (CA 9 1975), CA 9 seems to have held, although with almost no discussion, that tender
offerors do not have a private right of action under § 14(e) even for injunctive relief, because "the Williams Act was designed to protect cash tender offerees, not offerors." 528 F.2d at 232.

For that reason, CA 9 denied permanent injunctive relief premised on harm to the tender offeror. The court seems to have considered the possibility of the tender offeror seeking injunctive relief based on harm to the shareholders, but the court concluded that the facts did not warrant such relief:

"We see no possibility that Hi-Shears misrepresentation resulted in any harm to the cash tender offerees, certainly none that could not be compensated by money damages. See Rondeau, 422 U.S. at 59-60, 95 S.Ct. at 2076-77. 528 F.2d at 232.

B. Legislative Intent and Consistency with Underlying Purpose

Continuing the examination of the factors mentioned in Cort as they apply to the instant case, I conclude that the second and third factors are essentially positive. Given the large number of securities laws cases in which private causes of action had been implied, I think that one can find an implicit legislative intention to create a private cause of action, at least for shareholders. Apparently, only two witnesses alluded to the question of implied actions, and then only quite generally. For the reasons given in Borak and subsequent cases, implied causes of action under the securities laws are certainly consistent with the underlying purposes
of the legislative scheme. The importuning of the SEC in this case is ample evidence of its conviction that private causes of action under § 14(e), in general, and in favor of tender offerors, in particular, are necessary supplements to its enforcement efforts. This is, in other words, definitely not a case like National Railroad Passenger Corp. v. National Assn. of Railroad Passengers, 414 U.S. 453 (1974) or Securities Investor Protection Corp. v. Barbour, 421 U.S. 412 (1975), where the implication of any private cause of action might interfere with the accomplishment of the legislative purpose.

The predominant reason that CA 2 in this case and CA 1 in H. K. Porter Co. v. Nicholson File Co., 482 F.2d 421 (CA 1 1973) implied a private cause of action in favor of a defeated tender offeror is that such actions will promote the purposes of the statute. Indeed, the following quotation shows that CA 1 implied the cause of action despite inconsistency with what was to become the first factor in Cort:

"From the statutory scheme and the legislative history, it seems clear that the overriding purpose of § 14(e) is the protection of the investor. Yet affording for the offeror and the target's manage­ment a cause of action for damages would in many instances further that purpose. With an obvious economic stake in the out­come of the tender offer battle, they have the incentive to detect violations and vigorously pursue remedies." See Bromberg,
Significant arguments can be made in support of implying a private cause of action in favor of tender offerors and target corporations. Although there is some evidence that, at least initially, target corporations were intended beneficiaries of the statute, that evidence alone probably would not be sufficient. Certainly, if a cause of action were implied in favor of the target corporation, the even-handedness mentioned so frequently in the legislative history would suggest that a corresponding cause of action should exist in favor of the tender offeror. The contestants are directly affected by violations which affect the outcome of tender fights, and there is an element of basic fairness in allowing them to sue for such violations. Even if one were concerned only for the shareholders, allowing the contestants to sue might be wise. They possess the information, motivation, and resources to move quickly and effectively to bring violations to the attention of the courts. It is difficult to know how often actions would be brought by contestants that would not have been brought by shareholders, but, to the extent that there is a difference, the deterrent effect is enhanced. There seems to be general agreement among the courts and the commentators that a private cause of action in favor of
tender offerors can be supported on the above grounds.

Despite the fact that an implied private cause of action in favor of tender offerors will supplement Commission enforcement efforts, the court in Nicholson File did recognize the potential for a conflict with the underlying statutory purpose of protecting investors. The court sharply distinguished between recovery from individual defendants and recovery from the corporation, recognizing that allowing recovery from the corporation might penalize the intended beneficiaries who held stock in the corporation. The case was before the court on appeal from the denial of a motion to dismiss, so the court was not directly confronted by the issue. It did however, provide the following guidance for the DC:

"Any recovery in damages from the corporation must be consistent with the primary congressional aim of protecting investors, and the district court would be warranted in denying damages, otherwise established, if it should conclude that to award them would be to subvert that statutory purpose." 482 F.2d at 425.

BPC and the Pipers frequently refer to this inconsistency with statutory purpose. One could admit that in the particular case there is an inconsistency, but still support an implied cause of action because of the longer term deterrent effect that such recoveries would produce. The fact that the protected class must pay is, nevertheless, a legitimate objection.
C. Relegation to State Law

In my opinion, this factor adds nothing to the decision one way or the other. In view of the subsequent decision in Cort, one can be sure that Judge Timbers would not now rely on the fact that CCI would have a common law action against BPC as a basis for implying a private cause of action under § 14(e). Although there may be state law treatment of the actions taken by the parties in this case, it is not an area with which the federal courts are unfamiliar. There has been considerable federal intrusion into this type of securities laws related area. The Court is not foreclosed by Cort from concluding that an implied cause of action should exist.

D. Other Considerations

CCI argues that Congress intended to equate the tender offer rules with proxy rules. There are some obvious parallels between the two situations, and some differences. CCI quotes from an SEC amicus brief in an earlier case saying that it was the intention of the agency that the two sets of rules be interpreted similarly. Assuming that one followed CCI to this point in the argument, the last hurdle is too tall. CCI argues that, "Moreover, in control contests waged by proxies, the courts had recognized implied actions under Section 14(a) [proxies] for stockholders, management, and
rival contestants," CCI Brief at 40. In the accompanying footnote CCI cites only a DC court case from 1964 for the proposition concerning rivals, but CCI states that the case was cited with approval by this Court in Mills. I checked Mills and the case is cited with approval, but for another proposition concerning the different issue of causation. This is either sloppiness or shady practice or both. In the absence of stronger authority for standing for rivals in the proxy situation, I don't think this argument is worth much. As far as I am concerned, the danger with these analogies to proxy rules is that the Court might wind up stating broad dicta about proxy rules which are not before it in this case and which may possibly involve other considerations.

Allowing a tender offeror to sue would not create the same kinds of problems with strike suits that concerned the Court in Blue Chip Stamp and thus weighed in favor of maintaining the purchaser/seller requirement. The tender offeror is not the man on the street who argues that he would have bought but-for the violation. The interest of the tender offeror is indisputable. However, there are some similarities. The claim here is for a non-contractual "lost opportunity" and the damages are, as the discussion infra amply indicates, somewhat speculative. The extent to which a decision in favor of an implied cause of action would spawn litigation depends in great part on the rules, to be discussed below, concerning the proof necessary to establish liability and establish damages. If the approach taken by CA 2 were followed, every defeated tender offeror would surely bring an action under § 14(e). Depending upon the liberality of these other rules, such actions will have some
the making of tender offers, because they will add to their expense. On the other hand, CCI argues that tender offers will be discouraged if offerors do not have standing because no sane businessman will make an offer if he can be exposed to violations with impunity. This argument overlooks the fact that shareholders would be able to recover against an offeror or management that caused them injury through deceptive practices. The threat of shareholder suits and Commission enforcement will deter many violations. In those situations where shareholders would not sue and where a defeated tender offeror would sue, the social benefit at issue is the incremental enforcement effect of the actions by the tender offeror. In a sense, the issue here is whether that incremental effect is, on balance, worth implying a cause of action.

