

Spring 1978

## Securities Regulation—In Pari Delicto As a Bar to Private Antifraud Action by Tippee against Tipper—*Tarasi v. Pittsburgh National Bank*

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### Recommended Citation

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the value of his secured claim. This was accomplished by granting a remedy similar to that provided a junior lienor where both a senior and junior mortgage are given by a mortgagor with legal title to the land. In an area where both the remedies and the rationale of the decisions have been muddled, *Fincher* provides an excellent solution.

THOMAS A. HENZLER

## SECURITIES REGULATION— IN PARI DELICTO AS A BAR TO PRIVATE ANTIFRAUD ACTION BY TIPPEE AGAINST TIPPER

*Tarasi v. Pittsburgh National Bank*<sup>1</sup>

The defendant S. Robert Mialki, who was a friend and personal banker of the plaintiff William Tarasi, informed him that two corporations, Meridian Industries and Paragon Plastics, were negotiating a merger. Mialki told Tarasi, a relative newcomer to securities investment, that the value of Meridian Industries common stock probably would double and suggested that Tarasi invest. The information on the merger was represented to be "hush-hush." In response to these disclosures, Tarasi purchased 1,200 shares of Meridian at \$8.25 per share without revealing the information he had received from Mialki concerning the merger. Two other eventual plaintiffs were introduced to Mialki by Tarasi; both purchased stock upon similar representations. The merger between Paragon and Meridian did not occur, and the value of Meridian stock declined to about \$1.00 per share. The three purchasers filed suit against Mialki and Pittsburgh National Bank<sup>2</sup> and alleged violations of section 10(b) of the Securities Exchange Act of 1934<sup>3</sup> and rule 10b-5.<sup>4</sup>

1. 555 F.2d 1152 (3d Cir.), *cert. denied*, 98 S. Ct. 504 (1977).

2. The bank's alleged liability was based upon the fraudulent misrepresentations of its agent Mialki. Brief for Appellant at 17.

3. 15 U.S.C. § 78j(b) (1970) provides:

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.

4. 17 C.F.R. § 240.10b-5 (1977) provides:

It shall be unlawful for any person, directly or indirectly, by the

The defendant's motion for summary judgment was granted by the district court on the ground that the plaintiffs were *in pari delicto* (of equal fault) by virtue of their failure to disclose, at the time of their purchase of the Meridian shares, the secret information which they held. The Third Circuit affirmed and held that the defense of *in pari delicto* barred recovery by "tippees" injured as a result of their reliance on false, non-public information received from a corporate insider (a "tipper").

The applicability of the defense of *in pari delicto* in securities actions in general, and in tippee-tipper suits in particular, has engendered considerable controversy.<sup>5</sup> The matter ultimately turns on a policy determination, and two conflicting viewpoints have emerged concerning the best way to serve that policy.<sup>6</sup> *Tarasi* is significant because it considered both of these viewpoints carefully<sup>7</sup> and opted for application of *in pari delicto* as a matter of law.<sup>8</sup> This conscious choice by the court consolidates the position of the defense with respect to tippee-tipper suits under rule 10b-5.

Rule 10b-5, a general antifraud provision, was promulgated pursuant to section 10(b) of the Securities Exchange Act of 1934.<sup>9</sup> Although neither the rule nor the statute expressly provide for a civil remedy, such a remedy has been long recognized<sup>10</sup> and has developed to the point where private civil suits constitute an important enforcement

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use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

5. This controversy has given rise to a great deal of critical commentary. See, e.g., Bell, *How to Bar an Uninnocent Investor—The Validity of Common Law Defenses to Private Actions Under the Securities Exchange Act of 1934*, 23 U. FLA. L. REV. 1 (1970); Godfrey, *Plaintiff's Conduct as a Bar to Recovery under the Securities Acts: In Pari Delicto*, 48 TEX. L. REV. 181 (1969); Schiebelhut, *The Demise of In Pari Delicto in Private Actions Pursuant to Regulatory Schemes*, 60 CAL. L. REV. 572 (1972).

6. E.g., *Kuehnert v. Textstar Corp.*, 412 F.2d 700 (5th Cir. 1969) (applying *in pari delicto* to the tip situation). *Contra*, *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F. Supp. 50 (S.D.N.Y. 1971) (prohibiting the application of the defense).

