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October 15, 2004

VIA ELECTRONIC MAIL

Carole J. Washburn
Executive Secretary
Washington Utilities and
Transportation Commission
1300 S Evergreen Park Drive SW
Olympia, WA 98504-7250

Re: Docket No. UE-021178

Dear Ms. Washburn:

During the public hearing on Wednesday, October 13 in the above rulemaking proceeding, I indicated that I would investigate the process used for securities issuances in Oregon under ORS 757.410 and ORS 757.415. This letter sets forth my findings.

ORS 757.415(2) requires a public utility to secure an order authorizing a securities issuance *before* issuing such securities. (Similar to RCW 80.08.040, the required filing is "*before*" such issuance.) The application for such order is required to state "the amount of the issue and the purposes to which the issue or the proceeds thereof are to be applied." ORS 757.415(2)(a). Notably, the Oregon statute does not impose a requirement to describe the terms of the financing or the "estimated terms of financing" (the language in proposed WAC 480-100-242).

Utilities seeking orders under ORS 757.415 typically file an application describing the broad outlines of the proposed transaction, including the required information regarding the amount of the issue and the purposes to which the proceeds will be applied. Terms of the financing (i.e., maturities and pricing) are not required to be known at the time of the filing, nor are they required to be known before the Commission issues its order. Rather, the custom is that terms are broadly stated in a range of possible structures and prices, recognizing that the precise terms are typically not known until the time of the issuance.

Oregon
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An illustrative example, an application by Northwest Natural Gas Company, is attached as Exhibit A. In Docket No. UF 4208, NW Natural sought authority to issue \$160 million of Medium Term Notes. Under the authority requested, the Notes could either be secured or unsecured, and the maturities could range from nine months to thirty years. The only information regarding pricing was to identify spreads by reference to U.S. Treasury securities corresponding to the applicable maturity period, as indicated in Table 1 of the Staff Memo included as Appendix A to the Commission's Order. In this particular example, the OPUC granted the requested authority, subject to the limitations that the pricing was required to fall within the stated spreads. The utility was required to file the actual pricing information, once known, in a subsequent Report filed with the Commission "as soon as possible *after* each issuance and sale." Staff Recommendation, Item (1).

In addition, I was also asked about PacifiCorp's comments with respect to the definition of "control" included in proposed WAC 480-100-023. The source of this definition is a rule of the Securities and Exchange Commission, Rule 1-02(g), "Definition of terms used in Regulation S-X," as found at 17 CFR Part 210. (Regulation S-X pertains to the requirements for financial statements filed pursuant to the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935.) This is substantially the same definition for "control" as defined in Rule 12b-2(f) under the Securities Exchange Act of 1934.¹ It was suggested that the precedent of the SEC under its rules could be relied upon as a basis for interpreting the Commission's proposed rule (in the event the current proposed 480-100-023 is adopted in its current form). Upon researching case precedent interpreting these SEC rules, PacifiCorp's concerns regarding the vagueness and unenforceability of this definition remain. According to "*Disclosure and Remedies Under the Securities Laws*," Jacobs, at Volume 5B, § 11.4 (2003), this definition of "control" is "not abundantly helpful." According to this treatise:

The authorities suggest that either the power to control (whether or not exercised) or actual control (although asserted at the sufferance of those with the unexercised power) is sufficient. In a large corporation, control over a variety of work functions constitutes substantial control over the entire corporation. It follows that under certain facts more than one person could control a corporation. In general, the person who selects the directors controls the corporation, since the directors and the officers they

¹ "Control" is defined as "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 CFR Part 240 at Rule 12b-2, Definitions.



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appoint make policy decisions. While a majority stockholder would almost always be in control, holding 51 percent of the voting stock is not a prerequisite. Indeed, a person owning no stock could be in control under the proper circumstances. But a sizable stock of a public company is not necessarily a controlling position. This is so, in part, because actual control sometimes depends on such variables as voting rights, veto rights, or requirements for supermajority votes.

....
The Ninth Circuit, perhaps with all the foregoing in mind, opined that "control" is an elusive notion for which no clear-cut rule or standard can be devised.²

Id. at pages 11-45 – 11-48; 11-54.³ It is apparent from a review of this treatise that there is a substantial body of cases interpreting the definitions of "control" in the various SEC rules. It is respectfully submitted that incorporating this "elusive notion" of "control" in the Commission's rules may unnecessarily complicate their implementation and enforcement.

I hope this information is helpful, and responsive to the Commissioners' inquiry during the public meeting.

Very truly yours,

James M. Van Nostrand

JMV:jlf

cc: Fred Ottavelli

Attachments

² Citing *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433 (9th Cir. 1987); *Kersh V. General Council of Assemblies of God*, 804 F.2d 546 (9th Cir. 1986).

³ The pages from this treatise discussing the definition of "control" are included as Exhibit B to this letter.

EXHIBIT A

This is an electronic copy. Format and font may vary from the official version. Attachments may not appear.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UF 4208

In the Matter of)	
)	
NORTHWEST NATURAL)	ORDER
)	
Application for Authority to Issue and Sell)	
Securities.)	

**DISPOSITION: APPLICATION APPROVED WITH CONDITIONS
AND REPORTING REQUIREMENTS**

On April 15, 2004, NORTHWEST NATURAL (NWN) submitted an application to the Public Utility Commission of Oregon (Commission), requesting authority to offer, issue and sell up to \$160 million of Medium-Term Notes (MTNs). The basis for the current request is detailed in Staff's recommendation memo, attached as Appendix A.

Based on a review of the application and the Commission's records, the Commission finds that this application satisfies applicable statutes and administrative rules. At its public meeting on May 4, 2004, the Commission adopted Staff's recommendation and approved NWN's current request.

ORDER

IT IS ORDERED THAT the application of NORTHWEST NATURAL for authorization to issue and sell up to \$160 million of Medium-Term Notes is approved, subject to the conditions further specified in Appendix A.

Made, entered and effective _____.

BY THE COMMISSION:

Becky Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: May 4, 2004**

REGULAR CONSENT EFFECTIVE DATE _____ N/A _____

DATE: April 27, 2004

TO: Lee Sparling through Marc Hellman and Bryan Conway

FROM: Ming Peng

SUBJECT: NORTHWEST NATURAL GAS COMPANY: (Docket No. UF 4208)
Application for Authority to Issue and Sell Securities.

STAFF RECOMMENDATION:

The Commission should approve NW Natural's (NWN or Company) application, subject to the following conditions and reporting requirements:

- 1) The Company shall file the usual Report of Securities Issued and Disposition of Net Proceeds statements as soon as possible after each issuance and sale. This report also shall be used to notify the Commission as to any replacement, renewal, or extension of sale of each Note. The fees, interest rates, and expenses shall be cost effective and consistent with competitive market prices.
- 2) Under a Commission Order pursuant to this application, NWN may issue the Medium-Term Notes (MTNs or Notes) without further Commission approval as long as the interest rate spreads and agents' commissions do not exceed limits imposed by Tables 1 and 2 identified on page 3 of this memo, respectively, following the date of such Order.
- 3) A Commission approval in this docket shall remove any remaining authority from the approval granted in Docket UF 4191, of which the Company has represented that \$60 million authority remains.
- 4) The authorization shall remain in effect as long as the Company maintains debt ratings of at least BBB-/Baa3 (i.e., "investment-grade") from Standard & Poor's and Moody's Investors' Service, respectively on any debt security type it intends to market (i.e., senior secured versus unsecured).
- 5) The Commission reserves judgment on the reasonableness for ratemaking purposes of the Company's capital costs, capital structure and the commissions and expenses incurred for security issuances. In its next rate proceeding, the

Company will be required to show that its capital costs, including embedded expenses, and capital structure are just and reasonable.

DISCUSSION:

On April 15, 2004, NWN filed an application under Oregon Revised Statutes (ORS) 757.410, 757.415, 757.480 and OAR 860-027-0030 for an order authorizing the Company to offer, issue and sell up to \$160 million of MTNs. The MTNs will be either secured or unsecured and their maturities will range from nine months to thirty years.

NWN proposes issuing the MTNs without further Commission approval as long as the interest rate spreads and agents' commissions do not exceed limits imposed by Tables 1 and 2 in this memo, respectively. The proposed interest rate spreads and fees are consistent with previous Commission authorizations and they continue to be appropriate. NWN also proposes that such authorization remain in effect as long as the Company maintains investment-grade bond ratings from at least two nationally recognized bond rating organizations.

Use of Proceeds

NWN represents that the proceeds to be received by the Company from the sale of the Notes will be used for corporate purposes allowable under ORS 757.415 (1)(a) through (1)(d).

Expenses

NWN projects gross proceeds of \$160 million and total issuance fees are not expected to exceed \$1,469,050 or 0.92% of gross proceeds. The expenses include fees and commissions for agents and underwriters, SEC, accounting, stock exchange listing, bond rating agencies, and printing and engraving. The expenses appear reasonable.

