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# First Equity Corporation v. Utah State University and Donald A. Catron : Reply Brief

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

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BRIGHAM YOUNG UNIVERSITY
J. Reuben Clark Law School

FIRST EQUITY CORPORATION OF FLORIDA, a Florida corporation,

Plaintiff-Appellant,

-vs-

UTAH STATE UNIVERSITY, a body politic and corporate,

Defendant-Respondent,

and

DONALD A. CATRON, an individual,

Defendant.

BEAR STEARNS & CO., HARRIS UPHAM & CO., INC., HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., LEHMAN BROTHERS, INC., MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., SHEARSON, HAYDEN, STONE, INC. and SUTRO & CO., INC.,

Amici Curiae.

CASE NO. 13798

# REPLY BRIEF OF AMICI CURIAE

Appeal from the Orders of the First Judicial District Court of Cache County, VeNoy Christofferson, District Judge, Presiding

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## TABLE OF CONTENTS


| | | Page |
|---|---|---|
| I - | POINT I OF RESPONDENT'S BRIEF DOES NOT ADDRESS THE DISPOSITIVE ISSUE ON THIS APPEAL (THE ENFORCEABILITY OF THE UNIVERSITY'S CONTRACT WITH APPELLANT TO SUPPLY BROKERAGE SERVICES); THE JUDGMENT APPEALED FROM MUST BE REVERSED . . . . . . . . . . . . . . | 1 |
| II - | UNDER THE FACTS OF THIS CASE, RESPONDENT IS ESTOPPED FROM DENYING AUTHORITY TO ENTER INTO THE AGREEMENTS HERE INVOLVED WITH FIRST EQUITY CORPORATION FOR THE SUPPLYING OF BROKERAGE SERVICES . . . . . . . . . . . . . . | 4 |
| III - | THE UNDERLYING SECURITIES PURCHASE AND SALES TRANSACTIONS WERE NOT ULTRA VIRES; THE JUDGMENT APPEALED FROM MUST BE REVERSED . . . . . . | 9 |
| IV. - | RESPONDENT ASSERTED DEFENSE OF "REVOCATION OF AUTHORITY" IS WITHOUT FOUNDATION IN FACT OR IN LAW; THE JUDGMENT APPEALED FROM MUST BE REVERSED . . . . . . . . . . . . . . . . . . . . . | 18 |
| V - | THE CLAIMED VIOLATION OF "REGULATION T" DOES NOT CONSTITUTE A LEGAL DEFENSE TO THE CLAIMS ASSERTED BY APPELLANT; THE JUDGMENT APPEALED FROM MUST BE REVERSED . . . . . . . . . . . . . . . . | 21 |
| APPENDIX . . . . . . . . . . . . . . . . . . . . . . . . | | |


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Machine-generated OCR, may contain errors.

# AUTHORITIES

## Statutes, Regulations and Rules


| | Page |
|---|---|
| Comp. Laws of Utah 1888, Sec. 1855 . . . . . . . . . . | 10 |
| 1929 Session Laws, Ch. 41, Sec. 2 . . . . . . . . . . | 11 |
| 1929 Session Laws, Ch. 41, Sec. 3 . . . . . . . . . . | 11 |
| 1929 Session Laws, Ch. 41, Sec. 4 . . . . . . . . . . | 11 |
| Utah Code Ann. §33-1-1 (1953) . . . . . . . . . . . . | 10,17,18 |
| §33-1-3 (1953) . . . . . . . . . . . . | 10,17 |
| §51-7-1, et.seq. (Supp. 1975) . . . . | 12,13,18 |
| §51-7-2(b) . . . . . . . . . . . . . . | 18 |
| §53-32-2 (1953) . . . . . . . . . . . | 11 |
| §53-32-3 (1953) . . . . . . . . . . . | 11 |
| §53-32-4 (1953) . . . . . . . . . . . | 11,14 |
| §53-32-4 (1970) . . . . . . . . . . . | 9 |
| §53-48-10(4) (1953) . . . . . . . . . | 16 |
| §53-48-10(5) (1953) . . . . . . . . . | 12 |
| §53-48-20 (1953) . . . . . . . . . . . | 16 |
| Utah Const., Art. 10, Sec. 4 . . . . . . . . . . . . . | 11 |
| Rule 56(c) of the Utah Rules of Civil Procedure . . . . . . . . . . . . . . . . . . . . | 14 |


## Cases:


| | |
|---|---|
| Erie Railroad Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, 114 ALR 1487 (1938) . . . | 8 |
| Provo City v. Denver & Rio Grande Western R. Co., 156 F.2d 710 (10th Cir. 1946) . . . . . . . . . . . | 8 |
| Sendak v. Trustees of Indiana University, 254 Ind. 390, 260 N.E. 2d 601 (1970) . . . . . . . . . . . | 15-16 |
| State of Utah v. duPont Walston, Inc. ('74-'75 Binder) CCH Fed. Sec. L.Rep. ¶94812 (D. Utah, Oct. 1, 1974) . . . . . . . . . . . . . . . . . . . | 13 |
| Tooele City v. Elkington, 100 Utah 485, 116 P.2d 406 (1941) . . . . . . . . . . . . . . . . . . . | 7,8 |
| University of Utah v. Board of Examiners of State of Utah, 4 Utah 2d 408, 295 P.2d 348 (1956) . . . | 13 |
| Wall vs. Salt Lake City, 50 Utah 593, 168 P. 766 (1917) . . . . . . . . . . . . . . . . . . . . . . | 5,6,7,8 |


## Other Authorities:

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3 Dillon, Mun. Corps

IN THE SUPREME COURT OF THE STATE OF UTAH

| | | |
|---|---|---|
| FIRST EQUITY CORPORATION OF FLORIDA, a Florida corporation,<br><br>Plaintiff-Appellant,<br><br>-vs-<br><br>UTAH STATE UNIVERSITY, a body politic and corporate,<br><br>Defendant-Respondent,<br><br>and<br><br>DONALD A. CATRON, an individual,<br><br>Defendant.<br><br>BEAR STEARNS & CO., HARRIS UPHAM & CO., INC., HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., LEHMAN BROTHERS, INC., MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., SHEARSON, HAYDEN, STONE, INC. and SUTRO & CO., INC.,<br><br>Amici Curiae. | : | CASE NO. 13798 |

REPLY BRIEF OF AMICI CURIAE

I.

POINT I OF RESPONDENT'S BRIEF DOES NOT ADDRESS THE DISPOSITIVE ISSUE ON THIS APPEAL (THE ENFORCEABILITY OF THE UNIVERSITY'S CONTRACT WITH APPELLANT TO SUPPLY BROKERAGE SERVICES); THE JUDGMENT APPEALED FROM MUST BE REVERSED.

The various arguments set forth in Respondent's Brief under Point I, occupying 36 pages, simply missed the target and are not relevant to the dispositive issue on this appeal. In that section of its Brief, Respondent seeks to persuade this Court that the security purchase and sale transactions engaged in by

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the University are ultra vires, and hence voidable. As amici curiae point out under Point I of their opening brief at pages 5 through 11, a finding that such transactions were ultra vires to the University would not be a defense to Appellant's claims here. Even assuming, contrary to the law, that such transactions were ultra vires, any rights or remedies arising or flowing therefrom would repose in the parties to the transactions. The record affirmatively shows that First Equity acted only as an agent of the University, carefully and faithfully carrying out specific instructions given by its principal - the University. (R. 140-49, 247)*

Respondent addresses the real issue here -- the validity and enforceability of the agency contract between the University and Appellant -- only tangentially in the extension of the argument contained in what is labeled Appendix A attached to the Brief. There, Respondent argues that the University has power "only" by "contract" to supervise the erection of college buildings, to adopt plans, drawings and specifications for those buildings, and to make all purchases and contracts for the buildings." (See Appendix A(2) to Respondent's Brief).

We submit that this argument is specious, for if valid, the University could not contractually bind itself to employ a President and other administrative officers to plan, direct and control what transpired in those "buildings" or to purchase the

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* Respondent does not challenge this fact, but curiously adds that with respect to other transactions not the subject of this litigation First Equity did not act as the University's agent. (Respondent's Brief at p. 8).

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myriad of supplies and services necessary to operate a University. If Appellant's argument were held to be valid, it would place in jeopardy the salary of every employee and the fee of every consultant and supplier of services employed or retained by the University. If any one of them, at the specific direction and under order of the University, were to execute an act ultra vires to the University, and all within the scope of his employment, he could not collect his salary or fee.