I find this a difficult question that has become more difficult the longer I have worked on it. Originally, I felt rather sure that an action should be implied, although with much more stringent rules of proof, causation, damages, etc., than applied by CA 2. My reason was that actions by tender offerors would provide a valuable supplement to Commission enforcement. In this case, that valuable effect must be counter-balanced to some extent by the fact that the protected class may be harmed by allowing such an action. If an implied cause of action for tender offerors can be squared with Cort, it can only be with considerable effort, in light of what I perceive to be the one-sided legislative history relating to congressional intent. The attempted analogies to proxy rules establish nothing and would expose the Court to a holding on proxy rules as well as § 14(e). The following list of policy considerations
involved in the implication of a private cause of action do cut against the extension by CCI:

"In the situation presented by this case, those issues include (1) whether allowing damages to others than target shareholders suing in that capacity would open the door to a host of other claims, such as suits by displaced directors and management for lost fees and salaries; (2) the impact on innocent shareholders who accept an exchange offer of permitting suits by a competing offeror for unlimited damages against the company whose securities the innocent shareholders accept; (3) what the standard of blameworthiness and the measures of damages should be; (4) whether the inevitable deterrence of tender offers that arises when potential damage liability is expanded outweighs the benefits to shareholders that tender offers bring; (5) the supposed need for damage actions by tender offerors as a supplement to the expert agency's enforcement efforts -- particularly in a case where the agency has itself obtained relief for the protected class; (6) the impact of increasing the workload of the federal courts; and (7) the significance in the federal system of duplicating or displacing state law." BPC Reply at 25-26.

A final point needs to be made. Petrs suggest that, if a tender offeror has a cause of action, it should be restricted to seeking injunctive relief. Although I am concerned about the extent of the recovery in this case, I do not think that it is necessary or desirable to limit the implied cause of action in this case. The Court rejected such a distinction in Borak, as did CA 1 in Nicholson File, supra. Petrs' citation to this Court's decision in Hawaii v. Standard Oil Co., 405 U.S. 251 (1972) is suggestive at best. The Clayton Act, the statute at issue in that case, contained different language in § 4, which allowed private actions for damages to "business or property by reason of anything forbidden in the anti-trust laws" and § 16, which provided for injunctive relief, but
without the limitation of the "business or property" language. Hawaii is, therefore, not a case where, from a single statutory provision, the Court implied a cause for injunctive relief but denied one for monetary relief. The case does, however, illustrate one situation where Congress was more liberal with respect to injunctive relief than monetary relief. Certainly, if the Court refuses to imply a cause of action for monetary relief, it should not exclude the possibility of an implied cause for injunctive relief.

Allowing a tender offeror to bring an action for injunctive
relief alone might create an issue concerning
the irreparable harm component. If a tender
offeror had no action under the Williams Act for money damages, it
could be argued that any harm is likely to be irreparable harm. On
the other hand, injunctive relief probably could be limited to
shareholders without losing any of the supplementary enforcement
effect related to the tender offeror's knowledge and resources. In
a tender offer contest, everyone with any interest will be a share­
holder of one magnitude or another. In the instant case, CCI, as
a substantial shareholder of Piper, sued for injunctive relief on
that basis alone. If that is the case, then the irreparable harm
determination can be made with respect to the likelihood of irrepar­
able harm to the shareholders rather than to the tender offeror.
II. Scienter and § 14(e)

A. Does Ernst & Ernst Govern § 14(e)?

Assuming that a private cause of action can be implied from § 14(e) in favor of a tender offeror, the question is whether scienter and intent to deceive must be shown in order to recover. If so, the language in Ernst & Ernst v. Hochfelder, 96 S.Ct. 1375 (1976) will be of critical importance. Both CCI and the SG have argued that the standards announced in Ernst & Ernst for implied actions under Rule 10b-5 do not apply to implied actions under § 14(e).

One basis for this position is the language of the statute itself. With minor modifications, § 14(e) is a codification of sections 2 and 3 of Rule 10b-5 with a specific application to tender offers. It is argued that the statute uses the disjunctive "or" between the prohibitions against making untrue statements, etc., and the prohibitions against engaging in fraudulent acts, etc. Sections 2 and 3 of Rule 10b-5 are also connected by the disjunctive "or."

The Court did note in Ernst & Ernst that,

"Viewed in isolation the language of subsection (2), and arguably that of subsection (3), could be read as proscribing, respectively, any type of material misstatement or omission, and any course of conduct that has the effect of defrauding investors, whether the wrongdoing was intentional or not." 96 S.Ct. at 1390.

The Court rejected this interpretation in Ernst & Ernst on two grounds: 1) the clear administrative history of Rule 10b-5 and 2) the limited authorization of § 10(b) which could not be extended by the Commission's rule-making activities.

Because § 14(e) is itself a statute, the second of the above reasons clearly does not apply. Because many courts seem to
have concluded that the purpose of enacting § 14(e) was to extend Rule 10b-5 to tender offer situations where it might not have applied -- for example, because of the purchaser/seller requirement -- the administrative history of Rule 10b-5 might well be relevant here, as well.

Both CCI and the SG base arguments on the legislative history in their attempts to show that Congress intended to ban misstatements whether intentionally or inadvertently made. See CCI Brief at 70-71 and notes; SEC Brief at 66 and n. 160, 154 n. 364; BPC Reply at 38-39. While perhaps suggestive to some extent, the evidence I am inclined to think that the strongest point is the obviously close relationship of § 14(e) to Rule 10b-5, suggesting that the Rule 10b-5 scienter doctrine is incorporated almost by reference.

All of the courts that have dealt with § 14(e) seem to have assumed that it specifically extends Rule 10b-5 to tender offers and have therefore applied the same standards. In Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937 (CA 2 1969), Judge Friendly stated:

"In effect [§ 14(e)] applies Rule 10b-5 both to the offeror and to the opposition -- very likely, except perhaps for any bearing it may have on the issue of standing, only a codification of existing case law." 409 F.2d at 940-41.

Similarly Professor Bromberg has stated:

"The words of 14(e) are more specific than those of 10b-5 in coverage of opposition solicitations. Indeed, this and the related matter of who can sue are probably the only difference of any import."

In an attempt to avoid the scienter requirements of Ernst & Ernst, CCI and the SEC argue that § 14(e) should be interpreted as
liberally as Rule 14a-9 governing proxies, which the first part of § 14(e) resembles. Some commentators have noted this similarity. See Bromberg, Securities Law of Tender Offers, 15 N.Y.L.F. at 470-71. In Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (CA 2 1973), Judge Friendly agreed that the reasons for requiring scienter in a Rule 10b-5 action do not exist in a Rule 14a-9 suit. The reason for this conclusion was the fact that § 10(b) "is addressed to 'any manipulative or deceptive device or contrivance' . . . whereas section 14(a) contains no such evil-sounding language."

The force of the analogy is lost, however, because Judge Friendly in a footnote contrasted the earlier decision of CA 2 in the instant case that "scienter must be proved in a private action under section 14(e) . . . ." Judge Friendly cited with approval the following language from Judge Mansfield in that case:

"Congress' use of the words "fraudulent," "deceptive," and "manipulative" in § 14(e), when coupled with the partially similar language and the legislative history of the earlier-enacted § 10(b), indicates that its purpose was not to punish mere negligence . . . ." 480 F.2d at 1299 n. 17.

In my opinion, CCI and the SEC have failed to establish that a different and less demanding standard should be applied to § 14(e) than that applied to Rule 10b-5.

B. The Basis of Liability, Assuming that Rule 10b-5 Standards Govern an Action under § 14(e)

Assuming that Rule 10b-5 standards do govern in an action under § 14(e), your opinion last term in Ernst & Ernst v. Hochfelder, 96 S.Ct. 1375 (1976) is of central importance. Because of the helpful discussion that I had with you about that opinion, I am
able to write this memo more directly because of the clarification of my uncertainties about the intended scope of the opinion. Although Ernst & Ernst involved a different problem, its language and intended scope do extend to this case. Depending upon the analysis of this case some issues may remain to be decided.

