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FRAUD ON THE MARKET: THE DECLINE OF RELIANCE IN A 10b-5 ACTION

I. INTRODUCTION

Since the Supreme Court's decision in Affiliated Ute Citizens v. United States,¹ there has been considerable variation among the circuits regarding the requirement of reliance as an element of an action under rule 10b-5 of the federal securities regulations.² The differences seem to stem from a disagreement as to the underlying purposes of the securities regulations. While the regulations were established to force disclosure of material investment information and to maintain market stability, they were also designed to protect the investing public.³ In an attempt to reconcile these sometimes disparate purposes, one circuit has designed a theory since labeled "fraud on the market."⁴ While it does not eliminate the reliance requirement of a 10b-5 action, this theory does substantially lessen the plaintiff's burden of proof. The reaction to this theory has led to further differences of opinion regarding exactly what the role of reliance should be, and the extent to which reliance must be proven to make out a prima facie case of securities fraud.⁵

2. Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033 (7th Cir.), cert. denied, 434 U.S. 875 (1977); Chelsea Assoc's. v. Rapanos, 527 F.2d 1266 (6th Cir. 1975); Blackie v. Barrack, 524 F.2d 891 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976); Carras v. Burns, 516 F.2d 251 (4th Cir. 1975); Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2nd Cir. 1974); Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 482 F.2d 880 (5th Cir. 1973).
3. Eight policies have been identified as the underlying goals of rule 10b-5, (17 C.F.R. § 240.10b-5 (1981)). They are: (1) maintaining free securities markets; (2) equalizing access to information; (3) insuring equal bargaining strength; (4) providing for disclosure; (5) protecting investors; (6) assuring fairness; (7) building investor confidence; and (8) deterring violations while compensating victims.” 5 A. JACOBS, THE IMPACT OF RULE 10b-5, at § 6 (1980).
5. See Panzirer v. Wolf, 663 F.2d 365 (2nd Cir. 1981); Shores v. Sklar, 647 F.2d 462

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II. BACKGROUND

The Securities Act of 1933\(^6\) and the Securities Exchange Act of 1934\(^7\) (hereinafter “Acts” or “Securities Acts”) were enacted to protect investors from the many abuses which led to the stock market crash of 1929.\(^8\) Rule 10b-5 was promulgated under section 10-b of the Securities Exchange Act as a provision designed to protect investors from manipulative and deceptive practices in connection with the sale or purchase of securities.\(^9\)

Rule 10b-5 is grounded in the common law tort of deceit.\(^10\) Dean Prosser lists the traditional elements of deceit as:

1. a false representation made by the defendant;
2. knowledge or belief by the defendant that the representation is false;
3. defendant’s intent to induce plaintiff to act or refrain from acting in reliance upon the misrepresentation;
4. justifiable reliance on the part of the plaintiff in acting or refraining from acting; and
5. actual damage to the plaintiff as a result of such reliance.\(^11\)

The federal courts, attempting to compensate parties injured by


7. 15 U.S.C. §§ 77b to 77e, 77j, 77m, 77o, 77a, 78a to 78d, 78e to 78k-1, 78l, 78m to 78o, 78o-3, 78o-4, 78p to 78q-7, 78r to 78dd-2, 77ee to 78hh, 78ii, 78jj, 78kk (1976).
9. Rule 10b-5 was promulgated under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1976), and is set out in 17 C.F.R. § 240.10b-5 (1981). It states:

   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, or
   (c) To engage in any act, practice, or course of business
   which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.
fraudulent securities transactions, have used deceit as merely a starting point for a 10b-5 action in order to develop a federal common law that "will promote the broad policy goals of 10b-5."\textsuperscript{12}

The Supreme Court, however, has reversed an earlier trend of expanding liability under 10b-5, beginning with its 1975 decision in \textit{Blue Chip Stamps v. Manor Drug Stores},\textsuperscript{13} and most recently in the holding in \textit{Chiarella v. United States}.\textsuperscript{14} The Court has moved toward a more stringent common law approach, requiring proof of the traditional elements of fraud and deceit in any 10b-5 action.\textsuperscript{15}