Based on Staff's review, the application appears reasonable and meets the appropriate statutory requirements.

PROPOSED COMMISSION MOTION:

NW Natural's application for the authority to borrow up to \$160,000,000 of Medium-Term Notes be approved with Staff's Conditions.

NWN's Series B MTNs

Table 1. Maximum Spreads

Maturity		<u>Maximum Spread Over Benchmark U.S. Treasury Yield¹</u>	
		If Treasury Yield is 6.5% or Lower	If Treasury Yield Exceeds 6.5%
<u>Equal to or Greater Than</u>	Less Than		
9 months	2 years	+ 170 basis points ²	+ 85 basis points
2 years	3 years	+ 180 basis points	+ 95 basis points
3 years	4 years	+ 190 basis points	+ 100 basis points
4 years	6 years	+ 200 basis points	+ 105 basis points
6 years	9 years	+ 205 basis points	+ 110 basis points
9 years	10 years	+ 215 basis points	+ 110 basis points
10 years	11 years	+ 220 basis points	+ 115 basis points
11 years	15 years	+ 230 basis points	+ 120 basis points
15 years	20 years	+ 240 basis points	+ 125 basis points
20 years	30 years & 1 day	+ 265 basis points	+ 130 basis points

Table 2. Maximum Agent Commission Fees

<u>Range of Maturities</u>	<u>Commission (Percentage of Aggregate Principal Amount of Medium-Term Notes Sold)</u>
From 9 months to less than 1 year	.125%
From 1 year to less than 18 months	.150%
From 18 months to less than 2 years	.200%
From 2 years to less than 3 years	.250%
From 3 years to less than 4 years	.350%
From 4 years to less than 5 years	.450%
From 5 years to less than 6 years	.500%
From 6 years to less than 7 years	.550%
From 7 years to less than 10 years	.600%
From 10 years to less than 15 years	.625%
From 15 years to less than 20 years	.675%
From 20 years to 30 years	.750%

¹ The Benchmark Treasury Yield, with respect to any of the Medium-Term Notes' maturity range, means the yield to maturity of that issue of direct obligations of the United States which, out of all actively traded issues of such obligations with a remaining term to maturity within such Medium-Term Notes' maturity range, is generally considered by dealers in such obligations to be the standard for such obligations. With respect to the issuance of any of the Medium-Term Notes, the Benchmark Treasury Yield shall be determined as of the time the commitment to purchase such Medium-Term Notes is received by the Company or its agents.

² Basis point is defined as one one-hundredth of a percentage point; i.e., 100 basis points is 1 percent.

EXHIBIT B

Securities Law Series

**Disclosure and Remedies
Under the Securities Laws**

(formerly titled *Litigation and Practice Under Rule 10b-5*)

by **Arnold S. Jacobs**

VOLUME 5B

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Section 20(a) claim against the controlling person must be dismissed if the controlled persons are found not liable.¹⁶

Some guidelines have emerged regarding the class of persons who are deemed to be in control. For purposes of reports issuers are required to file under the Exchange Act, "control" is defined in Rule 12b-2(f) as "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."¹⁷ This definition is not abundantly helpful even if it were applicable to 10b-5 as well as to 1934 Act reports¹⁸ and

¹⁶Shapiro v. UJB Fin. Corp., 964 F.2d 272, 279 (3d Cir.), cert. denied 506 U.S. 934 (1992); Van Dyke v. Coburn Enterprises, Inc., 873 F.2d 1094, Blue Sky L. Rep. (CCH) ¶ 72975, Fed. Sec. L. Rep. (CCH) ¶ 94404 (8th Cir. 1989); Deviries v. Prudential-Bache Securities, Inc., 805 F.2d 326, Fed. Sec. L. Rep. (CCH) ¶ 92988 (8th Cir. 1986); Moss v. Morgan Stanley Inc., 719 F.2d 5, Fed. Sec. L. Rep. (CCH) ¶ 99478, 70 A.L.R. Fed. 511 (2d Cir. 1983); Maywalt v. Parker & Parsley Petroleum Co., 808 F. Supp. 1037, Fed. Sec. L. Rep. (CCH) ¶ 97229 (S.D.N.Y. 1992); Fox v. Equimark Corp., 782 F. Supp. 295 (W.D. Pa. 1991); Steiner v. Shawmut Nat. Corp., 766 F. Supp. 1236, Fed. Sec. L. Rep. (CCH) ¶ 96241 (D. Conn. 1991); Haft v. Eastland Financial Corp., 755 F. Supp. 1123, Fed. Sec. L. Rep. (CCH) ¶ 95787 (D.R.I. 1991); In re VMS Securities Litigation, 752 F. Supp. 1373, Fed. Sec. L. Rep. (CCH) ¶ 96278 (N.D. Ill. 1990); Leonard v. Stuart-James Co., Inc., 742 F. Supp. 653, Fed. Sec. L. Rep. (CCH) ¶ 95442 (N.D. Ga. 1990); VT Investors v. R & D Funding Corp., 733 F. Supp. 823, Fed. Sec. L. Rep. (CCH) ¶ 94958 (D.N.J. 1990); H.B. Holdings Corp. v. Scovill, Inc., Fed. Sec. L. Rep. (CCH) ¶ 95,201, at 95,817 (S.D.N.Y. 1990); Harrison v. Dean Witter Reynolds, Inc., 715 F. Supp. 1425, Fed. Sec. L. Rep. (CCH) ¶ 94760, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 7346 (N.D. Ill. 1989); In re Ultimate Corp. Sec. Litig., Fed. Sec. L. Rep. (CCH) ¶ 94,522, at 93,318 (S.D.N.Y.), reconsideration denied Fed. Sec. L. Rep. (CCH) ¶ 94,523 (S.D.N.Y. 1989); Wingsco Energy One v. Vanguard Groups Resources 1984, Inc., Fed. Sec. L. Rep. (CCH) ¶ 94,038, at 90,864 (S.D. Tex. 1988) (need primary violation); Roberts v. Heim, 670 F. Supp. 1466, Blue Sky L. Rep. (CCH) ¶ 72616, Fed. Sec. L. Rep. (CCH) ¶ 93291, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6701 (N.D. Cal. 1987); Deutschman v. Beneficial Corp., 668 F. Supp. 358, Fed. Sec. L. Rep. (CCH) ¶ 93388 (D. Del. 1987); Grey v. Gruntal & Co., Fed. Sec. L. Rep. (CCH) ¶ 93,262, at 96,281 n.20 (S.D.N.Y. 1987); O'Keefe v. Courtney, 655 F. Supp. 16, Fed. Sec. L. Rep. (CCH) ¶ 93248 (N.D. Ill. 1985); Bochicchio v. Smith Barney, Harris Upham & Co., Inc., 647 F. Supp. 1426, Fed. Sec. L. Rep. (CCH) ¶ 93024, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6448 (S.D.N.Y. 1986); Xaphes v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 632 F. Supp. 471, Fed. Sec. L. Rep. (CCH) ¶ 92702 (D. Me. 1986); Blanes v. Paine Webber Jackson & Curtis, Inc., 593 F. Supp. 458 (D.P.R. 1984); see Ferreri v. Fox, Rothschild, O'Brien & Frankel, 690 F. Supp. 400 (E.D. Pa. 1988) (no Section 20(a) cause of action when the defendant is not alleged to control another person). See also In re Washington Pub. Power Supply Sys. Sec. Litig., Fed. Sec. L. Rep. (CCH) ¶ 94,325, at 92,136 (W.D. Wash. 1988), vacated, remanded sub nom. Class Plaintiffs v. City of Seattle, 19 F.3d 1291 (9th Cir. 1994) (official immunity of controlled person no defense to controlling person); cf. § 3:27 (Section 11 of the 1933 Act) and § 3:143 N. 26 (Section 12 of the Securities Act), and the accompanying text.

¹⁷See also Exchange Act Rule 12b-22 (disclaimer of control).