For purposes of this memorandum, at least, I suggest some modification of terminology which will hopefully make it easier to be precise about the issues. A principle source of confusion in this area of the law is the word "scienter" which has been used to mean quite different things. See White v. Abrams, 495 F.2d 724, 728 n.3 (CA 9 1974). One author has suggested that scienter should be defined as "knowledge of the facts, either actual or constructive." Bucklo, "Scienter and Rule 10b-5", 67 NW.U.L.Rev. 562 (1973) ["Bucklo"]. So defined, scienter is one of three elements of common law fraud. The other two requirements are "intent that a statement be misleading and intent that it be conveyed to a certain person or group of persons and acted upon by them." Bucklo at 571-72.

As we discussed, Ernst & Ernst was, in the above terminology, a scienter case posing the question whether a negligent failure to discover facts which would reveal fraud was actionable. Because Ernst & Ernst did not even know the critical facts, allegedly because of its negligence, there was no question of intent to deceive in not revealing them. There was considerable disagreement among the lower courts and the commentators (particularly the commentators) as to whether a person could be liable under Rule 10b-5 for negligently failing to discover the truth about facts that were either omitted or misrepresented. This Court held that there could
not be liability in that situation.

The opinion phrased the question for resolution as "whether a private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the absence of any allegation of scienter -- intent to deceive, manipulate, or defraud," 96 S.Ct. at 1381. The opinion provided the following definition of terms:

"In this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud. In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5," 96 S.Ct. at 1381 n. 12.

Thus, in *Ernst & Ernst* the Court decided what was, in my suggested terminology, an issue of scienter, but did so by using language appropriate for an issue of intent to deceive. I understand that your position is that intent to deceive was intended by Congress and is necessary, although you have reserved judgment as to the possibility of liability for recklessness.

At least with respect to BPC and the Piper individuals the instant case presents the question anticipated in *Ernst & Ernst*. Here there were misrepresentations or omissions of known facts, and the questions are whether intent to deceive is necessary, and, if so, whether it was present. This case appears to present the situation where there was a knowing misstatement, but no intent to deceive. Although many knowing misstatements will be made with the intent to deceive, that conclusion does not necessarily follow, and this, according to the findings of the DC accepted by the CA, is a case where it did not.
This case may, therefore, require an exploration of the concept of "recklessness" in a Rule 10b-5 or § 14(e) situation. Because of the likely significance of the question of recklessness, I include the following excerpt from Prosser's Law of Torts. I presume that you would not be satisfied with any less rigorous formulation.

"The usual meaning assigned to 'wilful,' 'wanton,' or 'reckless,' according to taste as to the word used, is that the actor has intentionally done an act of an unreasonable character in disregard of a risk known to him or so obvious that he must be taken to have been aware of it, and so great as to make it highly probable that harm would follow. It usually is accompanied by a conscious indifference to the consequences, amounting almost to willingness that they shall follow; and it has been said that this is indispensable. Since, however, it is almost never admitted, and can be proved only by the conduct and the circumstances, an objective standard must of necessity in practice be applied. This requirement therefore breaks down, and receives at best lip service, in any case where it is clear from the facts that the defendant, whatever his state of mind, has proceeded in disregard of a high degree of danger, either known to him or apparent to a reasonable man in his position.

The result is that 'wilful,' 'wanton' or 'reckless' conduct tends to take on the aspect of highly unreasonable conduct, or an extreme departure from ordinary care, in a situation where a high degree of danger is apparent. As a result there is often no clear distinction at all between such conduct and 'gross' negligence, and the two have tended to merge and take on the same meaning, of an aggravated form of negligence, differing in quality rather than in degree from ordinary lack of care. It is at least clear, however, that such aggravated negligence must be more than any mere mistake resulting from inexperience, excitement, or confusion, and more than mere thoughtlessness or inadvertence, or simple inattention, even to the extent of falling asleep at the wheel of an automobile, or even of an intentional omission to perform a statutory duty, except in those cases where a reasonable man in the actor's place would have been aware of great danger,
and proceeding in the face of it is so entirely unreasonable as to amount to aggravated negligence. 4th Ed. at 185-186.

I have less trouble applying the concept of recklessness to a scienter situation as defined above. From various indications a person may know that there is a substantial likelihood that a particular statement is misleading. If, in the face of that knowledge, he proceeds without further investigation, he has been reckless with respect to the truth of that fact. Under Prosser's formulation, recklessness as to the existence of facts carries with it at least a hint of willingness to mislead in the event they are false. If, on the other hand, a person knows that a particular statement is not accurate, and, in the face of that knowledge, makes the statement or does not modify it, the question of his intent is squarely presented. He may, of course, have had the specific intent to deceive. If so, there is no problem. The problem arises when he did not have the specific intent to deceive. In deciding what to disclose and what not to disclose, a person may make a mistake of judgment. I presume that the decision not to disclose a known fact may be made either negligently or recklessly. The question is: "Reckless as to what?", and, apart from the circular reply, "As to whether to disclose", the answer (I think) must be "As to whether the fact was material." This answer does not help very much. In TSC Industries, Inc. v. Northway, Inc., 96 S.Ct 2126 (1976), the Court defined the concept of materiality for purposes of proxy rule 14a-9 as that information for which "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." Id. at 2133.

* Marshall's op. last Term.
Since the definition of *materiality* has an objective reasonableness standard built into it, a decision not to disclose a fact that has been held to be material is necessarily negligent -- unless one makes the unlikely assumption that a lower standard of reasonableness should exist for corporate executive than for shareholders.

I am not sure how one would move up the scale of seriousness from negligence to recklessness, perhaps passing on the way the concept of "gross" negligence. These are notoriously fuzzy areas of the law. One possibility is the decision approaches recklessness as the materiality of the fact becomes clearer. This approach essentially would leave it to the trier of fact as to how to characterize the faulty decision not to disclose. Another more demanding variation would be to require that the person was warned by another, perhaps counsel, that a fact should be disclosed. If a person were somehow put on notice in this way, the element of a knowing disregard of a known risk would be clearer.

I think that the requirement of an intent to deceive under Rule 10b-5 is something of a departure from doctrine as it had developed. Neither Judge Timbers nor Judge Mansfield thought that intent to deceive was required in addition to a knowing misstatement. In her article, Bucklo states that, "The distinction [between *scienter* and intent to deceive] is important because proof of an intention to mislead has been eliminated as an element of proof 10b-5." Bucklo, *supra* at 573. If the Court were to refuse to allow liability for recklessness, specific intent to deceive would have to be shown. This would reduce Rule 10b-5 to a rule of common law fraud in this respect. One could invite the trier of fact to
infer intent to deceive from the fact of the decision not to disclose a fact which a reasonable person would want to know in making a decision, but a requirement of proof of subjective intent would certainly make the plaintiff's task much more difficult. I would favor including recklessness as a basis for liability. In most cases where recklessness, as defined by Prosser, is found, intent to deceive is at least probable. If recklessness as to the existence of material facts would support liability, then recklessness in deciding not to disclose facts would be an a fortiori case.

With the above introduction, I turn to a description of the standards imposed below. It is necessary to describe both the general statements and the specific application of the standards. In their statements of general standards, the judges tended to mix questions of scienter and of intent to deceive.

The CA 2 judges who decided this case below apparently became involved in something of a struggle over the scienter doctrine to be applied in a § 14(e) case. There was general agreement that § 10b-5 standards should be imported in a § 14(e) case, so the disagreements set out below indicate a tension in both areas.