While the Supreme Court's trend appears to be one of contraction of liability, the circuit courts still follow the expansive precedent established by \textit{Affiliated Ute}: When the defendant has not disclosed relevant information, a plaintiff is allowed to establish the reliance necessary to prove fraud through the use of a rebuttable presumption;\textsuperscript{16} where there is an omission, the defendant must disprove reliance.\textsuperscript{17}

Utilizing this presumption as a sign that the Court would permit recovery where the plaintiff is faced with the almost impossible burden of proving reliance on information not known to him, the circuit courts have expanded the plaintiff's ability to

\begin{itemize}
  \item \textsuperscript{13} 421 U.S. 723 (1975).
  \item \textsuperscript{14} 445 U.S. 222 (1980).
  \item \textsuperscript{16} 406 U.S. at 152-54 (1971). \textit{See also, Common Law Catch, supra note 15, at 852-53.}
  \item \textsuperscript{17} Id.
\end{itemize}
plead and prove the reliance element in a 10b-5 action.18 "Fraud on the market" or reliance upon the "integrity of the market" is one such expansion.19 Essentially, the reasoning is that the plaintiff should be able to rely on the fact that the price of any security which can be purchased or sold on the market has been set without manipulation or artificial inflation, and, thus, rely indirectly on the truth of the underlying representations of the validity of the stock.20

Because there is little in the way of legislative intent relating to the goals of 10b-5, the courts have discerned the underlying policies of the rules from legislative and judicial history.21 One of the policies which has been identified is the protection of investors in the market. Congress chose to implement this policy by imposing a duty of honesty and fair dealing through the requirement of disclosure.22 The Acts were not intended to create a form of investor's insurance, however, since the plaintiff still must prove causation.23 Liability is qualified, for "it must be kept in mind that the nation's welfare depends upon the mainte-

18. See cases cited note 2, supra.
20. Id.
21. The purpose of the bill is to protect the investing public and honest business. . . . The aim is to prevent further exploitation . . . of the public by the sale of unsound fraudulent and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power.
22. Rule 10b-5 attempts to "qualify the doctrine of caveat emptor by imposing standards of honesty and fair dealing." Tcherepnin v. Knight, 389 U.S. 336 (1967). In Santa Fe Indus. v. Green, the Supreme Court noted that it had repeatedly "described the 'fundamental purpose' of the Securities Exchange Act of 1934 as implementing a 'philosophy of full disclosure'; once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute." 430 U.S. 462, 477-78 (1977).
nance of a viable, vigorous business community." Acknowledging the conflict in the legislative scheme between investor protection and the survival of the business community, the courts have sought a balance by constructing workable limitations to liability under rule 10b-5, requiring something more than that "someone simply do something bad in connection with a purchase or sale of securities." 28

One of the traditional limitations to a defendant's liability has been the requirement that the plaintiff prove reliance on the defendant's misrepresentations or, in the case of an omission, that the facts withheld were material to his investment decision.

Developing the Reliance Requirement

In List v. Fashion Park, 27 a suit which arose because of an insider's nondisclosure when purchasing a minority shareholder's stock, the Second Circuit analyzed the test for reliance in common law terms: "[T]he test of 'reliance' is whether 'the misrepresentation is a substantial factor in determining the course of conduct which results in [the recipient's] loss.'" 28 The court imposed a requirement that the plaintiff prove the defendant's fraudulent conduct actually caused the injury.

The Supreme Court first attempted to define the elements of a 10b-5 cause of action in Affiliated Ute Citizens v. United States. 29 In Ute, there was no proof of reliance upon defendant's

