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## Securities Exchange Act—Treatment of Intrastate Use of Telephone.—Rosen v. Albern Color Research, Inc.—and Nemitz v. Cunny

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federal administration makes a sure prediction on how much leeway will be allowed the states at least theoretically difficult.

The existence of a pervasive federal regulatory scheme would afford ample grounds for implying Congressional intent to foreclose state action. There would always be the danger of a "mischievous conflict," produced when the federal and state agencies, acting on the same subject matter and applying similar standards, arrive at different results.<sup>87</sup> The problem of "forum-shopping" would also arise.<sup>88</sup> A consideration of the practicalities of the situation, however—the necessity for immediate and thoroughgoing action, the demonstrated ability of at least some of the states to accomplish results, and the sheer inadequacy of any federal program, however grandly conceived, to reach and regulate every aspect of the problem and to remedy every individual wrong technically within the scope of the act—outweighs the difficulties and dangers threatened by concurrent federal and state regulation. Indeed, it is submitted, if any area calls for concerted action, it is that of employment discrimination. The decision in *Colorado v. Continental* should have the effect of encouraging rather than limiting such action, regardless of potential Congressional action.

JEROME K. FROST

**Securities Exchange Act—Treatment of Intrastate Use of Telephone.—***Rosen v. Albern Color Research, Inc.*<sup>1</sup>—and *Nemitz v. Cunmy*.<sup>2</sup>—In the *Rosen* case, the plaintiff brings an action under Section 10(b) of the Securities Exchange Act of 1934<sup>3</sup> alleging misrepresentations and failures to disclose by the defendant during transactions for the sale of securities conducted in part through telephone conversations. At the time of the telephone conversations both parties were within the city limits of Philadelphia. In this hearing on a motion which the court treated as a motion for summary judgment, the fundamental issue concerned the determination of whether this use of the telephone was a transaction in *interstate* or *intrastate* com-

<sup>87</sup> *Bethlehem Steel Corp. v. New York State Labor Relations Bd.*, supra note 11, at 775.

<sup>88</sup> Pennsylvania, six of whose cities have Fair Employment ordinances, provides for an election of forum by the party and then foreclosure. It also provides for the possibility of conflict by declaring that the state rule is to be applied by municipal courts in event of conflict. Pa. Stat. Ann., tit. 43, § 962(b).

<sup>1</sup> 218 F. Supp. 473 (E.D. Pa. 1963).

<sup>2</sup> 221 F. Supp. 571 (N.D. Ill. 1963).

<sup>3</sup> 48 Stat. 881 (1934), 15 U.S.C. § 78j (1958).

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

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merce. The court in granting summary judgment for the defendant HELD: The specific use of the telephone by two parties within the same state is the use of an instrumentality in *intrastate* commerce in spite of its possible use in interstate commerce. The plaintiff, therefore, has no right to relief under the Act.

One week prior to the decision of the *Rosen* case the United States District Court, Northern District of Illinois arrived at a conflicting conclusion in the case of *Nemitz v. Cunny*. In the latter case a seller of securities brought an action under section 10(b) alleging a fraudulent sale of securities as a result of telephone conversations between parties in the same state. On a motion to dismiss which precipitated much the same issue as in *Rosen*, the court HELD: The telephone is an instrumentality of interstate commerce, and section 10(b) extends to its use even in local transactions.

With no case or statutory law on point both courts were compelled to decide this issue as a matter of first impression. The *Rosen* court takes the more narrow viewpoint in arguing that the telephone is an instrument of interstate commerce, but is equally an instrument of intrastate commerce, and that the prevailing characteristic depends upon the use of the instrument at a given time. The two characteristics are treated as alternatives and not co-existent. For support the court depends on an analogous treatment by Mr. Justice Holmes of the locomotive as an instrumentality.<sup>4</sup> The court alludes also to the more supporting language of Section 17(a) of the Securities Act of 1933 which uses the wording, "use of . . . instruments . . . in interstate commerce" (Emphasis added.)<sup>5</sup> and Section 1343 of the Crimes and Criminal Procedure Act which refers to "wire, radio, or television communication in interstate or foreign commerce. . . ." (Emphasis added.)<sup>6</sup> The court points out that the District Court, Northern District of Illinois (which later decided the *Nemitz* case), said in 1952, "The purpose of section 17(a) of the 1933 Act and section 10(b) of the 1934 Act are similar and the phraseology employed is substantially similar."<sup>7</sup>

On this point the *Nemitz* court arrives at the opposite conclusion in holding that "It is clear that the use of a telephone constitutes the use of an instrumentality of interstate commerce, unless of course the telephone is merely a part of a private or inter-office hookup."<sup>8</sup> This conclusion derives little or no direct support from the cases cited because none of them was

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<sup>4</sup> *Minneapolis & St. Louis R.R. v. Winters*, 242 U.S. 353, 357 (1917).