Judge Timbers' analysis was as follows:

"As for the concept of culpability, intent to defraud is not an indispensable element in a private action under Rule 10b-5; knowledge of falsity or reckless disregard for the truth may be sufficient. . . . We have indicated, however, that mere negligent conduct is not sufficient "to permit plaintiffs to recover damages in a private action under § 17(a) or § 10(b)," (A-35)."
Judge Timbers suggested that, "Those with greater access to information, or having a special relationship to investors making use of the information, often may have an affirmative duty of disclosure." (A-36). Judge Timbers summarized his position as follows:

"In sum, and put as simply as possible, the standard for determining liability under § 14(e) on the part of a person making a misleading tender offer, or a responsible officer of a corporation making such an offer, is whether plaintiff has established that defendant either (1) knew the material facts that were misstated or omitted, or (2) failed or refused to ascertain such facts when they were available to him or could have been discovered by him with reasonable effort." (A-36-A-37).

Judge Gurfein stated his position as follows:

"I agree that some kind of scienter must be shown. But I do not think a litmus paper test of scienter will ever be found. I am content to accept the general formulation that mere negligence will not suffice in a private action for money damages and that 'recklessness that is equivalent to wilful fraud,' SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 868 (Friendly, C.J. concurring), is required for a violation of Section 14(e) as well as of Section 10(b)."

Judge Mansfield agreed that some form of scienter is necessary and that "while less than the specific fraudulent intent required to prove common law fraud will suffice, mere negligence is not enough . . . ." (A-103). Judge Mansfield stated that although "an intent to defraud has not been shown, defendants' conduct amounted to more than mere negligence," (A-103). He did not feel that the analysis would be aided by abstract labels such as "culpability" or various gradations of "recklessness." (A-104). Relying on other sections of the securities acts, Judge Mansfield concluded that:
"[T]he scienter requirement would be satisfied upon a showing that the person charged knew the material facts misstated or omitted and could reasonably have been expected to appreciate their significance, see Heit v. Weitzen, 402 F.2d 909, 914 (2d Cir. 1968), or, if he did not know them, that he had reasonable cause to believe that there might be a material failure in disclosure and yet did not ascertain and disclose the facts even though he could have done so without any undue effort. In short, the scienter requirement would be met if the corporate officer (1) knew the essential facts and failed to disclose them, or (2) failed or refused, after being put on notice of a possible material failure in disclosure, to apprise himself of the facts under circumstances where he could reasonably have ascertained and disclosed them without any extraordinary effort. (A-106).

C. The Violations as Analyzed by the D.C. and the C.A.:

1) The Piper Individuals' letters in January. The DC held that there was no violation here because the characterization of the tender offer as "inadequate" referred to factors other than price. The DC also concluded that, if the reference was to price, "it would be more fatuous than misleading." App. at A-135.

CA 2 disagreed with the DC's characterization of the January letters, concluding that "inadequate" referred to price, and that the letters were materially misleading.

"At that time Piper stock was selling on the market for considerably less than $65 per share. First Boston in fact had given Piper its opinion that the price offered was 'fair and equitable'. The Piper corporation itself, acting through the Piper family, at that time was contemplating a large sale of Piper stock to Grumman at the same price," App. at A-38.

CA 2 held that corporate officers have a high fiduciary duty of honesty and fair dealing to their shareholders and that the "Piper this obligation when they sent out these shareholder letters family obviously disregarded, knowing that they were materially
This fact situation presents the intent to deceive question of whether the Pipers were reckless in deciding not to disclose known facts.

2) The Piper Press Release in January. The DC found that the Grumman deal was not a sham and that the "put" was simply a way of Grumman getting out of the situation in the event that a Grumman-Piper merger did not materialize. The DC analyzed the release as it related to possible confusion by Chris-Craft, finding that CCI was not confused and would not have changed its course. See App. at A-136-137.

CA 2 held that Piper should have described the existence of the "put" in the Grumman deal.

"By failing to disclose this provision, the release portrayed the Grumman agreement as a completed, favorable deal between Piper and Grumman which also was likely to provide a basis for further and more profitable relations between the two companies." App. at A-40.

CA 2 concluded that:

"The Piper family recklessly disregarded its obligation to shareholders in failing to disclose with substantial accuracy a transaction which was likely to affect the attitude of Piper shareholders toward the CCI tender offer." App. at A-40.

This fact situation also presents the question of recklessness with respect to a known fact.

3) The BPC Failure to Correct the BAR Valuation. The DC held that BPC had erred in carrying its BAR stock on its books at $18.4 million, "an unconventional figure in terms of transactional accounting, and one with a checkered history." App. at A-142. The DC explained the history of that valuation as follows:
"Historical cost of the BAR stock, less depreciation and other accounting adjustments, was $29.8 million. In 1965, in view of a then possible sale of BAR, Bangor Punta wrote the asset down to some $8 million. That sale did not materialize and the carrying figure was again revised (this time upward) to reflect an $18.4 million valuation of the BAR investment by investment bankers. The book increase resulting from this revaluation was credited directly to earned surplus (bypassing the income accounts)."

Because of the discussion concerning the sale of BAR, which culminated in the sale of the stock in October, 1969, for $5 million, the DC concluded that BPC should not have carried the stock at the $18.4 million figure. [The DC concluded that BPC had not delayed a previously agreed upon sale. App. at D-13.] As to the requirement of disclosure, the DC held that:

"For the circumstances do indicate a sufficiently serious consideration of the possibility of sale at a figure some $13 million below the then carrying value of the BAR stock on Bangor Punta's books so as to force the conclusion that the Bangor Punta directors could not, at the time, have believed that the $18.4 million figure (based on an appraisal of 1965 fair market value) any longer represented a responsible appraisal of market value of the BAR holding."

The DC held further that:

"I find that Bangor Punta did not intentionally or purposefully mislead Piper Aircraft stockholders or the public or investors by the omission to make disclosure of the sale under consideration nor did Bangor Punta or its directors intend to gain an advantage over Chris-Craft by the non-disclosure in the contest being waged for control of Piper. There was no purposeful connection between the non-disclosure and the contest for control. In other words, the non-disclosure was not prompted by an improper purpose."

In a later decision, the DC reiterated the above finding in slightly different language: "None of the registration errors, including
the BAR item, went beyond mere negligent omission or misstatement of fact." App. at A-148.

CA 2 held that the BAR misrepresentation was a violation that would support liability. Judge Timbers' opinion at this point seems remarkably inconsistent. He acknowledged that the evidence does not show that BPC failed to disclose the sales negotiations in bad faith, App. at A-47, but then stated that intent to defraud is not an indispensable element in a private action for damages under the antifraud provisions of the federal securities laws. Judge Timbers then stated what can only be described as a negligence standard, noted that corporate officers must have a range of discretion in discharging their duties, and then redefined the standard as recklessness or gross negligence in a footnote. Only an extended quotations can do justice to this passage:

"The securities laws impose upon an offeror of an exchange offer a duty to act reasonably in discovering facts material to the offer as of the time of the transaction and in disclosing fully those material facts of which the offeree is presumably unaware and which ostensibly would influence his judgment. Cf. Kohler v. Kohler Co., supra, 319 F.2d at 642. Corporate officers have a reasonable area of discretion in determining how far to explore the facts and in deciding what facts need to be disclosed. So long as they operate within this area, the securities laws do not impose liability. In order to encourage candor in the securities market, and well informed decisions by investors, this discretion must be exercised with caution."

