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THE RELEVANCE OF TORT LAW DOCTRINES TO RULE 10b-5: SHOULD CARELESS PLAINTIFFS BE DENIED RECOVERY?

Margaret V. Sachs*

INTRODUCTION

Private litigation under section 10(b)1 of the Securities Exchange Act of 19342 and rule 10b-53 is at present riddled with tort law doctrines.4 Familiar tort concepts such as aiding and abet-

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* Associate Professor of Law, University of Bridgeport School of Law. A.B. 1973, J.D. 1977, Harvard University.

1 Section 10(b) 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.

15 U.S.C. § 78j(b) (1982) [hereinafter cited as section 10(b)].


3 Rule 10b-5, promulgated by the Securities and Exchange Commission (SEC) in 1942, 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,

(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 the light of the circumstances under which they were made, not misleading,

(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.

17 C.F.R. § 240.10b-5 (1985) [hereinafter cited as rule 10b-5].


4 Tort principles underlay judicial implication of a private action under rule 10b-5.
Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946), the first case to imply a private action under rule 10b-5, was premised on the theory that "[t]he disregard of the command of a statute is . . . a tort." Id. at 513. The Supreme Court's subsequent acknowledgements of the private action have failed to address its putative basis in tort law. See Herman & MacLean v. Huddleston, 459 U.S. 375, 380-81 & n.10 (1983); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976); Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6, 13 n.9 (1971). The Court's rejection of the tort law basis does seem to follow, however, from its recent rulings that implied actions are appropriate only where intended by Congress. See, e.g., Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 15-24 (1979) (no implied private action under § 206 of the Investment Advisors Act of 1940, 15 U.S.C. § 80b-6 (1982)); Touche Ross & Co. v. Redington, 442 U.S. 560, 574-79 (no implied action for damages under § 17(a) of the 1934 Act, 15 U.S.C. § 78q(a) (1982)).


In Bateman Eichler, Hill Richards, Inc. v. Berner, 105 S. Ct. 2622 (1985), the Supreme Court rejected the in pari delicto defense of securities professionals in a suit brought by their tippees. The Court based its rejection of the defense on enforcement considerations. For a discussion of the circumstances in which an in pari delicto defense may still be valid, see infra note 293.
action by a number of lower federal courts.10 The United States Supreme Court had not addressed the relevance of any of these doctrines11 until its decision this year in Bateman Eichler, Hill Richards, Inc. v. Berner.12 By disallowing a defense of in pari delicto on statutory enforcement grounds, Bateman plainly signals the now precarious status of tort law doctrines in rule 10b-5 private actions.

Bateman is the most recent of a series of decisions over the past decade in which the Court has indicated that the intent of Congress governs the elements of the rule 10b-5 action.13 The Supreme Court has enumerated several factors that must be considered in determining congressional intent: the language and history of section 10(b) and rule 10b-5; the structure of the 1934 Act and the Securities Act of 1933;14 the policies underlying both the 1933 and

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1 See cases cited supra notes 5-9. Lower court decisions on whether recklessness may be a basis for liability also illustrate the prominence of tort law in rule 10b-5 actions. Several lower courts have accepted recklessness as a basis for liability because of its sufficiency under common law deceit. See McLean v. Alexander, 599 F.2d 1190, 1198 (3d Cir. 1979); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1024 (6th Cir. 1979); Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 45-46 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); Sundstrand Corp. v. Sun Chem. Corp., 553 F. Supp. 1007 (S.D.N.Y.) (distinguishing Northwest Airlines and Texas Industries and upholding right of contribution under rule 10b-5), certificate for interlocutory appeal granted, 553 F. Supp. 333 (S.D.N.Y. 1982).

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1934 Acts; and the elements of deceit under the common law.\textsuperscript{15}

This Article has two objectives: first, to examine the Court's jurisprudence for the rule 10b-5 action;\textsuperscript{16} second, to apply the Court's jurisprudence to the duty of care, a rule 10b-5 doctrine of common law origin.\textsuperscript{17} The duty of care requires that the court dis-

\textsuperscript{15} In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), for example, the Court held that a private plaintiff under rule 10b-5 must have purchased or sold the security in question. The holding was premised on the language of § 10(b), statutory structure, and statutory policy.

In Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Court held that rule 10b-5 does not encompass liability for negligence. The holding was premised on the language of § 10(b), statutory structure, and legislative history.

In Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977), the Court held that rule 10b-5 liability requires misrepresentation or nondisclosure. The holding was premised on the language of § 10(b), legislative history, and statutory policy.

In Chiarella v. United States, 445 U.S. 222 (1980), the Court held that under rule 10b-5, silence was actionable only if the defendant had a duty to disclose. The Court premised its holding on common law deceit after finding that the language and history of § 10(b), as well as statutory policy, were not helpful.

A substantially different reading of the Court's jurisprudence has been offered by Professor Daniel R. Fischel, who claims that the appropriate factors are limited to the language, structure, and history of § 10(b). See Fischel, Secondary Liability Under Section 10(b) of the Securities Act of 1934, 69 Calif. L. Rev. 80, 94 (1981). He specifically rejects both policy, id. at 100-02, and common law deceit, id. at 94, as relevant factors.

\textsuperscript{16} See generally W. Prosser \& W. Keeton, Prosser and Keeton on Torts § 108 (5th ed. 1984). See also infra notes 318-29 and accompanying text (discussing status of duty of care under common law deceit).


Under rule 10b-5 a private plaintiff must plead and prove the following elements:

1. \textbf{PURCHASER/SELLER REQUIREMENT}. The plaintiff must be a purchaser or seller of a security. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754-55 (1975).

2. \textbf{MATERIALITY}. The fact omitted or misrepresented must have been material. A fact is material "if there is a substantial likelihood that a reasonable . . . [investor] would consider it important. . . ." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Although the \textit{TSC Industries} standard was propounded in the context of § 14(a) of the 1984 Act, 15 U.S.C. § 78n(a) (1982), and rule 14a-9, 17 C.F.R. § 240.14a-9 (1988), it also applies to actions brought under § 10(b) and rule 10b-5. See Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474 n.14 (1977) (\textit{TSC Industries} cited as sole authority for finding of lack of materiality under rule 10b-5); S.D. Cohn & Co. v. Woolf, 426 U.S. 944 (1976) (rule 10b-5 action remanded for reconsideration in light of \textit{TSC Industries}). See also Abrams v. Oppenheimer Gov't Sec., Inc., 737 F.2d 582, 593 (7th Cir. 1984) (\textit{TSC Industries} standard applied to rule 10b-5 action); Madison Consultants v. FDIC, 710 F.2d 57, 62 (2d Cir. 1983) (same); Simpson v. Southeastern Inv. Trust, 697 F.2d 1257, 1259 (5th Cir. 1983) (same); Austin v. Loftsgaarden, 675 F.2d 168, 176 & n.17 (8th Cir. 1982) (same).

3. \textbf{SCIENTER}. Defendant must have acted with scienter, defined as an intent to deceive, manipulate, or defraud. Ernst \& Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).
miss a rule 10b-5 private action when the plaintiff has carelessly ignored information, relied upon suspicious information, or failed to seek warranted additional information. Every circuit that has

The Supreme Court has not determined whether recklessness is sufficient for liability. *Id.* at 194 n.12; Herman & MacLean v. Huddleston, 459 U.S. 375, 378 n.4 (1983). Lower courts after *Hochfelder* have held recklessness to be sufficient for liability. E.g., Pegasus Fund, Inc. v. Laraneta, 617 F.2d 1335, 1340 (9th Cir. 1980); Healey v. Catalyst Recovery, Inc., 616 F.2d 641, 649 (3d Cir. 1980); Broad v. Rockwell Int'l Corp., 614 F.2d 418, 440 (5th Cir. 1980). *See also* cases cited *supra* note 10.

(4) "IN CONNECTION WITH" REQUIREMENT. The fraud must have occurred "in connection with" the purchase or sale of a security. See the texts of § 10(b), *supra* note 1, and rule 10b-5, *supra* note 3. *See also* Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) (addressing scope of "in connection with" requirement).


(7) JURISDICTIONAL MEANS REQUIREMENT. The defendant must have used interstate commerce, the mails, or a facility of a national securities exchange. *See supra* notes 1, 3. *Cf.* Affiliated Ute Citizens v. United States, 406 U.S. 128, 148 (1972) (affirming district court's holding that defendants made use of jurisdictional means).


19 *See, e.g.*, Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1518 (10th Cir. 1983) (reliance on oral misrepresentations that contradicted memorandum); White v. Sanders, 689 F.2d 1366, 1369 (11th Cir. 1982) (jury might have reasonably believed that plaintiffs were reckless in ignoring evidence that should have made them suspicious); Lane v. Midwest Bancshares Corp., 337 F. Supp. 1200, 1210-11 (E.D. Ark. 1972) (reliance on suspect balance sheet).

20 *See, e.g.*, City Nat'l Bank v. Vanderboom, 422 F.2d 221, 231 (8th Cir.) (failure to seek audit report), *cert. denied*, 399 U.S. 905 (1970); Kohler v. Kohler Co., 319 F.2d 634, 641 (7th Cir. 1963) (failure to investigate discrepancy as to earnings); Altschuler v. Cohen, 471 F. Supp. 1372, 1384 (S.D. Tex. 1979) (allegedly material information could
considered the duty of care has upheld it, albeit under a variety of names and burden of proof allocations. This Article concludes, however, that the duty of care is not appropriate to rule 10b-5 litigation and should be rejected.

Part I of this Article traces the development of the duty of care


21 See cases cited supra note 7.

22 Other names used in referring to the duty of care include: justifiable reliance, reasonable reliance, reasonable diligence, and due diligence. See infra notes 31-34 and accompanying text.

23 The circuits disagree as to whether the plaintiff or the defendant bears the burden of proof concerning the duty of care. See infra notes 102-11 and accompanying text. A distinction exists among those circuits placing the burden on the plaintiff; some circuits impose the burden of proof on the plaintiff in every case, whereas at least one circuit places the burden of proof on the plaintiff only when the defendant has placed the plaintiff's care in issue. See infra notes 102-06 and accompanying text.

under rule 10b-5. The duty of care was first used to restrict the scope of rule 10b-5 and originally was applied in only two types of cases in which the need for limits was especially compelling: claims premised on the defendant's negligence and claims brought by insiders, corporations, and securities professionals. Although the Supreme Court's decisions in *Affiliated Ute Citizens v. United States* \(^{25}\) and *Ernst & Ernst v. Hochfelder* \(^{26}\) did not address the duty of care directly, the decisions facilitated expanded application of the doctrine. Part I examines this broader reach and potentially harsher impact of the present duty of care.

Parts II, III, and IV examine the Supreme Court's rule 10b-5 jurisprudence. Part II begins with the language and history of section 10(b) and rule 10b-5, including an exploration of the difficulties in utilizing these factors to determine congressional intent. The analysis of statutory structure in Part II prompts the conclusion that the duty of care cannot be reconciled with section 29(a) of the 1934 Act. \(^{27}\)

Part III addresses the underlying policies of the 1933 and 1934 Acts and demonstrates their inconsistency with the policies that lower courts have advanced to justify the duty of care. Part III shows that the duty of care is inconsistent with the congressional policy of statutory enforcement and thereby contravenes the Supreme Court's decision in *Bateman Eichler, Hill Richards, Inc. v. Berner*. \(^{28}\)

Part IV examines common law deceit. In accordance with congressional intent, the relevant deceit standards are those of the most liberal jurisdictions in 1934. \(^{29}\) In those jurisdictions, a plaintiff's carelessness did not bar recovery. \(^{30}\) Thus, rule 10b-5's duty of care is inconsistent with the common law as well as with statutory structure and policy. As such, it is contrary to the intent of Congress and should be abandoned.

## I

**Development of the Duty of Care Under Rule 10b-5**

Whether discussed in explicit terms or as justifiable reliance, \(^{31}\)
reasonable reliance, reasonable diligence, or due diligence, courts have applied the duty of care to rule 10b-5 actions involving both open market and face-to-face transactions. Courts have even extended the duty of care to class actions. Face-to-face transactions, however, provide the more common context for litigation of duty of care issues. Such transactions are more likely to involve inconsistent or otherwise problematical information that a careful investor would be expected to clarify. Accordingly, duty of care issues are especially likely to arise in transactions involving close corporations, private placements, and customer-broker relations.