7. 555 F.2d at 1159-61.

8. *Id.* at 1164.

9. See notes 3 & 4 *supra*.

10. The first case to establish this implied civil action was *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946). All of the circuits now recognize the private action, in accordance with the broad statutory objective of protecting investors from fraudulent practices. 3 L. LOSS, SECURITIES REGULATION 1763-64 (1961, Supp. 1969). The U.S. Supreme Court implicitly approved the civil action in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

device under the statute.<sup>11</sup> In furtherance of the remedial purposes of a rule 10b-5 civil action, the courts have permitted extensive recoveries<sup>12</sup> and extended the scope of rule 10b-5 beyond traditional insiders to encompass anyone holding confidential, inside information.<sup>13</sup> Persons given inside information concerning corporate affairs are classified as "tippees"<sup>14</sup> and have a duty either to disclose their information upon the purchase or sale of securities or to refrain from trading.<sup>15</sup> Consequently, problems arise when a tippee, himself in violation of the rule because of a failure to disclose, attempts to recover for losses incurred by his reliance on a fraudulent tip.

The common law defense of *in pari delicto* has found application in this tippee-tipper context. As the rule generally is applied, if the parties to a lawsuit are *in pari delicto*, the court will aid neither party, and leave the loss where it falls.<sup>16</sup> However, the doctrine has had its limitations. Traditionally, *in pari delicto* has been applied in the interest of society and not in the interests of the individual litigants. Courts have refused to allow the interposition of the defense when the defendant's misconduct exceeds that of the plaintiff, or when the defense works a greater injus-

11. Although rule 10b-5 was used rarely in its early years, it is now the basis for approximately one-third of all cases, public and private, brought under the federal securities laws and generates almost as much litigation as all the other antifraud provisions combined. A. BROMBERG, *SECURITIES LAW: FRAUD—SEC RULE 10b-5* § 2.5(6) (1967). The practical effect of this civil action is to provide a significant supplement to the criminal prosecution provisions of the securities laws. Godfrey, *supra* note 5 at 181.

12. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969), demonstrates the tendency to provide extensive recovery. Note also that the judicial imposition of civil liability under the rule has eliminated the necessity of proving the required elements of common law fraud. *E.g.*, *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 831 (D. Del. 1951). *See also* Posner, *Developments in Federal Securities Regulation*, 22 *Bus. Law.* 645, 654 (1967). The common law elements of fraud are: (1) a false representation, (2) of a material fact, (3) made with knowledge of its falsity, and (4) with intent to deceive, (5) which representation is relied upon by plaintiff, (6) resulting in damage to him. W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* §§ 100, 104 at 700, 736 (3d ed. 1964).

13. *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

14. A "tippee" has been defined as a person given information by an insider in breach of trust. *Ross v. Licht*, 263 F. Supp. 395, 410 (S.D.N.Y. 1967).

15. A. BROMBERG, *supra* note 11, § 7.4(6)(a); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). If a tippee fails to disclose the inside information when purchasing or selling securities, he can be held liable to the injured seller or buyer.

16. J. POMEROY, 3 *EQUITY JURISPRUDENCE* §§ 940-941 (5th ed. 1941). The defense has been accepted under federal law. *See, e.g.*, *Precision Instr. Mfg. Co. v. Automotive Maintenance Mach. Co.*, 324 U.S. 806 (1945).

A companion principle is the equitable doctrine of "unclean hands" under which a party is unable to obtain equitable relief if he himself has engaged in misconduct in the transaction at issue. This doctrine is inapplicable in *Tarasi* because the plaintiff sought only monetary damages.

tice to the public interest than would permitting a recovery.<sup>17</sup> Because the application of *in pari delicto* hinges upon what best serves the public interest, courts have viewed the defense unfavorably when a plaintiff asserts a right to recovery based upon remedial legislation. In these areas of the law, public policy encourages private actions as enforcement devices for a public interest, even though a windfall may accrue to a wrongdoing plaintiff.

The leading case illustrating this view is *Perma Life Mufflers, Inc. v. International Parts Corp.*,<sup>18</sup> in which the Supreme Court explained:

We have often indicated the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes. . . . [T]he antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws. The plaintiff who reaps the reward of treble damages may be no less morally reprehensible than the defendant, but the law encourages his suit to further the overriding public policy in favor of competition. A more fastidious regard for the relative moral worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of antitrust enforcement.<sup>19</sup>

The mandate of *Perma Life* in antitrust actions would appear equally applicable to securities regulation suits. A major policy consideration in both the antitrust and securities areas has been the encouragement of private actions by facilitating recoveries.