Such is not and should not be the law. As between the principal and its agent, such a risk is borne by the principal (see opening brief of amici curiae, Point I). Respondent seeks to circumvent this universally accepted rule of agency law by grasping in desperation at those cases holding that, as between an agent and the adverse party to the transaction, the agent is liable for his own action. We do not quarrel with that doctrine. Indeed, it will make the other agents of the University (Mr. Catron, the Institutional Council and the Board of Trustees) who authorized or ratified the service contract between the University and Appellant liable to Appellant if the University escapes liability on an ultra vires theory. However, the doctrine of these cases does not apply because the Respondent has not asserted that the Appellant, its agent, has breached its duty to the Respondent or to any third party. Nor is there anything in the record which even suggests that Appellant breached that duty. Appellant has fulfilled its duty to the University by carefully following the University's instructions and is entitled to compensation for its services. Assum-

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ing arguendo,that those underlying transactions were ultra vires, the University is, nonetheless, liable to its own agent, the Appellant, for the fees which it agreed to pay for the services which were rendered to the University by the Appellant.

## II.

### UNDER THE FACTS OF THIS CASE, RESPONDENT IS ESTOPPED FROM DENYING AUTHORITY TO ENTER INTO THE AGREEMENTS HERE INVOLVED WITH FIRST EQUITY CORPORATION FOR THE SUPPLYING OF BROKERAGE SERVICES.

In POINT II of the brief of amici curiae, an argument is set forth that the University is estopped from asserting that the contracts complained of were ultra vires. Respondent's reply commencing at page 43 of its opening brief asserts that the cases and authorities cited and relied upon by amici curiae are inapposite. This conclusion is bottomed entirely upon the continuing assumption of Respondent that the underlying securities purchase transactions were "ultra vires." From this assumption is bootstrapped another, namely, that since the purchase transactions were ultra vires, the agreement of the University to pay for brokerage services is also ultra vires. As we argue at Point I of this brief, _supra_, the second assumption does not follow the first, even assuming, arguendo, the validity of the first. When the second assumption falls, as it must, the entire underpinning for this portion of Respondent's brief collapses and it becomes clear that the doctrine of estoppel applies under the facts and circumstances of this case.

However, assuming, arguendo, the validity of the assumption that both the underlying purchase transaction and the agree-

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ment between the University and First Equity Corporation for the providing of brokerage services were found to be "ultra vires," Respondent's argument, nonetheless, is not valid. The benchmark case of this Court on this subject is Wall vs. Salt Lake City, 50 Utah 593, 168 P.766 (1917). That case has not been reversed nor has the doctrine there announced been changed by this Court in subsequent cases. That case was a much weaker case for the application of an estoppel doctrine against a governmental body than is the case at bar because, there, the City was acting purely in its "governmental" capacity. By contrast, here, the University was acting in its proprietary capacity, dealing as an investor and entering into a contract for the provision of designated services. This Court in Wall at page 604 recognized this vital difference in governmental action, and the legal consequences thereof, by citing and quoting with approval 3 Dillon, Mun. Corps. (5th Ed.) Sec. 1194 which in pertinent part states:

> Municipal corporations, as we have seen, are regarded as having, in some respects, a double character, one public, the other (by way of distinction) private. As respects property not held for public use, or upon public trust, and as respects contracts and rights of a private nature, there is no reason why such corporations should not fall within limitation statutes, and be affected by them unless excluded from them. . . .

Despite this distinction and the fact that in Wall plaintiff sought to cut off the rights of the City to a public street, the Court imposed upon the City the doctrine of estoppel in pais. In so doing, it recognized that this was the doctrine to be applied only in special circumstances, stating at page 601:

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(Referring to cases holding that estoppel does not apply such as those cited by Respondent):

> None of them present a case like this, where the municipality, by its own affirmative acts, declarations, and conduct, misled the party, or induced him to believe that he had the right to rely upon the assurances which the municipality, after a long period of time, sought to repudiate to his injury. Indeed, it is hardly to be expected that many cases, if any at all, can be found in the published report similar to the case at bar. It will be found upon examination that many of the cases above cited placed emphasis upon the fact that the municipality did not do anything affirmatively to mislead the party claiming the right to the ground in dispute. [Emphasis added]

It is difficult to imagine language that more nicely fits the facts and circumstances of this case, and, in addition, we are here talking about a simple contract for brokerage services which clearly falls within the ambit of proprietary, not governmental, action. The court in *Wall* then stated at page 607:

> We believe, as was said by the Court in *City of Sullivan v. Tichnor*, supra, cited by appellant, that:
>
> "A municipal corporation can no more profit by fraud upon property owners than an individual and may be estopped by conduct."
>
> Or, as said by Judge Dillon, in note one to the section above quoted, referring to the character of acts necessary to constitute an estoppel:
>
> "The principle of estoppel in pais has been applied to exceptional cases where the elements calling for its exercise appear to have been an abandonment of the public use for the prescriptive period, inclosure and expensive improvements, such as large and costly buildings, or acts of the municipality inducing the abutter to believe that there is no longer any street, and the expenditure of money in reliance upon the acts of the municipality. The absolute bona fides of the abutter or adverse possessor is a most important factor where an estoppel in pais is claimed. The acts relied on must be of such character as to amount to a fraud, if the city were permitted to claim otherwise."

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> We hold that this case falls within the exceptional class of cases referred to by Judge Dillon, and that it is the duty of the Court to decide it as "right and justice require." It is our opinion that the City is estopped from claiming the premises in question as a public street. [Emphasis by the Court]

We respectfully assert that this doctrine is here applicable. It is difficult to conceive of clearer action on the part of the University to induce action on the part of its agent pursuant to the agency contract. The same was accomplished by the ritual of a formal resolution. (R. 137-38, 151). First Equity Corporation acted in good faith, advancing its own funds, and performing requested services in precisely the manner designated by the University. "Right and justice require" the imposition of the doctrine of estoppel. Indeed, as was true in Wall, to permit the University to escape responsibility for its contract under the facts on this record would permit it to "profit by fraud." It should not be permitted so to do.

In Tooele City v. Elkington, 100 Utah 485, 116 P.2d 406 (1941), this Court discussed Wall at length. This Court cited with approval, relied upon and followed the reasoning in Wall to the facts then before it, though after "balancing the justices of the cause," the Court refrained from applying the doctrine in the Tooele City case stating at page 494:

> In the case at bar, the consideration given the city by Elkington was small, if anything; the deed was made in contravention of the statute; there is no evidence that the property has been assessed against the defendants or their predecessor in interest; the time element is short; and there was not a replatting or a change in the whole neighborhood to the benefit of all adjacent landowners.

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In its opening brief, Respondent relies primarily upon a Federal decision, Provo City v. Denver & Rio Grande Western R. Co., 156 F.2d 710 (10th Cir. 1946), as modifying the doctrine enunciated in Wall and Tooele City. Respondent's position is not valid because:

a) In Provo City, the court specifically found (156 F.2d at 712) that the defendant Railroad had full knowledge of the underlying facts and hence was not in a position to invoke the doctrine of estoppel in pais in any event.

b) In Provo City, the City was clearly acting in its governmental capacity, as contrasted with the University's proprietary contract which Appellant here seeks to enforce.

c) The Court of Appeals in Provo City restricted the application of its opinion to estoppel applied against "a city in respect of its right to reopen a street for use of a public thoroughfare" and recognized that the doctrine would apply in "peculiar circumstances" such as those presented in Wall. Furthermore, a vigorous dissenting opinion was written by Judge Phillips which asserted that the majority opinion misconstrued and misapplied both Wall and Elkington.

d) Finally, Provo City was a case in the Federal courts. As the court specifically found in Provo City, the Federal Court is without constitutional power under the teachings of Erie Railroad Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, 114 ALR 1487 (1938), to change existing Utah law in any way. Its only function was to construe and apply the substantive law of the State of Utah as enunciated by this Court.

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We respectfully submit from the foregoing that the cases and authorities set forth in the opening brief of amici curiae are here controlling and that the doctrine of estoppel in pais should be imposed against the University. This is particularly true with respect to such unappropriated funds as "grants, gifts, devises, bequests," "dedicated credits" and "tuitions, fees and Federal grants" with respect to which the Legislature in the most clear and unambiguous fashion has delegated to the University the authority to "convert" and "invest". (Utah Code Ann. Sec. 53-32-4 (1970), discussed infra). How could the University receive a gift of common stock and proceed to convert and reinvest proceeds from such conversion without employing the services of a broker? The University obviously had the power to employ a broker and should be estopped from denying the same under the peculiar facts and circumstances demonstrated by this record. The judgment appealed from should be reversed.