A. Early Rule 10b-5 Duty of Care Cases

Courts originally applied the duty of care to rule 10b-5 litiga-

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36 See infra notes 38-40 and accompanying text.


tion as a way to limit liability. The Fifth Circuit Court of Appeals offered an explanation for the perceived necessity of this limitation:

Considered alone, the sweeping language of Rule 10b-5 creates an almost completely undefined liability. All that the rule requires for its violation is that someone "do something bad" in connection with a purchase or sale of securities. Without further delineation, civil liability is formless . . . . In recognition of this problem, courts have sought to construct workable limits to liability . . . .

The duty of care was among the "workable limits" identified by the Fifth Circuit.

The early duty of care cases measured the plaintiff's carelessness by a negligence standard. Courts were divided, however, on the relation of the duty of care to the other elements of the private action. Some courts regarded the duty of care as a separate element; other courts subsumed it under the elements of causation, reliance, or materiality. Courts also disagreed about whether to

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41 E.g., Herpich v. Wallace, 430 F.2d 792, 804-05 & n.12 (5th Cir. 1970) (citing reasonable reliance as one limitation upon "formless" liability under rule 10b-5); Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 520, 543-44 (2d Cir. 1967) (same); McLean v. Alexander, 420 F. Supp. 1057, 1077 (D. Del. 1976) (duty of care originated "as a defensive response to the increasing number of private actions brought under 10b-5"), rev'd on other grounds, 599 F.2d 1190 (3d Cir. 1979). See also Straub v. Vaisman & Co., 540 F.2d 591, 597 (3d Cir. 1976) ("where the basis of a 10b-5 recovery began to broaden from intentional to negligent conduct, importation of the tort concept of a plaintiff's contributory negligence was a natural development").

Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963), appears to have been the first rule 10b-5 case to utilize the duty of care concept. In Kohler the Seventh Circuit refused to hold the defendant liable, in part on the ground that the plaintiff had access to the information he claimed was misstated. Id. at 640. Other early cases utilizing the duty of care concept include Myzel v. Fields, 386 F.2d 718, 736-37 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968), and Phillips v. Reynolds & Co., 294 F. Supp. 1249, 1254 (E.D. Pa. 1969).

42 Herpich v. Wallace, 430 F.2d 792, 804-05 (5th Cir. 1970) (citations omitted).

43 Id. at 805 & n.12. Other "limits" were privity, causation, foreseeability, and the purchaser-seller requirement. Id.


45 See supra note 17 for the elements of a rule 10b-5 private action.


48 E.g., Thomas v. Duralite Co., 524 F.2d 577, 585-86 (3d Cir. 1975); City Nat'l
judge the duty of care subjectively or objectively and whether the plaintiff or the defendant had the burden of proof. These differences were of little consequence during the 1960s and early 1970s, however, because at that time courts applied the duty of care in only two categories of rule 10b-5 cases.

The first category of cases applying the duty of care consisted of those purporting to reject a rule 10b-5 scienter requirement. True rejection of the scienter requirement did not occur in any circuit because no court actually imposed liability when scienter was lacking. What may thus far have been overlooked, however, is that in dismissing claims alleging liability without scienter, courts frequently focused on the plaintiff's lack of care. Indeed, the duty of care repeatedly served as a basis for dismissal, affirmance of a defendant's verdict, or reversal of a plaintiff's verdict in cases in


Courts have recognized that the duty of care arose to curb liability for nonintentional conduct. See, e.g., Dupuy v. Dupuy, 551 F.2d 1005, 1019 (5th Cir.), cert. denied, 434 U.S. 911 (1977); Straub v. Vaisman & Co., 450 F.2d 591, 597 (3d Cir. 1976). What has not been recognized, however, is the duty of care's role in insuring that liability for unintentional conduct was never imposed.


which scienter was at least formally not required.

The second category of cases applying the duty of care was a limited subgroup of cases in which scienter was expressly at issue: those in which the plaintiff was a securities professional, a corporation, or an insider. The Second Circuit explained the rationale for applying the duty of care in these cases:

The securities laws were not enacted to protect sophisticated


61 Early cases did not explicitly acknowledge the application of the duty of care to scienter cases involving insiders, corporations, and securities professionals. Some did, however, implicitly acknowledge it. For example, in Rochez Bros., Inc. v. Rhoades, 491 F.2d 402 (3d Cir. 1974), the court held that "before an insider may claim reliance on a material misrepresentation or nondisclosure, he must fulfill a duty of due care." Id. at 409 (emphasis added). Similarly, in Thomas v. Duralite Co., 524 F.2d 577 (3d Cir. 1975), the court held that the "plaintiff, as an 'insider,' had the duty of using due care to ascertain the relevant facts." Id. at 585-86 (emphasis added). In Frigitemp Corp. v. Financial Dynamics Fund, Inc., 524 F.2d 275 (2d Cir. 1975), the court imputed constructive knowledge to the corporate plaintiff but then noted that "[w]hether 'constructive knowledge,' or 'ready access to the information involved,' is always a bar to the plaintiff we need not decide." Id. at 282 (citation omitted; emphasis deleted). In Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968), the court assessed the justifiable reliance of the insider plaintiff, but not that of the ordinary plaintiff. Id. at 735-37.

Moreover, recent cases have erroneously assumed that the duty of care previously had no application to scienter cases. See, e.g., Mallis v. Bankers Trust Co., 615 F.2d 68, 78 (2d Cir. 1980), cert. denied, 449 U.S. 1125 (1981); Dupuy v. Dupuy, 551 F.2d 1005, 1019 (5th Cir.), cert. denied, 434 U.S. 911 (1977). This error has created interpretative problems. For example, in Dupuy v. Dupuy, 551 F.2d 1005 (5th Cir.), cert. denied, 434 U.S. 911 (1977), the court had difficulty explaining why the duty of care had been invoked in Clement A. Evans & Co. v. McAlpine, 434 F.2d 100 (5th Cir. 1970), cert. denied, 402 U.S. 988 (1971), because the McAlpine plaintiff had alleged scienter. 551 F.2d at 1019 n.26. The Dupuy court failed to recognize the significance of the plaintiff's status as a brokerage firm in McAlpine, preferring instead to cast McAlpine aside as an "exception." Id.
businessmen from their own errors of judgment. Such investors must, if they wish to recover under federal law, investigate the information available to them with the care and prudence expected from people blessed with full access to information. 62 Accordingly, in many of these cases, courts based their dismissals on the plaintiff’s failure to meet his duty of care. 63 Not all courts accepted the application of the duty of care in these circumstances, however. Some courts appeared to regard the duty of care as applicable to scienter cases, regardless of the plaintiff’s identity. 64 They reasoned that carelessness, even where the plaintiff was sophisticated, would not expunge the defendant’s fraud, because “sophisticated investors, like all others, are entitled to the truth.” 65

In cases involving scienter and an unsophisticated plaintiff, lack of care did not defeat recovery, even when the plaintiff had been on notice of the need for further inquiry. The Tenth Circuit’s decision in Zabriskie v. Lewis 66 illustrates this view. In Zabriskie, the defendants allegedly orally misrepresented the negotiability of certain stock. The defendants argued that the legend on the face of the stock certificate had given the plaintiff notice of the stock’s non-negotiability. 67 The Tenth Circuit refused to impose a duty of care, reasoning that

[the plaintiff’s] reliance on the statements of these two men would not seem to indicate a lack of diligence but rather a justifiable reliance. As to her alleged receipt of actual notice from the legend, the oral statement indicating the stock was negotiable could easily have satisfied any question the legend raised in the mind of this unsophisticated investor. 68

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62 Hirsch v. Du Pont, 553 F.2d 750, 763 (2d Cir. 1977). In Mallis v. Bankers Trust Co., 615 F.2d 68 (2d Cir. 1980), cert. denied, 449 U.S. 1123 (1981), the court limited the application of the quoted statement to situations like Hirsch where the plaintiff’s actions are “far beyond negligence.” Id. at 79.

63 See cases cited supra notes 58-60.

64 In Metro-Goldwyn-Mayer, Inc. v. Ross, 509 F.2d 930 (2d Cir. 1975), the court upheld the omissions claim of a corporate plaintiff that had access to documents containing the allegedly omitted information. Id. at 933.


65 Stier v. Smith, 473 F.2d 1205, 1207 (5th Cir. 1973).

66 507 F.2d 546 (10th Cir. 1974).

67 The legend read:

The shares of Stock represented by this certificate are held for investment and not for distribution, and cannot be presented for transfer until compliance with the Securities Act of 1933 as amended.

Id. at 552 n.12.

68 Id. at 552-53. See also Myzel v. Fields, 386 F.2d 718, 735-37 (8th Cir. 1967) (issue of justifiable reliance adjudicated as to insider plaintiff, but not as to noninsider plaintiff), cert. denied, 390 U.S. 951 (1968). Cf. Bird v. Ferry, 497 F.2d 112, 114 (5th Cir. 1974)
Thus, courts invoked the duty of care as a means of curbing the application of rule 10b-5 only when the need for a curb seemed especially acute. Such situations involved claims premised on the defendant's negligence and claims brought by certain privileged or sophisticated plaintiffs.

B. The Supreme Court Speaks By Indirection: *Affiliated Ute* and *Hochfelder*

Prior to *Affiliated Ute Citizens v. United States*, courts often subsumed the duty of care under the element of reliance. In *Affiliated Ute*, the Supreme Court refused to dismiss the plaintiff's claim merely because the plaintiff had failed to prove reliance upon material factual omissions:

Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material . . . . This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.

*Affiliated Ute* thus recognized the difficulty of establishing reliance upon omitted information. The Court relieved the plaintiff of this burden by placing the burden on the defendant to establish that the plaintiff had not relied upon the omitted information. The plaintiff retained the burden of establishing reliance, however, if he alleged misrepresentations rather than omissions.

By eliminating the plaintiff's burden of proving reliance in omissions cases, the *Affiliated Ute* Court further complicated the uncertain relationship between reliance and the duty of care. If reli-

(verbatim against broker affirmed despite plaintiff's failure to request receipts or audit account).

69 See supra notes 41-43 and accompanying text.
70 See supra notes 52-56 and accompanying text.
71 See supra notes 57-63 and accompanying text.
73 See supra note 48 and accompanying text.
74 406 U.S. at 153-54 (citations omitted).
ance subsumed the duty of care,\(^7\) the burden of proof allocations applicable to reliance would also apply to the duty of care. Thus, after *Affiliated Ute*, a plaintiff would have had to prove that he had met his duty of care in a misrepresentation case but not in an omissions case.\(^7\) Courts could not justify this allocation, however, because proof of the duty of care is not inherently more difficult in omissions cases than in misrepresentation cases.\(^8\) Consequently, most courts after *Affiliated Ute* separated reliance from the duty of care.\(^8\)

*Affiliated Ute* thus systematized the relationship between the duty of care and the other elements of the rule 10b-5 action. The previous uncertainty regarding this relationship probably contributed to the selective application of the duty of care.\(^8\) By systematizing this relationship, *Affiliated Ute* also facilitated the eventual extension of the duty of care to all private rule 10b-5 actions.\(^8\)

*Ernst & Ernst v. Hochfelder*\(^8\) further enhanced the status of the duty of care in rule 10b-5 cases. The *Hochfelder* Court held that rule 10b-5 did not encompass liability for mere negligence.\(^8\) The Court held that liability under rule 10b-5 requires scienter, defined as an intent to deceive, manipulate, or defraud.\(^8\) The Court expressly left open the question of whether scienter embraces recklessness.\(^8\)

By eliminating liability based on the defendant's negligence, *Hochfelder* prompted courts to reconsider the relevance of the plaintiff's negligence.\(^8\) Every circuit to reconsider the issue, however, has reaffirmed the duty of care,\(^9\) at least in modified form,\(^9\) after

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78 See supra note 48 and accompanying text.


80 Courts were unable to identify any other policy that would allocate proof of the duty of care in accordance with whether the plaintiff's allegations involved omissions or misrepresentations. See id. at 1016.

81 E.g., id. at 1015-16.


83 See infra notes 114-17 and accompanying text.


85 Plaintiffs had specifically conceded defendants' lack of scienter. Id. at 190 n.5.

86 Id. at 193.

87 See id. at 194 n.12. See also Herman & MacLean v. Huddleston, 459 U.S. 375, 378 n.4 (1983) (question again left open). Lower courts after *Hochfelder* have upheld the sufficiency of recklessness. See supra note 17.