* We do not hold that a corporation prima facie has acted unreasonably if the omission or misstatement is material. Corporate officials must be allowed considerable room for discretion; otherwise their normal functions as corporate officials will be inhibited. The totality of the facts and circumstances must be examined to determine whether the officials were reckless or grossly negligent.
We believe that the officers of BPC greatly transgressed their allowable area of discretion in not disclosing the BAR negotiations and other circumstances reflecting the value of the BAR. The officials in charge of the exchange offer were well aware of the discussions with Amoskeag and the activities of the special BAR committee. They also were aware of all the other circumstances that indicated that the book value of the BAR was deceptive and unrealistic. Their judgment not to reveal basic information about the then current status of the BAR holdings clearly was unreasonable. They showed reckless disregard for the import of their activities concerning the BAR. They knew that the book value of the BAR set forth in the registration statement was no longer realistic. Considering the totality of the facts and circumstances, they failed to discharge their clear duty of proper discharge.

We hold that such conduct on the part of BPC and its officers violated § 14(e)." App. at A-47-48.

Our concern is the holding with respect to intent to defraud, and, for this purpose, Judge Timbers is not helpful. He clearly says that the decision not to disclose was unreasonable — a negligence standard. When he talks about "reckless disregard for the import of their activities" it is hard to know what he is addressing. One could interpret as addressing the question of the materiality of the information.

Although Judge Gurfein is not specific about any of the violations that were found, the BAR misstatement, like the others, must be presumed to satisfy his scienter requirement of "recklessness that is equivalent to willful fraud" because he voted in favor of liability.

Judge Mansfield applied his scienter standard rather tersely, indicating, as suggested above, that a misstatement of a known fact which is material is sufficient to establish liability:

"Since the defendants in the present case had knowledge of the material facts misstated or omitted or had
sufficient notice of possible misstatements and could reasonably have ascertained the facts with a minimum of effort, the proof clearly satisfies the standard." App. at A-106-107.

One can learn more about Mansfield's appraisal of the BAR incident from his discussion of the issue of the injunctive relief sought by the SEC, an issue that is not before this Court. He states that Judge Timber's characterization of BPC's conduct as 'most flagrant' . . . simply ignore[s] undisputed contrary findings of fact . . . App. at A-117. Judge Mansfield also, in part, came to the defense of the BPC decision on BAR:

"The $18.4 million ascribed to BAR as 'stated book value' on BPC's financial statements was an obsolete and hence misleading figure in view of pending negotiations for sale of the railroad at a much lower price. Some caveat or reference to the negotiations was required. However, I cannot agree that BPC's failure to furnish additional data was 'flagrant.' This characterization ignores the fact that under generally accepted accounting principles 'stated book value' may properly be used in a financial statement and is not viewed in the financial world as the equivalent of market value. A person able to read a balance sheet would probably have recognized that such 'historical' cost did not necessarily represent current liquidating value. Furthermore, to write down the figure immediately to $5 million might have been treated by the SEC as speculative and possibly misleading, in view of the other forms of disposition of BAR that were still under consideration." App. at A-122-123.

Although Judge Mansfield did not speak in terms of the recklessness of the decision not to disclose, one could argue from the above language that he would not have so characterized the decision. A similar, albeit less precise, reading can be obtained from Judge Gurfein's treatment of the injunction issue. He acknowledged that sustained recklessness might be sufficient to justify an injunction, but held that the DC had not abused its discretion in denying one.
4. The First Boston ("FB") § 14(e) Violation. The DC refused to impose any liability on FB. It found no fraud and no deceit. The court stated that even if there were a basis for imposing liability on BPC or Piper, there was less basis for FB. The court held that FB worked in good faith in the interest of its clients and that the substantial decision-making power was in the hands of the clients. App. at A-158.

The CA disagreed with the DC. Here, as in the case of BPC's liability for the BAR omission, Judge Timbers was unclear as to what the minimum level of scienter is. The court noted the existence of liability under § 11 in appropriate circumstances, but went on to hold that liability can also be imposed under § 14(e). Although an underwriter does not literally "make" statements, the court held that liability under § 14(e) was possible because of the importance of the underwriter's role in the tender offer process. CA 2 was aware of the due diligence defense to an action under § 11, but held that it did not have to decide if a reasonableness (negligence) standard should be imposed under § 14(e) "since First Boston's conduct, in our view, went far beyond mere negligence." There are other indications that CA 2 required more than mere negligence for FB's liability:

"An underwriter is liable under § 14(e) as an aider and abettor of the issuer if he was aware of a material falsity in the registration statement or was reckless in determining whether material falsity existed." App. at A-47.

Here the court is dealing with a scienter question, as defined above to mean knowledge of the facts, rather than intent to deceive. CA 2 held that:
"If it was aware of facts that strongly suggested, even though they did not conclusively show, that the registration materials were deceptive, it was duty-bound to make a reasonable further investigation." App. at A-51.

The court then focused on the minutes of several BPC board meetings which discussed the possibility of a sale of BAR and concluded that:

"These minutes, if not sufficient in themselves to lead a reasonable person to believe that the registration statement was misleading, certainly would have impelled a reasonable person to explore further. The only additional investigation by First Boston was to question company officials about the possible sale of the BAR. First Boston did not seek verification of the officials' answer that a sale was not anticipated at that time." App. at A-54.

CA 2 held that under these circumstances FB's certification of the registration statement amounted to an almost complete abdication of its responsibility. After indicating the additional investigation that FB should have done, CA stated that, "We hold that First Boston possessed enough information reasonably to deduce that the BPC registration statement was materially inaccurate." App. at A-55.

Judge Mansfield held that he would impose liability on an underwriter under §14(e) "solely upon the principle of implying liability as a means of promoting private enforcement of the anti-fraud provisions of the securities laws," App. at A-116. He stated that he drew no encouragement in that holding from §11 and stated that one could argue that §11 presents an argument against implying liability under §14(e) against an underwriter. App. at A-117. Judge Mansfield did not provide any further discussion of the action of FB, but this probably fell under his scienter standard imposing liability where a corporate officer,
"failed or refused, after being put on notice of a possible material failure in disclosure, to apprise himself of the facts under circumstances where he could reasonably have ascertained and disclosed them without an extraordinary effort." App. at A-106.

The liability of BPC must be for recklessness in deciding not to disclose the information about the BAR. BPC knew all the facts that caused the courts below to decide that the BAR information should have been disclosed. The liability of FB is in my opinion different. It must be based on recklessness in failing to discover the full extent of the facts concerning the BAR. The point was that FB had knowledge of facts that should have led it to investigation further. Thus, combining BPC and FB we have the issues of recklessness in failing to discover facts (FB) and recklessness in failing to disclose known facts (BPC and Pipers).

5) My View of the Facts (hesitant):
I think that the best thing that the Court could do with such a confused case as this would be to remand for consideration in light of the standards set out in the opinion. It is practically impossible to be confident about the standards being applied by the judges below. If this is not done, I would characterize the violations as below:

1) The Pipers. The DC analysis does not really help here. Viewed in the total context of this case, I would hold that the Pipers were reckless in their decision not to disclose that they had reason to believe that $65 was a fair price and that there was a put in the Grumman deal.

2) BPC. I view this as a hard question. I think that the materiality of the BAR information is strong, but BPC has put forward
some convincing reasons why it did not disclose the information. I think that they might have disclosed it and analyzed the effect in the alternative, depending upon how the final deal was structured. I would probably come down on the side of rejecting liability.