24. Woodward v. Metro Bank of Dallas, 522 F.2d 84, 91 (5th Cir. 1975) (quoting Herpich v. Wallace, 430 F.2d 792, 804-05 (5th Cir. 1970)).
25. Id.
27. 340 F.2d 457 (2d Cir. 1975). The plaintiff in List was an experienced investor who sold his shares of Fashion Park stock upon the advice of his broker. The broker knew that two of the directors of Fashion Park were at that time bidding upon the stock, but did not consider it important enough to disclose to the plaintiff. The directors purchased plaintiff's stock. A merger was announced approximately three weeks later, offering $50 a share to all minority shareholders; the plaintiff had sold his shares for $18.50 each. Plaintiff alleged that the defendants conspired to purchase his stock by not disclosing their status as directors, which would have been a fact pertinent to his decision. The court found that the plaintiff would have negotiated the sale even if he had known that the purchasers were directors of the corporation.
28. Id. at 462.
29. 406 U.S. 128 (1971). Affiliated Ute involved a suit by members of an Indian tribe against bank employees who had arranged sales of the tribal members' stock. The stock represented a distribution of the tribe's assets: cash, oil, land, gas and mineral rights, and un adjudicated and un liquidated claims against the government. The employ-
fraudulent conduct because the conduct principally had been silence when there was a duty to disclose. Finding that while reliance was necessary to establish causation, reliance upon an omission would be almost impossible to prove. The Court held:

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 in the sense that a reasonable investor might have considered them important in the making of this decision . . . . This obligation to disclose and this withholding of a material fact establish the requisite element of causation.

In *Ute* the Court eased the plaintiff's burden, but it did not eliminate the causation requirement of reliance. Instead, it recognized that reliance should be presumed when there has been a material deception through omission.

After *Ute*, the Second Circuit discussed the two components of causation which are necessary to establish causation-in-fact in a fraudulent securities transaction. Where the defendant's action principally concerned misrepresentation, the plaintiff must show both "loss causation—that the misrepresentation or omissions caused the economic harm—and transaction causation—that the violations in question caused the appellant to engage in the transaction in question." While loss causation is relatively easy to show, proof of transaction causation requires the plaintiff to prove reliance on the defendant's misrepresentations. However, because of the *Ute* presumption, in an omissions case the plaintiff need not prove reliance to establish transaction causation. She must show instead that the facts in question were

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ees received various commissions for their market-making activity, yet at no time revealed to the tribe that they were gaining financially from the sales, or that the shares were selling at a higher price than the members were receiving.

30. Id. at 153.
31. Id. at 153-54.
"material in the sense that a reasonable investigator [sic] might have considered them important."

In its decision in Chiarella v. United States, the Supreme Court again referred to reliance as an element of a 10b-5 action. As long as an affirmative duty to disclose is placed on the defendant, any breach of that duty and reliance by the plaintiff upon the breach will give rise to liability:

Thus, administrative and judicial interpretations have established that silence in connection with the purchase or sale of securities may operate as a fraud actionable under section 10b despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure. But such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.

Chiarella notably requires the existence of a duty between the parties to the transaction. The Court refused to impose a general duty upon all participants in market transactions, requiring only some recognized relationship which caused the defendant's silence to become intentionally misleading.

Since Ute, there has been a disagreement among the circuits as to when the presumption of reliance should be invoked. The critical distinction is between misrepresentation and omission. When there has been primarily affirmative misrepresentation, proof of reliance is required; when there has been primarily

34. Id. at 380 (citing Affiliated Ute Citizens v. United States, 406 U.S. at 152-53 (1971)).
36. Id. at 230.
37. [T]he element required to make silence fraudulent—a duty to disclose—is absent in this case . . . . We cannot affirm petitioner's conviction without recognizing a general duty between all participants in market transactions to forgo [sic] actions based on material, nonpublic information. Formulation of such a broad duty, which departs radically from the established doctrine that duty arises from a specific relationship between two parties . . . . should not be undertaken absent some explicit evidence of congressional intent.

Id. at 232-33.
38. See cases cited note 2, supra. See also Crane, supra note 32, at 102-03; The Reliance Requirement, supra note 10, at 588-89.
omission or manipulation, reliance is presumed from materiality.

**Protecting the Integrity of the Market**

In *Superintendent of Insurance v. Bankers Life and Casualty Co.*, the Supreme Court first defined the causal link of 10b-5. The Court found that Congress had attempted to bar any fraud used "in connection with" the purchase or sale of securities. The Court read 10b-5 as a means of insuring that deceptive and manipulative devices would not be used either in face-to-face transactions or organized markets:

>[Section 10b] is not "limited to preserving the integrity of the securities markets" . . . , though that purpose is included. Section 10b must be read flexibly, not technically and restrictively. Since there was a "sale" of a security and since fraud was used "in connection with" it, there is redress under §10b. . . .