89 See cases cited supra note 7. For a discussion of the modified duty of care, see infra notes 99-124 and accompanying text. As will be shown, most circuits have equated the modified duty of care with avoidance of recklessness, making the phrase "duty of
conceding that the preclusion of negligent liability rendered the duty of care less necessary. Courts have premised this reaffirmation on five new justifications for the duty of care: deterrence of investor carelessness, promotion of anti-fraud policies, promotion of market stabilization, "fairness," and provision of a causal link between the defendant's wrong and the plaintiff's injury. By precipitating recognition of these five new justifications, Hochfelder fostered the entrenchment of the duty of care under rule 10b-5. care" something of a misnomer. Nevertheless, this Article uses the "duty of care" phrasing throughout.

Courts advanced three reasons for modifying the duty of care rather than retaining it intact. First, its necessity diminished after the Supreme Court eliminated liability for negligence in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). See supra notes 85-86 and accompanying text.

Second, courts did not perceive the duty of care as a defense to traditional common law fraud, which they analogized to rule 10b-5. See, e.g., Dupuy v. Dupuy, 551 F.2d 1005, 1018-19 (5th Cir.), cert. denied, 434 U.S. 911 (1977); Holdsworth v. Strong, 545 F.2d 687, 694 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977). But cf. Frigitemp Corp. v. Financial Dynamics Fund, Inc., 524 F.2d 275, 282 (2d Cir. 1975) (duty of care had been defense to common law fraud). As Part IV of this Article shows, a split of authority existed among common law courts in 1934 concerning the relevance of the plaintiff's carelessness to deceit actions.

Third, courts believed Congress had attached greater importance to the defendant's intentional fraud than to the plaintiff's negligence. E.g., Dupuy v. Dupuy, 551 F.2d 1005, 1019 (5th Cir.), cert. denied, 434 U.S. 911 (1977). As Parts II and III of this Article demonstrate, the issue of the plaintiff's negligence did not concern Congress, and it is therefore an inappropriate determinant of the scope of rule 10b-5.

The perceived anti-plaintiff trend in the Supreme Court's recent rule 10b-5 decisions may have been an unstated justification for retaining the duty of care. Reconsideration of the duty of care in light of Affiliated Ute and Hochfelder occurred principally between 1976 and 1980, see supra note 7, a time when the Supreme Court was restricting the scope of rule 10b-5. E.g., Chiarella v. United States, 445 U.S. 222 (1980) (silence actionable only where defendant has duty to disclose); Sante Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (liability requires manipulation or deception); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (private plaintiff must be purchaser or seller of security). But cf. Bateman Eichler, Hill Richards, Inc. v. Berner, 105 S. Ct. 2622 (1985)
C. Duty of Care Cases After Affiliated Ute and Hochfelder

Duty of care cases after Affiliated Ute and Hochfelder have attempted to relax the pre-Hochfelder negligence standard. The relaxed standards, all of which are applied subjectively, have taken several forms. The Second, Fifth, Tenth, and Eleventh Circuits measure the duty of care by a recklessness standard, with the burden of proof on the plaintiff. The Seventh Circuit also uses a recklessness standard, but the burden of proof ap-


For why the standard was relaxed rather than retained intact, see supra note 90.

E.g., Nye v. Blyth Eastman Dillon & Co., 588 F.2d 1189, 1197 (8th Cir. 1978); Dupuy v. Dupuy, 551 F.2d 1005, 1016 (5th Cir.), cert. denied, 434 U.S. 911 (1977); Holdsworth v. Strong, 545 F.2d 687, 696-97 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977); Straub v. Vaisman & Co., 540 F.2d 591, 598 (3d Cir. 1976). None of these cases acknowledged that previously some courts had applied the duty of care objectively. See supra note 50 and accompanying text.


E.g., Gower v. Cohn, 643 F.2d 1146, 1156 (5th Cir. 1981); Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111, 1122 (5th Cir. 1980); Dupuy v. Dupuy, 551 F.2d 1005, 1020 (5th Cir.), cert. denied, 434 U.S. 911 (1977).


See cases cited supra notes 102-05. None of these cases explains why the plaintiff should carry the burden of proving the duty of care rather than the defendant.

In the Second Circuit, the plaintiff must prove that he exercised due care only if the defendant places the plaintiff's care in issue. Mallis v. Bankers Trust Co., 615 F.2d 68, 79 (2d Cir. 1980), cert. denied, 449 U.S. 1123 (1981). In the Fifth and Eleventh Circuits, however, the plaintiff must meet this burden of proof in every case. Dupuy v. Dupuy, 551 F.2d 1005, 1014 (5th Cir.), cert. denied, 434 U.S. 911 (1977); White v. Sanders, 689 F.2d 1366, 1369 (11th Cir. 1982). This difference is significant. Compare Fallani v. American Water Corp., 574 F. Supp. 81, 84 (S.D. Fla. 1983) (granting motion to dismiss for failure to allege plaintiff's lack of recklessness) with Savino v. E.F. Hutton & Co., 507 F. Supp. 1225, 1234 n.6 (S.D.N.Y. 1981) (denying motion to dismiss for failure to allege lack of recklessness).

Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1048 (7th Cir.), cert. denied, 434 U.S. 875 (1977). Although the Sundstrand court stated that nonfulfillment of the duty of care requires "gross conduct somewhat comparable to that of defendant," id. (quoting Holdsworth v. Strong, 545 F.2d 687, 693 (10th Cir. 1976), cert. denied, 430
pears to be on the defendant. The standard of care in the Third Circuit is reasonableness, and the defendant bears the burden of proof. Although the Third Circuit standard resembles negligence, it is more lenient than those pre-Hochfelder cases that required the plaintiff to prove a lack of negligence.

Despite these modifications, the post-Hochfelder duty of care potentially has a much harsher impact on plaintiffs than its predecessor. First, the post-Hochfelder duty of care has a much wider scope. Before Hochfelder, courts ordinarily applied the duty of care only when the defendant lacked scienter or when the plaintiff was a securities professional, corporation, or insider. After Hochfelder, the duty of care applies to the claims of all types of investors. For U.S. 955 (1977), the court equated this standard with recklessness in the next paragraph. Id. The rationale for this equation appears to be that a plaintiff's recklessness makes him comparable to the defendant because the defendant can be found liable for reckless conduct. Id. at 1047-48. See also Spatz v. Borenstein, 513 F. Supp. 571, 585 (N.D. Ill. 1981) (equating lack of care with recklessness).

When a particular defendant acts intentionally, however, the question arises as to whether he is comparable to a plaintiff who acts recklessly. Compare Zobrist v. Coal-X, Inc., 708 F.2d 1511 (10th Cir. 1983) (reversing judgment in favor of a reckless plaintiff and against defendant who acted intentionally) with id. at 1520 (Holloway, J., dissenting) (reckless plaintiff should be entitled to recover from defendant who acts intentionally).

108 See, e.g., J.H. Cohn & Co. v. American Appraisal Assocs., 628 F.2d 994, 998 (7th Cir. 1980); Goodman v. Epstein, 582 F.2d 388, 405 & n.47 (7th Cir. 1978), cert. denied, 440 U.S. 939 (1979); Bruce v. Rosenberg, 468 F. Supp. 777, 779 (E.D. Wis. 1979). None of these cases addresses the reasons for placing the burden on the defendant rather than on the plaintiff.


110 E.g., Straub v. Vaisman & Co., 540 F.2d 591, 598 (3d Cir. 1976). The Third Circuit offered the following conclusory justification for placing the burden of proof on the defendant: "the failure to meet . . . [the duty of care] standard is in the nature of an affirmative defense." Id. at 598.

111 See supra note 46 and accompanying text; see also Dupuy v. Dupuy, 551 F.2d 1005, 1017-18 (5th Cir.) (explaining Third Circuit's action in shifting burden of proof from plaintiff to defendant as relaxation of duty of care standard), cert. denied, 434 U.S. 911 (1977).

112 See supra notes 52-56 and accompanying text.

113 See supra notes 57-63 and accompanying text.


Nonfulfillment of the duty of care also has resulted in the dismissal of the claims of plaintiffs who were not insiders, corporations, or securities professionals. See, e.g., Thompson v. Smith Barney, Harris Upham & Co., 709 F.2d 1413 (11th Cir. 1983); Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983); White v. Sanders, 689 F.2d 1366 (11th Cir. 1982). Cf. Goodman v. Epstein, 582 F.2d 388, 405-06 (7th Cir. 1978) (duty of care to be decided at trial), cert. denied, 440 U.S. 939 (1979). See also Siebel v.
example, courts have recently dismissed claims of a businessman, a physician, and citizens of Italy for failing to satisfy the duty of care.

The post-*Hochfelder* duty of care also has a harsher impact than its predecessor when the plaintiff has notice of the need for further inquiry. Before *Hochfelder*, notice did not defeat the claim of an ordinary investor if the defendant acted with scienter. After *Hochfelder*, notice is sufficient to defeat an ordinary investor's claim, as the Tenth Circuit's decision in *Zobrist v. Coal-X, Inc.* illustrates. In *Zobrist* a purchaser of an interest in a limited partnership claimed that he was given oral assurances that the investment was "no risk" after he challenged the defendants' assertions that the investment was a "sure thing" and "couldn't miss." The trial court entered judgment against the defendants. The Tenth Circuit reversed, imputing to the plaintiff knowledge of a private placement memorandum which contained a statement of risks. The court concluded that even if the plaintiff had not read the memorandum before investing, the plaintiff had been reckless to rely on the defendants' oral assurances given their inconsistency with the memorandum.

The reach and impact of the duty of care in rule 10b-5 litigation

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Scott, 725 F.2d 995, 1000 (5th Cir.) (district court's finding of sufficient care not clearly erroneous, although a "close" question), *cert. denied*, 104 S. Ct. 3515 (1984).

A few of the foregoing cases were brought by individual plaintiffs with financial sophistication. *See*, e.g., *Zobrist v. Coal-X, Inc.*, 708 F.2d 1511, 1517 (10th Cir. 1983). Such cases illustrate the duty of care's expansion because they were not brought by insiders, securities professionals, or corporations.


118 *See supra* notes 66-68 and accompanying text.

119 708 F.2d 1511 (10th Cir. 1983). *See also* *White v. Sanders*, 689 F.2d 1366 (11th Cir. 1982). In *White* plaintiffs were purchasers of corporate notes that subsequently became worthless. They alleged that the defendant had misrepresented the safety of the notes as well as his own impartiality. The trial court entered judgment notwithstanding the verdict for the plaintiff. The Eleventh Circuit reversed, concluding that the jury reasonably might have found the plaintiffs "reckless in ignoring certain circumstantial evidence that should have made them suspicious." *Id.* at 1369. *Cf.* *Siebel v. Scott*, 725 F.2d 995, 1001 n.5 (5th Cir.) (court declined to charge plaintiffs with knowledge of statement contained in their prospectuses because defendant's testimony called into question truth of statement), *cert. denied*, 104 S. Ct. 3515 (1984).

120 708 F.2d at 1516.

121 *Id.* at 1514.

122 *Id.* at 1518.

123 *Id.* at 1514. The plaintiff had, however, signed an agreement acknowledging that the investment was subject to risks set forth in the memorandum. *Id.*

124 The court held that the plaintiff should not have relied on the defendants' oral assurances without "further inquiry." *Id.* at 1519.
has expanded enormously after Hochfelder. Parts II, III, and IV of this Article offer a framework for evaluating this expanded doctrine.

II

THE ELEMENTS OF RULE 10b-5: LANGUAGE, HISTORY, AND STATUTORY STRUCTURE

The Supreme Court has repeatedly emphasized that the intent of Congress governs the elements of the rule 10b-5 action. The Court measures this intent by the following factors: the language and history of section 10(b) and rule 10b-5, the structure of the 1933 and 1934 Acts, the policies underlying both those Acts, and the elements of deceit under the common law.125 The duty of care must be evaluated in accordance with this framework.