## III.

### THE UNDERLYING SECURITIES PURCHASE AND SALES TRANSACTIONS WERE NOT ULTRA VIRES; THE JUDGMENT APPEALED FROM MUST BE REVERSED.

The bulk of Respondent's brief is devoted to argument that the securities transactions in which Appellant acted as Respondent's agent broker were ultra vires. The argument is grounded upon two erroneous assumptions:

a) That neither the Utah Constitution nor enactments of the Territorial or State Legislatures delegate to the University power to purchase and sell common stocks, and;

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b) That Utah Code Annotated, Sections 33-1-1 and 33-1-3 constitute "enabling" legislation, are the only repository of University authority to purchase securities and constitute an absolute prohibition against purchasing any security not on the statutory list contained in Section 33-1-1.

It does not appear to us that either of these assumptions is valid.

1. <u>At all times here pertinent, the University was empowered to invest both appropriated and non-appropriated funds in common stocks</u>.

A. <u>Appropriated Funds</u>. Pertinent portions of the Territorial enactments, the Constitutional provisions and subsequently enacted statutes by the State Legislature are quoted and discussed in the Brief of amici curiae under POINT IV at pages 15-22 of their opening brief. We will not restate them here. However, by way of summary, we invite the attention of the Court to the following general grants of authority historically given to the University which apply to appropriated funds as well as most other property that falls into the hands of the University.

(i) Comp. Laws of Utah 1888, Section 1855. The University was established by the Territorial Legislature as a common law trust. The Trustees were given "general control and supervision" over "all appropriations", subject only to the proviso that their action shall be "not inconsistent with the laws of the Territory."

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(2) Utah Constitution, Art. 10, Sec. 4. The Constitution specifically provides that all of the rights conferred upon the University by the Territorial Legislature "are hereby perpetuated."

(3) 1929 Session Laws, Ch. 41, Sec. 2; Utah Code Ann. Sec. 53-32-2 (1953). In 1929, the Utah Legislature reiterated the perpetuation of all such rights theretofore "granted or conferred" and further provided that the University "may sue and be sued and contract and be contracted with" and "may take, hold, lease, sell and convey real and personal property as the interests of the college may require."

(4) 1929 Session Laws, Ch. 41, Sec. 3; Utah Code Ann. Sec. 53-32-3 (1953). The same Legislature, in the following Section provided specifically that the University may "bring and maintain actions to recover, protect and preserve property and rights of the university and to enforce any contract relating thereto."

(5) 1929 Session Laws, Ch. 41, Sec. 4; Utah Code Ann. Sec. 53-32-4 (1953). In the next section, the same Legislature authorized the University to "take by purchase, grant, gift, devise or bequest any real or personal property for the use of any department of the college and for any purpose appropriate to the object of the University." It also provided that the University "may convert property" and that property received by the University may be "held, invested and managed and the proceeds thereof used by the board of trustees for the purposes

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and under the conditions prescribed in the grant or donation."

(6) Utah Code Ann. Sec. 53-48-10(5) (1953). In 1969, the Legislature also reiterated the general power of the University to "handle its own financial affairs under the general supervision of the board."

We respectfully submit that these various statutory provisions conferred upon the University very broad discretionary investment powers which included the authority to invest in common stocks. Throughout Respondent's Brief, it is asserted that the Legislature could not have so intended for it would permit the University to engage in gross speculative endeavors. This is not true. It will be recalled that the University was established by the Territorial Legislature as a common law trust and all of the common law and statutory restrictions upon actions of such fiduciaries tethered the investment policy of the University. Furthermore, the Territorial Legislature specifically reserved the right to enact subsequent laws to correct or control any abuses by requiring that all control and supervision over appropriations must not be "inconsistent with the laws of the Territory." These provisions were perpetuated and expanded upon by the Constitution and subsequent statutes. The Legislature, in its wisdom, did not see fit to impose specific restrictions upon the investment policy of the University until enactment of the State Money Management Act on February 2, 1974 (Utah Code Ann. Sections 51-7-1, et. seq., Supp. 1975).



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Respondent relies heavily upon University of Utah v. Board of Examiners of State of Utah, 4 Utah 2d 408, 295 P.2d 348 (1956). Its reliance upon that case is not here apropos. As Respondent asserts in its brief, "the University of Utah" there was contending that "it was completely free from the control of the Legislature, administrative bodies, commissions, agencies and officers of the State." Amici curiae make no such contention in this case. They assert that the Legislature may control the kinds and types of investments made by the University. However, the Legislature refrained from so acting until enactment of the State Money Management Act in 1974 (Utah Code Ann. §§ 51-7-1 et. seq. (1953)).

The opinion of Judge Aldon J. Anderson in State of Utah v. duPont Walston, Inc. ('74-'75 Binder) CCH Fed. Sec. L. Rep. ¶94812 (D. Utah, Oct. 1, 1974) reflects that virtually identical arguments were asserted by Respondent in an action in the United States District Court against duPont Walston, Inc. as are set forth in its brief before this Court. After reviewing Respondent's arguments and the Territorial, Constitutional and legislative enactments discussed above, Judge Anderson commented in that case at page 96,716:

> The Court has serious concerns with plaintiffs' [The State of Utah and Utah State University] theory [that the University does not have power to invest in common stocks] for it does not appear that the Utah Code Ann. Sec. 33-1-1 (1966) is an enabling statute which clearly sets forth the investment guidelines for State universities.

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B. Unappropriated Funds. In POINT I, Subpoint B, Respondent asserts that "Judge Christofferson did not find a triable issue of fact in granting USU's cross motion." (Respondent's Brief, p. 35). This assertion by Respondent and the argument in aid thereof simply does not square with the record in this proceeding. As amici curiae point out in POINT III of their Brief, at pages 14-15, the Court below did indeed recognize such "triable issue of fact."

Judge Christofferson first made a legal assumption that "there was authority for the university to invest those [grant or contract] funds." (R. 258). He then stated that "there is at least a triable issue of fact whether USU . . . had funds which it had received from individual grants or development contracts sufficient to pay for all or part of said stock." (R. 435B)

In argument Respondent seeks to bifurcate the action of the Court below and ignore a portion of the record before this Court. (Respondent's Brief at pp. 35, et. seq.) The Court below was not at liberty so to act for Rule 56(c) of the Utah Rules of Civil Procedure requires the Court to consider all matters of record in disposing of a motion for summary judgment. The existence of this triable issue of fact alone clearly requires reversal of the judgment appealed from.

We also invite the attention of the Court to the fact that the "assumption" of the Court below that "there was authority for the University to invest those funds" was a correct assumption. Utah Code Ann. Sec. 53-3-4 (1953) enacted in 1929 and still in force specifically authorizes the University in its "corporate capacity" to take by purchase, grant, gift, devise or bequest any

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property, real or personal, to "convert" the same "into other property" and to invest and manage the same. The Indiana Supreme Court in Sendak v. Trustees of Indiana University, 254 Ind. 390, 260 N.E. 2d 601 (1970) resolved an identical issue, holding that the Board of Trustees, under a near identical statute, was empowered to invest such funds in common stocks. The Sendak court held:

1) That the State of Indiana was not the owner of gifts from private donors to the University of Indiana Board of Trustees;

2) That the Board of Trustees of Indiana University acts in a dual capacity as Directors of the University operations and as common law Trustees of private trusts created for the benefit of the University by private donors; and

3) That the Board of Trustees was authorized to make and hold investments in common stock of private corporations out of money received from private sources. In reaching this conclusion, the Indiana Court stated:

> The property with which we are concerned was not given to the State of Indiana. Thus, the State of Indiana is not the owner of the gifts from the private donors to the trustees. They were given in trust upon certain limitations and specifications. To say that they became the property of the State of Indiana would be a violation of the trust imposed upon the trustees pursuant to the statute under which they are authorized to accept such funds. The trustees have a duty and obligation, as trustees have in a private trust, to use good judgment and prudence in the management of the funds entrusted to them and to keep them properly and prudently invested, with due regard to enhancing the income, as far as the same may be reasonably and safely done. The mere fact

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> that the trustees happen to act in another capacity and are a corporate body affected with a public interest does not prohibit them from also acting as trustees of private funds, particularly in this case, where the statute specifically authorizes such activity. It is true that the property here involved has certain public or charitable purposes, but that does not make the State of Indiana the owner of such funds any more than the State of Indiana is the owner of funds placed in trust with some other private trustee for the same purposes, namely, educational purposes at Indiana University. [260 N.E. 2d at 603]

The principles applied by the Indiana Supreme Court in the Sendak case should be applied in this case by this Court.

