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# Securities Law -- Fraud -- Rule 10b-5 Private Actions -- Adoption of Flexible Duty Standard -- White v. Abrams

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rule limiting recovery to those in privity with the defendant would not come any closer to fulfilling the compensatory purpose, since many persons with a claim to compensation would go totally unsatisfied, while only a few would be made whole. It is submitted that it may be more equitable to provide at least some compensation for all, rather than full compensation for the few who can establish privity through the fortuitous matching of buy and sell orders. Finally, the compensatory function of private damage actions in the case of open-market violations of the disclose or abstain rule is open to serious question under either the privity or the *Shapiro* rule.[82]

The court's finding of the Rule 10b-5 violations on the part of all defendants is clearly supported by reason and authority. However, there is some question as to whether the authority depended upon for the imposition of such broad civil liability for damages supports the court's conclusions. In any case, the result of *Shapiro* seems desirable in terms of its effectiveness in fulfilling the purposes of private actions in Rule 10b-5 cases.

ROGER BRUNELLE

**Securities Law—Fraud—Rule 10b-5 Private Actions—Adoption of Flexible Duty Standard—*White v. Abrams*[1]**—Defendant, Abrams, was a trusted friend and investment advisor of plaintiffs, White and others. Abrams encouraged plaintiffs to make substantial investments in several corporations which subsequently went bankrupt.[2] The corporations paid Abrams substantial commissions for obtaining the investments.[3] Plaintiffs brought a suit seeking rescission and punitive damages for violations of section 17(a) of the Securities Act of 1933,[4] section 10(b) of the Securities Exchange Act of 1934,[5] SEC

[82] Thus, it has been argued that a violation of Rule 10b-5 of the type which occurred in *Shapiro* has not really damaged anybody. Note, 80 Harv. L. Rev. 468, 475 (1966); Comment, 16 U.C.L.A. L. Rev. 404, 409-10 (1969).

[1] 495 F.2d 724 (9th Cir. 1974).

[2] Id. at 727.

[3] Id.

[4] 15 U.S.C. § 77q(a) (1970). Since the relevant language of section 17(a) is almost identical to the language of Rule 10b-5, the court assumed that the elements of a private action under that section are the same as those of an action under Rule 10b-5. 495 F.2d at 727 n.2.

[5] 15 U.S.C. § 78j(b) (1970), which provides in part:

> 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.

Rule 10b-5,[6] and for common law fraud. The complaint alleged certain misrepresentations and non-disclosures by Abrams in connection with the investments. A jury found the defendant not liable under the theory of common law fraud, but returned a verdict for plaintiffs on the federal securities laws counts and awarded them compensatory damages.[7]

On appeal to the Ninth Circuit, defendant Abrams argued that the trial court had improperly instructed the jury on the scope of duty imposed by clause (b) of Rule 10b-5. The court had instructed as follows:

> If you find that defendant made a material misrepresentation to plaintiffs in connection with the sale to plaintiffs of a promissory note or share of stock, the law is that defendant has violated the Federal securities laws even if you find that defendant did not know the falsity of the misrepresentations he made to plaintiffs.[8]

The Ninth Circuit reversed and remanded. HELD: section 10(b) and Rule 10b-5 do not impose liability without fault—the defendant has no duty to insure the truthfulness of representations he has made, but will be liable for misrepresentations and omissions only where he was in some way at fault or culpable.[9] In giving instructions to the trial court, the Ninth Circuit articulated a "flexible duty standard" of liability under which "the proper standard to be applied is the extent of the duty that rule 10b-5 imposes upon [a] particular defendant."[10] In applying the flexible duty standard, the trial court was directed to determine what duty of disclosure the law should impose upon a particular defendant. In instructing the jury on the defendant's duty, the trial court was directed to require it to consider: (1) the relationship of the defendant to the plaintiff; (2) the defendant's access to the information as compared to the plaintiff's access; (3) the benefit derived from the relationship by the defendant; (4) the defendant's awareness of whether the plaintiff relied upon their relationship in making the investment decisions; and (5) the defendant's activity in initiating the securities

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[6] 17 C.F.R. § 240.10b-5 (1974), which 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, 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.