A. The Language of Section 10(b)

The Supreme Court's rule 10b-5 analysis begins with the language of section 10(b):126 "[W]e turn first to the language of [section] 10(b), for '[t]he starting point in every case involving construction of a statute is the language itself.'"127 Statutory language has nevertheless been of limited usefulness to the Court. The language of section 10(b) has provided partial support for some elements, such as scienter128 and the purchaser-seller requirement.129 Statutory language fails, however, to offer a basis for other elements, such as a duty to disclose in cases challenging the defendant's silence.130

Three principal difficulties arise in inferring the elements of rule 10b-5 from the language of section 10(b). First, the wording of

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125 See supra notes 13-15 and accompanying text.
126 For the text of § 10(b), see supra note 1.
128 See Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (deriving scienter requirement from language and history of § 10(b) and also from statutory structure).
129 See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (deriving purchaser-seller requirement from language of § 10(b), statutory structure, and statutory policy).
130 See Chiarella v. United States, 445 U.S. 222, 228 n.9, 233 (1980) (reversing conviction because duty to disclose, as developed under common law and incorporated into § 10(b), does not exist outside fiduciary relationship). Chief Justice Burger dissented in Chiarella because he considered the duty to disclose requirement to be consistent with the language of § 10(b), which encompasses "any person engaged in any fraudulent scheme." Id. at 240 (Burger, C.J., dissenting) (emphasis in original).

Other rule 10b-5 decisions not predicated upon the language of § 10(b) include Dirks v. SEC, 463 U.S. 646 (1983) (tippee liability) and Herman & MacLean v. Huddleston, 459 U.S. 375, 389 (1983) (establishing appropriate standard of proof in private action).
section 10(b) is imprecise and susceptible to alternative readings. The Court's analysis in Hochfelder is illustrative. In holding that rule 10b-5 requires scienter, the Court relied upon the words "manipulative or deceptive . . . in conjunction with 'device or contrivance.'" The Court first attempted to infer the intent of Congress from the 1934 dictionary definitions of "manipulative," "device," and "contrivance." The Court failed to note, however, that in the history of the 1934 Act, "device" was used synonymously with "practice," a word that does not necessarily support an inference of scienter. The Court also attempted to confer special importance upon the word "manipulative," which it deemed "a term of art [in the securities field] . . . connot[ing] intentional or willful conduct." In doing so, the Court apparently overlooked the fact that the words "manipulative" and "deceptive" are "expressed in the disjunctive, and each should be given its separate meaning."

Indeed, the Hochfelder Court appeared to concede that it could not ground the scienter requirement solely on the language of section 10(b). After announcing that the clarity of the language made "further inquiry . . . unnecessary," the Court nonetheless sought additional support for its conclusion in the legislative history of the 1934 Act. The Court made a similar concession in Santa Fe Industries, Inc. v. Green. After deeming the language of section 10(b) to be "dispositive" of the matter at issue, the Santa Fe Court proceeded to examine policy considerations.

Another difficulty in drawing inferences from the language of section 10(b) is uncertainty over whether this language reflects the intent of Congress in the prima facie case only or in affirmative de-

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132 Id. at 197. The Court also inferred a scienter requirement from the words "[t]o use or employ." Id. at 199 n.20.
133 Id. at 199 nn.20-21 (quoting WEBSTER'S INTERNATIONAL DICTIONARY (2d ed. 1934)). The Court did not seek a dictionary definition for "deceptive," a word that characterizes the consequences of the defendant's acts, not his state of mind. Cox, supra note 52, at 575.
134 Aaron v. SEC, 446 U.S. 680, 707 (1980) (Blackmun, J., concurring in part and dissenting in part) (citing S. REP. No. 792, 73d Cong., 2d Sess. 18 (1934)).
135 425 U.S. at 199.
137 425 U.S. at 201.
138 Id. at 201-06.
140 Id. at 477. The issue in Santa Fe was whether liability under rule 10b-5 could be premised on conduct not involving misrepresentation or nondisclosure. The Court held that misrepresentation or nondisclosure was essential to liability under rule 10b-5. Id. at 474-77. See also Schreiber v. Burlington Northern, Inc., 105 S. Ct. 2458 (1985) (misrepresentation or nondisclosure held essential to liability under § 14(e) of the 1934 Act).
141 430 U.S. at 477-80.
fenses as well. Even in the wake of Bateman Eichler, Hill Richards, Inc. v. Berner, the Court’s first rule 10b-5 decision involving an affirmative defense, this difficulty remains unresolved. In Bateman the Court does not address the lack of support for the in pari delicto defense in the language of section 10(b). Possibly, the Court chose not to refer to the language of section 10(b) because it regarded this language as relevant to the prima facie case only.

A third difficulty pertains solely to the private action. Inferring from section 10(b)’s language elements unique to private actions may be inappropriate because Congress in 1934 did not consider private actions under section 10(b). The Bateman Court may have failed to look to the language of section 10(b) since the affirmative defense at issue pertains only to private actions. This private action difficulty also may account for the Court’s reasoning in Blue Chip Stamps v. Manor Drug Stores, which held that under rule 10b-5 private plaintiffs must be either purchasers or sellers. Although the Court found support for the purchaser-seller requirement in the words “in connection with the purchase or sale,” as well as in the defeat in 1957 and 1959 of proposed amendments which would have added the phrase “any attempt to purchase or sell,” statutory language did not provide the ultimate basis for its decision:

[W]e would by no means be understood as suggesting that we are able to divine from the language of [section] 10(b) the express


144 Cf. Kuehnert v. Texstar Corp. 412 F.2d 700, 705 (5th Cir. 1969) (Godbold, J., dissenting) (rejecting defenses of in pari delicto and unclean hands partly because they are not set out in language of § 10(b) and rule 10b-5).

145 See infra notes 159-61 and accompanying text.

146 See 5C A. Jacobs, supra note 17, § 238.02, at 10-84.

147 421 U.S. 723 (1975).

148 Id. at 733.

"intent of Congress" as to the contours of a private cause of action under Rule 10b-5... It would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 foreordained the present state of the law with respect to Rule 10b-5.150

The Court was somewhat more reluctant in Blue Chip than in Hochfelder151 or Sante Fe152 to rely upon statutory language because only in Blue Chip did the questioned element pertain exclusively to the private action.

The above analysis supports the conclusion that the Court regards the language of section 10(b) as an important starting point but not the sole factor in interpreting rule 10b-5. Other factors become especially important if the questioned element involves either the private action or an affirmative defense.

Determining the appropriateness of the duty of care must, therefore, begin with the language of section 10(b). Even allowing for the imprecision of that language, nothing in section 10(b) suggests that a defendant might avoid liability because of the victim’s carelessness. On the contrary, the entire provision is directed at the defendant’s fraudulent activity; the possibility that the plaintiff might have averted the fraud is not discussed.

The duty of care should not be rejected, however, for lack of a basis in the language of section 10(b) because that language alone does not reliably indicate congressional intent about the duty of care. First, the duty of care is an element unique to private actions,153 which were not considered by Congress in 1934.154 Second, the duty of care is just as plausibly an affirmative defense as an element of the plaintiff’s case.155 If Congress intended section 10(b) to convey only the elements of the prima facie case, and if Congress intended the duty of care to be an affirmative defense, one would not expect to find the duty of care in section 10(b).

B. History of Section 10(b)

The Supreme Court has consistently identified section 10(b)’s

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150 Id. at 737. Statutory policy was the ultimate basis for the decision. See id. at 737-49. Justice Powell concurred "to emphasize the significance of the texts of the Acts of 1933 and 1934 and especially the language of § 10(b) and Rule 10b-5." Id. at 755 (Powell, J., concurring).

151 See supra notes 137-38 and accompanying text.

152 See supra notes 140-41 and accompanying text.

153 See supra note 17.

154 See infra notes 159-61 and accompanying text.

155 The disagreement between the circuits supports the fact that this ambiguity exists. See supra notes 102-11 and accompanying text.
history as an appropriate basis for interpreting rule 10b-5.\textsuperscript{156} As the Court has acknowledged,\textsuperscript{157} however, that history is extremely limited. Indeed, Congress gave scant attention to section 10(b)\textsuperscript{158} and completely failed to consider section 10(b) private actions.\textsuperscript{159} Only two substantive references to section 10(b) appear in the legislative history. One is a statement from the Senate Report that section 10(b) is "aimed at those manipulative and deceptive practices which have been demonstrated to fulfill no useful function."\textsuperscript{160} The other is a statement from the House Hearings by Thomas Corcoran, speaking for the drafters:

Subsection (c) [later section 10(b)] says, "Thou shalt not devise any . . . cunning devices."

\ldots

Of course subsection (c) is a catch-all clause to prevent manipulative devices [sic] I do not think there is any objection to that kind of a clause. The Commission should have the authority to deal with new manipulative devices.\textsuperscript{161}

Section 10(b)'s history has, consequently, seldom provided a basis for the Court's rule 10b-5 decisions.\textsuperscript{162} Although the Court attempted to rely upon this history in \textit{Ernst & Ernst v. Hochfelder},\textsuperscript{163} the attempt was not persuasive. To uphold the scienter requirement, the Court purported to find support in Corcoran's references

\begin{itemize}
  \item \textsuperscript{156} \textit{E.g.}, \textit{Santa Fe Indus., Inc. v. Green}, 430 U.S. 462, 473 & n.13 (1977); \textit{Ernst & Ernst v. Hochfelder}, 425 U.S. 185, 202 (1976).
  \item \textsuperscript{157} \textit{See, e.g}, \textit{Santa Fe Indus., Inc. v. Green}, 430 U.S. 462, 473 n.13 (1977); \textit{Ernst & Ernst v. Hochfelder}, 425 U.S. 185, 201-06 (1976).
  \item \textsuperscript{158} Only two substantive references to § 10(b) appear in the legislative history of the 1934 Act. \textit{See infra} notes 160-61 and accompanying text.
  \item \textsuperscript{159} The legislative history of the 1933 and 1934 Acts is assembled in \textit{Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934} (J. Ellenberger & E. Mahar eds. 1973) [hereinafter cited as \textit{Legislative History}].
  \item \textsuperscript{160} The Supreme Court has recognized that Congress did not contemplate private actions under section 10(b). \textit{E.g.}, \textit{Blue Chip Stamps v. Manor Drug Stores}, 421 U.S. 723, 729 (1975).
  \item \textsuperscript{161} \textit{Stock Exchange Regulation,}, \textit{Hearings on H.R. 7852 & H.R. 8720 Before the House Interstate & Foreign Commerce Comm., 73d Cong., 2d Sess. 115 (1934), reprinted in 8 Legislative History, supra note 158, item 23, at 115.
  \item \textsuperscript{162} \textit{E.g., Herman & MacLean v. Huddleston}, 459 U.S. 375, 389-90 (1983) (legislative history provided no specific basis for determining standard of proof in rule 10b-5 private action); Chiarella v. United States, 445 U.S. 222, 226 (1980) (legislative history provided no direct help in determining whether silence is actionable absent duty to disclose); \textit{Sante Fe Indus., Inc. v. Green}, 430 U.S. 462, 473 & n.13 (1977) (legislative history did not specifically address whether conduct can be actionable absent misrepresentation, deception, or nondisclosure). \textit{But cf.} \textit{Blue Chip Stamps v. Manor Drug Stores}, 421 U.S. 723, 732-33 (1975) (support for purchaser-seller requirement inferred from defeat in 1957 and 1959 of amendments that would have added to § 10(b) the words "attempts to purchase or sell").
  \item \textsuperscript{163} 425 U.S. 185, 201-06 (1976).
\end{itemize}
to "manipulative" and "cunning" devices. The Court then relied upon portions of congressional reports that are of questionable relevance because they are not directed at section 10(b).

Indeed, the Court underscored the probable irrelevance of these reports when it observed that "Congress fashioned standards of fault . . . on a particularized basis" and "ascertainment of congressional intent with respect to the standard of liability created by a particular section . . . rest[s] primarily on the language of that section."

Although analyzing legislative history is an obvious means of discovering congressional intent, the history of section 10(b) is so limited as to be virtually useless in most instances. This history perhaps is least useful when the questioned element is unique to the private action and therefore not even contemplated by Congress.

Thus, for example, legislative history provided no basis for determining the appropriateness of the in pari delicto defense in Bateman Eichler, Hill Richards, Inc. v. Berner.

Nothing in the history of section 10(b) suggests that Congress was concerned about investor carelessness. This lack of concern is an insufficient basis for rejecting the duty of care, however, because it may have resulted from Congress's failure to consider private actions.