In the past, the defense of *in pari delicto* has been applied sporadically in securities actions.<sup>20</sup> However, in the tippee-tipster situation the defense has been invoked increasingly to bar a plaintiff tippee's recovery against a tipster. The question how best to fulfill the overall policy of securities regulation becomes acutely difficult to resolve in this particular situation. The policy of encouraging private actions by disallowing the defense conflicts with the concern for deterring the tippee's own violation by barring his recovery. In dealing with this conflict, the federal courts have formulated the following test to determine the applicability of the defense: whether the unlawful conduct of the plaintiff is of *sufficient magnitude*, compared to defendant's derelictions, to establish the foundation for *in pari delicto*; and, if so, whether the policies and public interest underlying the securities laws, and specifically rule 10b-5, would

17. 3 J. POMEROY, *supra* note 16, § 941. However, the application of the defense often has led to confusion and inconsistency; its general relevance in modern judicial procedure is in dispute. See Chafee, *Coming into Equity with Clean Hands*, 47 MICH. L. REV. 877, 878 (1949); Comment, *Rule 10b-5: The In Pari Delicto and Unclean Hands Defenses*, 58 CAL. L. REV. 1149, 1162-67 (1970).

18. 392 U.S. 134 (1968). See Note, *In Pari Delicto and Consent as Defenses in Private Antitrust Suits*, 78 HARV. L. REV. 1241 (1965).

19. 392 U.S. at 138-39.

20. 2 L. LOSS, SECURITIES REGULATION 955-56 (2d ed. 1961).

best be served by application of the defense.<sup>21</sup> The *Tarasi* court worked within this commonly accepted framework and determined the propriety of *in pari delicto* by applying the test to the facts before it.<sup>22</sup>

The court's examination first centered upon the relative magnitude of the fault of the plaintiff tippees. The court found two 10b-5 violations by the defendant tipper: the fraudulent statements upon which the tippees relied, and the selective release of inside information.<sup>23</sup> The conduct of the plaintiffs was measured against this latter violation. The court pointed out that the plaintiffs' conduct in purchasing securities without disclosing their secret information was wholly voluntary.<sup>24</sup> Based upon this voluntary conduct, it determined that the tippees were joint participants in wrongdoing with the defendant. It further emphasized that this voluntary conduct was the *sine qua non* of their injuries.<sup>25</sup> Thus, the court concluded that the conduct of the tippees was of sufficient magnitude and had a sufficient causal relation to their losses to establish the foundation for the application of *in pari delicto*.

There are several problems in this reasoning. In assessing the applicability of *in pari delicto* to securities suits, the federal courts generally have required that the plaintiff be an active and joint participant in the defendant's wrongdoing.<sup>26</sup> This standard has been refined to comport better with *Perma Life*; it requires that the plaintiff's fault be "mutual, simultaneous and relatively equal" to that of the defendant.<sup>27</sup> In *Tarasi* the court admitted that the parties never had agreed upon or even contemplated a joint or mutual program of illegal conduct.<sup>28</sup> It thus appears doubtful whether the standard for the application of *in pari*

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21. See, e.g., *Woolf v. S.D. Cohn & Co.*, 515 F.2d 591 (5th Cir. 1975); *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969); *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F. Supp. 50 (S.D.N.Y. 1971). See generally Annot., 26 A.L.R. Fed. 682 (1976).

22. 555 F.2d at 1161-62.

23. *Id.* at 1161.

24. *Id.* at 1162. The court attempted to distinguish this voluntary conduct from the passive "coerced" conduct in which the plaintiffs in *Perma Life* were said to have engaged.

25. *Id.*

26. *Pearlstein v. Scudder & German*, 429 F.2d 1136, cert. denied, 401 U.S. 1013 (2d Cir. 1970) (disallowing *in pari delicto*, and distinguishing earlier securities cases applying the defense by suggesting that it was applicable only when plaintiff participates in the initiation of the defendant's violation of which he is complaining); *Serzysko v. Chase Manhattan Bank*, 290 F. Supp. 74 (S.D.N.Y. 1968) (*in pari delicto* applied where plaintiff initiated the violations, misleading defendant into making a loan in violation of securities laws).