[7] 495 F.2d at 727-28.

[8] Id. at 728.

[9] Id.

[10] Id. at 734-35.

transaction in question.[11] The Ninth Circuit emphasized that the trial court may make additions to or adaptations of the above factors in a particular case.[12]

*White v. Abrams* offered the Ninth Circuit its first opportunity to speak on the standard of liability in private actions under Rule 10b-5 since its 1961 and 1962 decisions in *Ellis v. Carter*[13] and *Royal Air Properties, Inc. v. Smith*,[14] where it held that common law fraud need not be alleged or proved in a Rule 10b-5 action.[15] After rejecting the interpretations that it had imposed liability without fault or for negligence in *Ellis* and *Royal Air*,[16] the Ninth Circuit in *White* took issue with the Second Circuit's latest formulations of the standard of Rule 10b-5 liability as expressed in *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*[17] and *Lanza v. Drexel & Co.*[18] It rejected any discussion of liability in terms of the scienter or state-of-mind element which has been the focus of the traditional mode of analysis in Rule 10b-5 cases. Instead, reasoning that a defendant's duty can only be determined in the context of the specific fact situation, the Ninth Circuit adopted a "duty analysis," leaving to the trier of fact the determination of that duty, which could range from a duty only to avoid intentional fraud to a duty to use extreme care to disclose all material facts.[19]

This note will initially pinpoint the issues on which the Second and Ninth Circuits disagree. By way of background to an examination of the *White* standard, there will then be a brief review of the origin of the controversy over the proper standard of liability in a private action under Rule 10b-5, a presentation of the Second Circuit's mode of Rule 10b-5 analysis, focusing upon the state-of-mind element, and a discussion of the history of the Ninth Circuit's position on the standard of liability. Proceeding to the *White* standard, there will be an examination of its conceptual basis and then an evaluation of its practical effect.

In *White v. Abrams*, the Ninth Circuit expressed its disagreement with the Second Circuit on two basic issues arising in the determination of the standard of liability in private actions under Rule 10b-5: (1) the proper mode of analysis; and (2) the degree of culpability or fault required to impose liability on the defendant.[20]

[11] Id. at 735-36.

[12] Id. at 735.

[13] 291 F.2d 270 (9th Cir. 1961).

[14] 312 F.2d 210 (9th Cir. 1962).

[15] 312 F.2d at 212; 291 F.2d at 274.

[16] 495 F.2d at 734. The trial judge was not alone in reading *Ellis* and *Royal Air* as imposing liability without fault. E.g., Kohn v. American Metal Climax, Inc., 458 F.2d 255, 313 (3d Cir.), cert. denied, 409 U.S. 874 (1972).

[17] 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 910 (1973).

[18] 479 F.2d 1277 (2d Cir. 1973) (en banc). For a thorough analysis of the *Lanza* opinion, see Comment, *Lanza v. Drexel & Co.* And Rule 10b-5: Approaching The Scienter Controversy In Private Actions, 15 B.C. Ind. & Com. L. Rev. 526 (1974).

[19] 495 F.2d at 732, 734-36.

[20] Id. at 734-36.

The court unequivocally rejected the traditional mode of analysis which focuses on the state of mind of the defendant.[21] Although deliberately refusing to espouse "a negligence standard or any other standard that focuses solely upon state of mind and its various compartmentalizations,"[22] the Ninth Circuit indicated that it perceives a difference between its position on the degree of culpability and that of the Second Circuit: "We believe it unfortunate that the Second Circuit attempted to limit [a defendant's] duty by requiring some degree of scienter or culpability and by holding that mere negligent conduct would not be sufficient for liability."[23] Instead of specifying a single theory of liability under the Rule, the Ninth Circuit has left the determination of the duty and, implicitly, the selection of the theory of liability to the trier of fact, thereby allowing the minimum degree of culpability required for the imposition of liability under the Rule to vary from case to case.[24] It is the thesis of this note that the issues of the mode of analysis and the requisite degree of culpability are distinct and that both require resolution in developing a standard of liability for private actions under Rule 10b-5. Whether a court adopts a duty analysis or a state-of-mind analysis, it must still come to grips with what degree of culpability if any—*i.e.*, what single theory of liability—Rule 10b-5 requires.