While the reliance by a plaintiff on a particular misstatement or omission might be relatively easy to prove or disprove in a face-to-face transaction, an open market transaction poses a far more difficult problem. The Ninth Circuit dealt with this problem when it developed a doctrine designed as an extension of the *Ute* presumption of reliance.

This doctrine of "fraud on the market" was first articulated in *Blackie v. Barrack*. In that case, the plaintiff sought to certify a large class of shareholders who had invested over a substantial period of time. The plaintiffs asserted reliance on the inflated prices of the stock, which were the result of the defendant's alleged misrepresentations of the financial integrity of the corporation. The court found that while reliance is necessary to demonstrate the causal connection between the defendant's wrongdoing and the plaintiffs' harm, causation could be established adequately by proof of purchase and the materiality of the misrepresentation without any direct proof of reliance. The court explained:

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40. Id. at 12-13.
41. Id. at 12.
42. Id.
43. 524 F.2d 891 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976).
44. Id. at 906.
Materiality circumstantially establishes the reliance of some market traders and hence the inflation in the stock price—when the purchase is made, the causational chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case.

A purchaser on the stock exchanges . . . relies generally on the supposition that the market price is validly set and that no unsuspected manipulation has artificially inflated the price, and thus indirectly on the truth of the representations underlying the stock price. . . .

The Blackie court reasoned that individual "transaction causation" could be inferred from materiality in an open market transaction, and shifted the burden of disproving the prima facie case to the defendant. The Ninth Circuit found that the defendant could disprove such a presumption in at least two ways: "(1) by disproving materiality or by proving that, despite materiality, an insufficient number of traders relied to inflate the price; and (2) by proving that an individual plaintiff purchased despite knowledge of the falsity of the representation, or that he would have, had he known of it."

The court wrote of reliance as an alternative method of establishing causation. In its view, causation could be established by materiality as well as reliance; the concepts are not necessarily concomitant. Reliance, however, is not eliminated, for it begins to play a more important role for the defense. The defendant must now argue that in spite of the alleged materiality of the fraud, the plaintiff in fact did not rely on any of the representations, or that an insufficient number of other traders relied on the fraud to actually have any effect on the price.

The reasoning of Blackie was recently adopted by the Fifth Circuit in Shores v. Sklar and the Second Circuit in Panzirer.

45. Id. at 907.
46. This means that the violation caused the plaintiff to engage in the transaction and is to be distinguished from "loss causation." See text accompanying note 33, supra.
47. 524 F.2d at 906 (9th Cir. 1975).
48. Id.
49. Id. at 906-07 n.22.
50. 647 F.2d 462 (5th Cir. 1981).
In Panzirer, the plaintiff asserted the "fraud on the market" theory after she purchased stock based on a report she had read in the Wall Street Journal. While she alleged material misrepresentations and omissions in the defendant corporation's annual report, she had never actually seen that document. She argued that, had the annual report been accurate, the Wall Street Journal would never have issued a favorable article and she would not have made the purchase. The court agreed and reasoned that just as material misrepresentations and omissions will be presumed to affect the price of securities, so they should be presumed to affect the information in the "heard on the street" column: "Where the plaintiff acts upon information from those working in or reporting on the securities markets, and where that information is circulated after a material misrepresentation or omission, the plaintiff has stated a sufficient claim of reliance on the misrepresentation or omission."

The Shores court also applied the reasoning of Blackie, finding that the plaintiff need not rely specifically on material misrepresentations and omissions relating to any single disclosure document. If the plaintiff can prove that the existence of the security on the market resulted in a perpetration of fraud upon the investment community, and the security was purchased in reliance on the validity of the market, the plaintiff will be given an opportunity to recover.