¹⁸Rule 10b-5 cases discussing Section 20(a) have generally not relied on the Rule 12b-2(f) definition. Those which have referred to that definition include Sheinkopf v. Stone, 927 F.2d 1259, Fed. Sec. L. Rep. (CCH) ¶ 95865, 20 Fed. R. Serv. 3d 32 (1st

were limited to corporations and other entities to which it is obviously directed. The authorities suggest that either the power to control (whether or not exercised) or actual control (although asserted at the sufferance of those with the unexercised power) is sufficient.¹⁹ In a

Cir. 1991); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, Fed. Sec. L. Rep. (CCH) ¶ 95500 (9th Cir. 1990); *Schlifke v. Seafirst Corp.*, 866 F.2d 935, Fed. Sec. L. Rep. (CCH) ¶ 94174 (7th Cir. 1989); *Metge v. Baehler*, 762 F.2d 621, Fed. Sec. L. Rep. (CCH) ¶ 92037 (8th Cir. 1985); *G.A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, Fed. Sec. L. Rep. (CCH) ¶ 97862, 30 Fed. R. Serv. 2d 1605 (5th Cir. 1981); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, Fed. Sec. L. Rep. (CCH) ¶ 97702, 7 Fed. R. Evid. Serv. 1080 (5th Cir. 1980); *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, Fed. Sec. L. Rep. (CCH) ¶ 95313, 38 A.L.R. Fed. 709 (3d Cir. 1975); *In re Midlantic Corp. Shareholder Litigation*, 758 F. Supp. 226 (D.N.J. 1990); *Dowling v. Narragansett Capital Corp.*, 735 F. Supp. 1105, Fed. Sec. L. Rep. (CCH) ¶ 95488 (D. R.I. 1990); *Borden, Inc. v. Spoor Behrins Campbell & Young, Inc.*, 735 F. Supp. 587, Fed. Sec. L. Rep. (CCH) ¶ 95204 (S.D.N.Y. 1990); *Bray v. R.W. Technology, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 95,225, at 95,977 (D. Mass. 1990); *Gorsey v. I.M. Simon & Co.*, Fed. Sec. L. Rep. (CCH) ¶ 94,996, at 95,578 (D. Mass. 1990); *Cammer v. Bloom*, 711 F. Supp. 1264, Fed. Sec. L. Rep. (CCH) ¶ 95211 (D.N.J. 1989); *In re ZZZZ Best Sec. Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 94,485, at 93,085 (C.D. Cal. 1989), mdf'd Fed. Sec. L. Rep. (CCH) ¶ 94,881 (C.D. Cal. 1990); *Marshall v. Quinn-L Equities, Inc.*, 704 F. Supp. 1384, Fed. Sec. L. Rep. (CCH) ¶ 94812 (N.D. Tex. 1988); *Laven v. Flanagan*, 695 F. Supp. 800, Fed. Sec. L. Rep. (CCH) ¶ 95257 (D.N.J. 1988); *Walker v. Cardinal Sav. and Loan Ass'n*, 690 F. Supp. 494, Blue Sky L. Rep. (CCH) ¶ 72984, Fed. Sec. L. Rep. (CCH) ¶ 94456 (E.D. Va. 1988); *Kitchens v. U.S. Shelter*, Fed. Sec. L. Rep. (CCH) ¶ 93,920, at 90,163 (D.S.C. 1988); *Kimmel v. Labenski*, Fed. Sec. L. Rep. (CCH) ¶ 93,651, at 97,991 (S.D.N.Y. 1988); *Seidel v. Public Service Co. of New Hampshire*, 616 F. Supp. 1342, Fed. Sec. L. Rep. (CCH) ¶ 92383 (D.N.H. 1985); *Index Fund, Inc. v. Hagopian*, 609 F. Supp. 499, Fed. Sec. L. Rep. (CCH) ¶ 91944 (S.D.N.Y. 1985); *In re Catanella and E.F. Hutton and Co., Inc. Securities Litigation*, 583 F. Supp. 1388, Fed. Sec. L. Rep. (CCH) ¶ 91497 (E.D. Pa. 1984); *Metge v. Baehler*, 577 F. Supp. 810, Fed. Sec. L. Rep. (CCH) ¶ 99665 (S.D. Iowa 1984) (citing text); *Hokama v. E.F. Hutton & Co., Inc.*, 566 F. Supp. 636, Fed. Sec. L. Rep. (CCH) ¶ 99415 (C.D. Cal. 1983); *Westlake v. Abrams*, 565 F. Supp. 1330, Fed. Sec. L. Rep. (CCH) ¶ 99270 (N.D. Ga. 1983); *Baugh v. Citizens & S. Nat'l Bank*, Fed. Sec. L. Rep. (CCH) ¶ 97,997, at 91,130 (M.D. Ga. 1980); *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, Fed. Sec. L. Rep. (CCH) ¶ 96834 (D. Md. 1978); *Harriman v. E. I. DuPont De Nemours & Co.*, 372 F. Supp. 101, Fed. Sec. L. Rep. (CCH) ¶ 94399 (D. Del. 1974) ("helpful"); see *Kennedy v. Tallant*, Fed. Sec. L. Rep. (CCH) ¶ 95,779, at 90,820 (S.D. Ga. 1976) (relying on comparable 1933 Act provision); cf. *Gould v. American-Hawaiian S. S. Co.*, 535 F.2d 761, Fed. Sec. L. Rep. (CCH) ¶ 95512 (3d Cir. 1976) (proxy rules).

Rule 405 promulgated under the 1933 Act contains the same definition of "control" as Rule 12b-2(f) under the 1934 Act. This definition was referred to in *Roberts v. Heim*, 670 F. Supp. 1466, Blue Sky L. Rep. (CCH) ¶ 72616, Fed. Sec. L. Rep. (CCH) ¶ 93291, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6701 (N.D. Cal. 1987); *In re Diasonics Securities Litigation*, 599 F. Supp. 447, Fed. Sec. L. Rep. (CCH) ¶ 91815, 1 Fed. R. Serv. 3d 915 (N.D. Cal. 1984).

¹⁹*Durham v. Kelly*, 810 F.2d 1500, Blue Sky L. Rep. (CCH) ¶ 72490, Fed. Sec. L. Rep. (CCH) ¶ 93149, 7 Fed. R. Serv. 3d 102 (9th Cir. 1987) (actual power or influence); *Buhler v. Audio Leasing Corp.*, 807 F.2d 833, Fed. Sec. L. Rep. (CCH) ¶ 93056 (9th Cir. 1987) (actual power or influence); *Kersh v. General Council of Assemblies of*

large corporation, control over a variety of work functions constitutes substantial control over the entire corporation.²⁰ It follows that under certain facts more than one person could control a corporation.²¹ In general, the person who selects the directors controls a corporation,

God, 804 F.2d 546, Fed. Sec. L. Rep. (CCH) ¶ 93000 (9th Cir. 1986); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, Fed. Sec. L. Rep. (CCH) ¶ 92864 (7th Cir. 1986) (actually exercised control; ability to persuade and give counsel does not constitute control); *San Francisco-Oklahoma Petroleum Exploration Corp. v. Carstan Oil Co., Inc.*, 765 F.2d 962, Fed. Sec. L. Rep. (CCH) ¶ 92094 (10th Cir. 1985); *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, Fed. Sec. L. Rep. (CCH) ¶ 95313, 38 A.L.R. Fed. 709 (3d Cir. 1975); *In re Midlantic Corp. Shareholder Litigation*, 758 F. Supp. 226 (D.N.J. 1990) (power or potential power); *Brug v. Enstar Group, Inc.*, 755 F. Supp. 1247, Fed. Sec. L. Rep. (CCH) ¶ 97277 (D. Del. 1991) (power or potential power); *Reshal Associates, Inc. v. Long Grove Trading Co.*, 754 F. Supp. 1226, Fed. Sec. L. Rep. (CCH) ¶ 96250 (N.D. Ill. 1990) (potential for control); *Koplin v. Labe Federal Sav. and Loan Ass'n*, 748 F. Supp. 1336, Fed. Sec. L. Rep. (CCH) ¶ 95735 (N.D. Ill. 1990) (potential for control); *Wiley v. Hughes Capital Corp.*, 746 F. Supp. 1264, Fed. Sec. L. Rep. (CCH) ¶ 95745, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 7646 (D. N.J. 1990) (potential power); *Binder v. Gordian Securities, Inc.*, 742 F. Supp. 663, Fed. Sec. L. Rep. (CCH) ¶ 95608 (N.D. Ga. 1990) (need not exercise power); *Craig v. First American Capital Resources, Inc.*, 740 F. Supp. 530, Fed. Sec. L. Rep. (CCH) ¶ 95817 (N.D. Ill. 1990) (potential for control); *Borden, Inc. v. Spoor Behrins Campbell & Young, Inc.*, 735 F. Supp. 587, Fed. Sec. L. Rep. (CCH) ¶ 95204 (S.D.N.Y. 1990) (potential power); *Cammer v. Bloom*, 711 F. Supp. 1264, Fed. Sec. L. Rep. (CCH) ¶ 95211 (D.N.J. 1989) (power or potential power); *In re Thortec Sec. Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 94,330, at 92,159 (N.D. Cal. 1989) (actual power); *Laven v. Flanagan*, 695 F. Supp. 800, Fed. Sec. L. Rep. (CCH) ¶ 95257 (D.N.J. 1988); *In re Washington Pub. Power Supply Sys. Sec. Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 94,325, at 92,135-92,136 (W.D. Wash. 1988), vacated, remanded sub nom. *Class Plaintiffs v. City of Seattle*, 19 F.3d 1291 (9th Cir. 1994) (actual power or influence); *Commins v. Johnson & Higgins, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 94,092, at 91,099-91,100 (N.D. Cal. 1988) (actual power or influence); *Wingsco Energy One v. Vanguard Groups Resources 1984, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 94,038, at 90,864 (S.D. Tex. 1988) (actually exercised power); *Hill v. Equitable Bank*, 655 F. Supp. 631, Fed. Sec. L. Rep. (CCH) ¶ 93229 (D. Del. 1987) (power or potential power to control); *Savino v. E. F. Hutton & Co., Inc.*, 507 F. Supp. 1225, Fed. Sec. L. Rep. (CCH) ¶ 97850 (S.D.N.Y. 1981) (need only control by status and not actual control); *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, Fed. Sec. L. Rep. (CCH) ¶ 96834 (D. Md. 1978); *Sharp v. Coopers & Lybrand*, 457 F. Supp. 879, Fed. Sec. L. Rep. (CCH) ¶ 96612 (E.D. Pa. 1978) (power or potential power); *Sun First Nat. Bank of Orlando v. Miller*, 77 F. R.D. 430, Fed. Sec. L. Rep. (CCH) ¶ 96285 (S.D.N.Y. 1978) (citing text); *Harriman v. E. I. DuPont De Nemours & Co.*, 372 F. Supp. 101, Fed. Sec. L. Rep. (CCH) ¶ 94399 (D. Del. 1974); cf. *Securities and Exchange Commission v. Zimmerman*, 407 F. Supp. 623, Fed. Sec. L. Rep. (CCH) ¶ 95425 (D.D.C. 1976) (Section 13(a) of the 1934 Act) (actual power even though at sufferance of another); H.R. Rep. No. 910, 100th Cong., 2d Sess. 17 (1990) (whether or not exercised). See generally 2 Loss 770-82; 5 Loss 2700-708; Sommer, "Who's 'In Control'?—S.E.C.," 21 Bus. Law. 559, 562-83 (1966).