C. The Language and History of Rule 10b-5

The Court has repeatedly signaled that rule 10b-5 is governed not only by the language and history of section 10(b), but also

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164 Id. at 203. See supra note 161 and accompanying text.
165 Cox, supra note 52, at 581.
166 425 U.S. at 204-06. The Court conceded that the portions relied upon had not been directed specifically at section 10(b). See id. at 204.
167 Id. at 200.
168 Id. Chief Justice Burger's dissent in Chiarella v. United States, 445 U.S. 222, 239 (1980) (Burger, C.J., dissenting) illustrates the limited usefulness of § 10(b)'s history. The Chief Justice relied upon the statement from the Senate Report that § 10(b) was aimed at "practices which . . . fulfill no useful function," see supra note 160 and accompanying text, in concluding that the silence of someone with material inside information should be actionable without a duty to speak because such silence "serves no useful function." Id. at 241. This reasoning fails to recognize that conduct serving no useful function is impossible to identify with specificity.
169 See supra notes 159-61 and accompanying text.

At least one case upholding the duty of care has acknowledged that the legislative history offers no affirmative support for the duty of care. See Dupuy v. Dupuy, 551 F.2d 1005, 1019 (5th Cir.), cert. denied, 444 U.S. 911 (1977).
172 See supra notes 126-27 and accompanying text.
173 See supra note 156 and accompanying text.
by the language\textsuperscript{174} and history\textsuperscript{175} of the rule itself. Although reliance upon administrative interpretation of statutes is widely accepted,\textsuperscript{176} such reliance is particularly appropriate here because Congress expressly provided in section 10(b) for the promulgation of rules by the SEC.\textsuperscript{177} Unfortunately, the language and history of rule 10b-5 are not especially informative. The brief history consists of a short release,\textsuperscript{178} a paragraph in the SEC's 1942 annual report,\textsuperscript{179} and the subsequent recollections of an SEC staff attorney.\textsuperscript{180} Moreover, issues unique to private actions cannot be meaningfully inferred from the rule's language and history because the SEC gave no consideration to private actions.\textsuperscript{181}

The language and history of rule 10b-5 can help only if they do not expand the scope of section 10(b) in ways prohibited by Con-


\textsuperscript{175} E.g., Chiarella v. United States, 445 U.S. 222, 226 & n.7 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 & n.32 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 736 n.8 (1975).

\textsuperscript{176} See, e.g., Udall v. Tallman, 380 U.S. 1, 16 (1965).

\textsuperscript{177} For the text of \S\ 10(b), see supra note 1.

\textsuperscript{178} SEC Securities Exchange Act Release No. 3230 (May 21, 1942), reprinted in 5 A. JACOBS, THE IMPACT OF RULE 10b-5 \S 5.02, at 1-128 (1980). The release prefaces the text of the rule as follows:

The Securities and Exchange Commission today announced the adoption of a rule prohibiting fraud by any person in connection with the purchase of securities. The previously existing rules against fraud in the purchase of securities applied only to brokers and dealers. The new rule closes a loophole in the protection against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase. The text of the Commission's action follows:

The Securities and Exchange Commission, deeming it necessary for the exercise of the functions vested in it and necessary and appropriate in the public interest and for the protection of investors so to do, pursuant to authority conferred upon it by the Securities Exchange Act of 1934, particularly Sections 10(b) and 23(a) thereof, hereby adopts the following Rule X-10B-5 . . . .

\textsuperscript{179} 8 SEC ANN. REP. 10 (1942). Entitled "[r]ule for additional protection to investors," the paragraph states only as follows:

During the fiscal year the Commission adopted Rule X-10B-5 as an additional protection to investors. The new rule prohibits fraud by any person in connection with the purchase of securities, while the previously existing rules against fraud in the purchase of securities applied only to brokers and dealers.

\textsuperscript{180} See Conference on Codification of the Federal Securities Laws, 22 BUS. LAW. 793, 921-22 (1967) (remarks of Milton Freeman). Freeman explained that the commissioners upon approving rule 10b-5 simply commented, "[W]e are against fraud, aren't we?" Id. at 922.

\textsuperscript{181} See supra notes 178-80 and accompanying text.
gress. In *Ernst & Ernst v. Hochfelder*, for example, the Court rejected an argument against scienter predicated on subsections (b) and (c) of the rule. After conceding that these subsections might by themselves embrace liability without scienter, the Court ruled that the scope of rule 10b-5 “cannot exceed the power granted the Commission by Congress under [section] 10(b).” The *Hochfelder* Court did not foreclose the possibility, however, that the scope of rule 10b-5 could be narrower than that of section 10(b).

Neither the language nor the history of rule 10b-5 provides support for the duty of care. The language of the rule, like that of the statute under which it was promulgated, exclusively addresses the defendant’s fraud, not the possibility that under different circumstances the fraud might have been averted. Moreover, nothing in the history of rule 10b-5 demonstrates that the SEC was concerned about investor carelessness. The remaining factors require further investigation because the absence of support from the administrative language and history may be attributable to SEC inattention to private actions.

D. Statutory Structure

The Supreme Court has identified statutory structure as a basis for interpreting rule 10b-5. The Court’s concern with statutory structure has three aspects: (1) language, (2) express remedies, and (3) other sections providing inferences about section 10(b).

1. Language

The Court has interpreted section 10(b) by contrasting its language with the language of other sections of the 1933 and 1934

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183 *Id.* at 212-14.
184 *Id.* at 212.
185 *Id.* at 214.
186 *Cf.* Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 543-44 (2d Cir. 1967) (conceding that language of rule does not require reasonable reliance); Herpich v. Wallace, 450 F.2d 792, 804-05 (5th Cir. 1970) (same).
187 *See supra* notes 178-80 and accompanying text.
188 For the text of § 10(b), *see supra* note 1.
189 If rule 10b-5 did provide for a duty of care, its scope would be narrower than that of § 10(b). This result would be consistent with the Court's decision in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). *See supra* notes 182-85 and accompanying text.
190 *See supra* notes 178-80 and accompanying text.
Acts. The Court has, however, failed to recognize that these contrasts sometimes lack meaning, as the Court's decision in *Blue Chip Stamps v. Manor Drug Stores* illustrates.

In *Blue Chip Stamps* the Court upheld the purchaser-seller requirement in private actions under rule 10b-5, based in part on the contrasting language of section 16(b), which expressly authorizes private actions by plaintiffs who have neither purchased nor sold. The Court noted that section 10(b) contains no comparable authorization for private actions and concluded that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly." The Court thus implied that section 10(b) reflected an affirmative congressional decision to deny standing to those who were not purchasers or sellers.

This reasoning fails to consider the most plausible explanation for the difference between section 16(b) and section 10(b). Under section 16(b) Congress expressly provided for private actions and therefore had to identify the appropriate private plaintiff. In contrast, Congress did not contemplate private actions under section 10(b); hence, Congress had no occasion to identify the appropriate private plaintiff. The purpose of contrasting the language of section 10(b) with the language of other sections is to clarify Congress's choice of words in section 10(b). These contrasts are least valuable when they involve matters not considered by Congress in drafting section 10(b): elements unique to the private action or not a part of the prima facie case.

In contrast to section 10(b), three sections of the 1933 Act expressly impose a "duty of care." One imposes the duty on the plain-

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195 Section 16(b) provides in relevant part:

> [A]ny profit realized by [a beneficial owner, director, or officer] from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months, . . . shall inure to and be recoverable by the issuer . . . . Suit to recover such profit may be instituted . . . . by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer. . . .

*Id.*

196 421 U.S. at 734. The Court also gave weight to the contrast between the "'in connection with the purchase or sale' of securities" language from § 10(b) and the "'in the offer or sale' of securities" language from § 17(a) of the 1933 Act, 15 U.S.C. § 77q (1982). *Id.* at 733-34.
197 See supra notes 159-61 and accompanying text.
198 See supra notes 145-52 and accompanying text.
199 See supra notes 142-44 and accompanying text.
tiff, and two impose it on the defendant. An express remedy for fraud in a registration statement, provides the defendant with a defense if he "had, after reasonable investigation, reasonable ground to believe . . . that the statements therein were true." Similarly, section 12(2), an express remedy for fraud in prospectuses and communications, provides the defendant with a defense if he "did not know, and in the exercise of reasonable care could not have known of [the fraud]." Section 13, the statute of limitations for actions under section 11 and section 12(2), allows actions to be brought within one year after discovery of the fraud "should have been made by the exercise of reasonable diligence." These three sections indicate that Congress's willingness to penalize carelessness expressly, regardless of whether the duty is imposed on the plaintiff or the defendant.

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200 See infra note 206 and accompanying text.  
201 See infra notes 202-05 and accompanying text. Imposing a duty of care manifests Congress's willingness to penalize carelessness expressly, regardless of whether the duty is imposed on the plaintiff or the defendant.  
203 Section 11(b) provides a defense for a nonexpert defendant concerning the portion of the registration statement not prepared by an expert. It reads as follows:  
[N]o person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—  

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . .

Id.  
204 1933 Act § 12(2), 15 U.S.C. § 771(2) (1982) [hereinafter cited as section 12(2)]. Section 12(2) reads as follows:  
Any person who—  

(2) offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him . . . .

Id.  
205 Id.  
206 1933 Act § 13, 15 U.S.C. § 77m (1982) [hereinafter cited as section 13]. Section 13 reads in pertinent part: "No action shall be maintained to enforce any liability created under [§ 11] or [§ 12(2)] of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . ." Id.  
207 Id.
gress did not hesitate to penalize carelessness expressly, and therefore, it is arguable that its failure to do so in section 10(b) was intentional.

The problem with this argument is that the language of section 10(b) may not reliably reflect congressional intentions concerning the duty of care. The duty of care is unique to private actions, which Congress did not consider.\textsuperscript{208} In addition, the duty of care may be an affirmative defense rather than a part of the prima facie case.\textsuperscript{209} Section 10(b) may be exclusively addressed to the prima facie case.\textsuperscript{210} The absence of a duty of care from section 10(b), therefore, may imply nothing about congressional intent. Given this possibility, it would seem imprudent to attach significance to contrasts between section 10(b) and sections 11, 12, and 13.

Sectional comparisons as to the duty of care, however, are far from meaningless. The express remedies\textsuperscript{211} do not impose a duty of care on the plaintiff.\textsuperscript{212} The absence of a plaintiff's duty of care from the express remedies indicates that Congress did not regard the duty of care as an inevitable component of a private action.

2. Express Remedies

The Court has sought to avoid interpretations of rule 10b-5 that would nullify the express remedies and thereby ostensibly violate congressional intent.\textsuperscript{213} The Court’s decisions in \textit{Ernst & Ernst}...
v. Hochfelder\textsuperscript{214} and Blue Chip Stamps v. Manor Drug Stores\textsuperscript{215} illustrate this analysis. In Hochfelder the Court focused on the absence of a scienter requirement in sections 11 and 12(2) in holding that rule 10b-5 requires scienter.\textsuperscript{216} The Hochfelder Court observed that sections 11 and 12 contain procedural barriers not present in section 10(b).\textsuperscript{217} The Court reasoned that if rule 10b-5 did not require scienter, plaintiffs would cease using sections 11 and 12(2), thereby nullifying those causes of action and their accompanying procedural barriers.\textsuperscript{218} Similarly, in Blue Chip Stamps, the Court upheld the purchaser-seller requirement in part because all of the express remedies were limited to purchasers and sellers: “It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.”\textsuperscript{219}

Although the impact on the express remedies is a factor to consider when interpreting rule 10b-5, the Court has indicated that a marginal negative impact on the express remedies that is short of nullification ought not to affect interpretation of the rule. In Herman & MacLean v. Huddleston\textsuperscript{220} the Court held that conduct actionable under section 11 could be actionable under rule 10b-5 because there was no risk of section 11’s nullification.\textsuperscript{221} The Court offered no objection to possible reduced utilization of section 11 resulting from giving plaintiffs a choice between section 11 and rule 10b-5.