Section 53-48-10(4) (1953) authorizes the University to manage and control funds classified as "dedicated credits such as tuitions, fees" and "Federal grants" for use in institutional work programs. Utah Code Annotated, Sec. 53-48-20 (1953) likewise authorizes the University to accept "contributions, grants or gifts from any private organization, company, firm, industry or individual, or any governmental agency" and to "retain, accumulate, invest, commit and expend" funds so received.

It follows from the foregoing that the University at the time here pertinent had authority delegated by the State Legislature, which authority in earlier years had been delegated by the Territorial Legislature, to invest its appropriated funds in common stocks.*

Further, it appears to us to be clear beyond reasonable

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*As we have previously noted in Points I and II, supra, the existence of this authority is not relevant to disposing of the issues now before this Court. We comment and argue herein only in response to the lengthy argument set forth in Respondent's Brief.

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dispute that the University was empowered to invest non-appropriated funds in common stocks. The Court below so recognized and reserved this issue of fact. It was the burden of the moving party, the University, to establish on the record this missing link to sustain a motion for summary judgment. The judgment granting the University's motion for summary judgment must be reversed.

2. Sections 31-1-1 and 31-1-2, Utah Code Annotated, constitute neither investment "enabling" statutes nor a statutory prohibition against investment in properties not specifically stated on the approved statutory list.

The complete text of Section 31-1-1 (1953), Utah Code Annotated, is set forth in the Appendix to the opening brief of amici curiae. It applies with equal force and effect to "any private, political, or public instrumentality, body, corporation or person." It neither explicitly nor by implication constitutes an initial grant of power to such public or private corporations or persons to invest in specific properties; nor does it explicitly or by implication constitute an exclusive list of properties in which public and private corporations and persons may invest. Section 33-1-3, Utah Code Annotated, specifically provides:

> The provisions of this Act are supplemental to any and all other laws relating to and declaring what shall be legal investments for the persons, corporations . . . referred to in this Act. . . . [Emphasis added]

And, as is pointed out at pages 21-3 of the opening brief of amici curiae, the State Money Management Act enacted on February

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2, 1974 (Utah Code Ann. §51-7-1, et. seq. (1953)) for the first time imposes specific legislative restraints on investment in common stock by the University. All inconsistent sections of the Utah statutes were specifically repealed by that Act. Respondent in its brief so admits and affirmatively asserts at page 34:

> Indeed the Act specifically amends any pre-existing sections of the Code dealing with the deposit and investment of public funds (e.g. Sec. 65-1-65).

The Legislature expressly stated that the purpose of that Act was "to establish and maintain" a continuing state-wide policy for the deposit and investment of public funds. (Utah Code Ann. §51-7-2(b) (Supp. 1975)). Since Section 31-1-1 is neither "enabling" nor "prohibitory", the Legislature had no reason to and did not amend that section when it established such policy by enacting the Money Management Act.

It follows that neither of the basic premises underpinning Respondent's "no power" argument is sound. Not until the enactment of the State Money Management Act were the restrictions which Respondent claims flow from Section 31-1-1 enacted into law by the Legislature. At the time of the investments here at issue, the State was empowered by statute to invest in common stocks. Section 31-1-1 did not and does not now impair that power. The judgment appealed from should be reversed.

## IV.

### RESPONDENT'S ASSERTED DEFENSE OF "REVOCATION OF AUTHORITY" IS WITHOUT FOUNDATION IN FACT OR IN LAW; THE JUDGMENT APPEALED FROM MUST BE REVERSED.

In argument commencing at page 57 of Respondent's Brief, the University asserts that the action of the Court below should

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be affirmed because "USU had withdrawn from Catron any authority it had previously conferred upon him of which fact First Equity had notice." Respondent reaches this conclusion by a curious and erroneous pyramiding of inferences. The first inference is that "either First Security Bank or Walker Bank, or both of them", were put on inquiry as to Catron's authority by virtue of reading newspaper reports that the "Attorney General's office believed it was illegal for USU to purchase stock." Respondent does not advise the Court as to how notice of such Attorney General's belief on the legality of University action related in any way to revocation of specific authorizations from USU to Mr. Catron. Second, the Court is asked to infer that from such notice, First Security Bank and Walker Bank were saddled with a duty to investigate to determine whether or not Catron's authority had been revoked. Third, the Court is asked to infer that such inquiry would have resulted in a declaration by the University that Catron had no authority. Next, the Court is asked to infer that both of the banks involved had been retained by Appellant and were acting as its agents, not the agents of the University. Finally, the Court is asked to infer that such knowledge, synthesized through this chain of inferences, somehow was imputable to Appellant. We assert that this entire argument is wholly without merit. None of the authorities cited would justify the result claimed.

The uncontroverted facts are:

1. The Institutional Council by formal resolution specifically authorized Mr. Catron to represent and bind the Univer-

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sity in the purchase and sale of securities. The formal resolution further provided that he and other designated officers of the University may bind the University by giving "written or verbal instruction to the brokers concerning the herein named transactions" and finally "[t]hat this resolution shall be and remain in full force and effect until written notice of the revocation hereof shall be delivered to the brokers." (R. 106, 137-8).

2. The record contains no evidence that written notice of revocation was ever given to Appellant.

3. The record contains no evidence that oral revocation was given to Appellant.

4. The record contains no evidence that any representative of Appellant was advised of the newspaper articles relied upon by Respondent or that Appellant received any information whatsoever that would put it on notice of any revocation of authority conferred by the formal resolution of the Institutional Council.

5. First Security Bank and Walker Bank were selected and designated by Mr. Catron, not by Appellant. All of the dealings by Appellant with either of those banks was at the direction and instruction of Catron. (R. 363, Paragraphs 28-29).

We respectfully submit that this argument forwarded by Respondent is without merit and that the judgment appealed from must be reversed.


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V.

THE CLAIMED VIOLATION OF "REGULATION T" DOES NOT CONSTITUTE A LEGAL DEFENSE TO THE CLAIMS ASSERTED BY APPELLANT; THE JUDGMENT APPEALED FROM MUST BE REVERSED.

The Respondent likewise cannot prosper under the various arguments set forth under Point II of its opening brief. In those arguments, Respondent claims that First Equity violated Regulation T promulgated by the Federal Reserve Board and that such violation constitutes a defense to Appellant's claims. The Court below erroneously so held. The proper interpretation to be afforded Regulation T is clearly a question of Federal law. Subsequent to the filing of Respondent's brief herein, the United States District Court for the District of Utah entered Memorandum Opinion and order through which claims of the University asserted against other brokers on identical transactions were dismissed with prejudice. As is apparent from the Memorandum Opinion and Order which is reproduced for the convenience of this Court herein as Appendix A, Respondent made the same arguments and cited the same cases before the United States District Court as are contained in its opening brief before this Court. On Motions for Summary Judgment and Motion for Judgment on the Pleadings, the Federal Court rejected the claims as a matter of law. The Federal Court held that following the adoption by the Federal Reserve Board of "Regulation X" (designated to regulate the obtaining of credit by a borrower - the University here), any theretofore implied

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right of action on the part of a borrower against an extender of credit (the Appellant here) for the latter's violation of Regulation T was extinguished. The Federal Court also denied any such right of action on the part of the University on the additional grounds of an "in pari delicto" defense, and that any implied right of action would not inure to an institutional investor such as the University. In so ruling, the Federal Court stated in part at pages 10-12:

> Both Regulations T and X were promulgated under Section 7 of the 1934 Act and the purposes of both regulations are aimed at realizing or stabilizing a desirable macroeconomic goal of Congress rather than the protection of investors.
>
> While an implied right of action under Regulation T has been granted by some courts, the promulgation of Regulation X and the facts of this case put the issue of the interface of the two regulations directly before the court. Regarding the status of the private right of action in light of the interface, at least four different results can be suggested: (1) The basis for a private damage action for violation of Regulation T has been undermined and canceled out by the amendment of section 7 of the 1934 Act and the promulgation of Regulation X thereunder for the reason that in the past under Regulation T the broker shouldered the entire responsibility for compliance with the margin requirements, but Regulation X now puts the responsibility equally upon the investor. (2) The private right of action survives in the face of the promulgation of Regulation X; however, Regulation X provides an in pari delicto or equal fault defense in an action by an investor that the court or jury can manipulate in making a determination as to the degree of culpability of each party. (3) The private right of action survives in the face of promulgation of Regulation X, unless the investor has wilfully and intentionally tried to evade the provisions of the margin requirements. (4) The private right of action survives in the face of the promulgation of Regulation X and a broker can expose himself to almost strict liability for a violation of Regulation T for the reason that someone should be

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> saddled with the responsibility of assuring compliance with the margin requirements and the broker is in the best posture to do this. The *in pari delicto* defense would be denied under this approach for the reason that private suits serve an important enforcement function and this enforcement purpose would disallow an in pari delicto defense in the securities area as it has been disallowed in the antitrust area.
>
> The court is of the opinion that, as outlined in the first alternative, the promulgation of Regulation X has removed the necessary legal underpinning for implying a private right of action for a violation of the margin requirements, and that Regulation X cancels out the private right of action implied under Regulation T. As a matter of law, therefore, Count V in the complaints which alleges a violation of Regulation T should be dismissed for failure to state a claim upon which relief can be granted. Further, however, the court is of the opinion that the motions for summary judgment would have to be granted in favor of defendants for other reasons under the facts of these cases.*

It follows that the Court below erred in dismissing Appellant's complaint because of non-compliance by Appellant with the requirements of Regulation T and the judgment here appealed from must be reversed.