²⁰Cf. *S.E.C. v. Netelkos*, 592 F. Supp. 906, Fed. Sec. L. Rep. (CCH) ¶ 91607 (S.D.N.Y. 1984) (1933 Act).

²¹*Ronson Corp. v. Liquifin Aktiengesellschaft*, 483 F.2d 846, Fed. Sec. L. Rep. (CCH) ¶ 94088 (3d Cir. 1973); see *Harriman v. E. I. DuPont De Nemours & Co.*, 372 F. Supp. 101, Fed. Sec. L. Rep. (CCH) ¶ 94399 (D. Del. 1974).

since the directors and the officers they appoint make policy decisions. While a majority stockholder would almost always be in control,²² holding 51 percent of the voting stock is not a prerequisite.²³ Indeed, a person owning no stock could be in control under the proper circumstances.²⁴ But a sizable block of a public company is not necessarily a controlling position.²⁵ This is so, in part, because actual control sometimes depends on such variables as voting rights, veto rights, or requirements for supermajority votes.²⁶ Nor is a passive lender a controlling person.²⁷ Similarly, one merger partner does not control the

²²Gould v. Ruefenacht, 471 U.S. 701, 105 S. Ct. 2308, 85 L. Ed. 2d 708, Fed. Sec. L. Rep. (CCH) ¶ 92048 (1985) (majority constitutes control in many, but not all, cases); Borden, Inc. v. Spoor Behrins Campbell & Young, Inc., 735 F. Supp. 587, Fed. Sec. L. Rep. (CCH) ¶ 95204 (S.D.N.Y. 1990) (sole stockholder in control); H.B. Holdings Corp. v. Scovill, Inc., Fed. Sec. L. Rep. (CCH) ¶ 95,201 at 95,817 (S.D.N.Y. 1990) (go up chain of parentage); Klapmeier v. Telecheck Intern., Inc., 315 F. Supp. 1360, Fed. Sec. L. Rep. (CCH) ¶ 92814 (D. Minn. 1970) (majority stockholder might be deemed controlling person as a matter of law); cf. Financial Counsellors, Inc. v. Securities and Exchange Commission, 339 F.2d 196 (2d Cir. 1964) (corporation alter ego of its majority stockholder; construing control under Exchange Act § 15(b)). Compare Aid Auto Stores, Inc. v. Cannon, 525 F.2d 468, Fed. Sec. L. Rep. (CCH) ¶ 95247 (2d Cir. 1975) (holder of option on 50 percent of stock not in control under Section 12(1) of the 1933 Act).

²³Gould v. Ruefenacht, 471 U.S. 701, 105 S. Ct. 2308, 85 L. Ed. 2d 708, Fed. Sec. L. Rep. (CCH) ¶ 92048 (1985); Saunders Leasing System, Inc. v. Societe Holding Gray D'Albion, S.A., 507 F. Supp. 627, Fed. Sec. L. Rep. (CCH) ¶ 97881 (N.D. Ala. 1981) (25 percent of stock is control); Westlake v. Abrams, 504 F. Supp. 337, Fed. Sec. L. Rep. (CCH) ¶ 97963 (N.D. Ga. 1980) (absence of substantial ownership does not foreclose control person status); Harriman v. E. I. DuPont De Nemours & Co., 372 F. Supp. 101, Fed. Sec. L. Rep. (CCH) ¶ 94399 (D. Del. 1974); Thompson Ross Sec. Co., 6 S.E.C. 1111, 1119 (1940).

²⁴See Drobbin v. Nicolet Instrument Corp., 631 F. Supp. 860, Fed. Sec. L. Rep. (CCH) ¶ 92489 (S.D.N.Y. 1986) (Section 14(f) of the 1934 Act) (need not be stock ownership); Klapmeier v. Telecheck Intern., Inc., 315 F. Supp. 1360, Fed. Sec. L. Rep. (CCH) ¶ 92814 (D. Minn. 1970) ("the absence of a substantial ownership of shares does not foreclose" controlling person status).

²⁵Laven v. Flanagan, 695 F. Supp. 800, Fed. Sec. L. Rep. (CCH) ¶ 95257 (D.N.J. 1988) (17.5 percent block; three nominees out of sixteen directors); Kennecott Copper Corp. v. Curtiss-Wright Corp., 449 F. Supp. 951, Fed. Sec. L. Rep. (CCH) ¶ 96408 (S.D.N.Y. 1978) (30 percent block; no common directors).

²⁶Gould v. Ruefenacht, 471 U.S. 701, 105 S. Ct. 2308, 85 L. Ed. 2d 708, Fed. Sec. L. Rep. (CCH) ¶ 92048 (1985).

²⁷Sanders Confectionery Products, Inc. v. Heller Financial, Inc., 973 F.2d 474, Bankr. L. Rep. (CCH) ¶ 74917, Fed. Sec. L. Rep. (CCH) ¶ 96966, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 8063 (6th Cir. 1992); Schlifke v. Seafirst Corp., 866 F.2d 935, Fed. Sec. L. Rep. (CCH) ¶ 94174 (7th Cir. 1989); Wingsco Energy One v. Vanguard Groups Resources 1984, Inc., 699 F. Supp. 1241, Fed. Sec. L. Rep. (CCH) ¶ 93998 (S.D. Tex. 1988); Wingsco Energy One v. Vanguard Groups Resources 1984, Inc., Fed. Sec. L. Rep. (CCH) ¶ 94,038, at 90,864 (S.D. Tex. 1988); Seattle-First Nat. Bank v. Carlstedt, 678 F. Supp. 1543, Blue Sky L. Rep. (CCH) ¶ 72636, Blue Sky L. Rep. (CCH) ¶ 72646, Fed. Sec. L. Rep. (CCH) ¶ 93402 (W.D. Okla. 1987); Hill v. Equitable Bank, 655 F. Supp. 631, Fed. Sec. L. Rep. (CCH) ¶ 93229 (D. Del. 1987); Schlifke v. Seafirst Corp.,

other merger partner even though it received an option on the other merger partner's shares and obtained in the merger agreement covenants prohibiting extraordinary corporate actions by the other merger partner without the first partner's approval.²⁸ Outside attorneys²⁹ and accountants³⁰ who have no influence over the entity's day-to-day operations are not controlling persons.