Eliminating the duty of care under rule 10b-5 would not nullify the express remedies. Eliminating rule 10b-5’s duty of care would merely achieve equalization because none of the express remedies imposes a duty of care on the plaintiff.\textsuperscript{222} Rule 10b-5 and the express remedies would still retain virtually all their present advantages and disadvantages. For example, unlike sections 11 and 12(2), rule 10b-5 would still require scienter, but it would lack the proce-

\textsuperscript{214} 425 U.S. 185 (1976).
\textsuperscript{215} 421 U.S. 723 (1975).
\textsuperscript{216} See 425 U.S. at 208-09.
\textsuperscript{217} Id. at 209-10. These procedural barriers, set forth in § 11(e), apply at the district court’s discretion and include the posting of a bond at the start of the action and assessment of costs at the end of the action. See id.
\textsuperscript{218} Id. at 210-11.
\textsuperscript{219} 421 U.S. at 736.
\textsuperscript{220} 459 U.S. 375 (1983).
\textsuperscript{221} Id. at 382-84. Another reason that the Huddleston Court held § 11 and rule 10b-5 to be cumulative remedies was that “the two provisions involve distinct causes of action and were intended to address different types of wrongdoing.” Id. at 381. Section 11 “was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering.” Id. at 381-82 (footnotes omitted). Rule 10b-5, in contrast, is a “catchall” fraud provision requiring scienter. Id. at 382.
\textsuperscript{222} See supra note 212 and accompanying text.
dural barriers of those sections.\textsuperscript{223} Elimination of the duty of care might increase the use of rule 10b-5 and concomitantly decrease utilization of the express remedies. This possibility, however, is highly speculative and by no means constitutes nullification.

3. Other Sections Providing Inferences About Section 10(b)

The Supreme Court has examined other statutory sections capable of providing inferences about section 10(b).\textsuperscript{224} In Blue Chip Stamps v. Manor Drug Stores,\textsuperscript{225} for example, the Court assessed the purchaser-seller requirement in light of section 28(a),\textsuperscript{226} which limits recovery in any 1934 Act private action to "actual damages."\textsuperscript{227} The Court found the purchaser-seller requirement consistent with section 28(a) on the ground that a purchaser or seller would more easily establish actual damages than would a person who is neither.\textsuperscript{228} Similarly, in Dirks v. SEC\textsuperscript{229} the Court held a ban on tippee trading consistent with section 20(b).\textsuperscript{230} Because section 20(b) makes illegal violations of the 1934 Act committed "through or by means of any other person,"\textsuperscript{231} the Court reasoned that it outlawed trades by tippees that benefit insiders.\textsuperscript{232}

The duty of care cannot be reconciled with section 29(a) of the 1934 Act.\textsuperscript{233} In recognition of the weak relative bargaining position of investors,\textsuperscript{234} section 29(a) voids "[a]ny condition, stipulation, or

\textsuperscript{223} See supra note 217 and accompanying text. Nor does it appear likely that eliminating the duty of care under rule 10b-5 would significantly affect the largely ignored § 9(e), described by Professor Loss as "no bargain." See L. Loss, supra note 212, at 1052. Nor would it affect the likewise ignored § 18, described as no better than common law deceit. See id. at 1055.

\textsuperscript{224} See infra notes 225-32 and accompanying text.

\textsuperscript{225} 421 U.S. 723 (1975).

\textsuperscript{226} Section 28(a) of the 1934 Act, 15 U.S.C. § 78bb(a) (1982) [hereinafter cited as section 28(a)]. Section 28(a) reads in pertinent part: "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover . . . a total amount in excess of his actual damages on account of the act complained of." Id.

\textsuperscript{227} Id.

\textsuperscript{228} 421 U.S. at 734-35. The Court also found the purchaser-seller requirement consistent with § 29(b) of the 1934 Act, 15 U.S.C. § 78cc(b) (1982) [hereinafter cited as section 29(b)]. The Court noted that § 29(b), which makes contracts in violation of the 1934 Act voidable, is sometimes mentioned as a justification for implying a private action under § 10(b), "[b]ut that justification is absent when there is no actual purchase or sale of securities, or a contract to purchase or sell . . . ." 421 U.S. at 735.

\textsuperscript{229} 463 U.S. 646 (1983).

\textsuperscript{230} Section 20(b) of the 1934 Act, 15 U.S.C. § 78t(b) (1982) [hereinafter cited as section 20(b)]. Section 20(b) reads as follows: "It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person." Id.

\textsuperscript{231} Id.

\textsuperscript{232} 463 U.S. at 659.

\textsuperscript{233} Section 29(a), supra note 27.

\textsuperscript{234} Even sophisticated investors are protected by § 29(a). Cf. Esposito v. Sweeney,
provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder.” As the Supreme Court explained in connection with the parallel 1933 Act provision:

Section 29(a) reflects the judgment that penalizing investors for their own mistakes is less important than prosecuting the Act’s violators. Under section 29(a), for example, an investor retains his 1934 Act rights if a purchase contract provision has waived them.

No. 80 C 2861 (N.D. Ill. May 13, 1982) (available on LEXIS, Genfed library, Dist. file) (voiding under § 29(a) a contractual provision of nonreliance notwithstanding plaintiff’s alleged sophistication); Brown v. Gilligan, Will & Co., 287 F. Supp. 766, 772 (S.D.N.Y. 1968) (noting that broker-dealers are protected by 1933 Act provision that parallels § 29(a)).

Section 29(a), supra note 27. Justice White has suggested that the words “waive compliance with any provision of this chapter” in § 29(a) are “literally inapplicable” to private rule 10b-5 actions, because such actions were judicially implied rather than created by Congress. See Dean Witter Reynolds, Inc. v. Byrd, 105 S. Ct. 1238, 1244 (1985) (White, J., concurring) (emphasis in original). Lower courts have not adopted Justice White’s position. See, e.g., cases cited supra note 234. Assuming that Justice White’s position were adopted someday by the Court, assessment of the duty of care by reference to § 29(a) would remain appropriate. Section 29(a) would still reflect the intent of Congress and thereby provide a basis for inferring the sort of private action Congress might have constructed under § 10(b) had it considered such actions. A contrary conclusion would suggest that statutory structure is irrelevant to interpreting rule 10b-5 private actions.

The parallel 1933 Act provision is § 14 of the 1933 Act, 15 U.S.C. § 77n (1982) [hereinafter cited as section 14]. Section 14 reads as follows: “Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.” Id.

Wilko v. Swan, 346 U.S. 427, 435 (1953). In Wilko an agreement to require arbitration was voided pursuant to § 14.

The only substantive comment in the legislative history concerning § 29(a) was that the section was “taken verbatim out of the Securities Act.” Stock Exchange Practices: Hearings on S. Res. 56 & S. Res. 97 (73d Cong.) Before the Senate Banking and Currency Comm., 73d Cong., 2d Sess. 6578 (1934), reprinted in 6 LEGISLATIVE HISTORY, supra note 158, item 22, at 6578 (statement of Thomas Corcoran, spokesman for drafters). The history of the 1933 Act, however, is silent concerning the scope of § 14. See generally Federal Securities Act 1933: Hearings on H. 4314 Before the House Comm. of Interstate and Foreign Commerce, 73d Cong., 1st Sess. (1933), reprinted in 2 LEGISLATIVE HISTORY, supra note 158, item 58, at 17-19, 110, 147-48, 170, 222; Securities Act 1933: Hearings on S. 875 Before the Senate Comm. on Banking & Currency, 73d Cong., 1st Sess. (1933), reprinted in 2 LEGISLATIVE HISTORY, supra note 158, item 21, at 86-87, 175, 277.

even if the waiver was intentional.\textsuperscript{239}

Section 29(a) is not, however, limited to waivers of the right to sue. Investors who contractually acknowledge nonreliance are nonetheless entitled to prove reliance in court. In \textit{Rogen v. Ilikon Corp.},\textsuperscript{240} for example, a sales contract acknowledged that the plaintiff and his father were "fully familiar with the business and prospects of the corporation, [were] not relying on any representations or obligations to make full disclosure with respect thereto, and [had] made such investigation thereof as they deem[ed] necessary."\textsuperscript{241} The defendant argued that this acknowledgment established nonreliance as a matter of law. The First Circuit rejected the argument:

\begin{quote}
[W]e see no fundamental difference between saying, for example, "I waive any rights I might have because of your representations or obligations to make full disclosure" and "I am not relying on your representations or obligations to make full disclosure." Were we to hold that the existence of this provision constituted the basis (or a substantial part of the basis) for finding non-reliance as a matter of law, we would have gone far toward eviscerating Section 29(a).\textsuperscript{242}
\end{quote}

Thus, Congress effectively has eliminated waiver of unmatured claims in order to maximize the efficacy of the securities acts.\textsuperscript{243}

Although section 29(a) does not by its terms prohibit the duty of care and duty of care determinations typically do not involve waivers,\textsuperscript{244} section 29(a) and the duty of care nonetheless have antithetical underlying philosophies. By safeguarding even deliberately waived claims, section 29(a) recognizes the informational advantage of securities defendants over securities plaintiffs and places the highest value upon enforcement of violations. The duty of care, on the other hand, compromises enforcement in order to penalize in-


\textsuperscript{241} 361 F.2d 260 (1st Cir. 1966).

\textsuperscript{242} \textit{Id.} at 265.

\textsuperscript{243} See supra notes 18-20 and accompanying text.

vestor carelessness. Congress’s enactment of section 29(a) strongly suggests that had Congress addressed section 10(b) private actions, it would have decisively rejected the duty of care.

III

ELEMENTS OF RULE 10b-5: STATUTORY POLICY

The Supreme Court has consistently looked to the underlying policies of the 1933 and 1934 Acts in interpreting rule 10b-5.\textsuperscript{245} Only once has the Court found language, structure, and history sufficiently dispositive to make considering policy unnecessary.\textsuperscript{246} The Court has, moreover, provided guidelines for the identification and application of relevant policies.

The first guideline is that only policies with demonstrable importance to Congress can be used to interpret rule 10b-5. The Court’s decision in \textit{Santa Fe Industries, Inc. v. Green}\textsuperscript{247} offers an illustration. In limiting rule 10b-5 to conduct involving misrepresentation or nondisclosure, the Court rejected an argument that rule 10b-5 embraced all security-related “unfairness.”\textsuperscript{248} Reasoning that the principal purpose of the 1934 Act was “‘to substitute a philosophy of full disclosure for the philosophy of \textit{caveat emptor},’”\textsuperscript{249} the Court concluded that “once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute.”\textsuperscript{250} Similarly, in \textit{Blue Chip Stamps v. Manor Drug Stores},\textsuperscript{251} the Court applied the policy of curbing vexatious litigation only after establishing the importance of that policy to Congress.\textsuperscript{252}

The Court’s second guideline is that conflicting policies must be balanced against each other. In \textit{Blue Chip}, for example, the Court evaluated the purchaser-seller requirement in terms of two conflicting policies: curbing vexatious litigation and protecting worthy plaintiffs. In the Court’s view, the purchaser-seller requirement

\textsuperscript{246} \textit{See Ernst & Ernst v. Hochfelder}, 425 U.S. 185, 214 n.33 (1976). In \textit{Santa Fe Indus., Inc. v. Green}, 430 U.S. 462 (1977), the Court first suggested that policy considerations might be superfluous, \textit{see id.} at 477, but nonetheless proceeded to examine policy, \textit{see id.} at 477-80. In \textit{Chiarella v. United States}, 445 U.S. 222 (1980), the Court attempted to derive a relevant policy from the legislative history but was unsuccessful. \textit{See id.} at 233 (no evidence of congressional support for general prohibition against trading on inside information).
\textsuperscript{247} 430 U.S. 462 (1977).
\textsuperscript{248} \textit{Id.} at 477.
\textsuperscript{249} \textit{Id.} (quoting \textit{Affiliated Ute Citizens v. United States}, 406 U.S. 128, 151 (1972)).
\textsuperscript{250} \textit{Id.} at 478.
\textsuperscript{251} 421 U.S. 723 (1975).
\textsuperscript{252} \textit{Id.} at 740-41.
curbed vexatious litigation by facilitating pre-trial dismissal of all actions except those where the plaintiffs "actually purchased or actually sold, and whose version of the facts is therefore more likely to be believed by the trier of fact." On the other hand, the Court found the purchaser-seller requirement to be at variance with protection of those few plaintiffs who are neither purchasers nor sellers, but are actually injured by fraud. The Court concluded that the value of curbing vexatious litigation outweighed the harm of barring recovery to these plaintiffs.

Finally, the Court has viewed the absence of an identifiable statutory policy as potentially implying congressional endorsement of established legal principles. An illustration is provided by the Court's decision in *Chiarella v. United States*, which held that silence is not actionable absent a duty to speak. The Court reasoned that a contrary holding required "recognizing a general duty between all participants in market transactions to forego actions based on material, nonpublic information." Such a duty, the Court observed, "departs radically from the established [tort] doctrine," and hence "should not be undertaken absent some explicit evidence of congressional intent."

The Court's guidelines for identifying and applying statutory policy supply the appropriate context for examining the policies advanced by lower courts in justification of the duty of care. These guidelines are also helpful in analyzing the conflict between the duty of care and the policy of enforcing section 10(b).