Respectfully submitted,

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79 South State Street
Salt Lake City, Utah

and

WORSLEY, SNOW & CHRISTENSEN
Continental Bank Bldg.
Salt Lake City, Utah
Attorneys for Amici Curiae

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*The court then proceeded to state supplemental grounds for dismissing the University's cause with prejudice, namely (1) the University is an "institutional investor" beyond any conceivable protection of Regulation T within the intent of Congress; and (2) after the promulgation of Regulation X, an in pari delicto defense would defeat any claim of the University founded upon Regulation T.

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IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

NORTHERN DIVISION

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v. NC 74-38

BEAR, STEARNS & CO., a corporation,

Defendant.

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v. NC 74-39

BLYTH EASTMAN DILLON & CO., INC., a corporation,

Defendant.

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v. NC 74-40

BOSWORTH, SULLIVAN & COMPANY, INC., a corporation,

Defendant.

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UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v. NC 74-41

HARRIS, UPHAM AND CO., INC.,

Defendant.

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v. NC 74-42

HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC.,

Defendant.

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v. NC 74-43

LEHMAN BROTHERS, INC.,

Defendant.

UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v. NC 74-44

SHEARSON, HAMMILL & CO. INC.,

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UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiff,

v.

SUTRO & CO., INC.,

Defendant.

NC 74-45

THE STATE OF UTAH, and UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,

Plaintiffs,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., a corporation,

Defendant.

NC 74-46

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MEMORANDUM OPINION AND ORDER GRANTING DEFENDANT MERRILL LYNCH'S MOTION FOR JUDGMENT ON THE PLEADINGS AND ALL OTHER DEFENDANTS' MOTIONS TO DISMISS ON COUNTS I, II, III, IV AND V OF THE COMPLAINTS AND DISMISSING THE PENDENT CLAIMS BASED ON STATE LAW THEORIES

---

Vernon B. Romney, Utah Attorney General and David L. Wilkinson, Assistant Utah Attorney General, Salt Lake City, Utah, for plaintiff in all the above-entitled matters, and Richard W. Giauque and Brent M. Stevenson of Van Cott, Bagley, Cornwall and McCarthy, Salt Lake City, Utah, for plaintiffs in MC 74-46.

Keith E. Taylor, Daniel M. Allred and Krege B. Christensen of Parsons, Behle & Latimer, Salt Lake City, Utah, for defend-

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ants Bear, Stearns & Co., NC 74-38; Harris, Upham & Co., Inc., NC 74-41; Hornblower & Weeks-Hemphill, Noyes, Inc., NC 74-42; Lehman Brothers, Inc., NC 74-43; Shearson, Hammill & Co., Inc., NC 74-44; Sutro & Co., Inc., NC 74-45; and Merrill Lynch, Pierce, Fenner & Smith, Inc., NC 74-46.

Parker M. Nielson of Salt Lake City, Utah, for defendant Blyth Eastman Dillon & Co., Inc., NC 74-39.

Harold G. Christensen and R. Brent Stephens of Worsley, Snow & Christensen of Salt Lake City, Utah, for defendant Bosworth, Sullivan & Company, Inc., NC 74-40.

On September 20, 1974, plaintiff[1/] in the above-entitled matters filed suits against the nine named stock brokerage firms. As set out below, the cases arise from similar investment transactions in the same investment program carried on by Utah State University [hereinafter the University] and in most cases the allegations in plaintiff's complaints and the defenses thereto are identical.[2/] Although the cases have not been consolidated, they have been processed simultaneously and argued together, and this order will apply to all the cases as set out above.

In these actions the plaintiff University seeks to recover losses arising out of certain investments it made in common stock through the various defendant brokerage firms. For a period of time subsequent to June, 1970, the then Assistant Vice President of Finance of the University and the University's investment officer, made numerous investments in securities on behalf of the University and executed such investments through various securi-

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ties brokerage houses in Utah and elsewhere, some of which are named as defendants in the actions herein. Many of the aforesaid investments were in common stocks, the market price of some of which declined markedly subsequent to the University's investments, allegedly resulting in substantial loss to the University.

On November 15, 1974, all the defendants filed a motion to dismiss pursuant to Fed. R. Civ. P. 12(b), 8(e)(1), and 9(b)[3/] except defendant Merrill Lynch who, on that day, filed a motion for judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c). These motions were accompanied by memoranda in support thereof and the parties have filed extensive memoranda since that time; to wit, plaintiff filed a memorandum in opposition to the aforementioned motions on December 11, 1974; defendants filed a reply memorandum in support of their motions on December 17, 1974; plaintiff filed a supplemental memorandum in opposition on December 19, 1974; and on February 4 and 11, 1975, the parties filed post-hearing memoranda in support of their respective positions. Oral argument was requested by all of the parties and was heard, with counsel for all of the parties present and participating, on January 29 and 30, 1975, at which time the matter was taken under advisement. On May 5, 1975, the court filed an order allowing the parties to file affidavits or other supporting materials in support of certain factual allegations made in their motions and memoranda in order that the pending motions to dismiss could alternatively be treated by the court as motions for summary judgment pursuant

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to Fed. R. Civ. P. 12(b).

COUNTS I, II AND III OF THE COMPLAINTS.

Counts I and II of each complaint allege violations of section 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o-3, and of the National Association of Security Dealers (hereinafter NASD) Rules of Fair Practice, Article III, § 1[4/] and § 2[5/] promulgated by NASD thereunder. Count III is similar in nature and is based upon an alleged violation of section 6 of the 1934 Act, 15 U.S.C. § 78f and upon Rule 405 ("Know-Your-Customer Rule) of the New York Stock Exchange and Rule 411 of the American Stock Exchange (which is similar to said Rule 405), promulgated by the respective stock exchange thereunder.

In State of Utah v. duPont Walston, Inc., et al., CCH SEC. L. REP. ¶ 94,812, at 96,713 (D.C. Utah, October 1, 1974) (hereinafter cited as duPont), this court decided that a private right of action does not exist for the aggrieved customer to sue a broker-dealer in federal court for violation of a rule of one of the self-regulatory bodies to which the broker-dealer belongs. Counts I, II and III of all of the complaints, except the Merrill Lynch complaint, NC 74-46, are virtually identical, both in form and in substance, to the complaint in duPont. Therefore, based upon the court's ruling in duPont, defendants'[6/] motions to dismiss are hereby granted as to Counts I, II and III for failure to state a claim upon which relief can be granted.

Counts I, II and III in the Merrill Lynch complaint are different from their counterparts in the other complaints in that

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an allegation is made that the facts alleged in the first three counts also violate Rule 10b-5. It appears that plaintiffs in the Merrill Lynch complaint seek to buttress a Rule 10b-5 claim with reference to the NASD and Stock Exchange Rules as these rules might bear upon the duty owed to the plaintiffs by defendants. Since the court has already ruled that alleged violations of these rules do not give rise to a private right of action, it is difficult to conceive what different result or advantage plaintiffs might seek, evidentiary or otherwise, by combining the alleged violations of the rules with a 10b-5 claim. If the violation of the aforementioned rules cannot sustain a private right of action standing alone, it adds nothing to combine these allegations with alleged Rule 10b-5 violations, especially when Count IV of the complaint alleges a separate Rule 10b-5 claim. Thus, for the reasons set forth above in regard to the unavailability of a private right of action under the aforementioned rules and with the reasons set forth below regarding the Rule 10b-5 count of the complaint, Counts I, II and III of the Merrill Lynch complaints, NC 74-46, are dismissed as being cumulative and redundant.