In addition to one person exercising control, a controlling group concept may be employed. Under this approach, persons acting together for a common purpose with sufficient power in the aggregate to be considered a controlling person will be deemed members of a controlling group.³¹ As a consequence, each group member is treated as a controlling person. For example, a few stockholders may be deemed a control group if they (1) own a sizable block of stock and the remaining shares are widely distributed and (2) are united by friendship or related by blood or marriage or have historically acted together.³² Similarly, directors and executive officers normally would

866 F.2d 935, Fed. Sec. L. Rep. (CCH) ¶ 94174 (7th Cir. 1989); *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, Fed. Sec. L. Rep. (CCH) ¶ 96391 (N.D. Cal. 1978). Compare *Metge v. Baehler*, 762 F.2d 621, Fed. Sec. L. Rep. (CCH) ¶ 92037 (8th Cir. 1985) (lender not in control under the facts); *Mecca v. Gibraltar Corp. of America*, 746 F. Supp. 338, Fed. Sec. L. Rep. (CCH) ¶ 95486 (S.D.N.Y. 1990) (lender is a control person under the facts); *Hill v. Equitable Bank, Nat. Ass'n*, 599 F. Supp. 1062, Fed. Sec. L. Rep. (CCH) ¶ 91824 (D. Del. 1984) (lending bank could be a controlling person); *In re Falstaff Brewing Corp. Antitrust Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 96,284, at 92, 812, 92,815 (E.D. Mo. 1977) (sufficient to withstand a motion if it is alleged that lenders controlled the issuer's daily affairs); *Miller v. Woodmoor Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 96,109, at 91,999 (D. Colo. 1976) (lender who made day-to-day decisions about its participation could be a controlling person).

²⁸*Woodward & Lothrop, Inc. v. Schnabel*, 593 F. Supp. 1385, Fed. Sec. L. Rep. (CCH) ¶ 91596 (D.D.C. 1984). See also *Beatty v. Bright*, 345 F. Supp. 1188, Fed. Sec. L. Rep. (CCH) ¶ 93599 (S.D. Iowa 1972) (merger contract clause that one party can approve other's proxy material insufficient to make first a controlling person); § 12:22 N. 25 and the accompanying text (liability of one merger partner for statements by other in a proxy statement).

²⁹*Morin v. Trupin*, 809 F. Supp. 1081, Blue Sky L. Rep. (CCH) ¶ 73802, Fed. Sec. L. Rep. (CCH) ¶ 97302, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 8189 (S.D.N.Y. 1993); *Marshall v. Quinn-L Equities, Inc.*, 704 F. Supp. 1384, Fed. Sec. L. Rep. (CCH) ¶ 94812 (N.D. Tex. 1988).

³⁰*Morin v. Trupin*, 809 F. Supp. 1081, Blue Sky L. Rep. (CCH) ¶ 73802, Fed. Sec. L. Rep. (CCH) ¶ 97302, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 8189 (S.D.N.Y. 1993); *Nichols v. Merrill Lynch, Pierce, Fenner & Smith*, 706 F. Supp. 1309, Fed. Sec. L. Rep. (CCH) ¶ 94457 (M.D. Tenn. 1989) (employed to make financial projections, market studies, and feasibility reports).

³¹Control need not be present at a company's beginning or be continuous. Cf. *Securities and Exchange Commission v. International Chemical Development Corp.*, 469 F.2d 20, Fed. Sec. L. Rep. (CCH) ¶ 93658 (10th Cir. 1972) (construing 1933 Act § 5).

³²*Kemmerer v. Weaver*, 445 F.2d 76, Fed. Sec. L. Rep. (CCH) ¶ 93095 (7th Cir. 1971) (person who was son-in-law and brother of two controlling persons, and who was associated with family in controlling position, held to be in control himself); Har-

constitute a controlling group.³³ A person can be a member of a con-

riman v. E. I. DuPont De Nemours & Co., 372 F. Supp. 101, Fed. Sec. L. Rep. (CCH) ¶ 94399 (D. Del. 1974) (can arise from "business relationships, interlocking directors, family relationships and a myriad of other factors"); Mader v. Armel, Fed. Sec. L. Rep. (CCH) ¶ 93,027, at 90,798 (S.D. Ohio 1971), aff'd 461 F.2d 1123 (6th Cir.), cert. denied 409 U.S. 1023 (1972).

³³Wool v. Tandem Computers Inc., 818 F.2d 1433, Fed. Sec. L. Rep. (CCH) ¶ 93272, 8 Fed. R. Serv. 3d 91 (9th Cir. 1987) (executive officers are controlling persons); Morse v. Abbott Laboratories, 756 F. Supp. 1108, Fed. Sec. L. Rep. (CCH) ¶ 98139 (N.D. Ill. 1991) (officers have been found liable); Travelers Ins. Co. v. Lewis, 756 F. Supp. 172, Fed. Sec. L. Rep. (CCH) ¶ 95785 (S.D.N.Y. 1991) (rebuttable presumption of control); In re MDC Holdings Securities Litigation, 754 F. Supp. 785, Fed. Sec. L. Rep. (CCH) ¶ 95729 (S.D. Cal. 1990) (reasonable to presume officers and directors are controlling persons); Wiley v. Hughes Capital Corp., 746 F. Supp. 1264, Fed. Sec. L. Rep. (CCH) ¶ 95745, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 7646 (D.N.J. 1990) (reasonable to presume officers are in control); Binder v. Gordian Securities, Inc., 742 F. Supp. 663, Fed. Sec. L. Rep. (CCH) ¶ 95608 (N.D. Ga. 1990) (officer is a controlling person although mere status as an officer not enough); Gorsey v. I.M. Simon & Co., Fed. Sec. L. Rep. (CCH) ¶ 94,996, at 95,578 (D. Mass. 1990) (executive committee members are in control); Nelson v. National Republic Bank, Fed. Sec. L. Rep. (CCH) ¶ 91,481, at 98,400 (N.D. Ill. 1984); Moerman v. Zipco, Inc., 302 F. Supp. 439, Blue Sky L. Rep. (CCH) ¶ 70828, Fed. Sec. L. Rep. (CCH) ¶ 92478 (E.D.N.Y. 1969) ("conclusion is inescapable" that directors are controlling persons); see G.A. Thompson & Co., Inc. v. Partridge, 636 F.2d 945, Fed. Sec. L. Rep. (CCH) ¶ 97862, 30 Fed. R. Serv. 2d 1605 (5th Cir. 1981) (person who was a director, officer, and 24 percent stockholder is a controlling person); Kemmerer v. Weaver, 445 F.2d 76, Fed. Sec. L. Rep. (CCH) ¶ 93095 (7th Cir. 1971) (control status of directors and officers conceded); Maywalt v. Parker & Parsley Petroleum Co., 808 F. Supp. 1037, Fed. Sec. L. Rep. (CCH) ¶ 97229 (S.D.N.Y. 1992) (status as an officer or director insufficient, but a narrowly-defined group of corporate officers are presumed to be in control); In re Midlantic Corp. Shareholder Litigation, 758 F. Supp. 226 (D.N.J. 1990) (adequately pleading of control by officers and directors); Dowling v. Narragansett Capital Corp., 735 F. Supp. 1105, Fed. Sec. L. Rep. (CCH) ¶ 95488 (D.R.I. 1990) (directors prima facie are in control); George v. Blue Diamond Petroleum, Inc., 718 F. Supp. 539, Fed. Sec. L. Rep. (CCH) ¶ 95441 (W.D. La. 1989) (officer and director is a controlling person); Cammer v. Bloom, 711 F. Supp. 1264, Fed. Sec. L. Rep. (CCH) ¶ 95211 (D.N.J. 1989) (inclined to hold directors as controlling persons based on status); Malik v. Universal Resources Corp., 425 F. Supp. 350, 364 & n.61 (S.D. Cal. 1976) (director-officer held to control corporation's president); Holloway v. Howerdd, 377 F. Supp. 754, Fed. Sec. L. Rep. (CCH) ¶ 94820 (M.D. Tenn. 1973); Kennedy v. Tallant, Fed. Sec. L. Rep. (CCH) ¶ 95,779, at 90,821 (S.D. Ga. 1976) (directors who own all of the class of stock which elects a majority of the directors). Compare Metge v. Baehler, 762 F.2d 621, Fed. Sec. L. Rep. (CCH) ¶ 92037 (8th Cir. 1985) (director's liability presupposes actual participation in corporation's operations); Herm v. Stafford, 663 F.2d 669, Blue Sky L. Rep. (CCH) ¶ 71681, Fed. Sec. L. Rep. (CCH) ¶ 98335 (6th Cir. 1981) (a director is not automatically a controlling person; need actual participation or some influence); Mader v. Armel, 461 F.2d 1123, Fed. Sec. L. Rep. (CCH) ¶ 93530 (6th Cir. 1972) (frightening to say a director controls officers and is therefore liable); Martin v. Brown, 758 F. Supp. 313 (W.D. Pa. 1990) (status as officer, director, or stockholder, absent more, insufficient); Craig v. First American Capital Resources, Inc., 740 F. Supp. 530, Fed. Sec. L. Rep. (CCH) ¶ 95817 (N.D. Ill. 1990) (officer and director insufficient as such); In re Par Pharmaceutical, Inc. Securities Litigation, 733 F. Supp. 668, Fed. Sec. L. Rep. (CCH) ¶ 95253 (S.D.N.Y. 1990) (director status alone not

trolling group even though he is not an officer or director, and someone else owns a majority of the stock.³⁴ On the reverse side of the coin, a corporation can control its officers.³⁵