A. Policies Advanced By Lower Courts in Justification of the Duty of Care

Lower courts have attempted to justify the duty of care on the basis of five policies: (1) deterrence of investor carelessness, (2) promotion of anti-fraud policies, (3) fairness, (4) promotion of market stabilization, and (5) provision of a causal link between the defendant's fraud and the plaintiff's injury. An analysis of each of these policies reveals that none survives scrutiny.

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253 *Id.* at 743.
254 *Id.*
255 *Id.* The danger of abuse from oral testimony was an additional reason to avoid vexatious litigation. *Id.* at 743-44.

The duty of care does not further the policy of curbing vexatious litigation. Unlike the question of whether the plaintiff actually bought or sold, the question of the plaintiff's care is a jury question not resolvable by pre-trial motion. Greenwald v. Integrated Energy, Inc., 102 F.R.D. 65, 70 (S.D. Tex. 1984) (collecting cases).
257 *Id.* at 233.
258 *Id.*
1. **Deterrence of Investor Carelessness**

At least one federal appellate court has asserted that the duty of care is necessary to deter investor carelessness.\(^{259}\) Nothing in the history of the 1934 Act, however, suggests that Congress intended to penalize careless investors.\(^{260}\) Congress was concerned with penalizing the perpetrators of fraud, not its victims.\(^{261}\) The policy of deterring investor carelessness, therefore, does not justify the duty of care. Nor can the duty of care be justified on the ground that it was a firmly entrenched principle of common law deceit in 1934 which Congress endorsed by not affirmatively rejecting. In 1934 common law jurisdictions were divided as to the appropriateness of a duty of care in deceit actions.\(^{262}\)

2. **Promotion of Anti-Fraud Policies**

A federal appellate court has suggested that the duty of care promotes anti-fraud policies, apparently on the theory that fraud will fail when investors are careful.\(^{263}\) This suggestion is unsound. The argument assumes that fraud is most appropriately addressed through vigilance by victims of fraud rather than by prosecution of defrauders. The entire thrust of the 1933 and 1934 Acts is contrary to this position. Congress chose to regulate and impose penalties on defrauders as the most effective means of eliminating fraud.\(^{264}\)

3. **Fairness**

"Fairness" is said to require a duty of care that limits access to rule 10b-5 to "those who have pursued their own interests with care and good faith."\(^{265}\) This position is without merit. In *Sante Fe Industries, Inc. v. Green*,\(^{266}\) the Supreme Court specifically rejected fairness as a basis for interpreting rule 10b-5.\(^{267}\) Even if fairness is relevant, it does not justify the duty of care. Fairness by no means requires absolving blameworthy defendants in order to penalize careless
plaintiffs. More plausibly, fairness requires penalizing the wrongdoer, despite the sloppiness of his victim.

4. Stabilizing the Markets

The duty of care is said to stabilize the markets, ostensibly on the theory that greater investor caution will result in fewer market swings.268 This claim is without merit. Imposing a duty of care on investors will have little effect on market stability because the duty of care issue is litigated largely in the context of close corporations269 and private placements,270 where no public market exists to be stabilized.

5. Causation

Some courts have maintained that the duty of care is necessary to establish causation,271 on the theory that injury to a careless plaintiff results from his own lack of diligence, not from the defendant’s fraud.272 This position is unsound. Causation is not an absolute concept; rather it “is used . . . to identify those pressure points that are most amenable to the social goals we wish to accomplish.”273 At present, one pressure point is the plaintiff’s recklessness.274 Previously, the analogous pressure point was the plaintiff’s negligence.275 Neither point is fixed; the pressure point is simply the factor in the chain of causation that is most amenable to change and will serve to avoid the unwanted result.276 Causation might just as easily be limited to actual reliance: as long as the plaintiff in fact relied on the fraudulent misrepresentation or omission, the fraud should be deemed to have caused the plaintiff’s injury.277

B. The Policy of Enforcing Section 10(b)

In Bateman Eichler, Hill Richards, Inc. v. Berner,278 the Supreme Court held that enforcement considerations constitute a significant policy against which to interpret rule 10b-5. Enforcement considerations, the Court held, are fully applicable to implied private federal

268 See supra note 94 and accompanying text.
269 See supra note 38 and accompanying text.
270 See supra note 39 and accompanying text.
271 For the elements of a rule 10b-5 private action, see supra note 17.
272 See supra note 97 and accompanying text.
274 See supra notes 102-05, 107 and accompanying text.
275 See supra note 44 and accompanying text.
276 Calabresi, supra note 273, at 106.
277 The plaintiff still would carry a significant burden of proof. See infra notes 330-31 and accompanying text.
securities actions. Such actions were said to serve as a "‘necessary supplement to Commission action.’” The Court might have noted further that Congress at least implicitly has ratified the enforcement function of private actions by never affirmatively prohibiting them.

*Bateman* was an action by tippees against their tippers. The plaintiffs, ordinary investors, charged that a corporate insider and a broker deliberately provided them with material nonpublic information that was false. Following losing trades based on this information, the plaintiffs sued under rule 10b-5. The defendants relied upon the *in pari delicto* defense: they argued that by trading on nonpublic information, the plaintiffs had become securities law violators and were therefore not entitled to sue. The Supreme Court rejected the defense because of enforcement considerations and the defendants' greater culpability.

The Court outlined a two-prong test to determine when to permit the defense. The defendant must prove that (i) the plaintiff and the defendant had been equal participants in the violation at issue, and (ii) dismissal of the action "would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public." The Court initially sought to determine


281 *In pari delicto* is Latin for "of equal fault." BLACK'S LAW DICTIONARY 711 (5th ed. 1979).


283 *Id.* at 2629. There were three views as to the appropriate application of the standard. Under one view, the standard could never be met; tippers were precluded as a matter of law from invoking the defense. According to this view, the tipper inevitably is more blame-
the relative culpability of the parties under the first prong. This finding, however, is closely linked to the goal of the second prong because the relative culpability of the parties largely determines whether allowing the defense in a given case furthers effective enforcement of the securities laws.\textsuperscript{284} Thus, although enforcement concerns are the express focus of the second prong, they are implied in the first prong as well. Indeed, enforcement is no better served by disallowance of the defense than by allowance when the plaintiff and the defendant are equally culpable.\textsuperscript{285}

Applying the first prong, the Court held that insiders and brokers who tip are more culpable than their tippees, at least absent special circumstances. While conceding that the plaintiffs "may well

worthy than the tippee, because the tipper "is at the fountainhead of the confidential information" and possesses the capacity to wreak greater harm. Nathanson v. Weis, Voisin, Cannon, Inc., 325 F. Supp. 50, 57 (S.D.N.Y. 1971). Moreover, maintaining the action conferred greater benefit to the investing public: "If the prophylactic purpose of the law is to restrict the use of all material inside information until it is made available to the investing public, then the most effective means of carrying out this policy is to nip in the bud the source of the information, the tipper." \textit{Id.} See Kuehnert v. Texstar Corp., 412 F.2d 700, 706 (5th Cir. 1969) (Godbold, J., dissenting) ("The best way to stop the misuse of confidential material is to discourage the insider-tipster from making the initial disclosure which is the first step in the chain of dissemination."); Moholt v. Dean Witter Reynolds, Inc., 478 F. Supp. 451 (D.D.C. 1979) (broker's greater culpability bars use of \textit{in pari delicto} defense).

A second view focused upon the particular circumstances, rather than upon tippers and tippees collectively. Under this view, the defense was disallowed when the plaintiff's illegal role was tangential to the conspiracy, see Chemetron Corp. v. Business Funds, Inc., 682 F.2d 1149, 1182 (5th Cir. 1982), \textit{vacated on other grounds}, 460 U.S. 1007 (1983), but allowed when the plaintiff's role was central to the conspiracy, see James v. Du Breuil, 500 F.2d 155, 159 (5th Cir. 1974). Moreover, even when the plaintiff's violations were equal in magnitude to the defendant's, the defense could still be disallowed if to do so were consistent with enforcement considerations specific to the case. For example, the defense was denied to a defendant who issued private placements because "[t]he private action . . . arguably occupies an even more important place in the area of private placements than in other areas of Securities Act enforcement where activities of an issuer must both be reported to and approved by the S.E.C." Woolf v. S.D. Cohn & Co., 521 F.2d 225, 227-28 (5th Cir. 1975), \textit{vacated and remanded on other grounds}, 426 U.S. 944 (1976). \textit{Cf.} James v. Du Breuil, 500 F.2d 155, 160 (5th Cir. 1974) (defense allowed partly because public was not implicated directly in transaction).

Under the third view, tippers apparently could always invoke the defense. Courts adopting this view regarded tippers and tippees as equally blameworthy; the lawsuit between them was said to amount to an "accounting between joint conspirators." Kuehnert v. Texstar Corp., 412 F.2d 700, 703 (5th Cir. 1969). Moreover, courts viewed allowing the defense to be more beneficial to the investing public because disallowance provided tippees with a virtual warranty. If the tip was not profitable, the tippee simply could sue the tipper. Tarasi v. Pittsburgh Nat'l Bank, 555 F.2d 1152, 1163-64 (3d Cir.), \textit{cert. denied}, 434 U.S. 965 (1977); Kuehnert v. Texstar Corp., 412 F.2d 700, 705 (5th Cir. 1969).

For a discussion of the status of the \textit{in pari delicto} defense after \textit{Bateman}, see infra note 293.\textsuperscript{284} 105 S. Ct. at 2632.\textsuperscript{285} \textit{Cf.} \textit{Perma Life Mufflers, Inc. v. International Parts Corp.}, 392 U.S. 134, 146 (1968) (White, J., concurring).
have violated the securities laws," the Court noted that "there are important distinctions between the relative culpabilities of tippers, securities professionals, and tippees in these circumstances." First, the Court observed that because a tippee's liability is "solely derivative" from the tipper, the tippee usually is less culpable. Second, the Court noted that insiders and brokers who tip may commit additional offenses not committed by their tippees, such as violating fiduciary duties owed the issuer and defrauding the tippee. Such offenses, according to the Court, are "particularly egregious when committed by a securities professional."

Applying the second prong, the Court held that under the circumstances dismissal of the action would thwart enforcement. Noting the SEC's scarce resources, the Court pointed out that if tippees could not sue tippers for fraud, many violations would remain unprosecuted. The Court reasoned that by permitting tippees' actions against brokers and insiders, the "sources" of inside information, insider trading would be deterred.

Although Bateman addressed only the in pari delicto defense, the decision applies equally to other common law doctrines. If this defense is subordinate to enforcement considerations, there is no principled basis for preventing subordination of other common law doctrines that are antithetical to enforcement.

Common law doctrines that foster statutory enforcement may be retained. In American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp. the Court upheld the defendants' antitrust liability based on a common law "apparent authority" theory.