3) FB. If BPC is not liable, then FB should not be liable. I think that FB might have been negligent in not going further in its investigation, but I would not characterize its mistake as reckless.
III. Rule 10b-6

In its en banc decision concerning the preliminary injunction, CA 2 held that BPC had violated Rule 10b-6 by purchasing Piper shares during the pendency of its exchange offer. The theory, again, was that, because of the exchange offer, Piper shares constituted rights to purchase BPC shares. Although it would seem that the last thing a tender offeror would want to do would be to artificially drive up the price of the shares for which it is offering to exchange its own shares, CA 2 held that there was a possible manipulative purpose to be served: "If the price of the target company's stock does increase in response to cash purchases by the exchange offeror after the offer has been announced, many shareholders in the target company are likely to assume that the price increase results solely from the bullish effect of the exchange offer on the market." App. at C-17. CCI and the SEC agree that this fact situation raises concerns consistent with the purpose of the rule. Although CA 2 spoke about the purpose of Rule 10b-6 being to avoid manipulation, it said nothing about the need to establish any element of scienter. The court simply concluded that BPC could not "lawfully purchase these shares during the tenure of its exchange offer." No other findings as to liability were required.

On remand, the DC was still rather unsympathetic to the Rule 10b-6 theory. It had to answer two questions left open by CA 2: whether any of the exceptions of Rule 10b-6 applied and what remedy was appropriate for the violation. Although it held that none of the exemptions applied, the DC found that this was a mere technical violation, that on these facts the case was more
nearly within the spirit of the exemptions to the rule than within the rule itself. Finally, the DC denied recovery because of the failure of CCI to establish causation. I will return to the causation issue in another section of the memo.

A. Standing:

BPC argues that the Court's decision in Blue Chip Stamps holding that the purchaser-seller requirement of Rule 10b-5 cannot be ignored eliminates CCI's standing to sue for the violation here, because CCI did not buy any of the BPC shares the price of which was supposedly being manipulated. I think that Blue Chip Stamps would control here despite the fact that the purchaser-seller language does not appear in Rule 10b-6.

The language is in the statute, and Ernst & Ernst indicates that the Commission cannot go farther with its rules than the statutory language authorizes.

CCI and the SG have argued that there is no purchaser-seller requirement because the manipulative practice forbidden by Rule 10b-6 is also forbidden by the general language of § 14(e). I think that this argument is a loser. The case was not tried on this basis. It might be the case that an overt attempt to manipulate in violation of Rule 10b-6 would be a violation of § 14(e), but that was not the theory here.

In its brief the SEC appears largely to have abandoned the theory that there is no need to worry about the requirements of Rule 10b-6 because the activities proscribed there are also illegal under § 14(e). The SEC spends a number of pages (163-171) relating the history of Congress' concern about manipulation, which extended beyond false information
to the creation of false impressions of investor activity on the markets. The SEC now argues that Blue Chip Stamps and Ernst & Ernst "may well be inapplicable to this case . . ., but if applicable should not militate against the maintenance of an action under Rule 10b-6 as the lower court held." SEC's Brief at 183. The argument is that the class of persons to be benefitted by the rule includes "all users of the markets for the relevant securities -- that is, the securities being distributed, or rights to purchase the securities being distributed." Id.

"[W]here a defeated offeror has purchased relevant securities -- the target company's stock -- it is precisely the kind of purchaser intended to be afforded a private remedy in actions grounded upon Section 10(b). SEC's Brief at 187.

I think this is far-fetched. Under any theory that makes sense, Rule 10b-6 is concerned with manipulation of the securities being distributed; here, the BPC package. If one focuses on the Piper shares it is because of the manipulation that they can create with respect to the BPC securities.

3. Scienter. The SEC argues that where a person knowingly does an act proscribed by a rule such as 10b-6, no additional scienter is required. Id. at 188-89 and n. 431. The SG contends that if a particularized consideration of each case is necessary, there would be no point in the Commission establishing specific rules. The SEC also argues that it is not necessary to show any manipulative effect on the market because that more properly is "an argument to be addressed to the Commission in advance of
the transaction." SEC's Brief at 187.

The SEC argues that Rule 10b-6 was adopted pursuant to the Commission's authority under both Section 9(a)(6) and 10(b) of the Act and that any limitations upon recovery "to be obtained for violations of Rule 10b-6, should be consistent with the terms of Section 9(e), not the parties interpretations of this Court's decisions under Rule 10b-5. SEC's Brief at 191. This is an ingenious argument, but it is a bit too convoluted to convince me. I do see the close relationship between the concerns of § 9 and the Rules 10b-6, 7, and 8. But the fact remains that the rule at issue here is Rule 10b-6. If that is not dispositive of the question of the authority under which a rule was issued, the SEC has failed to do more than simply assert that the Commission relied on both statutes in issuing the rules. I think that the case must be evaluated under the general rules established for § 10(b) and the rules enacted under it, and not § 9. See BPC Reply at 56-57.

If the 10b-6 issue gets beyond the standing question, I have real problems with the rest of CA 2's treatment. I am simply unsure about the scienter question. I can see the SEC's point about such a requirement eliminating much of the importance of their rule-making authority. There may be some room for a per se rule of manipulation under specific rules such as 10b-6. There is authority to that effect. See Jaffee & Co. v. S.E.C., 446 F.2d 387 (CA 2, 1971). This question seems to be a significant one on which the parties have not focused a great deal of attention. BPC argues that if a per se rule covering these
facts exists at all, it is Rule 10b-13, which is much more specific than Rule 10b-6. Rule 10b-13 was not effective at the critical times of this case.

Assuming that scienter has to be proved, I tend to favor BPC. CCI makes a number of shrill accusations about warnings of counsel, etc. BPC denies these. Apparently, BPC did not get the explicit warning from the SEC staff that CCI got concerning the interpretation of Rule 10b-6 to cover this factual situation. The DC holding that this was a purely technical violation is so strong that it is difficult to overcome.

Assuming that a per se rule does exist, so that scienter need not be shown, the per se rule can only establish the violation. It seems excessive to say that for an implied private cause of action the courts will presume market effect, reliance on market effect, and causation of loss. As to causation, see the discussion in the separate section on that subject.
IV. The Causation Issues

CA 2's treatment of the question of causation cuts across the whole case and is probably the most questionable part of the entire decision. If the Court does not conclude that the case should be reversed on a logically prior issue, the question of causation could be one of the earliest ways to dispose of the case.

The questions here involve two earlier decisions of the Court in the securities area, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970) and Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972). Because of the relevance of these cases, I will provide a thumbnail summary of each one.

Mills involved a challenge under Rule 14a-9 to a merger which allegedly had been effected through a materially misleading proxy statement. The courts below found that there had been a material omission from the proxy statement. The CA had held that if the defendants could show by a preponderance of the evidence that the merger would have received a sufficient vote even if the proxy statement had not been misleading, plaintiffs would be entitled to no relief. This holding was based on the common law requirement of reliance. The CA had concluded, however, that the question of individual reliance by thousands of individuals could scarcely be shown. The CA resolved this difficulty by holding that the merger would be upheld if it were shown to be fair to the minority shareholders. This Court reversed the CA, noting that § 14(a) was based on the principle...
of corporate suffrage and that the CA's resolution would allow the stockholders to be bypassed. The Court centered its analysis on the concept of materiality, which "embodies a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote." 396 U.S. at 384. The Court reasoned as follows:

"Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction. This objective test will avoid the impracticalities of determining how many votes were affected, and, by resolving doubts in favor of those the statute is designed to protect, will effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions."

The Court in Mills was careful to place its language in context:

"Our conclusion that petitioners have established their case by showing that proxies necessary to approval of the merger were obtained by means of a materially misleading solicitation implies nothing about the form of relief to which they may be entitled." 396 U.S. at 386.