27. *James v. DuBreuil*, 500 F.2d 155, 160 (5th Cir. 1974). In *James v. DuBreuil* the plaintiff and the defendant conspired together to defraud others. To further this mutual purpose, the plaintiff backdated a document to avoid securities laws. To some extent, *James v. DuBreuil* may be construed as implicitly cutting back on the Fifth Circuit's earlier decision in *Kuehnert v. Texstar Corp.*

28. 555 F.2d at 1162.

*delicto* was met. It also is arguable that the tippees were less reprehensible than the tipper because they were duped by the insider defendant. The information on which the plaintiffs acted was false, and because the anticipated merger did not occur, their purchase of securities did not harm the sellers. One also must question whether the court was correct in measuring the plaintiffs' transgressions against the defendant's supposed tipping violation, instead of against the defendant's fraudulent statements which were the basis of the plaintiffs' claims.

Assuming that the plaintiffs' fault did establish the foundation for *in pari delicto*, the ultimate determinant is whether the defense can be harmonized with the policy and public interest underlying rule 10b-5.<sup>29</sup> The court in *Tarasi* discussed and weighed the conflicting policies. It expressly recognized that disallowing the defense and subjecting the tipper to liability for his misrepresentation would place pressure on the source of the tip and deter the tipper from releasing information known to be false. However, the court found this consideration outweighed by the prophylactic effect of the *in pari delicto* defense on the tippees' use of inside information and so concluded that the defense should apply as a matter of law.<sup>30</sup>

It is questionable whether this decision in fact best fulfills the overall objectives of the Securities Exchange Act of 1934 and rule 10b-5. The principal intent behind rule 10b-5 and the civil action implied thereunder was to protect investors. Section 10(b) of the Act expressly delineates this intention.<sup>31</sup> As the means to secure investor protection, the courts have looked to the implied civil action and its dual purpose—detering violations and compensating injured investors.<sup>32</sup>

The deterrence of violations will be most effectively accomplished by placing either liability or the burden of loss or both where they will exert the maximum deterrent force. Concededly, a tippee who realizes that he may lose his investment by fraud *and* be deprived of legal recourse by *in pari delicto* would be deterred from trading on the basis of a secret tip.

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29. The court in *Tarasi* noted that even if *in pari delicto* would appear technically applicable (*i.e.*, equal fault truly existed), it cannot be used as a bar to "thwart recovery in private actions under regulatory statutes." The defense's impact on statutory schemes must be assessed. 555 F.2d at 1158-59. *Accord*, *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. at 139. Securities cases have found *Perma Life's* approach of basing recovery upon enforcement considerations applicable even in the true "equal fault" situation. *See Kuehnert v. Texstar Corp.*, 412 F.2d 700, 704, 705 (5th Cir. 1969) (majority opinion and dissent).

30. 555 F.2d at 1164.

31. *See* note 3 *supra*.

32. *See* the discussions of the dual policies of deterrence of violations and compensation of injured investors in *Woolf v. S.D. Cohn & Co.*, 515 F.2d 591 (5th Cir. 1975); Comment, *The Prospects for Rule X-10B-5: An Emerging Remedy for Defrauded Investors*, 59 *YALE L.J.* 1120, 1156 (1950); Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding & Abetting, Conspiracy, In Pari Delicto, Identification, and Contribution*, 120 *U. PA. L. REV.* 597, 660-62 (1972).

To the extent that the tippee is encouraged to trade only after full disclosure of all material information, the *Tarasi* application of *in pari delicto* fulfills an objective of rule 10b-5. As a practical matter, the deterrent effect on the tippee may not be significant. As in *Tarasi*, the tippee is typically an "odd-lot" buyer or seller,<sup>33</sup> unsophisticated in securities dealings and acting on a spur-of-the-moment "hot tip." It is unrealistic to believe that the prospective unavailability of legal remedies would inhibit such a person from acting on confidential information passed down by a high corporate executive. The unsophisticated tippee may not even be aware that a duty to disclose exists; hence there may be no deterrent effect whatsoever on his use of the tip.