<sup>5</sup> 48 Stat. 74 (1933), 15 U.S.C. § 77q(a) (1958).

<sup>6</sup> Crimes and Criminal Procedure Act § 18(a), 70 Stat. 523 (1956), 18 U.S.C. § 1343 (1958).

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be . . . [penalized].

<sup>7</sup> *Northern Trust Co. v. Essaness Theatres Corp.*, 103 F. Supp. 954, 964 (N.D. Ill. 1952).

<sup>8</sup> *Supra* note 2, at 573.

confronted with the intrastate use of the telephone.<sup>9</sup> The *Nemitz* court is actually the first to hold specifically that the telephone shall qualify as an instrumentality of interstate commerce for purposes of section 10(b) regardless of its local use in a particular circumstance.

The second point of conflict involves the question of whether or not Congress intended to extend its control over securities transactions into the area of intrastate activities. The two courts agree that there is ample authority for the proposition that Congress has the power to regulate intrastate commerce when it is necessary for the protection of interstate commerce.<sup>10</sup> The *Rosen* court dismisses the question summarily based on the language of the Act. "We are not here concerned with abstract considerations of power, but with actual manifestations of Congressional purpose and intent."<sup>11</sup> The *Nemitz* court takes an equally firm but opposite stand in declaring: "[U]nder a clear reading of the statute, it is certain that [section 10(b)] would apply to the facts of this case even though there are involved an *intrastate* transaction and a closed corporation. . . ."<sup>12</sup> (Italics in original.)

Support by analogy might be drawn from the exercise of this power by Congress in other areas of interstate commerce to meet "burdens and obstructions . . . [which exercise] is not limited to transactions which can be deemed to be an essential part of a 'flow' of interstate or foreign commerce."<sup>13</sup> The *Nemitz* court admits the lack of direct authority, however, in saying, "the construction I have placed upon [section 10(b)] . . . , under the facts of this case, goes beyond what any other case has held. . . ."<sup>14</sup>

Since the heart of the question concerns how wide a net Congress intended to cast in using the words "instrumentalities of interstate commerce," a logical key to the problem is the expressed purpose of the Act. No rephrasing of the words of section 2 of the Act<sup>15</sup> could express the purpose more clearly:

For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto . . . , and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, . . . and to insure the maintenance of fair and honest markets in such transactions.

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<sup>9</sup> *Western Union Tel. Co. v. Lenroot*, 323 U.S. 490 (1944); *Western Union Tel. Co. v. James*, 162 U.S. 650 (1896); *Primrose v. Western Union Tel. Co.*, 154 U.S. 1 (1894); *Telegraph Co. v. Texas*, 105 U.S. 460 (1881); *Matheson v. Armbrust*, 284 F.2d 670 (9th Cir. 1960); *Fratt v. Robinson*, 203 F.2d 627 (9th Cir. 1953).

<sup>10</sup> E.g., *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1936); *Lipinski v. United States*, 251 F.2d 53 (10th Cir. 1958).

<sup>11</sup> *Supra* note 1, at 476.

<sup>12</sup> *Supra* note 2, at 573.

<sup>13</sup> *NLRB v. Jones & Laughlin Steel Corp.*, *supra* note 10, at 36.

<sup>14</sup> *Supra* note 2, at 575.

<sup>15</sup> Securities Exchange Act of 1934 § 2, 48 Stat. 881 (1934), 15 U.S.C. § 78b (1958).

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The dangerous practices at which this Act is aimed could easily be adapted to fall outside of a narrow reading of the provisions of the Act. The courts have consistently taken the liberal view necessary to effect that "reasonably complete and effective" control. For example, in *Fratt v. Robinson*<sup>16</sup> the court held that section 10(b) applies to all securities transactions in spite of the fact that they are not handled on or through any securities exchange or any stock dealing organization, nor by any person connected with any business sometimes referred to as "over-the-counter" markets or businesses. Notice also that although there is no specific provision in section 10(b) for a private right of action, the courts have consistently read this provision into the Act.<sup>17</sup>

Perhaps the most dramatic indication that the courts have caught the spirit and intent of the Act is that section 10(b) has been held to apply to cases in which the mails or instrumentalities of interstate commerce were used only incidentally in a fraudulent transaction but played no part in directly conveying the fraudulent material or information.<sup>18</sup> The inescapable conclusion is that the courts have extended section 10(b) to the limit in every direction in order to encompass and totally behead this elusive Hydra—fraudulent and sharp practices in the securities market.