After considering "[p]ossible forms of relief," 396 U.S. at 386, the Court concluded that "damages should be recoverable only to the extent that they can be shown," 396 U.S. at 389, and remanded the case for further proceedings on the damages question. Mills has recently been interpreted by the Court as "holding that the questions of liability and relief are separate in private actions under the securities laws, and that
the latter is to be determined according to traditional principles," Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 64 (1975).

Ute involved a Rule 10b-5 action by an association of mixed-blood Indians against a bank and its officials. The bank had been made transfer agent for certain specialized shares issued when the United States distributed certain tribal assets held in trust. The bank officials were buying from the Indians at a lower price than they were selling to non-Indian buyers. The Court held that the bank was a market maker and had a duty to disclose. The activities of the bank officials were characterized as a device, scheme, or artifice that operated as a fraud on the Indian sellers. Turning to the issue of reliance, the Court held as follows:

"Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a pre­requisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. [Citing, inter alia, Mills] This obligation to disclose and this with­holding of a material fact establish the requisite element of causation in fact." 406 U.S. at 154.

I think that CA 2 got entirely too carried away with its purported application of Mills/Ute in the instant case. Before examining that application in the context of each of the violations, several more basic points need to be made. Both Mills and Ute involved plaintiffs who were members of the classes intended to be benefitted by the statutes under which
their actions were implied. The above quote from *Mills* actually speaks of "resolving doubts in favor of those the statute is designed to protect." Although I conclude that tender offerors such as CCI could be given an implied cause of action under § 14(e), I am convinced that Congress did not enact § 14(e) for the benefit of tender offerors. The Court could say that the *Mills/Ute* doctrine simply does not apply in favor of CCI. From the quoted language in *Ute* one could argue that the doctrine only applies to non-disclosure and not to misrepresentation. Both situations are present in the instant case. Policy considerations would indicate that no such distinction should be drawn. If the Court concludes that CCI should have an implied cause of action, then *Mills/Ute* probably should apply because of the difficulty of showing reliance. Properly applied, the doctrine would not be as sweeping as the holding of CA 2.

Another threshold issue is whether the presumption of reliance (if one characterizes *Mills/Ute* that way) should be rebuttable. The feeling that I get from *Mills* is that it was not intended to be rebuttable. Judge Mansfield preferred to speak of reliance as a matter of law rather than a presumption because of his concern that a presumption might be held to be rebuttable, with the problems of discovery and proof that would follow.

Assuming that *Mills/Ute* should apply to this case, the question is how should it apply. The basic objection to the CA 2 approach is that it took a doctrine from one kind of situation and mechanically applied it to another, significantly
different situation. The instant case involves much more complex causation issues from those in Mills and Ute. Assuming that Mills/Ute would dictate presumption of reliance in this case, hard causation issues remain. Mills and Ute are different in once a presumption of reliance was made, the cases were easy. In Mills, the presumption of reliance in casting votes (which were necessary to the approval of the merger) really left no causation question. The votes were necessary and they could not have been obtained without the proxy information which was misleading. Ute is similar, although for a slightly different reason. Once reliance was presumed or held to be unnecessary, everything else followed naturally: If the Indians had known that higher prices were available they surely would not have sold their shares at lower prices.

BPC argues that Mills and Ute "simply did not involve any presumption at all about how the shareholders, the plaintiffs there, would have acted in the absence of the defendants' violations. I don't agree with BPC's analysis, partly because I don't understand it, but I agree with their conclusion. See BPC Brief at 69-75, and BPC Reply at 41.


Taken altogether, the holding of CA 2 as to these violations is perhaps the most striking. The DC had found no violation. CA 2 held that violations had occurred. The odd thing is that CCI got more shares than it committed itself to accept. There was evidence that CCI might have trouble getting
extra money to buy any more shares, although CA 2 discounted this evidence. App. at A-62. The court held that CCI was denied the opportunity to purchase additional shares and that the effect of the misleading statements probably had a dampening effect on CCI's other efforts to get shares. Because of the narrow margin of victory, the Court held that the Pipers had denied CCI a fair opportunity to win. As a result the Pipers were held jointly and severally liable for the massive damages set by CA 2. Judge Mansfield parted company with the majority on this issue. He concluded from the record that CCI did not have the funds to buy any significant amount more than 300,000 shares. App. at A-113. For this proposition he relied on the fact that CCI had not gone into the market to buy shares that were available, either in large or small blocks. He found that by March 19, 1969, the effect of the press release was dissipated by the collapse of the Grumman deal. App. at A-115. Judge Mansfield viewed the speculation about continuing psychological effect as speculation. He would have affirmed the dismissal of the claim against the Pipers.

The CA 2 position left out an important consideration. Assuming that CCI could have purchased more shares, CA 2 should have determined whether the acquisition of the additional shares would have resulted in CCI's victory or BPC's defeat. The approach taken by CA 2 assumed that after CCI acquired some additional shares, all subsequent events would have proceeded unaltered. Unlike Mills and Ute a presumption of reliance does not answer all of the necessary questions.
Three additional arguments by the Pipers are made. They argue that the violations by BPC were intervening causes cutting off their liability. They argue that damages for their violations should be assessed in May, 1969, at which time there would have been no damages. Finally, they argue that CCI should have gotten out of its majority position by tendering to BPC.

3. The BAR Misrepresentation. CA 2 used Mills/Ute to presume reliance so that BPC would not have received the 7% of the Piper shares that it acquired through its exchange offer. The full impact of Mills/Ute as applied by CA 2 can be seen in the following quotation:

"Under the Mills-Ute test, we must presume that BPC's offer was not so appealing, considering the BAR loss, as to have attracted any takers. See Vine v. Beneficial Finance Co., supra, 374 F.2d at 635. Since BPC eventually acquired only about 51% of the outstanding Piper shares, it is clear that the 7% acquired through its exchange offer was critical to its success. Reliance and causation have been shown." App. at A-60.

If this were the test, every material misrepresentation would lead to potentially massive damages, even though an objective viewer could be sure that the result would not have been different without the misrepresentation. No rational tender or exchange offeror is going to try to get more shares than he needs for his goal, and that will often be 51%. Nothing is gained by having a rule that encourages such persons to get more shares to avoid the potential operation of this kind of presumption. Again, CA 2 failed to consider the possibility
that BPC would have won even without the shares.

BPC argues that Mills/Ute does not apply here. It argues that to the extent that it does apply, it was satisfied by the DC order that BPC offer rescission. BPC also makes the objections noted above, and argues that CCI did not have the resources and will to win.

Although the SEC is so discrete about this issue that one could miss the discussion in the middle of the tome that was submitted, it appears to agree that CA 2 got it wrong.

Rather than speaking of reliance and causation, the SG speaks of two kinds of "causation": "(i) causation for purposes of determining the existence of a cause of action -- that is, liability, and (ii) damages causation." SEC Brief at 145. The SEC argues that liability causation (reliance, in effect) should be presumed under Mills/Ute in a § 14(e) case. But, the SG acknowledges that CA 2 went too far in presuming causation of damages:

"But, as was held in Mills, supra, 396 U.S. at 389 and noted in Rondeau, supra, 422 U.S. at 64, "damages should be recoverable only to the extent that they can be shown." The presumption of causation from materiality, consequently, does not automatically entitle a private plaintiff to monetary damages -- a causal connection between the material misstatement or omission on the one hand, and the consequences complained of on the other, must be demonstrated. Thus, while the court below, having properly found material misstatements and omissions, properly presumed causation to establish liability (A. 55-63), the plaintiff here should be allowed to recover only those damages shown to have been caused by the violative conduct. For, as Judge Friendly stated in Crane Co. v. American Standard, Inc., 490 F.2d 332, 334 (CA 2, 1973):"
"Quite conceivably a judge might find the chain of causation so dubious and the task of determining damages so elusive as to lead him to decide that, except for some items that may be readily provable, he could not properly award anything save perhaps attorneys' fees." SEC's Brief at 147-148.