COUNT IV ALLEGED RULE 10b-5 VIOLATIONS

Count IV of each complaint alleges a violation of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. Count IV, in essence, alleges that defendant omitted to state certain material facts which were necessary

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in order to make the statements that the defendants did make, in connection with the purchase of securities by the plaintiff, not misleading. The alleged material omissions are the same allegations which are found in the first three counts of the complaints -- the suitability claims against defendant under the NASD and Stock Exchange Rules.

Omissions concerning the suitability of a stock are not the kind of omissions which give rise to Rule 10b-5 or any anti-fraud liability. Professor Bromberg states:

> The embryonic requirement that a broker dealer's recommendation be "suitable" for his customers, primarily in terms of risk and their needs and situations, is a product of industry self-regulation. Except for "boiler-shop"[7/] cases, it presently lies outside 10b-5 and other fraud rules. 1 BROMBERG, SECURITY LAWS: FRAUD, § 5.4, at 99-100 (1974), *accord*, VI L. LOSS, SECURITIES REGULATION 3720 (Supp. 1969).

The court has not been cited a case, nor has the court found a case, which has held on the merits that a broker-dealer's omissions concerning suitability of a stock is a basis for Rule 10b-5 liability. Disregarding the suitability allegations in Count IV, which do not give rise to Rule 10b-5 liability, the complaint fails to state a claim upon which relief can be granted. Therefore, Counts IV of plaintiffs' complaints are dismissed, pursuant to Fed. R. Civ. P. 12(b)(6), for the reasons set forth herein.



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## REGULATIONS T AND X

Except for the complaints against Lehman Brothers, Inc. and Sutro & Co., Inc., the University alleges in Count V of the complaints a violation of Regulation T of the Federal Reserve Board by defendants. The University further alleges that it maintained a special cash account with each of the defendants, and although it did not make payment within 35 days from the trade date of certain enumerated purchase transactions, the defendants did not cancel the purchases or otherwise liquidate the University's accounts, nor did the defendants apply for an extension of time as required by Regulation T.

Regulation T, promulgated pursuant to section 7(c) of the Securities Exchange Act of 1934, 15 U.S.C. § 78g(c), determines the initial minimum margin requirements that brokers and dealers may extend to their customers. Basically, a margin requirement is the amount of down payment required on any given security purchased on credit. When, as in these cases, a special cash account is used, the purchases or sales are essentially cash, nor credit transactions.[8/] If the cash, in the case of a purchase, is not deposited in the account within the required time,[9/] the broker-dealer must, subject to certain limitations, liquidate the account. Thus, a Regulation T violation occurs most generally when the broker-dealer fails to make a timely liquidation.

The main purpose behind section 7 of the 1934 Act, under which Regulation T was promulgated, was set forth in the report

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of the House Committee on Interstate and Foreign Commerce:

> The main purpose of these margin provisions . . . is not to increase the safety of security loans for lenders. Banks and brokers normally require sufficient collateral to make themselves safe without the help of law. Nor is the main purpose even protection of the small speculator by making it impossible for him to spread himself too thinly -- although such a result will be achieved as a by-product of the main purpose.
>
> The main purpose is to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry--to prevent a recurrence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for uses of local commerce, industry and agriculture, were drained by far higher rates into security loans and the New York call market.
>
> H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934).

As seen from the foregoing, only secondarily was the interest of lenders-brokers and investors considered.

While no civil remedy for margin violations exists under the 1934 Act, and even without the primary purpose of section 7 being the protection of the investor, courts have nevertheless been willing to imply a private right of action for investors from a mere Federal Reserve Board regulation based on one of three theories: tort, enforcement, or contract.[10/] Until recently the margin requirements, through Regulation T, were addressed exclusively to those who extended credit in securities transactions and, consequently, in any transaction in which credit for the purchase of securities was involved, the lender had the burden of observing margin requirements.



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In 1971, Congress amended section 7 of the 1934 Act to prohibit the receipt of loans by investors in violation of the margin requirements.[11/] This legislation was implemented through another Federal Reserve Board regulation, Regulation X. Regulation X makes unlawful an investor's obtaining of any credit in violation of the margin requirements; however, there is no violation if the borrower makes a good faith mistake and, upon discovery of the mistake, promptly takes whatever steps necessary to remedy the non-compliance.[12/]

In passing Title III of the Bank Records and Foreign Transactions Act, under which Regulation X was promulgated, Congress was concerned with deterring tax evasion and other criminal activities.[13/] Regulation X has as its stated purpose:

> [T]o prevent the infusion of unregulated credit obtained both outside and within the United States securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purpose of a loan or otherwise wilfully and intentionally evading the provisions of those regulations.[14/]

Both Regulations T and X were promulgated under section 7 of the 1934 Act and the purposes of both regulations are aimed at realizing or stabilizing a desirable macroeconomic goal of Congress rather than the protection of investors.

While an implied right of action under Regulation T has been granted by some courts, the promulgation of Regulation X and the facts of this case put the issue of the interface of the two regulations directly before the court. Regarding the status of the private right of action in light of the interface, at

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least four different results can be suggested: (1) The basis for a private damage action for violation of Regulation T has been undermined and canceled out by the amendment of section 7 of the 1934 Act and the promulgation of Regulation X thereunder for the reason that in the past under Regulation T the broker shouldered the entire responsibility for compliance with the margin requirements, but Regulation X now puts the responsibility equally upon the investor. (2) The private right of action survives in the face of the promulgation of Regulation X; however, Regulation X provides an _in pari delicto_ or equal fault defense in an action by an investor that the court or jury can manipulate in making a determination as to the degree of culpability of each party. (3) The private right of action survives in the face of the promulgation of Regulation X, unless the investor has wilfully and intentionally tried to evade the provisions of the margin requirements.[15/] (4) The private right of action survives in the face of the promulgation of Regulation X and a broker can expose himself to almost strict liability for a violation of Regulation T for the reason that someone should be saddled with the responsibility of assuring compliance with the margin requirements and the broker is in the best posture to do this. The _in pari delicto_ defense would be denied under this approach for the reason that private suits serve an important enforcement function and this enforcement purpose would disallow an _in pari delicto_ defense in the securities area as it has been disallowed in the antitrust area.[16/]



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The court is of the opinion that, as outlined in the first alternative, the promulgation of Regulation X has removed the necessary legal underpinning for implying a private right of action for a violation of the margin requirements, and that Regulation X cancels out the private right of action implied under Regúlation T. As a matter of law, therefore, Count V in the complaints which alleges a violation of Regulation T should be dismissed for failure to state a claim upon which relief can be granted. Further, however, the court is of the opinion that motions for summary judgment would have to be granted in favor of defendants for other reasons under the facts of these cases.

Most private actions under Regulation T have been brought in tort on the rationale that where a defendant's violation of a prohibitory statute has caused injury to the plaintiff, the latter has a right of action if one of the purposes of the enactment is to protect interests similar to those of the plaintiffs. The implication of a private right of action under Regulation T was based upon an enactment and a regulation promulgated thereunder, neither of which had as their purpose the protection of the investor. To find a basis on which to predicate liability under Regulation T, a secondary effect of shielding the investor from spreading his resources too thinly has been recognized.[17/] In light of the amendment to section 7 of the 1934 Act by Congress and the promulgation of Regulation X thereunder, it appears tenuous to continue to elevate what the report of the House Committee on Interstate and Foreign Commerce

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characterized as a "by-product" effect[18/] into a "purpose" of the enactment and then to imply from this implied purpose a private right of action for an investor, who now, like the lender, violates the law by carrying securities with the credit obtained in a transaction involving a Regulation T violation. In 1970 when Congress considered and amended the margin provisions in section 7 of the 1934 Act, a private remedy could have been provided at that time. Instead, however, Congress dealt only with countering secret foreign financing in circumvention of the margin regulations. Commenting on the policy implications of Regulation X, the court in S.E.C. v. Packer, Wilbur & Co., Inc., 362 F.Supp. 510, 515 (S.D.N.Y. 1973) stated: "The clear import of Regulation X is that Congress was determined not to limit the burden of compliance to brokers alone but rather extended it to customers as well."