The controversy over the proper standard of liability in a private action under section 10(b) and Rule 10b-5 has resulted from the absence of a provision in either the statute or the Rule for civil recovery by a defrauded seller or purchaser.[25] Therefore, neither specifies a standard of liability to be applied in a private action. Thus, when the federal courts decided that the statute and Rule permit a private action and civil liability,[26] they were forced to determine what degree of culpability, if any, on the part of a defendant should be required for recovery by the plaintiff.

Since the statute, the Rule, and the SEC's release accompanying the promulgation of the Rule[27] all speak in terms of "fraud," the Second Circuit looked initially to the common law tort action for fraud[28] as a source of the elements of the private action.[29] The

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[21] "[W]e reject scienter or any other discussion of state of mind as a necessary and separate element of a 10b-5 action." Id. at 734.

[22] Id.

[23] Id. at 732.

[24] Id. at 735-36.

[25] For the language of § 10 (b) and Rule 10b-5, see notes 5 & 6 supra.

[26] Kardon v. National Gypsum Co., 69 F. Supp. 512, 514 (E.D. Pa. 1946).

[27] SEC Securities Exchange Act Release No. 3230 (May 21, 1942), reprinted in 2 A. Bromberg, Securities Law: Fraud—SEC Rule 10b-5, App. B, at 295 (1973).

[28] The traditional elements of common law fraud are: scienter, materiality, reliance, causation, and damages. See W. Prosser, Handbook of the Law of Torts, § 105, at 685-86 (4th ed. 1971) [hereinafter cited as W. Prosser].

[29] We think that when, to conduct actionable under § 11 of the 1933 Act, there is added the ingredient of fraud, then that conduct becomes actionable under § 10(b) of

necessity of expanding the common law concept of fraud for the purposes of Rule 10b-5 arose, however, when the Second Circuit was faced with the complex fact situation in *SEC v. Texas Gulf Sulphur Co.*[30] *Texas Gulf Sulphur* was an enforcement proceeding brought by the SEC against a number of company executives, employees, relatives, friends, brokers, and attorneys for trading in the stock of the company at various times before and shortly after the public disclosure of the company's discovery of an extremely rich ore deposit. The wide range of culpability among the *Texas Gulf Sulphur* defendants forced the Second Circuit to reconcile the existing requirement of fraud[31] with the need to impose liability for conduct that, although lacking the intent to defraud necessary for strict common law scienter, was clearly contrary to the basic investor-protection policies of the federal securities laws.[32] Judge Waterman, speaking for the court, reduced the requirement of the state-of-mind element from strict intent to defraud to a minimum of "lack of diligence, constructive fraud, or unreasonable or negligent conduct . . . ."[33] Reacting against Judge Waterman's implication that Rule 10b-5 imposes liability for negligent conduct, Judge Friendly, in a concurring opinion, emphasized that *Texas Gulf Sulphur* was an enforcement proceeding and agreed that negligence would be sufficient to justify an injunction. However, he argued that the imposition of civil liability for mere negligence would go beyond the statutory authorization of section 10(b).[34]

The Second Circuit attempted to resolve the controversy in 1971 in *Shemtob v. Shearson, Hammill & Co.*[35] There, it held that "[i]t is insufficient to allege mere negligence."[36] By requiring allegations of facts amounting to "*scienter,* intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme or artifice to defraud,"[37] the court indicated that intent, as opposed to negligence, is the proper theory of liability in a private Rule 10b-5 action. Subsequently, in 1973, in *Lanza v. Drexel & Co.,*[38] the Second Circuit announced that liability under Rule 10b-5 would be imposed only for willful or reckless disregard for the truth,[39] for which the test would be whether the defendant "knew the material

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the 1934 Act and the Rule, at the suit of any defrauded person, whether or not he could maintain a suit under §§ 11 of the 1933 Act.

Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 786-87 (2d Cir. 1951).

[30] 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969).

[31] See *Fischman,* 188 F.2d at 786-87. See note 29 supra.

[32] 401 F.2d at 855.

[33] Id.

[34] Id. at 868 (concurring opinion).

[35] 448 F.2d 442 (2d Cir. 1971).

[36] Id. at 445.

[37] Id.

[38] 479 F.2d 1277 (2d Cir. 1973) (en banc).

[39] Id. at 1306.

facts misstated or omitted, or failed or refused, after being put on notice of a possible material failure of disclosure, to apprise [himself] of the facts where [he] could have done so without any extraordinary effort."[40] The requirement that the defendant have been put on notice indicates that the Second Circuit defines recklessness as a form of intentional conduct, and that the court requires a conscious awareness and disregard of a recognizable risk of harm on the part of a defendant in order to subject him to liability under the statute and Rule.

The Ninth Circuit's enigmatic decision in *Ellis v. Carter*[41] and its affirmation in *Royal Air Properties, Inc. v. Smith*[42] present a sharp contrast to the development of a standard of liability in the Second Circuit based on the state-of-mind element.

*Ellis* was a Rule 10b-5 action brought by a purchaser of securities who alleged that he had purchased shares from the defendant at higher than the market price in reliance upon defendant's false representation that the stock carried with it a voice in the management of the company. The court declined to hold that plaintiff must allege and ultimately prove "genuine fraud."[43]

> Section 10(b) speaks in terms of the use of "any manipulative device or contrivance" in contravention of rules and regulations as might be prescribed by the Commission. It would have been difficult to frame the authority to prescribe regulations in broader terms. Had Congress intended to limit this authority to regulations proscribing common-law fraud, it would probably have said so. We see no reason to go beyond the plain meaning of the word "any", indicating that the use of manipulative or deceptive devices or contrivances of whatever kind may be forbidden, to construe the statute as if it read "any fraudulent" devices.[44]

It was this language, as the court noted in *White*,[45] that caused confusion over the Ninth Circuit's standard of liability and, presumbly, that prompted the trial judge in *White* to instruct the jury that Rule 10b-5 imposes liability without fault, *i.e.*, without proof that the defendant knew the falsity of the misrepresentation or omission.[46]

Subsequent to *Ellis*, in *Royal Air*, the Ninth Circuit reaffirmed

[40] Id. at 1306 n.98. While the majority seemed to have no doubt that the Second Circuit had resolved the scienter versus negligence controversy, Judge Hays argued in a dissenting opinion that the issue had not yet been settled and indicated that he favored the imposition of liability for mere negligence. Id. at 1311, 1319 (dissenting opinion).

[41] 291 F.2d 270 (9th Cir. 1961).

[42] 312 F.2d 210 (9th Cir. 1962).

[43] 291 F.2d at 274.

[44] Id.

[45] 495 F.2d at 729-30.

[46] See id. at 728.

its position that common law fraud need not be alleged or proved to recover in a Rule 10b-5 case and clarified the meaning of the above-quoted language from *Ellis*. The court explained that "Rule 10b-5 . . . only requires proof of a material misstatement or an omission of a material fact in connection with the purchase or sale of any security *to make out a prima facie case.*"[47] However, the court did not delineate a standard of liability for ultimate recovery.

In the *White* opinion, the Ninth Circuit emphasized that *Royal Air* merely expressed the standard applicable to motions to dismiss or for a directed verdict at the end of plaintiff's case, and did not articulate the standard for recovery.[48] With the benefit of this clarification, it is possible to interpret *Ellis* and *Royal Air* as holding simply that the Ninth Circuit does not require proof of strict common law fraud, in the sense of intent to deceive, for liability under Rule 10b-5.