Furthermore, because scienter is a required element of a cause of action under rule 10b-5,<sup>34</sup> a tippee does not have a submissible case absent a showing that the tipper knowingly and intentionally passed on a false tip. The tippee is not given a "warranty of accuracy" on the tip he receives.<sup>35</sup> Rather, the scienter requirement bars legal recourse by the tippee against the tipper in all instances except when the falsity is intentional. Thus, even assuming the tippee to be sophisticated regarding securities matters, he already would be substantially deterred from trading on a tip without making full disclosure of its substance. The only *additional* deterrence wrought by the application of *in pari delicto* as a bar to the tippee's recovery would stem from his fear of intentional deceit. This added deterrence would be minimal because the tipping situation often involves a confidential relationship between the parties, as was the case in *Tarasi*.<sup>36</sup> In such a confidential situation, it is unreasonable to believe that a tippee would seriously suspect that the tipper would deceive him intentionally.

On the other hand, disallowing the interposition of *in pari delicto* would substantially deter fraudulent tipping by the tipper.<sup>37</sup> The appli-

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33. *Kuehnert v. Texstar Corp.*, 412 F.2d 700, 706 (5th Cir. 1969) (Godbold, J., dissenting).

34. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

35. The court in *Tarasi* was concerned that permitting a tippee to recover would give him a virtual "warranty of accuracy" on such tips, and that there would be "no incentive to forbear from using inside information." 555 F.2d at 1163. This stance adopts the analysis developed in Note, *Securities Regulation: Doctrines of In Pari Delicto and Unclean Hands Held to Bar 10B-5 Recovery by Tippee Against Corporate Insider*, 1969 DUKE L.J. 832, 839-40 (1969) (noting *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (5th Cir. 1969)). The *Tarasi* court repeatedly cited this article. 555 F.2d at 1158 n.23, 1163 n.55, 1164 n.57. However, it should be noted that in light of *Ernst & Ernst*, this analysis has become far less persuasive. The requirement of scienter erodes any broad "warranty of accuracy." The tippee is only warranted against knowing and intentional deceit.

36. Mialki was both a friend and the personal banker of *Tarasi*. 555 F.2d at 1154. In such circumstances, it seems doubtful that *Tarasi* would seriously fear that Mialki was intentionally perpetrating a fraud.

37. The court in *Tarasi* largely chose to ignore this factor, noting simply that the deterrent effect on the release of "true" tips would be minimal. 555 F.2d at

cation of every possible discouragement to the disseminator of false information seems more efficient than punishing (by denial of recovery) only the person to whom the information is communicated. The tipper, normally a relatively sophisticated entrepreneur or corporate insider (as in *Tarasi*), presumably is aware of the ban on certain conduct and the possibility of recovery by the tippee. At the fountainhead, the tipper has the greater potential for harm;<sup>38</sup> one tipper may relate the false inside information to a number of tippees. Therefore, permitting tippee recovery would achieve the maximum deterrent effect in the tippee-tipper situation, for it not only strikes at the source of the violation,<sup>39</sup> but also places liability on the party more likely to be deterred.

Investor protection also is furthered by the implied civil action under rule 10b-5 through the compensation of injured investors. The relief provided in private suits warns the transgressor that his conduct is proscribed and recompenses the party injured by a particular transaction. The plaintiffs in *Tarasi* were certainly "investors" by virtue of their purchases of securities. Contrary to the purpose of rule 10b-5, they were denied compensation. The plaintiffs were not "innocent investors";<sup>40</sup> however, almost no amount of gullibility, insufficient diligence, or blindness to what is going on has ordinarily disqualified a plaintiff from proceeding under rule 10b-5.<sup>41</sup> Nor have investors lost the protection of securities legislation by becoming involved to some extent in the illegality of a securities sale.<sup>42</sup>

The decision in *Tarasi v. Pittsburgh National Bank* departs from the liberal trend towards facilitating investor recovery.<sup>43</sup> The court ultimately protected the insider rather than the investor. In effect the corporate insider was told that if he releases false information which induces action on the part of one or more tippees, he need not fear

1163. This approach fails to emphasize properly an important consideration. A major objective of the securities laws and particularly rule 10b-5 has been to protect against the inequities flowing from trading stimulated by false information. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 858-59 (2d Cir. 1968), *citing* H.R. Rep. No. 1383, 73rd Cong., 2d Sess. 11 (1934).