The court, under the circumstances, credits Congress with adequate insight to provide enforcement of its own enactments. When Congress, with the knowledge that for years a private right of action had been implied by some courts under section 7 of the 1934 Act, amends the section in a manner which directly undercuts the legal basis upon which the private right of action was grounded and fails to directly authorize a private right, it would seem pretentious for this court to expand an area of federal law so recently considered by Congress by "implying" a private damage action for those guilty of margin violations under the law. For these reasons, the court holds that a private right of action no longer exists under Regulation T due to the

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amendment to section 7 of the 1934 Act which resulted in the promulgation of Regulation X.[19/] Therefore, Counts V of plaintiff's complaints are dismissed.

The court further observes that even if it be argued that a private right of action should still be implied in the face of Regulation X, the authorities do not support such an implication on behalf of an institutional investor as in this case. As Judge Friendly observed in a persuasive dissent in Pearlstein v. Scudder & German, 429 F.2d 1136, 1148 (2nd Cir. 1970), cert. denied. 401 U.S. 1013 (1971):

> To be sure, it may be proper in some instances to impose civil liability in furtherance of the subsidiary purpose of § 7(c), protection of the innocent "lamb" attracted to speculation by the possibility of large profits with low capital investment. . . . Pearlstein, an experienced speculator, was no lamb, and the trial judge specifically found that he was not induced to enter into the transactions by any expectation that defendant would be slow in selling him out if he were to default in payment.

The University, an institutional investor (and an agency of the sovereign) which must operate under guidelines established by statutes, regulations and rules, engaged itself in a far-flung, wide-ranging investment program in common stocks which it now asserts it had no authority to do. Neither the main purpose of section 7(c) -- e.g.,". . . to prevent a recurrence of the pre-crash situation where funds which would otherwise have been available at normal interest rates for use of local commerce, industry and agriculture. . . ."[20/] -- nor the secondary purpose -- e.g., the ". . . protection of the small speculator

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by making it impossible for him to spread himself too thinly . . ."[21/] -- are served by implying a private right of action under the facts of this case. The funds that were invested by the University would not, directly at least, be available to support local commerce, industry and agriculture, nor can the University be said to be the "small speculator" concerning whom Congress might have had secondary concern in making it impossible to spread itself too thinly. A threshold requirement of serving or forwarding the public purposes of section 7(c) of the 1934 Act must be met before a private right of action for civil liability can be implied thereunder. The rationale that argues for implying a private right of action for a financially strong institutional investor under either the primary or secondary purpose of section 7(c) hangs from a thin, fragmented thread. The court is unaware of any authority under which private civil liability should be implied or sustained in this case.

Lastly, even if a private right of action should still be implied in the face of Regulation X and the other considerations set out above, at the very least, Regulation X would provide an in pari delicto or equal fault defense which would sustain a motion for summary judgment in favor of defendants under the facts of this case. Regulation X makes the University equally responsible and liable with the defendants for the alleged margin violations. Ignorance of the law is generally no defense when charged with its violation; however, in this

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regard, the University cannot be characterized as unknow-ledgeable with regard to the requisites of Regulation X when it had ready access to legal counsel and also had available to it the experience and manpower of the office of the Utah Attorney General, itself a law enforcement agency, charged with advising various state agencies concerning the exercise of their powers. It is interesting to observe that the court has not been advised that the University took advantage of that portion of Regulation X which allows a purchaser to correct a non-compliance by promptly taking whatever remedial steps are necessary upon discovery of the violation.[22/] At best, therefore, the plaintiff's theory is novel, in that it seeks to selectively rescind and be made whole on all its loss transactions while keeping the benefits of its gain transactions. The court is unaware of any authority which would allow such a favorable remedy to a plaintiff who is equally guilty of violation of the regulation under which liability would be imposed against the defendant. Neither justice nor reason provide grounds on which to sustain a cause of action for the University's theory under all the circumstances of this case.

PENDENT CLAIMS BASED ON STATE LAW

In State of Utah v. duPont Walston, Inc., et al., CCH SEC. L. REP. ¶94,812, at 96,713 (D.C. Utah, October 1, 1974), the court was concerned with the pendent state law claims, and the court's observations therein expressed are equally applicable again in these cases. In United Mine Workers of America

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v. Gibbs, 383 U.S. 715 (1966) the Supreme Court held that as a matter of constitutional power, pendent federal jurisdiction exists whenever state and federal claims "derive from a common nucleus of operative fact" and are such that a plaintiff "would ordinarily be expected to try them all in one judicial proceeding." Id. at 725. The Court, however, stated further in this regard:

> That power need not be exercised in every case in which it is found to exist. It has consistently been recognized that pendent jurisdiction is a doctrine of discretion, not of plaintiff's right. Its justification lies in considerations of judicial economy, convenience and fairness to litigants; if these are not present a federal court should hesitate to exercise jurisdiction over state claims, even though bound to apply state law to them, Erie R. Co. v. Tompkins, 304 U.S. 64. Needless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of applicable law. Certainly, if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well. Similarly, if it appears that the state issues substantially predominate, whether in terms of proof, of the scope of the issues raised, or of the comprehensiveness of the remedy sought, the state claims may be dismissed without prejudice and left for resolution to state tribunals. Id. at 726-27. (Emphasis added.)

These cases present a clear instance where state claims should be dismissed now that the determination has been made that there is no federal claim. The federal claims have been dismissed before trial. The remaining pendent claims involve complicated questions necessitating the construction of a morass of seemingly conflicting state statutes in order to determine the scope of power and authority of a state institution to invest in common

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stocks. This is a classic instance when "needless decisions of state law should be avoided . . . as a matter of comity . . . by procuring . . . a surer-footed reading of applicable law." Id. at 726.

It is appropriate to observe that the court is advised that by virtue of a state court suit brought by the University many of the issues involved in the pendent claims are on appeal to the Utah Supreme Court. It should be the primary right of the State Supreme Court to construe the state statutes involved in these pendent claims. It would be abortive for this court to decide questions so fundamentally fraught with state interests when the issues are on appeal before the Utah court. Therefore, based upon the foregoing reasons,

IT IS HEREBY ORDERED that defendant Merrill Lynch's motion for judgment on the pleadings[23/] and all other defendants' motions to dismiss[24/] on Counts I, II, III, IV and V of the complaints are granted for failing to state a claim upon which relief can be granted, and plaintiff's complaints are dismissed, along with the causes of action based thereon, and the remaining state law pendent claims are dismissed without prejudice.[25/]

DATED this 8th day of July, 1975.

/s/ ALDON J. ANDERSON
ALDON J. ANDERSON
United States District Judge

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## FOOTNOTES

1. The University is the sole plaintiff in each of the actions with the exception of the suit filed against Merrill Lynch, NC 74-46, in which case the State of Utah is also named as a party plaintiff. A reference herein to the "University" or to the "plaintiff" is intended to embrace both plaintiffs in NC 74-46.

2. Each case has the same variety except NC 74-43 and NC 74-45 which do not have a count based upon the alleged violation of Regulation T, promulgated by the Board of Governors of the Federal Reserve System under Section 7(a) and (c) of the Securities Exchange Act of 1934.

3. The motion to dismiss of defendant Bosworth, Sullivan & Co., Inc., was filed pursuant to Fed. R. Civ. P. 12(b) only.

4. This rule provides:

> "A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

5. This is the NASD "suitability rule" which states that: "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

6. All defendants are contemplated except Merrill Lynch in NC 74-46.

7. "Boiler room" or "boiler-shop" is a high pressure sales campaign conducted by telephone. See VI L. LOSS, SECURITIES REGULATION 3708 (Supp. 1969).

8. 12 C.F.R. §220.4 (1973).

9. The required time in the case of a purchase through a special cash account is seven business days. 12 C.F.R. §220.4 (c)(ii)(2) (1973). However, as in this case, if payment is to be made against the delivery of the security by the broker, the required period may be extended to thirty-five days. 12 C.F.R. § 220.4(c)(ii)(5)(1973).

10. See Note, In pari delicto as a Defense to Violations of Margin Legislation under the Securities and Exchange Act of 1934, 9 U. SAN FRANCISCO L. REV. 113, 118-19 (1974); Note, Regulation X: A Complexis, 50 NOTRE DAME LAWYER 136 (1974).



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11. BANK RECORDS & FOREIGN TRANSACTIONS ACT OF 1970, TITLE III, 84 Stat. 1124, 15 U.S.C. § 78g(f)(1) (1971).

12. 12 C.F.R. § 224.1 (1973).

13. See H.R. Rep. No. 975 91st Cong., 2d Sess. 12 (1970).

14. 12 C.F.R. § 224.1 (1973).