In *White,* the Ninth Circuit repudiated the traditional analysis in Rule 10b-5 cases by adopting the flexible duty standard. The court's avowed rationale for this break was the unworkability of a single standard in the varied factual contexts arising in Rule 10b-5 cases.[49]

The way in which the Ninth Circuit's analysis under Rule 10b-5 differs from that of the Second Circuit is revealed by a comparison of the two courts' treatments of the concept of duty. Although the Second Circuit has not formulated its standard of liability in terms of duty, it is possible to express the reckless disregard standard in terms of the duty it imposes, since the concept of duty is merely a shorthand statement of the conclusion of whether a plaintiff's interests are entitled to legal protection from the conduct of the defendant.[50] Thus, the Second Circuit recognizes first a duty that is fixed and objective: to disclose material facts actually known to the defendant.[51] In order to promote the policies of the federal securities laws, there are additional facts that a defendant is presumed to know. From this conclusion, there arises a subordinate duty of investigation to discover material facts requiring disclosure. Under the reckless–disregard standard, this duty of investigation is imposed where the defendant is, in some way, put on notice of a possible failure of disclosure of a material fact.[52]

In contrast to the fixed, objective duty of the defendant in the Second Circuit's mode of analysis, the analysis adopted by the Ninth

[47] 312 F.2d at 212 (emphasis added).
[48] 495 F.2d at 730.
[49] Id.
[50] W. Prosser, supra note 28, § 53, at 325.
[51] SEC v. Texas Gulf Sulphur Co., 401 F.2d at 848.
[52] Lanza v. Drexel & Co., 479 F.2d at 1306 n.98.

Circuit results in a flexible duty that will vary with each fact situation: "[T]he proper standard to be applied is the extent of the duty that Rule 10b-5 imposes on this particular defendant."[53] The particular duty imposed upon a defendant is to be determined by focusing "on the goals of the securities fraud legislation by considering a number of factors that have been found to be significant in securities transactions."[54] Although it is not clear from the *White* opinion whether, in a jury trial, the court or the jury is to make this determination,[55] the subsequent 1974 decision by the Ninth Circuit in *Marx v. Computer Sciences Corp.*[56] indicates that the question of the defendant's duty is to be left to the jury.[57]

By leaving the question of a defendant's duty to the trier of fact, the court in *White* has avoided specifying a single theory of liability under Rule 10b-5. Indeed, by providing that the "standard" is the "duty,"[58] the Ninth Circuit has in fact avoided specifying any standard at all by which a defendant's duty may be measured. Moreover, by its failure to provide any guidance to the trial court in instructing the jury on the requisite degree of culpability, the court has formulated a "standard" that will allow the theory of liability to vary in each case: the court indicated that the flexible duty may vary from "a duty to use extreme care in assuring that all material information is accurate and disclosed"[59] to "only [a] duty . . . not to misrepresent intentionally material facts."[60]

It is difficult to predict how the *White* standard will operate in practice. The factors that the Ninth Circuit enumerated in *White* —relation between the parties, relative access to information, benefit derived by defendant, defendant's awareness of plaintiff's reliance, and defendant's initiative in the transaction[61]—merely call the attention of the trier of fact to the categories of facts that will be determinative of liability, without giving the trier any guidance in making that determination. Having considered these factors, which will be present in any securities transaction, and arrived at a score on each factor, the only formula that the trier of fact will have for combining those scores to yield a yes-or-no decision on liability is: "[t]he . . . standard . . . is the extent of the duty."[62]

Thus, under the flexible duty standard, juries in the Ninth Circuit will have to rely ultimately on their basic sense of fairness,

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[53] 495 F.2d at 734-35.

[54] Id. at 735. The factors are set out in the text at note 11 supra.

[55] In one paragraph, the court says: "In making this determination the *court* should focus . . . ," while in the next paragraph the court directs: "we feel the court should . . . require the *jury* to consider the [factors] . . . ." Id. (emphasis added).