In Shores, the alleged fraud dealt with an issue of municipal revenue bonds. These bonds were issued after a financing scheme was formulated based on several allegedly fraudulent misrepresentations and omissions. In this case, as in Panzirer, the plaintiff had never seen the offering circular which he claimed was fraudulent. He based his purchasing decision on his

51. 663 F.2d 365 (2d Cir. 1981).
52. Id. at 366-67.
53. Id.
54. Id. at 367.
55. 647 F.2d at 464 (5th Cir. 1981).
56. Essentially, the defendants in this case had engaged in a scheme to persuade the municipality of Frisco City, Alabama to incorporate an industrial development board. The defendants represented themselves as being experienced developers, financially secure and owning sufficient assets to cover a bond issue should it be declared in default. The board issued bonds based upon these representations. The defendants were unable to make any payments, which were necessary to amortize the bonds, and the bonds were subsequently declared to be in default. Id. at 464-67.
broker’s representations, which in turn were based on market information.\textsuperscript{57}

\textit{Shores} is perhaps the most interesting of the \textit{Blackie} progeny, for the majority and the dissent in their separate opinions develop two distinct arguments relating to the application of reliance in a 10b-5 action. The majority, while noting that the plaintiff’s admitted nonreliance upon the offering circular would defeat his 10b-5 claim based on material misrepresentations or omissions\textsuperscript{58} found that the allegation of a more pervasive scheme to defraud and fraudulent course of business would not fail due to lack of reliance on the circular. They reasoned that if those securities were placed on the market due to fraudulent misrepresentations and omissions, and the plaintiff had relied on the integrity of the market to establish their validity, then adequate causation-in-fact had been established.\textsuperscript{59} Thus, the presence of the securities in the market was material “in the sense that a reasonable investor might have considered [those facts] important in making his investment decisions.”\textsuperscript{60}

The majority analyzed the plaintiff’s allegations in light of what they considered to be the principal purposes of the Securities Acts. While they perceived disclosure as a means to insure

\textsuperscript{57} \textit{Id.} at 467.

\textsuperscript{58} The court referred to this as a 10b-5(2) claim. For applicable statutory language, see note 9 \textit{supra}.

\textsuperscript{59} The \textit{Shores} court noted that misrepresentation actions brought under rule 10b-5(2) may require a different showing of transaction causation than those actions attempting to show a scheme or course of business intended to defraud. The court observed that doing away with the requirement that the misrepresentation be a substantial factor in determining the course of conduct which results in the loss, in a conventional 10b-5(2) case, could establish a form of investor’s insurance. 647 F.2d at 469 n.6. The court also outlined the necessary elements of an action under 10b-5(1) and (3). The plaintiff’s burden of proof will be to show:

\begin{enumerate}
  \item defendants knowingly conspired to bring securities onto the market which were not entitled to be marketed, intending to defraud purchasers,
  \item plaintiff reasonably relied on the securities’ availability on the market as an indication of their apparent genuineness, and
  \item as a result of the scheme to defraud, plaintiff suffered a loss.
\end{enumerate}

\textit{Id.} at 469-70.

\textsuperscript{60} \textit{Affiliated Ute Citizens v. United States}, 406 U.S. at 153-54. \textit{The Shores} court relied on the reasoning of Schlick v. \textit{Penn-Dixie Cement Corp.}, 507 F.2d 374 (2nd Cir. 1974), for establishing transaction causation through materiality in a case where a fraud had been perpetrated through an omission. 647 F.2d at 419. \textit{See also} text accompanying note 33, \textit{supra}.
investor protection, in their view that was not the ultimate goal. They found that in this factual situation, where the plaintiff alleges a pervasive scheme to defraud, the Acts allow a plaintiff to rely "on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the market place."

The majority separated 10b-5 into two district causes of action, finding support for actions in the language of the rule itself. They reasoned that when the focus of the fraud shifts from a particular document to a more pervasive fraud, the search for causation must also shift and the plaintiff need not rely on any specific document.

The dissent in Shores believed that the majority's theory of investor protection defeated the equally important goal of making informed investment decisions. The dissent reasoned that by distinguishing between those securities which were initially entitled to be marketed (and later become the object of some fraud), and those which, absent fraud, would never have been marketed, the plaintiff's burden of proof of reliance and recovery would turn on what kind of security was purchased. They noted that Blackie, while allowing reliance on the integrity of the market to establish causation, also allowed that presumption to be overcome if the defendant could show a lack of reliance.