15. The first paragraph of Regulation X states its purpose as follows:

> [T]o prevent the infusion of unregulated credit obtained both outside and within the United States securities markets in circumvention of the provisions of the Board's margin regulations or by borrowers falsely certifying the purpose of a loan or otherwise wilfully and intentionally evading the provisions of those regulations. 12 C.F.R. § 224.1 (1973). (Emphasis added.)

The court reads this provision in two parts. The first part (ending at the first conjunction "or") explains the purpose of Regulation X in terms of preventing the infusion of unregulated credit, the mere circumvention of the margin regulations. The second part (following the first conjunction "or") speaks of preventing the false certification of the purpose of a loan, and the phrase "or otherwise wilfully and intentionally evading" is thought to refer only to "falsely certifying the purpose of a loan."

To conclude that an investor need not have a wilful intent to evade the margin requirements in order to violate Regulation X is consistent both with the obvious construction of the stated purpose of the regulation as herein explained and with the tenor of Regulation T and the federal securities fraud laws which do not require wilfulness in order to show a violation.

16. See Perma Life Mufflers, Inc. v. International Parts Corp., 293 U.S. 134, 138 (1968).

17. Remars v. Clayton Securities Corp., 81 F.Supp. 1014, 1017 (D. Mass. 1949). See also, H.R. Rep. No. 1383, infra note 18, in which deterring the investor from spreading himself too thinly was seen as a "by-product" of the main purpose of the regulation.

18. The report of the House Committee on Interstate and Foreign Commerce stated:

> The main purpose of these margin provisions . . . is not to increase the safety of security loans for lenders. Banks and brokers normally require sufficient collateral to make themselves safe without the help of law. Nor is the main purpose even protection of the small speculator by making it

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impossible for him to spread himself too thinly--
although such a will be achieved as a
by-product of the main purpose. H.R. Rep. No.
1383, 73d Cong., 2d Sess. 8 (1934).

19. The court is aware of the leading Regulation T decision of the Second Circuit, Pearlstein v. Scudder & German, 429 F.2d 1136 (2nd Cir. 1970), cert. denied, 401 U.S. 1013 (1971) which concluded that the disadvantages of giving the "unscrupulous" plaintiff a windfall recovery were outweighed by the "salutary policing effect" a private cause of action would have upon broker-dealers. Id. at 1141. The Pearlstein decision rejected the defense of in pari delicto in a suit alleging violation of Regulation T. However, the reasoning employed for that conclusion has been undermined by the subsequent enactment of Regulation X. The Pearlstein Court, as analogous authority, specifically referred to the antitrust decision of Perma Life Mufflers v. International Parts, 392 U.S. 134 (1968), which had rejected the in pari delicto defense in the antitrust area. In expanding on that analogy, the Second Circuit pointed out that

> [a]lthough Perma Life would apparently continue to deny recovery to plaintiffs who had not been coerced but who had benefited from the arrangement equally with the defendant, such a defense does not appear desirable in the securities area here involved, even when the investor may be shown to have had knowledge of margin requirements. Unlike the antitrust laws which forbid both seller and buyer to enter into a proscribed transaction, the federally imposed margin requirements forbid a broker to extend undue credit but do not forbid customers from accepting such credit. 429 F.2d at 1141.

The premise of that position--that buyers are not prohibited from entering into improper margin transactions--has been overruled by Regulation X. Thus, the primary ground of the Pearlstein argument for rejecting the in pari delicto defense in Regulation T cases is no longer valid. In addition, the analogy to the private policing policy of antitrust laws is weak at best, since those statutes specifically provide for private civil actions and encourage private enforcement actions by the treble damages provisions. In contrast, no such Congressional imprimatur exists for private actions under Regulation T. Thus, antitrust cases such as Perma Life are inappropriate authority in this case for rejecting the in pari delicto defense, or even for the importance of a private right of action.

In Pearlstein Judge Friendly dissented on the grounds that the holding would encourage customers to violate the margin rules. 429 F.2d 1148. A similar argument could be made against the court's holding in the instant case; that is, by abolishing a private right of action altogether, the incentive to comply

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with margin requirements is reduced for both broker-dealers and customers and, as a consequence, "devil's bargains" might result, depending upon the probabilities of detection through public enforcement. The court believes, however, that the potential for this kind of abuse is diminished by the current disinclination of broker-dealers to jeopardize their public image, their relationship with the SEC, and their standing among other broker-dealers in the industry. There are a sufficient number of other enforcement avenues of the regulations in question.

20. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 8 (1934).

21. Id.

22. 12 C.F.R. § 224.6(a)(1973).

23. The court is aware that a motion for judgment on the pleadings is theoretically directed towards a determination of the substantive merits of a controversy, but that it also has an incidental function under Fed. R. Civ. P. 12 (h)(2) of permitting certain procedural defects, as in this case-- a defense of failure to state a claim upon which relief can be granted--to be reaised after the close of the pleadings. 5 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE: Civil § 1369, at 701 (1969). The court, therefore, considers defendant Merrill Lynch's motion for judgment on the pleadings to be essentially in the same procedural posture as the other defendants' motions to dismiss filed pursuant to Fed. R. Civ. P. 12(b)(6).

24. Although affidavits and other supporting materials have been filed by the respective parties, the court elects to ground its holding herein on the defendants' original motions to dismiss.

25. The court has noted the suggestion of plaintiff's counsel in its brief that for the reason that this court has previously upheld identical 10b-5 counts in the duPont complaint (NC 74-9) and in the Merrill Lynch complaint (NC 74-46), that amendment to the complaint might be allowed if the court had question as to the sufficiency of the 10b-5 counts. Plaintiff's arguments in this regard are not well taken and they inaccurately represent this court's prior rulings. In duPont, the defendant filed a motion to dismiss all counts in the complaint and the motion was granted only in respect to Counts I, II and III, which were the "suitability" counts as in the instant cases. However, when the defendant in duPont filed its motion to dismiss as to all counts, the complaint did not at that time contain a 10b-5 count. Plaintiff amended the complaint to include the 10b-5 count after the motion to dismiss was filed. The sufficiency of the 10b-5 count in duPont was never briefed, argued, or considered by the court. Further, the court has never ruled on the viability of the 10b-5 count in the Merrill Lynch complaint.

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Counts I, II and III in the Merrill Lynch complaint are, as the court has previously stated in this order, different from their counterparts in the other complaints in that they are bottomed on alleged violations of Rule 10b-5 as well as on alleged violations of the stock exchange rules in question. In this court's order of October 11, 1974, in the Merrill Lynch case, a motion to dismiss these three counts, on the grounds that a private right of action does not exist, was denied. In that order the court merely held that it read the complaint to allege a 10b-5 claim, rather than a claim based solely on the stock exchange rules. Today the court has considered the sufficiency of those three counts and has determined that they should be dismissed, among other reasons, as being cumulative and redundant since Count IV of the Merrill Lynch complaint also alleges a 10b-5 violation. Supra at 7.

In view of the fact that plaintiff has chosen to stand on the 10b-5 pleading in its present form by not seeking opportunity to amend prior to the disposition of the motions to dismiss, and after now considering the nine complaints herein and the extensive briefinf and argument in pretrial motions in which the court has not been advised nor become aware of even an oblique reference to any additional facts that might be pleaded in order to state a claim in this regard, amendment at this juncture appears futile. See Forman v. Davis, 371 U.S. 178, 182 (1962). For these reasons, the court does not construe plaintiff's suggestion that amendment might be allowed as a motion for leave to amend.



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IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

NORTHERN DIVISION

| | | |
|---|---|---|
| UTAH STATE UNIVERSITY OF AGRICULTURE AND APPLIED SCIENCE, a Utah body politic and corporate,<br><br>Plaintiff,<br><br>-vs-<br><br>BEAR, STEARNS & CO., a corporation,<br><br>Defendant. | :<br>:<br>:<br>:<br>:<br>: | ORDER DENYING PLAINTIFF'S MOTION TO COMPEL DISCOVERY<br><br>NC 74-38 |

On October 18, 1974, plaintiff in the above-entitled matter filed a set of interrogatories upon the defendant. A series of objections and responses followed, including a motion to compel answers filed by the plaintiff on December 2, 1974. On May 8, 1975, plaintiff's counsel notified the court by letter that its motion to compel had not been ruled upon and requested that discovery now be allowed in view of the pending motion for summary judgment in this matter. The request for discovery, while appropriate, is mooted by the court's ruling this day in another order that there is no cause of action stated. Therefore,

IT IS HEREBY ORDERED that plaintiff's motion to compel is denied.

DATED this 8th day of July, 1975.

/s/ Aldon J. Anderson
ALDON J. ANDERSON
United States District Judge

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