[56] 507 F.2d 485 (9th Cir. 1974).

[57] Id. at 490.

[58] See text at note 53 supra.

[59] 495 F.2d at 736.

[60] Id.

[61] Id. at 735-36.

[62] Id. at 734-35. See text at note 53 supra.

*i.e.*, of what it is reasonable to require of a defendant. However, since a jury will have no formula for balancing the factors, it may conceivably impose liability for a high score on any single factor. As a result of this discretion, persons engaged in securities transactions will have to reckon with a *de facto* negligence standard of liability under Rule 10b-5, with the option available to defense counsel at trial of arguing for the imposition of liability only for more culpable conduct in a particular case. For, although a defendant might succeed at trial in persuading the trier of fact that his duty was only to avoid intentional misrepresentation, it will be unwise for persons engaged in securities transactions, anxious to avoid liability, to fail to make a reasonable investigation in all cases, since juries will have the option of holding them to a negligence standard.

The overly broad discretion vested in juries and the resultant uncertainty for persons engaged in securities transactions are the practical effects of the theoretical deficiencies of the flexible duty standard. It would be logical to adopt a negligence approach and thereby to conclude that a defendant's duty will vary with the fact situation. This would merely recognize that, in negligence cases, the jury determines the particular standard by deciding whether the defendant has exercised the ordinary care of a reasonable man under the particular circumstances. However, it is something quite different to allow the jury to impose liability, on the ground of breach of a duty, upon one defendant for failure to exercise ordinary care and upon another only for injury inflicted upon the plaintiff intentionally. It is always the function of the jury, in a negligence case, to determine the degree of diligence required of a defendant in order to qualify his conduct as that of a reasonable man under the circumstances.[63] It is never the function of the jury, however, to choose the theory of liability, *i.e.*, negligence or intent.[64] The Second Circuit's debate over liability for scienter versus negligence was necessary since the statute and Rule leave room for disagreement as to whether Congress intended to impose liability only for fraudulent intent or for negligence as well.

That recklessness and negligence are not absolutes, capable of being objectively applied, is well illustrated by the three opinions in *Lanza*. Judge Moore, speaking for the court, concluded that the circumstances shown by the record were not sufficient as a matter of law to put the outside director, Coleman, on notice of a possible material failure of disclosure.[65] Judge Hays, in a dissenting opinion, argued that the imposition of liability for negligence was appropriate for the protection of investors, and that Coleman's conduct was negligent.[66] Judge Timbers, in another dissent, also thought that Coleman should be liable, but on the ground that his conduct

[63] W. Prosser, supra note 28, § 37, at 207.

[64] Id. § 37, at 206.

[65] Lanza v. Drexel & Co., 479 F.2d 1277, 1289 (2d Cir. 1973) (en banc).

[66] Id. at 1319 (dissenting opinion).

showed reckless disregard for the truth.[67] Thus, Judge Hays and Judge Timbers found that liability should be imposed, but disagreed on whether the same body of facts showed negligence or reckless disregard for the truth.

Despite the disagreement that specific fact situations may generate, it is imperative, in view of the two distinct theories of liability of which Rule 10b-5 arguably admits, that the Ninth Circuit choose between the theories and not leave the question to the jury. Although recklessness and negligence are boundaries of a spectrum of conduct rather than absolute standards,[68] nevertheless, it is essential that the Ninth Circuit indicate to the lower courts its preference for one end of the spectrum in formulating a standard of liability for private actions under Rule 10b-5. Once the court of appeals has chosen between the recklessness end of the spectrum and the negligence end, there remains the problem of articulating a standard of liability in Rule 10b-5 cases, that is, a verbal formula that will be flexible enough to accomplish the goals of the statute and Rule in a wide range of fact situations while specifically directing the trier of fact to impose liability only on the basis of the chosen theory.