Control concepts are even less distinct when a business entity is not involved. A test which has been used (and which has been utilized as

enough); *Bray v. R.W. Technology, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 95,225, at 95,978–95,979 (D. Mass. 1990) (director must show actual participation; some directors and officers, but not others, held to be controlling persons); *Klein v. King*, Fed. Sec. L. Rep. (CCH) ¶ 95,002, at 95,611 (N.D. Cal. 1990) (director not automatically liable); *Ballan v. Wilfred American Educational Corp.*, 720 F. Supp. 241, 56 Ed. Law Rep. 170, Fed. Sec. L. Rep. (CCH) ¶ 94910 (E.D.N.Y. 1989) (status as officer, director, or stockholder alone not ample); *In re Genentech, Inc. Sec. Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 94,960, at 95,374 (N.D. Cal. 1989) (nine percent owner which controls a board seat not in control); *Laven v. Flanagan*, 695 F. Supp. 800, Fed. Sec. L. Rep. (CCH) ¶ 95257 (D.N.J. 1988) (three of sixteen directors not in control); *In re Worlds of Wonder Securities Litigation*, 694 F. Supp. 1427, 114 A.L.R. Fed. 883 (N.D. Cal. 1988) (a director is not automatically a controlling person); *Walker v. Cardinal Sav. and Loan Ass'n*, 690 F. Supp. 494, Blue Sky L. Rep. (CCH) ¶ 72984, Fed. Sec. L. Rep. (CCH) ¶ 94456 (E.D. Va. 1988) (outside director status alone insufficient); *Hemming v. Alfin Fragrances, Inc.*, 690 F. Supp. 239, Fed. Sec. L. Rep. (CCH) ¶ 93916 (S.D.N.Y. 1988) (status as officer, director, or stockholder not sufficient); *Kimmel v. Labenski*, Fed. Sec. L. Rep. (CCH) ¶ 93,651, at 97,900 (S.D.N.Y. 1988) (status as a director, standing alone, insufficient); *In re National Mortg. Equity Corp. Mortg. Pool Certificates Securities Litigation*, 636 F. Supp. 1138, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6570 (C.D. Cal. 1986) (directors not automatically controlling persons); *Beck v. Cantor, Fitzgerald & Co., Inc.*, 621 F. Supp. 1547, Fed. Sec. L. Rep. (CCH) ¶ 92455, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6180 (N.D. Ill. 1985) (mere officer title insufficient to confer control); *Bush v. Rewald*, 619 F. Supp. 585, Fed. Sec. L. Rep. (CCH) ¶ 92390 (D. Haw. 1985) (director not a controlling person absent influence in the corporation's regular affairs); *Stoller v. Baldwin-United Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 91,678, at 99,428 (S.D. Ohio 1984) (director not a controlling person solely by virtue of his status); *McFarland v. Memorex Corp.*, 493 F. Supp. 631, Fed. Sec. L. Rep. (CCH) ¶ 97368 (N.D. Cal. 1980) (under controlling person provision of the Securities Act, officers are not automatically controlling persons); *Camrose, Inc. v. Intervestor U.S. Real Estate Fund*, Fed. Sec. L. Rep. (CCH) ¶ 95,469, at 99,376 (S.D.N.Y. 1976) (inactive directors not controlling persons); *Dreyfus Leverage Fund v. Alodex Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 93,637, at 92,879 (S.D.N.Y. 1972) (officer not necessarily a controlling person); *American-Standard, No-action letter from the SEC* (Oct. 4, 1972), Fed. Sec. L. Rep. (CCH) ¶ 79,071, at 82,313 (fact question if an officer, director, or 10 percent stockholder is a member of a controlling group for purposes of Securities Act Rule 144; some person or group controls all corporations); *Speech by Commissioner Somer, "Directors and the Federal Securities Laws," Colorado Ass'n of Corporate Counsel*, Denver, Colo., Feb. 21, 1974, in Fed. Sec. L. Rep. (CCH) ¶ 79,669, at 83,803, 83,806 (courts split on whether directors are always in control or whether the issue is a question of fact; latter approach better); § 11:8 N. 4 and the accompanying text (Section 20(b) of the 1934 Act).

³⁴*Cf. Securities and Exchange Commission v. International Chemical Development Corp.*, 469 F.2d 20, Fed. Sec. L. Rep. (CCH) ¶ 93658 (10th Cir. 1972) (construing 1933 Act § 5).

³⁵*Cf. Kitchens v. U.S. Shelter*, Fed. Sec. L. Rep. (CCH) ¶ 93,920, at 90,163 (D.S.C. 1988) (Securities Act).

well for a corporation³⁶) requires “some indirect means of discipline or influence short of actual direction.”³⁷ While an employer-employee relationship would be sufficient,³⁸ if the employer has the ability directly or indirectly to influence the employee’s doing of the specific unlawful

³⁶For example, the *Kennedy, Harriman, Kemmerer, and Moerman* cases, § 11:4 Ns. 3-9 were decisions regarding control of an agricultural cooperative or a corporation.

³⁷*Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967); accord, *Sennott v. Rodman & Renshaw*, 414 U.S. 926, 94 S. Ct. 224, 38 L. Ed. 2d 160, Fed. Sec. L. Rep. (CCH) ¶ 94174 (1973) (Douglas, J., dissenting from denial of certiorari); *Kersh v. General Council of Assemblies of God*, 804 F.2d 546, Fed. Sec. L. Rep. (CCH) ¶ 93000 (9th Cir. 1986); *Commerford v. Olson*, 794 F.2d 1319, Fed. Sec. L. Rep. (CCH) ¶ 92809 (8th Cir. 1986); *Metge v. Baehler*, 762 F.2d 621, Fed. Sec. L. Rep. (CCH) ¶ 92037 (8th Cir. 1985); *Klapmeier v. Telecheck Intern., Inc.*, 482 F.2d 247, Fed. Sec. L. Rep. (CCH) ¶ 94066 (8th Cir. 1973); *Strong v. France*, 474 F.2d 747, Fed. Sec. L. Rep. (CCH) ¶ 93812 (9th Cir. 1973) (quoting *Myzel*); *Securities and Exchange Commission v. First Securities Co. of Chicago*, 463 F.2d 981, Fed. Sec. L. Rep. (CCH) ¶ 93430 (7th Cir. 1972); *Richardson v. MacArthur*, 451 F.2d 35, Fed. Sec. L. Rep. (CCH) ¶ 93260 (10th Cir. 1971); *Kemmerer v. Weaver*, 445 F.2d 76, Fed. Sec. L. Rep. (CCH) ¶ 93095 (7th Cir. 1971); *Mecca v. Gibraltar Corp. of America*, 746 F. Supp. 338, Fed. Sec. L. Rep. (CCH) ¶ 95486 (S.D.N.Y. 1990); *Ruiz v. Charles Schwab & Co., Inc.*, 736 F. Supp. 461, Fed. Sec. L. Rep. (CCH) ¶ 95464 (S.D.N.Y. 1990); *Dillon v. Militano*, 731 F. Supp. 634, Fed. Sec. L. Rep. (CCH) ¶ 94967 (S.D.N.Y. 1990); *Landry v. Price Waterhouse Chartered Accountants*, 715 F. Supp. 98 (S.D.N.Y. 1989); *Kitchens v. U.S. Shelter*, Fed. Sec. L. Rep. (CCH) ¶ 93,920, at 90,163 (D.S.C. 1988); *Technology Exchange Corp. of America, Inc. v. Grant County State Bank*, 646 F. Supp. 179, Fed. Sec. L. Rep. (CCH) ¶ 93100, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6449 (D. Colo. 1986); *Jones v. First Equity Corp. of Florida*, 607 F. Supp. 350 (E.D. Tenn. 1985); *Noland v. Gurley*, 566 F. Supp. 210, Fed. Sec. L. Rep. (CCH) ¶ 99439 (D. Colo. 1983); *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, Fed. Sec. L. Rep. (CCH) ¶ 96834 (D. Md. 1978); *Carr v. New York Stock Exchange, Inc.*, 414 F. Supp. 1292, Fed. Sec. L. Rep. (CCH) ¶ 95563 (N.D. Cal. 1976); *Kennedy v. Tallant*, Fed. Sec. L. Rep. (CCH) ¶ 95,779, at 90,820 (S.D. Ga. 1976); *Harriman v. E. I. DuPont De Nemours & Co.*, 372 F. Supp. 101, Fed. Sec. L. Rep. (CCH) ¶ 94399 (D. Del. 1974); *Gordon v. Burr*, 366 F. Supp. 156, Fed. Sec. L. Rep. (CCH) ¶ 94221 (S.D.N.Y. 1973) (comparing test of *Myzel* with Second Circuit’s holding that directors are liable only if they are culpable participants in a meaningful sense); *Hughes v. Dempsey-Tegeler & Co.*, Fed. Sec. L. Rep. (CCH) ¶ 94,133, at 94,540 (C.D. Cal. 1973), *aff’d* 534 F.2d 156 (9th Cir.), *cert. denied* 429 U.S. 896 (1976) (following *Myzel*); *Jezerian v. Csapo*, Fed. Sec. L. Rep. (CCH) ¶ 93,795, at 93,439 (S.D.N.Y. 1973); *Moerman v. Zipco, Inc.*, 302 F. Supp. 439, Blue Sky L. Rep. (CCH) ¶ 70828, Fed. Sec. L. Rep. (CCH) ¶ 92478 (E.D.N.Y. 1969); *Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949); *cf. Drobbin v. Nicolet Instrument Corp.*, 631 F. Supp. 860, Fed. Sec. L. Rep. (CCH) ¶ 92489 (S.D.N.Y. 1986) (Section 14(f) of the 1934 Act). Compare *Smith v. Bear*, 237 F.2d 79, 60 A.L.R.2d 1119 (2d Cir. 1956), where control was found because the president of Livingstone (the controlled corporation) was friendly with the partners of Bear, Stearns (the controlling entity), two-thirds of Livingstone’s capital came from wives and relatives of Bear, Stearns partners, and Bear, Stearns (as was its usual practice) paid for a direct wire. That the Bear, Stearns people never interfered with Livingstone’s management was insufficient to overcome the other points.

