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Law Case with Answer

Securities and Exchange Commission v. Texas Gulf Sulphur Company

Facts Texas Gulf Sulphur Co. (TGS), a mining company, drilled an exploratory hole—Kidd 55—near Timmins, Ontario. Assay reports showed that the core from this drilling proved to be remarkably high in copper, zinc, and silver. TGS kept the discovery secret, camouflaged the drill site, and diverted drilling efforts to another site to allow TGS to acquire land around Kidd 55. TGS stock traded at $18 per share.

Eventually, rumors of a rich mineral strike began circulating. On Saturday, the *New York Times* published an unauthorized report of TGS drilling efforts in Canada and its rich mineral strike. On Sunday, officers of TGS drafted a press release that was issued that afternoon. The press release appeared in morning newspapers of general circulation on Monday. It read, in pertinent part, "The work done to date has not been sufficient to reach definite conclusions and any statement as to size and grade of ore would be premature and possibly misleading."

The rumors persisted. Three days later, at 10:00 A.M., TGS held a press conference for the financial media. At

the time of the press conference, TGS stock was trading at $37 per share. At this press conference, which lasted about ten minutes, TGS disclosed the richness of the Timmins mineral strike and that the strike should run to at least 25 million tons in ore.

The following two company executives who had knowledge of the mineral strike at Timmins traded in the stock of TGS:

- **Crawford.** Crawford telephoned orders to his Chicago broker about midnight on the day before the announcement and again at 8:30 in the morning of the day of the announcement, with instructions to buy at the opening of the stock exchange that morning. Crawford purchased the stock he ordered.
- **Coates.** Coates telephoned orders to his stock broker son-in-law to purchase the company's stock shortly before 10:20 A.M. on the day of the announcement, which was just after the announcement had been made. Coates purchased the stock he had ordered.

After the public announcement, TGS stock was selling at $58. The SEC brought an action against Crawford and Coates for insider trading, in violation of Section 10(b) of the Securities Exchange Act of 1934. Are the defendant executives liable for engaging in insider trading?

Answer Yes, the defendant executives are liable for engaging in insider trading, in violation of Section 10(b) of the Securities Exchange Act of 1934. The insiders here were not trading on an equal footing with the outside investors. They alone were in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike.

Crawford telephoned his orders to his Chicago broker about midnight on the day before the announcement and again at 8:30 in the morning of the day of the announcement, with instructions to buy at the opening of the stock exchange that morning. Crawford sought to, and did, "beat the news." Before insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to ensure its availability to the investing public. Here, where a formal announcement to the entire financial news media had been promised in a prior official release known to the media, all insider activity must await dissemination of the promised official announcement. Crawford, an insider, traded while in the possession of material nonpublic information and is therefore liable for violating Section 10(b).

Coates's telephone order was placed shortly before 10:20 A.M. on the day of the announcement, which occurred a few minutes after the public announcement. When Coates purchased the stock, the news could not be considered already a matter of public information. Insiders should keep out of the market until the established procedures for public release of the information are carried out instead of hastening to execute transactions in advance of, and in frustration of, the objectives of the release. Assuming that the contents of the official release could instantaneously be acted upon, at a minimum, Coates should have waited until the news could reasonably have been expected to appear over the media of widest circulation rather than hastening to ensure an advantage to himself and his broker son-in-law.

Both Crawford and Coates, insider executives of TGS, engaged in illegal insider trading, in violation of Section 10(b) of the Securities Exchange Act of 1934. *Securities and Exchange Commission v. Texas Gulf Sulphur Company*, 401 F.2d 833, Web 1968 U.S. App. Lexis 5797 (United States Court of Appeals for the Second Circuit)

Critical Legal Thinking Cases

17.1 Definition of *Security* Dare To Be Great, Inc. (Dare), was a Florida corporation that was wholly owned by Glenn W. Turner Enterprises, Inc. Dare offered self-improvement courses aimed at improving self-motivation and sales ability. In return for an investment of money, the purchaser received certain tapes, records, and written materials. In addition, depending on the level of involvement, the purchaser had the opportunity to help sell the Dare courses to others and to receive part of the purchase price as a commission. There were four different levels of involvement.

The task of salespersons was to bring prospective purchasers to "Adventure Meetings." The meetings, which were conducted by Dare people and not the salespersons, were conducted in a preordained format that included great enthusiasm, cheering and charming, exuberant handshaking, standing on chairs, and shouting. The Dare people and the salespersons dressed in modern, expensive clothes, displayed large sums of cash, drove new expensive automobiles, and engaged in "hard-sell" tactics to induce prospects to sign their name and part with their money. In actuality, few Dare purchasers ever attained the wealth promised. The tape recordings and materials distributed by Dare were worthless. Is this sales scheme a "security" that should have been registered with the SEC? *Securities and Exchange Commission v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, Web 1973