The dissent perceived full and fair disclosure as a primary objective of the Securities Acts, disagreeing with what the majority saw as the central role of rule 10b-5. In contrast to the consumer-oriented legislation of the 1960s and 1970s, the "federal securities laws are based on the premise that the federal government's role is merely to ensure the free flow of complete and accurate information within the Nation's securities mar-

61. 647 F.2d at 470.
62. Id. at 471.
63. Id.
64. "The reliance that produces causation in the [case of a more pervasive fraud] cannot come from reading a document." Id. at 472.
65. Id. at 473.
66. Id.
67. Id. at 478-79.
68. Id. at 481.
Once that disclosure had been accomplished, the investor should be expected to protect himself; the "fairness of the terms of the transaction is at most a tangential concern of the statute."  

The dissent's position was that the goal of the Securities Acts, a high standard of business ethics in the securities industry, would be furthered by precluding recovery to a plaintiff who had made an investment decision without reference to the information promulgated under the disclosure requirements. "In short, the federal securities laws are intended to put investors into a position from which they can help themselves by relying upon disclosures that others are obligated to make. This system is not furthered by allowing monetary recovery to those who refuse to look out for themselves."  

III. DISCUSSION  

Because of the virtually unlimited language of rule 10b-5 and its judicially created cause of action, the duty of limiting the applicability of the rule has fallen to the courts. This has been accomplished by requiring various elements of tort liability to establish causation. First required in List, as one of the traditional elements of common law fraud, reliance by the plaintiff on the defendant's action or inaction has been one of those necessary elements of proof.  

Whenever there is any proposed expansion of the 10b-5 cause of action, the courts must evaluate the expansion in light of increased litigation or any interference with relevant state law, as well as considering whether such an extension will fulfill the legislative purposes of the Securities Acts. The circuits have attempted to find equitable solutions where plaintiffs have

69. Id. at 482.
70. Id. at 482 (citing Santa Fe Indus. v. Green, 430 U.S. 462, 477-78 (1977)).
71. Id. at 483. Surveying Supreme Court decisions, the dissent noted a consistent refusal to eliminate any of the basic elements of a 10b-5 action, and that reliance was one of those long standing requirements. Id. at 484 (citing Aaron v. SEC, 446 U.S. 680 (1980); Chiarella v. United States, 445 U.S. 222 (1980); Santa Fe Indus. v. Green, 430 U.S. 462 (1977); Ernst and Ernst v. Hochfelder, 425 U.S. 723 (1973)).
72. In Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723, 737 (1973), the Court wrote of the unanticipated growth of the 10b-5 actions, and the Court's duty to delineate what was a judicially created cause of action.
been victims of defendants’ wrongdoing. The Shores majority noted that doing away with proof of reliance where there are material misstatements or omissions would essentially institute a system of investor’s insurance, counter to what the legislature had intended in the Securities Acts.\textsuperscript{74} But the court has given investors an opportunity to avoid the requirement of reliance by alleging fraud on a broader scale.

Theoretically, the burden which is now placed on the defendant is no more exacting than that which was previously placed on the plaintiff to prove reliance. The Blackie court provided at least two ways for the defendant to meet this burden.\textsuperscript{75} Practically, however, this theory of the integrity of the market and reliance on that integrity to produce valid securities almost seems to eliminate a defendant’s means of disproving reliance and lead to far greater liability. Unless the defendant can prove that the plaintiff is a totally unreasonable investor—purchasing without regard to market knowledge—or that the fraud involved would not have any material effect on the price or information regarding the securities (two situations which are difficult to imagine in a financial world of easily influenced and quickly fluctuating stock prices), then the presumption will be that the defendant is responsible for the plaintiff’s loss. The notion that without researching any of the disclosure documents made available, a purchaser can simply presume that anything on the market is valid seems to be a considerable step in the direction of insured investments.