C. Causation with respect to the Rule 10b-6 Violation

As stated previously, the DC found the Rule 10b-6 violation to be a technical violation, without substance behind it, with no manipulative effect, which neither misled CCI or any Piper shareholders. Judge Timbers made an even more strained application of Mills/Ute with respect to this violation.

"Either the purchases were prohibited by the Rule or they were not. If they were, as we have held, then presumptively a stimulating effect was produced which misled the public. *** Piper shareholders presumptively were deceived by a material alteration in the value of the exchange package. They no doubt were influenced by this deception to take advantage of what seemed to be a highly favor-able BPC exchange offer." App. at A-66.

This approach presumes an effect, then presumes reliance on the effect (which might be proper under Mills/Ute) and then presumes causation of ultimate result from the reliance. The first and the third steps are not required by Mills/Ute and strike me as very excessive. Apparently, it struck Judges Mansfield and Gurfein as excessive also. In a sense, however, their holdings were even more striking. The fact of a violation of Rule 10b-6, without more, is sufficient to support the kind of massive liability imposed in this case. Judge Mansfield's analysis of the Rule 10b-6 issue is as follows:
"I concur in the view that since BPC's unlawful purchases of Piper shares enabled it to gain control of Piper, its conduct is actionable at the instance of CCI, which was thereby handicapped in its lawful competition for control. However, I cannot agree with the main opinion's view that BPC's purchases actually 'operated in the market to make BPC's exchange offer deceptively attractive.' There was no such proof. Nor do I accept the view that liability should be predicated upon the 'presumption' that 'Piper shareholders ... were deceived' or that the 'illegal purchases will substantially inflate' the price of the exchange offer. Unless the presumption were conclusive, BPC would be entitled to rebut it by offering proof that its cash purchases did not have any radiating effect upon the exchange offer.

For these reasons my concurrence is based solely on the ground that where a party acquires control of a target corporation through violation of applicable provisions of the securities acts and regulations promulgated thereunder (in this case Rule 10b-6), it is liable as a matter of law to a competitor for any damages caused by the illegal conduct." App. at A-111.

Judge Gurfein's essentially similar comments are at App. at A-96.

Reversal and remand as to all parties' liability would be required on the causation question alone.
V. The Question of Damages

One of the issues here, particularly in light of the position of FB, is the relationship that should exist between liability for a cause of action allowed under § 14(e) by implication and the express provisions of the Securities Act. There is a good, detailed discussion of this question in the SEC's Brief beginning at 151. The SEC argues that where liability is based on negligent conduct, the limitations of § 12(2) of the 1933 Act should govern, but that where liability is based on fraudulent conduct, the limitations should not govern. This analysis extends to the Pipers, BPC and FB.

With particular respect to FB, the SEC argues that a different result should occur depending upon whether FB was acting as an underwriter or a dealer-manager. If FB was acting in the role of an underwriter and was merely inadvertent, the SEC argues that the damage limitations of § 11 of the 1933 Act should apply. I agree that in this case FB was acting more in the role of an underwriter. See SEC's Brief at 159. The SEC is willing to find negligence on the part of FB from the findings of the courts below. SEC's Brief at 156 n. 365. Although the CA clearly concluded that FB's errors went beyond mere negligence, the SEC argues that the case should be remanded to the DC for a findings regarding FB's "culpability in terms of breach of its independent duty as an underwriter."

Assuming that CCI can establish causation, the question
of the calculation of damages arises. I do not know how much
the Court would like to say about this problem so I will be
brief. The DC compensated CCI for the loss of opportunity to
compete for control. As an element of damages, this seems
appropriate. The DC took an estimated fair market value and
applied a percentage that a hypothetical buyer would pay for
the chance to compete for control, assuming that BPC did not
have its illegal 14% of the shares.

The SG would have used a figure higher than CCI's cost,
in order to reflect the premium for control [BPC paid $70-80
at the end], but would have discounted this by the possibility
that CCI would not have won. This discounting, in a sense,
pushes the question of causation back into the damage calcula-
tion. Using this approach, one might not demand a preponderance
of proof that CCI would have won but for the violation. Instead,
one would discount by the chance of success.

CA 2 was peeved with the DC for ignoring its order to
compensate CCI for the decline in value of its shares suffered
when BPC won. This represents the problem of illiquidity and
the danger of a compelled merger, possibly at the bottom of a
business cycle when the values are low. This also seems an
appropriate element of compensation. There may be some double
counting here. The price one would pay for control probably
takes into account the possibility of being stuck in a minority
position.

The hardest part of the award is that part attributable
to the general market decline. The SG in his brief in opposition
to cert. rejected compensation for market decline. SG's Brief at 23 n. 14. Presumably the shares acquired by CCI before it had the intention of competing for control should not be included in the award for general market decline. Apart from that block I really do not know who should carry the risk of this loss. A defeated tender offeror is particularly likely to be stuck with a large block of relatively unmarketable stock. While it is true that CCI's stock would have declined had it won, it would not have had the same interest in selling had it won.
VI Questions Concerning First Boston

There are enough issues concerning the imposition of liability on FB to take up any two normal cases.

First is the question whether FB should be liable under an implied § 14(e) action since it did not "make" any misleading statements. Assuming that liability of FB can be sustained under the considerations discussed below, I think that CA 2 was probably right about this. The underwriter does play a pivotal position in the issuance of a registration statement and can reasonably be said to make statements contained in it.

Second is the question whether an implied cause of action under § 14(e) should lie in a situation where an express, but more limited, cause of action is provided by the securities laws. In Blue Chip Stamps the Court expressly reserved the question "whether an implied action under § 10(b) of the 1934 Act and Rule 10b-5 will lie for actions made a violation of the 1933 Act and subject of express civil remedies under the 1933 Act." 421 U.S. at 752 n. 15. FB argues that this case presents the analogous question regarding liability under § 14(e) and that the answer is "no." FB argues that an early exemption of exchange offers was deleted for a narrow purpose and that Congress never intended for § 14(e) to apply to exchange offers, but only to cash tender offers. FB Brief at 32 and n. 14. The language of the statute forecloses this argument.
It would be possible, and probably desirable, for the Court to take a more limited approach, if it is so inclined to restrict the reach of § 14(e) by reference to § 11 of the 1933 Act. I have read two law review notes on this case, in both of which the student authors conclude that CA 2 disrupted the delicate balance intended by Congress when it enacted § 11. "Chris-Craft and Section 14(e): The Expansion of Lead Underwriters' Liability", 42 Fordham L.Rev. 820 (1974); "Section 11 and Underwriter Liability: A Case of Statutory Misconstruction", 7 Rutgers-Camden L. Jour. 741 (1976). It is interesting to note that both notes conclude that, words aside, CA 2 used a negligence standard in its opinion on liability. The Fordham note seems to argue that underwriters should not be liable beyond the scope of § 11. Liability under § 14(e) would expose underwriters to suits from a larger plaintiff class, expose them to a generally longer statute of limitations (that of the forum), and subject them to damage awards which could considerably exceed, as here, the express limitations of § 11(e). The Rutgers-Camden note takes a more limited position, arguing that the damage limitations of § 11(e) should be applied in an implied action against an underwriter under § 14(e).