³⁸E.g., *Carpenter v. Harris, Upham & Co., Inc.*, 594 F.2d 388, Fed. Sec. L. Rep. (CCH) ¶ 96803 (4th Cir. 1979); *Zweig v. Hearst Corp.*, 521 F.2d 1129, Fed. Sec. L. Rep. (CCH) ¶ 95256, 32 A.L.R. Fed. 703 (9th Cir. 1975); *Spier v. Erber*, Fed. Sec. L.

act,³⁹ the employment status need not be established.⁴⁰ This test does not permit a court to find an institution (such as an exchange) to be a controlling person of a member firm.⁴¹ The first 10b-5 case to apply this standard, although not adopting the quoted test in so many words, demonstrates how little might be required for control. There, a

Rep. (CCH) ¶ 95,287, at 96,322 (S.D.N.Y. 1990); *Gruber v. Prudential-Bache Securities, Inc.*, 679 F. Supp. 165, Blue Sky L. Rep. (CCH) ¶ 72708, Fed. Sec. L. Rep. (CCH) ¶ 93646, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6888 (D. Conn. 1987); *Nelson v. Black & Co., Inc.*, 669 F. Supp. 341, Fed. Sec. L. Rep. (CCH) ¶ 93307 (D. Or. 1987); *Noland v. Gurley*, 566 F. Supp. 210, Fed. Sec. L. Rep. (CCH) ¶ 99439 (D. Colo. 1983); *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303, Fed. Sec. L. Rep. (CCH) ¶ 97905 (E.D. Va. 1981); *Smith v. Christie*, Fed. Sec. L. Rep. (CCH) ¶ 97,828, at 90, 121 (N.D. Cal. 1980); *Forman v. Ferro*, Fed. Sec. L. Rep. (CCH) ¶ 97,676, at 98,560 n.9 (E.D.N.Y. 1980); *Troyer v. Karcagi*, 476 F. Supp. 1142, Fed. Sec. L. Rep. (CCH) ¶ 96929 (S.D.N.Y. 1979).

³⁹*Harrison v. Dean Witter Reynolds, Inc.*, 715 F. Supp. 1425, Fed. Sec. L. Rep. (CCH) ¶ 94760, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 7346 (N.D. Ill. 1989) (no liability on employer when employee did acts outside of his employment and a rational plaintiff would have known that fact).

⁴⁰*Sennott v. Rodman & Renshaw*, 414 U.S. 926, 94 S. Ct. 224, 38 L. Ed. 2d 160, Fed. Sec. L. Rep. (CCH) ¶ 94174 (1973) (Douglas, J., dissenting from denial of certiorari) (controlling person liability broader than agency; not limited to employees); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, Fed. Sec. L. Rep. (CCH) ¶ 95500 (9th Cir. 1990) (reaches independent contractors; goes beyond respondeat superior); *Carpenter v. Harris, Upham & Co., Inc.*, 594 F.2d 388, Fed. Sec. L. Rep. (CCH) ¶ 96803 (4th Cir. 1979); *Christoffel v. E. F. Hutton & Co., Inc.*, 588 F.2d 665, Fed. Sec. L. Rep. (CCH) ¶ 96545 (9th Cir. 1978); *Fey v. Walston & Co., Inc.*, 493 F.2d 1036, Fed. Sec. L. Rep. (CCH) ¶ 94437 (7th Cir. 1974) (controlling person liability broader than common-law principal-agent concepts); *Harrison v. Dean Witter Reynolds, Inc.*, 715 F. Supp. 1425, Fed. Sec. L. Rep. (CCH) ¶ 94760, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 7346 (N.D. Ill. 1989); *Jones v. First Equity Corp. of Florida*, 607 F. Supp. 350 (E.D. Tenn. 1985) (agency relationship not required); *Bradshaw v. Van Houten*, 601 F. Supp. 983 (D. Ariz. 1985) (broader than agency); *Haynes v. Anderson & Strudwick, Inc.*, 508 F. Supp. 1303, Fed. Sec. L. Rep. (CCH) ¶ 97905 (E.D. Va. 1981); *Harriman v. E. I. DuPont de Nemours & Co.*, 372 F. Supp. 101, Fed. Sec. L. Rep. (CCH) ¶ 94399 (D. Del. 1974); *Hughes v. Dempsey-Tegeler & Co.*, Fed. Sec. L. Rep. (CCH) ¶ 94,133, at 94,540 (C.D. Cal. 1973), aff'd 534 F.2d 156 (9th Cir.), cert. denied 429 U.S. 896 (1976) (controlling person concept intended to extend beyond common-law agency); *Anderson v. Francis I. duPont & Co.*, 291 F. Supp. 705 (D. Minn. 1968); *Moscarella v. Stamm*, 288 F. Supp. 453 (E.D.N.Y. 1968); *Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949). See also § 11:4 N. 6.

In *Securities and Exchange Commission v. First Securities Co. of Chicago*, 463 F.2d 981, Fed. Sec. L. Rep. (CCH) ¶ 93430 (7th Cir. 1972), a 92 percent owner of a broker-dealer firm was held to be controlled by the firm because he acted as its president. Compare *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, Fed. Sec. L. Rep. (CCH) ¶ 95313, 38 A.L.R. Fed. 709 (3d Cir. 1975) (corporation cannot control chief executive officer who owns 50 percent of its stock, because officer controls corporation and they cannot simultaneously control each other).

⁴¹*New York Stock Exch., Inc. v. Sloan*, Fed. Sec. L. Rep. (CCH) ¶ 97,618, at 98,344 (S.D.N.Y. 1980) (stock exchange not in control of member firm); *Baty v. Pressman, Frohlich & Frost, Inc.*, 471 F. Supp. 390, Fed. Sec. L. Rep. (CCH) ¶ 96896 (S.D.N.Y. 1979).

brokerage firm was held accountable for the acts of its wire correspondent when it supplied the correspondent with a wire, cotton ticker, and forms, prescribed the manner in which his segregated and omnibus accounts were used, supplied him with research material, and directed SEC and exchange compliance.⁴² The Ninth Circuit, perhaps with all the foregoing in mind, opined that "control" is an elusive notion for which no clear-cut rule or standard can be devised.⁴³ Whatever the proper test, it is applied as of the time of the 10b-5 violation⁴⁴ and, according to some authorities, refers to control over the controlled person with respect to the acts constituting the violation.⁴⁵ "Affiliate" includes a person under common control with

⁴²*Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949). The court had previously found that no common-law agency relationship existed. *Id.* at 121. Compare *O'Keefe v. Courtney*, 655 F. Supp. 16, Fed. Sec. L. Rep. (CCH) ¶ 93248 (N.D. Ill. 1985) (doubt if clearing agent controls independent investment adviser); *Baum v. Phillips, Appel & Walden, Inc.*, 648 F. Supp. 1518, Fed. Sec. L. Rep. (CCH) ¶ 93045, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6461 (S.D.N.Y. 1986) (clearing broker not controlling person of registered representative of the introducing broker).

⁴³*Wool v. Tandem Computers Inc.*, 818 F.2d 1433, Fed. Sec. L. Rep. (CCH) ¶ 93272, 8 Fed. R. Serv. 3d 91 (9th Cir. 1987); *Kersh v. General Council of Assemblies of God*, 804 F.2d 546, Fed. Sec. L. Rep. (CCH) ¶ 93000 (9th Cir. 1986).