Control of the intrastate use of an interstate instrument would not be without precedent. In a case involving a railroad, the Supreme Court held that Congress, in the exercise of its paramount power, may prevent the common instrumentalities of interstate and intrastate commercial intercourse from being used in their intrastate operations to the injury of interstate commerce.<sup>19</sup> In a case involving the National Labor Relations Board, the Supreme Court held that if intrastate activities have such a close relation to interstate commerce that their control is essential or appropriate to protect that commerce from uses inimical to the welfare and public policy of the country as a whole, Congress cannot be denied the power to exercise that control.<sup>20</sup> Most directly on point is the line of federal cases in which Section 605 of the Federal Communications Act is held to apply to intrastate telephone communications. In *Lipinski v. United States*,<sup>21</sup> the Court of Appeals for the Tenth Circuit upheld a conviction under section 605 for intercepting intrastate communications. The words of the court are pertinent:

All of the telephone communications referred to in the indictment were intrastate communications. But Congress has plenary power to enact appropriate legislation for the government of interstate commerce, . . . and within the range of that power lies power to regulate intrastate activities when it is necessary for the protection of interstate commerce.

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<sup>16</sup> *Fratt v. Robinson*, supra note 9.

<sup>17</sup> E.g., *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195 (5th Cir. 1960); *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa. 1947).

<sup>18</sup> *Supra* note 7.

<sup>19</sup> *Houston & Texas Ry. v. United States*, 234 U.S. 342, 353 (1913).

<sup>20</sup> *NLRB v. Jones & Laughlin Steel Corp.*, supra note 10.

<sup>21</sup> *Lipinski v. United States*, supra note 10.

[T]he fact that the system . . . was used in both intrastate and interstate commerce did not derogate from the application of Section 605 to the particular telephones or telephone lines referred to in the indictment.<sup>22</sup>

Turning to the wording of section 10(b) itself it is clear that the transaction need not be interstate just as long as some "means or instrumentality of interstate commerce"<sup>23</sup> is in some way involved. It is also significant that when Congress wrote the comparable Section 17(a) of the Securities Act of 1933<sup>24</sup> the wording used was "use of any means or instruments . . . in interstate commerce." (Emphasis added.) This language seems to direct the kind of "use" test that the *Rosen* court proposes. But in section 10(b) Congress has changed this wording to "use of any means or instrumentality of interstate commerce."<sup>25</sup> (Emphasis added.) This would indicate that Congress was shifting its aim from the incidental use to the instrument itself. In this light the telephone is indisputably an instrument "of interstate commerce." These several factors indicate that when future courts reach this cross-road they will undoubtedly be inclined in the direction of the *Nemitz* decision.

JOHN F. DOBBYN

**Taxation—Calculation of Corporate Earnings and Profits—Cash Basis Association—Accrual of Federal Taxes Due in Determining Earnings and Profits.—*Demmon v. United States*.**<sup>1</sup>—The plaintiffs received and paid taxes on a trust distribution and now seek to recover a refund. The Tax Court had determined that the distributing body, Land Trust, which had computed and paid its taxes at trust rates, was an association taxable at corporate rates.<sup>2</sup> The court disallowed its distribution deduction and asserted a substantial additional tax for the years in question.<sup>3</sup> In any one of the years under examination, the amount of cash available for distribution out of earnings and profits would have been less than the amount actually distributed if the additional federal taxes due on current earnings had been deducted. The plaintiffs' yearly distribution from the trust was thus made up of not only earnings and profits of that tax year, but also of payments from some other fund-source of Land Trust (a distributing body which the government was now treating as a corporation for tax purposes). Their theory for a refund was that the difference between the amount distributed each

<sup>22</sup> *Id.* at 55-56.

<sup>23</sup> *Supra* note 3.

<sup>24</sup> Securities Act of 1933 § 17(a), 48 Stat. 74 (1933), 15 U.S.C. § 77q(a) (1958).

<sup>25</sup> *Supra* note 3.

<sup>1</sup> 321 F.2d 203 (7th Cir. 1963).

<sup>2</sup> *Estate of Scofield v. Commissioner*, 25 T.C. 774 (1956), affirmed on this issue, 266 F.2d 154 (6th Cir. 1959).

<sup>3</sup> The substantial additional tax totaled \$500,000 for the years 1945 to 1955.