Looking at the legislative scheme, the Securities Acts were set up as disclosure statutes, not only demanding full disclosure of issuers, brokers, dealers, and underwriters, but also obligating the investor to some form of diligence.\textsuperscript{76} As one commentator observed: “Two significant policy considerations behind the Securities Acts are providing full access to relevant information and market stability. Market stability may be threatened as much by investor carelessness as it is by manipulations, and full access is useless if investors are not encouraged to take advantage of that access.”\textsuperscript{77}

\begin{footnotes}
\item 74. 647 F.2d at 469 n.5 (5th Cir. 1981).
\item 75. See text accompanying note 48, supra.
\item 76. Crane, supra note 32, at 111.
\item 77. Id.
\end{footnotes}
In a fraudulent securities scheme, however, a plaintiff should also be given an opportunity to recover from a defendant’s willful manipulation and wrongdoing. The rule was enacted to protect investors as well, and by allowing a presumption of reliance to assist the plaintiff through the stage of summary judgment, he will be afforded an opportunity to prove a scheme which may perpetrate fraud on the entire investment community. Perhaps the view of the Blackie court that “reliance as a separate requirement is simply a milepost on the road to causation” is correct. Possibly reliance should not be demanded of a plaintiff to prove causation, but should be only one of the possible elements which would prove that defendant’s wrongdoing resulted in plaintiff’s harm.

IV. CONCLUSION

Central to the determination of the applicability of the fraud on the market theory is an ascertainment of the goals of the Securities Acts. If the Acts were designed to promote market stability, then informed decisions by investors are called for and allowing reliance on the general integrity of the market does not promote that goal. If instead the aim is investor protection, then clearly the fraud on the market theory advances that protection.

The policy of the courts has been to cut off defendant’s liability at the point where there is no reliance by the plaintiff on the defendant’s misrepresentations or omissions. Allowing reliance on the integrity of the market, however, expands a plaintiff’s opportunity for recovery when there is no reliance on those specific misstatements or omissions, but merely a belief that anything which can be purchased on the market has been placed there without fraud.

While the validity of this doctrine remains to be tested in the Supreme Court, there is disagreement among the judges on the individual courts and among the different circuits as to what degree of reliance is necessary to establish causation. While investors do have a duty to make informed decisions, obviously a fraudulent security should not be permitted to remain on the market, and the harm which results from its issue and trading

78. 5 A. Jacobs, supra note 3, at § 6.
79. 524 F.2d at 906 n.22 (9th Cir. 1975).
should be compensated. Recently, in *Chiarella*, in keeping with its recent contraction of 10b-5 liability, the Supreme Court refused to formulate a broader duty when asked to expand liability beyond its traditional scope. Adoption of a fraud on the market theory would certainly increase the liability of potential defendants beyond the traditional limitations established requiring proof of reliance. If the Court is faced with this doctrine while continuing its present course, it most likely would refuse to find liability for harm which results from a plaintiff's reliance on only the integrity of the market to establish valid securities. Because the securities regulations require disclosure, a decision of the Court not to allow proof of the element of reliance in this manner would be in accordance with those requirements. But, investors who are not aware of the levels of financial sophistication and the areas open to deception within the investing world would still be without a remedy for fraud on the market. Perhaps what is called for is not a new application of 10b-5, but a new anti-fraud statute which would insure that such harms do not go without redress.

M. Lynn Haggerty

80. 445 U.S. at 233 (1981). But in John Nuveen & Co. v. Sanders, [1981 Transfer binder] *Fed. Sec. L. Rptr.* (CCH) ¶ 97,900, a dissent to a per curiam opinion indicated that the court might be willing to expand another of the antifraud provisions—§ 12(2) of the 1933 Act, 15 U.S.C. § 77l(2) (1976)—by imposing a higher standard of reasonable investigation on underwriters when they examine an issuer's financial statement before release. (Id. Powel and Rehnquist, J.J., dissenting). Should the prospectus be released with the misrepresentation, the underwriter could be held liable as well as the issuer. See *Symposium—Securities Law*, 30 *Emory L.J.* 1, 6 (1981). See also *Steadman v. SEC*, 450 U.S. 91 (1981), allowing the SEC to prove a violation of antifraud provision § 17(a) of the 1933 Act, 15 U.S.C. 77q(a) (1976), by the standard of a preponderance of evidence, regardless of later possibly severe sanctions based on the same judgement.

While the court is refusing to expand the application of 10b-5 liability, in other areas of antifraud perhaps it is not so predisposed.