Herein lies the strength of the Second Circuit's mode of analysis: its effectiveness in balancing the criteria of flexibility and specificity. The Second Circuit's latest formulation of the state-of-mind element is whether the defendant "knew the material facts misstated or omitted, or failed or refused, after being put on notice of a possible material failure of disclosure, to apprise [himself] of the facts when [he] could have done so without any extraordinary effort."[69] The requirement of notice specifies to the jury that some degree of awareness is required for the imposition of liability. Furthermore, the formulation in terms of notice is sufficiently flexible to encompass the variety of fact situations arising under Rule 10b-5. Although the sufficiency of certain information to put a defendant on notice will vary, depending upon factors similar to those which the Ninth Circuit enumerated in *White*,[70] the concept of notice is broad enough to allow a jury to weigh these factors in a specific fact situation without resort to what the Ninth Circuit called "jamming facts together in an effort to fit the concept."[71]

Although the Ninth Circuit's flexible duty standard is not sufficiently specific, nonetheless, if it is determined as a matter of law that Rule 10b-5 imposes liability for negligence, then the factors enumerated by the Ninth Circuit in defining the flexible duty standard will be useful to a jury in evaluating a defendant's conduct to

[67] Id. at 1321 (dissenting opinion).

[68] A recent comment on Rule 10b-5 contended that the courts have actually been applying "a sliding scale [in determining] what constitutes sufficiently diligent conduct to avoid 10b-5 liability." Mann, Rule 10b-5: Evolution of A Continuum of Conduct To Replace The Catch Phrases of Negligence And Scienter, 45 N.Y.U.L. Rev. 1206, 1209 (1970).

[69] Lanza v. Drexel & Co., 479 F.2d at 1306 n.98. See text at note 39 supra.

[70] White v. Abrams, 495 F.2d 724, 735-36 (9th Cir. 1974). See text at note 11 supra.

[71] 495 F.2d at 736.

discover the presence or absence of the degree of care that a particular fact situation may require. A consideration of the *White* factors will help the jury determine what a reasonable man in defendant's position would have done.

It is submitted that the traditional concept of negligence, developed by the common law in response to a need for flexibility in handling a range of fact situations, should be incorporated into the *White* standard to satisfy the need for specificity as to the theory of liability. The federal courts have found the concept of a reasonable man useful in defining the other principal element of a private action—materiality[72]—and there is no reason why this concept may not be applied in the context of the degree of culpability. This could be done by defining the general duty imposed upon a defendant by Rule 10b-5 as that of making a reasonable investigation, and by requiring the jury to consider the factors enumerated in *White* when determining whether a defendant's investigation in a particular case was reasonable.

In sum, the *White* factors could, with the addition of the requirement of a reasonable investigation, provide a suitable standard for imposing liability under a negligence theory. However, it is submitted that it is not permissible to allow the theory of liability in a private action under Rule 10b-5 to vary from case to case as it will under the *White* standard of liability. Not only is it contrary to the theory of our legal system to allow the jury to determine the law applicable to a given set of facts, but it is also unfair as a matter of practice to give those engaged in securities transactions no prospective guidelines for conforming their behavior to the requirements of the securities laws. A buyer or seller of securities, in order to know how thorough an investigation is required of him in a particular transaction, needs to know whether section 10(b) and Rule 10b-5 impose liability on an intent theory or on a negligence theory.

JEFFREY B. STORER

**Corporations—Mismanagement—Equitable Principles Applicable to the Issue of Standing—*Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad Co.*** [1]—On October 13, 1964, petitioner Bangor Punta Corp. (Bangor Punta)[2] acquired 98.3% of the outstanding

[72] "A material fact is one to which a reasonable man would attach importance in determining his choice whether to make the sale or not." Ross v. Licht, 263 F. Supp. 395, 408 (S.D.N.Y. 1967).

[1] 417 U.S. 703 (1974).

[2] Bangor Punta, a Delaware corporation, is a diversified investment company. It effected this transaction, the subsequent sale of the assets of the Railroad, and the other transactions forming the basis of the complaint through its wholly-owned subsidiary, petitioner Bangor-Punta Operations, Inc., a New York corporation. Throughout the litigation, Bangor Punta