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286 105 S. Ct. at 2631.
287 Id. at 2630.
289 Id.
290 Id.
291 Id. at 2631.
292 Id. at 2631-32.
293 Id. at 2632. The Court also observed that securities professionals were more apt to be cognizant of possible penalties than ordinary investors. Thus, imposing penalties on professionals instead of investors would be more likely to have a deterrent effect. Id.
295 Id. at 570.
Although *American Society* was an antitrust case, it applies to securities cases as well. Indeed, both *American Society* and *Bateman* relied upon *Perma Life Mufflers, Inc. v. International Parts Corp.*, an antitrust decision that the *Bateman* court held "appl[ied] with full force" to implied federal securities actions. In *Perma Life* the Court rejected an *in pari delicto* defense as inconsistent with statutory enforcement. By endorsing application of tort law only so long as it bolsters statutory enforcement, *American Society* provides a corollary to *Perma Life* and *Bateman*. The *American Society* Court explained:

In the past, the Court has refused to permit broad common-law barriers to relief to constrict the antitrust private right of action. It stated [in *Perma Life*] that "the purposes of the antitrust laws are best served by insuring that the private action will be an ever-present threat" to deter antitrust violations. In *Perma Life* . . . the Court honored that purpose by denying defendants the right to invoke a common-law defense (the doctrine of *in pari

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296 Id. at 569-70.
297 See infra note 299 and accompanying text.
299 105 S. Ct. at 2629. The Court equated the enforcement goals of private securities actions with those of antitrust actions, despite the fact that treble damages are available only in antitrust actions. Cf. *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F. Supp. 50, 56 (S.D.N.Y. 1971) (noting unavailability of treble damages to private securities plaintiffs). One commentator has dismissed this distinction on the ground that antitrust plaintiffs are accorded treble damages in part to counteract the threat of later retaliation by defendants with whom they often share a market. See Note, *The Demise of In Pari Delicto in Private Actions Pursuant to Regulatory Schemes*, 60 Calif. L. Rev. 572, 573 n.6, 590 n.96 (1972).
300 In *Perma Life*, the plaintiff Midas Muffler dealers alleged that their dealership agreements with Midas and its affiliates violated the antitrust laws. Defendants advanced an *in pari delicto* defense, arguing that the plaintiffs were co-participants in the agreements, and were therefore not entitled to recover. In a five opinion decision, the Court rejected the defense. All five opinions stressed the importance of statutory enforcement. See 392 U.S. 134, 138-40 (opinion of Court); id. at 145 (White, J., concurring); id. at 147 (Fortas, J., concurring in result); id. at 151 (Marshall, J., concurring in result); id. at 154-55 (Harlan, J., concurring in part and dissenting in part). Writing for the Court, Justice Black noted that "fastidious regard for the relative moral worth of the parties would . . . seriously undermin[e] the usefulness of the private action as a bulwark of . . . enforcement." 392 U.S. at 139. He did not, however, endorse rejecting the *in pari delicto* defense in all circumstances. Instead, he reserved judgment as to its appropriate application when the plaintiff's conduct was active and voluntary: "We need not decide . . . whether . . . truly complete involvement and participation in a monopolistic scheme could ever be a basis . . . for barring a plaintiff's cause of action." Id. at 140.
delicto) that was inconsistent with the antitrust laws. In this case, we can honor the statutory purpose best by interpreting the antitrust private cause of action to be at least as broad as a plaintiff's right to sue for analogous torts . . . . 301

Under Bateman, Perma Life, and American Society, enforcement considerations must govern application of all other rule 10b-5 tort law doctrines, including the duty of care. 302

Evaluated in light of enforcement considerations, the duty of care doctrine does not withstand scrutiny. 303 The duty of care requires that courts dismiss the claims of careless plaintiffs who have not themselves violated rule 10b-5. Defendants in these actions, however, have violated rule 10b-5. Dismissing suits against violators in order to penalize nonviolators undermines the enforcement of section 10(b), in direct violation of Bateman, Perma Life, and American Society.

IV

THE ELEMENTS OF RULE 10b-5: COMMON LAW DECEIT

The Supreme Court has accorded common law deceit a limited role in interpreting rule 10b-5. The common law is relevant only when the factors discussed above are inconclusive. The Court has disregarded common law deceit principles where the statute's language, history, structure, or policy are dispositive. In Blue Chip Stamps v. Manor Drug Stores 304 the Court adopted the purchaser-seller requirement even though the common law did not require that the aggrieved party in a deceit action be a purchaser or a seller. 305 The Court found that statutory language, structure, and policy gave suf-

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301 456 U.S. at 569 (citations omitted).
302 The principal lower court application of Perma Life to rule 10b-5 has involved the in pari delicto defense. See supra note 283. A few courts, however, have suggested that Perma Life may be relevant to all rule 10b-5 common law defenses. See, e.g., Hughes v. Dempsey-Tegeler & Co., 534 F.2d 156, 184 (9th Cir.) (Trask, J., dissenting) ("[T]here is a clear trend in the law today to limit severely, if not abolish altogether, traditional common law defenses in securities and anti-trust actions, where considerations of public policy often outweigh whatever balance in equities the court finds between the individual litigants. . . . Availability of common law defenses, such as in pari delicto, assumption of risk, equitable estoppel, and waiver serve to make [the statutory] check upon abuses in the system's internal workings considerably less potent.")., cert. denied, 429 U.S. 896 (1976); Woolf v. S.D. Cohn & Co., 521 F.2d 225, 227 (5th Cir. 1975) (noting that tension between "traditional equitable defenses" and policies served by private rights of action under federal securities laws have yet to be resolved by the Supreme Court).
303 The circuits presently are split concerning whether the duty of care is a defense or an element of the plaintiff's case. See supra notes 102-10 and accompanying text. Bateman applies in either instance, however, because the duty of care remains a barrier to relief of common law origin, regardless of the burden of proof.
305 Id. at 744.
ficient affirmative support to the purchaser-seller requirement.306

The Court has turned to the common law of deceit, however, when the statutory factors are inconclusive. For example, in Chiarella v. United States307 the Court found statutory language,308 legislative history,309 and statutory policy310 unhelpful in resolving whether silence is actionable absent a duty to speak. Under these circumstances, the Court turned to the common law of deceit,311 which regarded a duty to speak as a necessary element for silence to be actionable.312 The Court characterized this common law principle as "established doctrine"313 and refused to follow the post-1934 trend in the common law identified by the dissent.314

The Court's reliance upon common law deceit when other criteria are inconclusive is consistent with congressional intent. Congress intended the federal securities laws to "rectify perceived deficiencies in the available common-law protections."315 According to the House Report on the 1934 Act:

If investor confidence is to come back . . . ., the law must advance. As a complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests as one horse trader watches another, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position.316

Thus, section 10(b) should be interpreted no more restrictively than the common law deceit action of that time period unless Congress has indicated to the contrary. Moreover, Congress's determination that common law protections were deficient suggests that in the face of divided common law opinions, the most liberal common law views of 1934 should govern.317

306 Id. at 733-49.
307 445 U.S. 222, 226 (1980) ("[N]either the legislative history nor the statute itself affords specific guidance for the resolution of this case.").
308 Id.
309 Id. at 233.
310 Id.
311 Id. at 227-28 & n.9.
312 Id. at 228.
313 Id. at 233.
314 Id. at 247-48 (Blackmun, J., dissenting).
316 H.R. REP. No. 1383, 73d Cong., 2d Sess., 5 (1934), reprinted in 5 LEGISLATIVE HISTORY, supra note 158, item 18, at 5 (emphasis added).
317 This appears to be Professor Loss's view. See L. Loss, supra note 212. at 812
Evaluating rule 10b-5’s duty of care by reference to the common law deceit action may be superfluous in view of the inferences available from the statute’s structure and policy. Nevertheless, the common law deceit action provides yet another ground for rejecting the duty of care. Although some common law deceit cases decided around 1934 imposed a duty of care, a number of others did not. Buckley v. Buckley is illustrative of the latter group. In Buckley the trial court entered judgment against the defendant for fraud in the sale of stock and refused to instruct the jury that the plaintiff’s failure to examine available books and records barred his recovery. The Michigan Supreme Court affirmed, holding that “no duty to use diligence in discovering a fraud is imposed on the injured party.”

In the most liberal jurisdictions courts refused to bar the plaintiff from recovery even if he had notice of the need to investigate and had failed to do so. Three types of notice were involved in these cases. First, in several cases, a document in the plaintiff’s possession constituted the notice to the plaintiff. In Albert v. Title Guarantee & Trust Co. the plaintiff purchased four mortgage participation certificates from the defendant, who had falsely represented to the plaintiff that the mortgages covered only “improved and income producing properties.” The trial court instructed the jury to determine whether a legend on the certificates would have “put a reasonable person on inquiry or knowledge that they were not improved by buildings or income-producing property.” The New York Court of Appeals held that this instruction was reversible error and stated that “[i]t is no excuse for a culpable misrepresentation that means of probing it were at hand.”

("Because of the legislative background it seems reasonable to assume at the very least that the most liberal common law views on these questions should govern under the statutes.")


See infra notes 320-29 and accompanying text.


221 Id. at 509, 202 N.W. at 956. See also King v. Livingston Mfg. Co., 180 Ala. 118, 127-78, 60 So. 143, 145-46 (1912) (“It would . . . be singular to hold a swindling deceiver exempt from liability because he has swindled only foolishly credulous and trusting persons . . . .”).

222 277 N.Y. 421, 14 N.E.2d 625 (1938).

223 Id. at 422-23, 14 N.E.2d at 625.

224 Id. at 423, 14 N.E.2d at 625.

225 Id. See also Martin v. Hughes, 156 Kan. 175, 131 P.2d 682 (1942) (deceit action alleging defendant orally misrepresented that used car was new; fact that age of car was inferable from title certificate held not to bar action); Southern Bldg. & Loan Ass’n v. Dinsmore, 225 Ala. 550, 144 So. 21 (1932) (deceit action alleging oral misrepresenta-
The second type of notice given to plaintiffs in these cases consisted of warnings from others. In *Bell v. Smith*, for example, the plaintiff was warned by her brother-in-law that a car she was about to purchase from the defendant was not a 1924 model, as the defendant had claimed. Plaintiff ignored the warning and purchased the car. The Supreme Court of New Jersey upheld a judgment for the plaintiff, reasoning that the plaintiff "chose to rely rather on the representations made by the defendant than on the warning from her brother-in-law."  

The third type of notice case involved something other than a warning or document. In *Steele v. Banninga*, the defendant, a real estate agent, falsely informed the plaintiff that a Mrs. Swenson was the sole owner of certain land. The plaintiff purchased the land with knowledge that a Mr. Stamp possessed and claimed ownership of the property. The Supreme Court of Michigan reversed the lower court's judgment for the defendant and ordered a new trial, after stating that the plaintiff's "[c]onstructive notice of Stamp's rights . . . constitutes no defense to this action."  

As the above discussion illustrates, in the more liberal jurisdictions in 1934, the duty of care did not bar recovery in a deceit action. It follows that the duty of care under rule 10b-5 should be rejected, absent contrary indications from Congress. As has been shown, however, no such contrary indications exist; rather, Congress has demonstrated its rejection of the duty of care through statutory structure and policy.

**Conclusion**

The Supreme Court's rule 10b-5 jurisprudence indicates that the elements of the rule 10b-5 action are governed by the intent of Congress, as evidenced by the following factors: the language and
history of section 10(b) and rule 10b-5, the structure of the 1933 and 1934 Acts, the policies underlying these Acts, and, where necessary, the views on common law deceit of the most liberal jurisdictions at the time the Acts were enacted. A plaintiff's duty of care in rule 10b-5 cases is manifestly inconsistent with the intent of Congress. The duty of care has no basis in the language or history of either section 10(b) or rule 10b-5. Moreover, it cannot be reconciled with either section 29(a) of the 1934 Act or with the congressional policy regarding enforcement of 1934 Act violations. Finally, the most liberal common law jurisdictions in 1934 did not impose a duty of care. Therefore, the duty of care has no proper place in rule 10b-5 litigation. A plaintiff's carelessness should no longer bar recovery for intentional securities fraud.

Abolishing the duty of care will not unduly expand the scope of rule 10b-5. Plaintiffs will still carry a considerable burden of proof, including scienter, materiality, and reliance. Thus, a plaintiff who carelessly ignored what should have been obvious will still be denied recovery unless he can demonstrate that he relied upon intentional and material omissions or misrepresentations.

The Court's rule 10b-5 jurisprudence applies not only to the duty of care, but also to all other common law doctrines that the rule 10b-5 action has imported. Some factors, however, will be more likely than others to provide affirmative evidence of congressional intent. The language of section 10(b) itself is largely useless as an indicator of congressional intent. It is difficult to discern whether this imprecise statutory language expresses congressional intent only in the prima facie case or in other aspects of the action as well. Relying on section 10(b)'s language is especially dubious with respect to private actions, because Congress never considered them.

The history of section 10(b) also is a largely useless indicator of congressional intent. Congress gave scant attention to section 10(b), leaving a brief and cryptic history of negligible interpretative value. Similarly, inferences regarding congressional intent are unlikely to emerge from the language and history of rule 10b-5 because the rule is the product of the SEC, not Congress. The most liberal views of common law deceit in 1934 also provide little help because they are at best only indirect evidence of congressional intent. The Court has conceded the relative unimportance of com-

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330 See supra note 17 for the elements of a rule 10b-5 private action.
mon law deceit by deeming it relevant only when the other factors are inconclusive. The most useful factors are the structure of the 1933 and 1934 Acts and the policies underlying those Acts. They provide fertile grounds for inferring what Congress would have done had it actually addressed all aspects of section 10(b).

Each common law doctrine that has found its way into the rule 10b-5 private action must be evaluated separately, because each requires discrete application of the relevant factors outlined above. Lower courts' failure to apply these factors flouts the intent of both the Supreme Court and Congress.