38. *Kuehnert v. Texstar Corp.*, 442 F.2d 700, 706 (5th Cir. 1969) (Godbold, J., dissenting); *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F. Supp. 50 (S.D.N.Y. 1971).

39. This argument was recognized by the court in *Tarasi* as deserving of some merit. 555 F.2d at 1163.

40. *Royal Air Properties v. Smith*, 312 F.2d 210, 213-14 (9th Cir. 1962) (the purpose of the Act was to protect the "innocent investor," not the one who waits to see how his investment turns out before invoking the provisions of the Act).

41. Comment, *supra* note 17, at 1154. *E.g.*, *Rogen v. Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966); *Surowitz v. Hilton Hotels Corp.*, 342 F.2d 596, 602 (7th Cir. 1965), *rev'd on other grounds*, 383 U.S. 363 (1966) ("[T]he policy of the federal securities laws is to protect investors, including the uninformed, the ignorant, and the gullible.").

42. *Can-Am Petroleum Co. v. Beck*, 331 F.2d 371, 373 (10th Cir. 1964).

43. See note 12 and accompanying text *supra*.

private enforcement of the securities laws. This result appears especially anomalous in light of the overall aims of rule 10b-5. The rule expressly proscribes "untrue statements" in connection with securities transactions. Its promulgation added to the existing body of securities law some protection for the investor against a third party to a securities transaction.<sup>44</sup> However, *Tarasi* insulates this third party from liability for a fraudulent statement, and leaves the investor who is injured by that misrepresentation uncompensated.

The *Tarasi* holding also runs counter to the public interest in encouraging private suits under rule 10b-5.<sup>45</sup> The resources of the Securities Exchange Commission are adequate to prosecute only the most flagrant abuses. Consequently, both the exposure of violations and enforcement of the rule's provisions depend largely upon the encouragement of private suits.<sup>46</sup> Applying *in pari delicto* denies the tippee the opportunity to recoup his losses. The defense eliminates the incentive to bring suit, with the result that many violations of the securities acts remain unexposed. Not only is the tippee unlikely to bring suit, he is deterred from even exposing the tipper's transgression. The tippee has nothing to gain from such exposure, and drawing attention to the fraudulent tip and subsequent transaction may expose himself to the possibility of criminal or administrative sanctions for attempted fraud by virtue of his failure to disclose.<sup>47</sup>

Conversely, disallowing *in pari delicto* and permitting the tippee to recover would encourage exposure of violations.<sup>48</sup> The possibility of recovery would be an incentive for the tippee to expose the tipper's misrepresentation. The Securities Exchange Commission could monitor such lawsuits with relative ease and could apply appropriate and consis-

44. Comment, note 32 *supra*, at 1138. This article points out that rule 10b-5 filled a gap in federal protection against securities fraud by giving to the seller or buyer of securities a remedy against a person who makes a misrepresentation inducing a transaction, where that person was not a party to the transaction.

45. Fratt v. Robinson, 203 F.2d 627, 632 (9th Cir. 1953). "[N]othing . . . would tend more . . . to deter fraudulent practices in security transactions . . . than the right of defrauded sellers or buyers . . . to seek redress in damages in federal courts." See also text accompanying notes 10-12 *supra*; Comment, *supra* note 17, at 1155-58.

46. A. BROMBERG, *supra* note 11, §§ 10.1-10.3. See also Woolf v. S.D. Cohn & Co., 515 F.2d 591 (5th Cir. 1975).

47. The possibility of criminal sanctions must be reckoned with, even though the sanctions are infrequently applied. A. BROMBERG, *supra* note 11, §§ 10.1-10.3. Sanctions are provided for in § 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (1970). The maximum criminal penalty is two years imprisonment and/or a \$10,000 fine. Few convictions have produced judicial opinions; most have come on pleas of *nolo contendere*. See United States v. Shindler, 173 F. Supp. 393 (S.D.N.Y. 1959) (holding 10b-5 valid in a criminal context).

48. Kuehnert v. Texstar Corp., 412 F.2d 700, 706 (5th Cir. 1969) (Godbold, J., dissenting); Comment, *supra* note 17, at 1157-58; Comment, *Deterrence of Tippee Trading Under Rule 10b-5*, 38 U. CHI. L. REV. 372, 376 (1971).