

This is a memorandum I wrote to Chairman Cohen after listening to Commission discussion of an invitation from the Second Circuit Court of Appeals to the Commission to submit an *amicus curiae* brief in the case of *Heit v. Weitzen*, involving the potential liability of corporations under Rule 10b-5 for putting out misleading statements. My memorandum focused on the difficulty of finding an appropriate measure of damages for aggrieved investors in the event such liability was established. The Chairman's penciled comments read as follows:

But it may have [been?] done for the corporation as a basis for promotion, options, bonuses, what have you — Remember also changing concepts of what is interest of corp — What if you can't trace loot except in a vague way which does not permit evaluation but someone was hurt? How do you get punitive damages & how much? Who is to marshal and allocate? We do need some new concepts but where are they?

As far as I recall, the question of damages was not addressed by the Commission in its *amicus* brief, or by the Second Circuit in the *Heit* decision. The question of the appropriate measure of damages in corporate misstatement cases has continued to be a difficult question. However, in the related area of liability under 10b-5 for insider trading, the Second Circuit, in *Elkind v. Liggett & Myers*, 635 F. 2d 156 (1980), adopted a measure of damages very similar to what I had suggested in the attached memo.

David L. Ratner
March 2003

MEMORANDUM

February 20, 1968

TO: The Chairman

FROM: David L. Ratner

RE: Rule 10b-5 – *Heit v. Weitzen*

The inability to come to grips with the remedy question at the Commission table this morning seems to me to result not so much from the difficulty of the problem as from attempting to apply seventeenth century (?) legal concepts to twentieth century problems.

The assumptions underlying the discussion appeared to be that, in order to establish and define a private right of action, you must:

1. Find somebody who was hurt;
2. Determine how much damage he suffered;
3. Find the person or entity responsible for the damage;
4. Determine whether he violated the law;
5. If he did, charge him for the amount of the damage.

This approach leads either nowhere or to such absurdities as holding the “corporation” liable to everybody who lost money by buying or selling its shares at a time when “the corporation” had published misleading information about itself.

These problems become manageable if you stare with a different assumption: that the purpose of Rule 10b-5, as of the securities laws generally, is to prevent or discourage certain practices, not so much because they may cause losses to particular investors as because they impair general public confidence in the securities markets. Private rights of action are simply one useful sanction in dealing with such practices. On this assumption, the steps in establishing the right of action would be as follows:

1. Find out whether there was a violation of the law;
2. Find out who did it (not corporations or other ethereal bodies, but flesh-and-blood types);

3. Find out what he got out of it (people seldom violate this kind of law unless they expect to get something out of it);
4. If his loot has a determinable value, find some person or group of people or entity to which it could be paid over without giving further offense to the conscience of the community.

This may result in payments of money to people who have no “right of action” in the seventeenth-century sense, but so what? That approach is one of the secrets of success of Section 16(b).

If the reward to the wrongdoer has no determinable monetary value (or even if it has), he can still be charged with punitive damages, if appropriate, or subjected to other obloquies such as being enjoined from certain activities, removed from office or, with due process, incarcerated.

I am afraid that if we do not produce some new and workable concepts in the remedy area, the courts will indeed cut back on the substance of the rule for fear of the consequences.

[Handwritten note by the Chairman: But it may have [been] done for the corporation as a basis for promotion, options, bonuses, what have you -- remember also changing concepts of what is interest of corp -- What if you can't trace loot except in a vague way which does not permit evaluation but someone was hurt? How do you get punitive damages & how much? Who is to marshal and allocate? We do need some new concepts but where are they?]