⁴⁴*Schlifke v. Seafirst Corp.*, 866 F.2d 935, Fed. Sec. L. Rep. (CCH) ¶ 94174 (7th Cir. 1989); *Carpenter v. Harris, Upham & Co., Inc.*, 594 F.2d 388, Fed. Sec. L. Rep. (CCH) ¶ 96803 (4th Cir. 1979) (obligations terminate when control stopped); *In re VMS Securities Litigation*, 752 F. Supp. 1373, Fed. Sec. L. Rep. (CCH) ¶ 96278 (N.D. Ill. 1990) (not liable for acts prior to becoming a control person); *Wingsco Energy One v. Vanguard Groups Resources 1984, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 94,038, at 90,864 (S.D. Tex. 1988); *Roberts v. Heim*, 670 F. Supp. 1466, Blue Sky L. Rep. (CCH) ¶ 72616, Fed. Sec. L. Rep. (CCH) ¶ 93291, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6701 (N.D. Cal. 1987) (same as *Kaliski*); *Schlifke v. Seafirst Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 93,107, at 95,444 (N.D. Ill. 1987) (citing text); *Kaliski v. Hunt Intern. Resources Corp.*, 609 F. Supp. 649, Fed. Sec. L. Rep. (CCH) ¶ 92282 (N.D. Ill. 1985) (not liable as a controlling person for acts occurring before he took control); *Metge v. Baehler*, 577 F. Supp. 810, Fed. Sec. L. Rep. (CCH) ¶ 99665 (S.D. Iowa 1984) (quoting text); *Holloway v. Howerdd*, 377 F. Supp. 754, Fed. Sec. L. Rep. (CCH) ¶ 94820 (M.D. Tenn. 1973).

⁴⁵*Sanders Confectionery Products, Inc. v. Heller Financial, Inc.*, 973 F.2d 474, Bankr. L. Rep. (CCH) ¶ 74917, Fed. Sec. L. Rep. (CCH) ¶ 96966, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 8063 (6th Cir. 1992); *Pommer v. Medtest Corp.*, 961 F.2d 620, Fed. Sec. L. Rep. (CCH) ¶ 96592 (7th Cir. 1992); *Schlifke v. Seafirst Corp.*, 866 F.2d 935, Fed. Sec. L. Rep. (CCH) ¶ 94174 (7th Cir. 1989); *Kersh v. General Council of Assemblies of God*, 804 F.2d 546, Fed. Sec. L. Rep. (CCH) ¶ 93000 (9th Cir. 1986) (need power with regard to the unlawful transaction); *Metge v. Baehler*, 762 F.2d 621, Fed. Sec. L. Rep. (CCH) ¶ 92037 (8th Cir. 1985) (control over entity and power to control the transaction); *Carpenter v. Harris, Upham & Co., Inc.*, 594 F.2d 388, Fed. Sec. L. Rep. (CCH) ¶ 96803 (4th Cir. 1979); *Christoffel v. E. F. Hutton & Co., Inc.*, 588 F.2d 665, Fed. Sec. L. Rep. (CCH) ¶ 96545 (9th Cir. 1978) (broker-dealer not a controlling person with respect to its employee when the employee acts as a guardian for an incompetent); *Maywalt v. Parker & Parsley Petroleum Co.*, 808 F. Supp. 1037, Fed. Sec. L. Rep. (CCH) ¶ 97229 (S.D.N.Y. 1992); *In re AnnTaylor Stores Securities*

the specified person.⁴⁶ If *A* controls *B* and *C*, and *B* and *C* are therefore affiliates, it does not follow that *B* controls *C* or *C* controls *B*.⁴⁷

A controlling person is responsible for those he directly controls (such as a corporation) as well as for indirectly controlled persons (such as corporate officers), based either on Section 20(a)'s "directly or indirectly" language or one of the other principles discussed in this Section 40. For instance, in one case, the directors were held to be controlling persons of a corporation, which in turn was responsible for the acts of its president on an agency basis. The directors therefore were indirectly responsible for the president's misdeeds.⁴⁸

Litigation, 807 F. Supp. 990, Fed. Sec. L. Rep. (CCH) ¶ 96940 (S.D.N.Y. 1992) (control over primary violator); *Martin v. Brown*, 758 F. Supp. 313 (W.D. Pa. 1990) (control over conduct to prevent liability); *Reshal Associates, Inc. v. Long Grove Trading Co.*, 754 F. Supp. 1226, Fed. Sec. L. Rep. (CCH) ¶ 96250 (N.D. Ill. 1990); *In re VMS Securities Litigation*, 752 F. Supp. 1373, Fed. Sec. L. Rep. (CCH) ¶ 96278 (N.D. Ill. 1990); *Koplin v. Labe Federal Sav. and Loan Ass'n*, 748 F. Supp. 1336, Fed. Sec. L. Rep. (CCH) ¶ 95735 (N.D. Ill. 1990); *Craig v. First American Capital Resources, Inc.*, 740 F. Supp. 530, Fed. Sec. L. Rep. (CCH) ¶ 95817 (N.D. Ill. 1990); *Bray v. R.W. Technology, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 95,225, at 95,977 (D. Mass. 1990) (control of corporation and specific transaction); *In re Worlds of Wonder Securities Litigation*, 721 F. Supp. 1140, Fed. Sec. L. Rep. (CCH) ¶ 94449 (N.D. Cal. 1989) (control over controlled person); *Ballan v. Wilfred American Educational Corp.*, 720 F. Supp. 241, 56 Ed. Law Rep. 170, Fed. Sec. L. Rep. (CCH) ¶ 94910 (E.D.N.Y. 1989) (control over primary violator); *Harrison v. Dean Witter Reynolds, Inc.*, 715 F. Supp. 1425, Fed. Sec. L. Rep. (CCH) ¶ 94760, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 7346 (N.D. Ill. 1989); *Ross v. Bolton*, Fed. Sec. L. Rep. (CCH) ¶ 94,410, at 92,655-92,656 (S.D.N.Y.), vacated in part Fed. Sec. L. Rep. (CCH) ¶ 94,411 (S.D.N.Y. 1989), aff'd 904 F.2d 819 (2d Cir. 1990) (control over transaction in question); *Neiman v. Clayton Brokerage Co. of St. Louis, Inc.*, 683 F. Supp. 196, Fed. Sec. L. Rep. (CCH) ¶ 93931 (N.D. Ill. 1988) (power over people and the specific transaction; power to stop transaction is not sufficient); *Schlifke v. Seafirst Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 93,107, at 95,444 (N.D. Ill. 1987); *In re Action Industries Tender Offer*, 572 F. Supp. 846, Fed. Sec. L. Rep. (CCH) ¶ 99560 (E.D. Va. 1983) (outside directors did not control anyone in the tender offer in question). Compare *Stern v. American Bankshares Corp.*, 429 F. Supp. 818, Fed. Sec. L. Rep. (CCH) ¶ 96033 (E.D. Wis. 1977) (first stating that do not need control over transaction, but then requiring it). Contra, *San Francisco-Oklahoma Petroleum Exploration Corp. v. Carstan Oil Co., Inc.*, 765 F.2d 962, Fed. Sec. L. Rep. (CCH) ¶ 92094 (10th Cir. 1985); *Epstein v. Haas Securities Corp.*, 731 F. Supp. 1166, Fed. Sec. L. Rep. (CCH) ¶ 94957 (S.D.N.Y. 1990); *Ross v. Bolton*, Fed. Sec. L. Rep. (CCH) ¶ 94,410, at 92,655-92,656 (S.D.N.Y.), vacated in part Fed. Sec. L. Rep. (CCH) ¶ 94,411 (S.D.N.Y. 1989), aff'd 904 F.2d 819 (2d Cir. 1990); *Laven v. Flanagan*, 695 F. Supp. 800, Fed. Sec. L. Rep. (CCH) ¶ 95257 (D.N.J. 1988) (need not have control over the transaction); *Commins v. Johnson & Higgins, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 94,092, at 91,099 (N.D. Cal. 1988) (control over securities violator); *King v. E.F. Hutton & Co.*, Fed. Sec. L. Rep. (CCH) ¶ 93,176, at 95,790 (D.D.C. 1987); *Stoller v. Baldwin-United Corp.*, Fed. Sec. L. Rep. (CCH) ¶ 91,678, at 99,428 (S.D. Ohio 1984).

⁴⁶Exchange Act Rule 12b-2(a). See also Securities Act Rule 405(a).

⁴⁷*Roberts v. Heim*, 670 F. Supp. 1466, Blue Sky L. Rep. (CCH) ¶ 72616, Fed. Sec. L. Rep. (CCH) ¶ 93291, R.I.C.O. Bus. Disp. Guide (CCH) ¶ 6701 (N.D. Cal. 1987).

⁴⁸*Moerman v. Zipco, Inc.*, 302 F. Supp. 439, Blue Sky L. Rep. (CCH) ¶ 70828, Fed. Sec. L. Rep. (CCH) ¶ 92478 (E.D.N.Y. 1969); see *Koehler v. Pulvers*, 614 F. Supp. 829,