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There Should Be No Reliance in the "Blue Sky"

David O. Blood

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I. INTRODUCTION

Since the Uniform Securities Act[1] (Uniform Act) was adopted by the National Conference of Commissioners on Uniform State Laws in 1956, much confusion has persisted concerning the issue of whether reliance should be a required element in a cause of action for securities fraud under the Uniform Act. Perhaps this confusion exists because reliance is an indispensable element of common law fraud and is necessary to establish a causal link between the alleged fraud and the injury suffered.[2] Likewise, in the specific area of federal securities fraud, the implied civil right of action based on Rule 10b-5[3] also requires a showing of reliance.[4] Despite the importance of reliance in these two areas, however, it should not be a required element of a

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1. UNIF. SECURITIES ACT, 7B U.L.A. 509 (1958); *see also* LOUIS LOSS, COMMENTARY ON THE UNIFORM SECURITIES ACT 5 (1976). In 1985, the National Conference of Commissioners on Uniform State Laws adopted a new Uniform Securities Act, which five jurisdictions have adopted. *See* UNIF. SECURITIES ACT, 7B U.L.A. 99 (1988) (Supp. 1997). The language in the new Uniform Securities Act that is relevant to the issue of reliance as an element of securities fraud, however, is substantially similar to that in the Uniform Securities Act of 1956. Furthermore, the significant majority of jurisdictions that have adopted the Uniform Act did so based on the 1956 version. Thus, references in this Comment are to the Uniform Securities Act of 1956.

2. *See* Field v. Mans, 116 S. Ct. 437, 444 (1995) (holding that "both actual and 'justifiable' reliance are required" for a claim of fraudulent misrepresentation (citing RESTATEMENT (SECOND) OF TORTS § 537 (1965))); *see also* Union Pac. R.R. Co. v. Village of South Barrington, 958 F. Supp. 1285, 1297 (N.D. Ill. 1997) (stating that Illinois law of fraudulent misrepresentation requires reliance); Deshais v. Consolidated Rail Corp., 956 F. Supp. 230, 239 (N.D.N.Y. 1997) (stating that reliance is required under New York common law fraud); WILLIAM L. PROSSER, HANDBOOK OF THE LAW OF TORTS 714 (4th ed. 1971) ("The causal connection between the wrongful conduct and the resulting damage . . . takes in cases of misrepresentation the form of inducement of the plaintiff to act, or to refrain from acting, to his detriment." (footnote omitted)).

3. *See* Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240 (1997). Rule 10b-5 was modeled after Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (1997).

4. *See* Oppenheimer v. Prudential Sec. Inc., 94 F.3d 189, 194 (5th Cir. 1996) (noting that the requirements for a civil cause of action based on Rule 10b-5 are "basically identical" to the requirements of common law fraud, which include reliance (citing Shores v. Sklar, 647 F.2d 462, 468 (5th Cir. 1981))).

fraud action under the Uniform Act. The clear language of the Uniform Act, which has been substantially adopted by most jurisdictions,[5] does not include an element of reliance in the explicit cause of action, and the Draftsmen's Commentary expressly states an intent to exclude it as an element. Furthermore, a reliance requirement is contrary to the sound policy of the Uniform Act in favor of protecting the investor and deterring fraud in the purchase and sale of securities. In spite of this reasoning, the issue of whether reliance is an element of state securities fraud actions that are based on the Uniform Act continues to be raised in litigation.[6]

Many of the jurisdictions that have addressed this issue have correctly determined that reliance is not required,[7] but there are conflicting opinions that would impose some element of reliance into the otherwise clear statute.[8] The opinions that suggest that reliance should be required tend to improperly confuse the policies and requirements of the Uniform Act with those found in other areas of fraud.[9] In light of the clear language of the Uniform Act, coupled with the drafters' comments and the important policies underlying the Uniform Act, it is time to clearly resolve the reliance issue and to restrain those jurisdictions and judges inclined to impose an element of reliance.

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5. At least 39 jurisdictions have substantially adopted the Uniform Securities Act with modifications. They are: Alabama, Alaska, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Guam, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, Oklahoma, Oregon, Pennsylvania, Puerto Rico, South Carolina, Tennessee, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. *See* BLUE SKY LAWS 1990 app. B at 578 (Practicing Law Institute ed., 1990). "In addition, [one or more] parts of the Uniform Act have been adopted . . . in Georgia, Illinois, New York, Rhode Island, Texas, and Vermont[; and] sizable portions [have been adopted] in California, Connecticut, Maine, and North Dakota." LOSS, *supra* note 1, at vi.

6. Within the last year, this issue has been raised in at least two cases. In one case the court properly declined to find any requirement of reliance after careful consideration of the applicable statute. *See* Connecticut Nat'l Bank v. Giacomi, 699 A.2d 101, 120 n.37 (Conn. 1997). In the other case, however, the court merely presumed, without any analysis, that reasonable reliance is "perhaps" required. *See* Dinco v. Dylex Ltd., 111 F.3d 964, 971 (1st Cir. 1997). Prior to these two cases, another court decided a case where the question of reliance was the sole issue to be resolved. Over a vigorous dissent and a split court, the majority properly held that reliance is not required. This conclusion, however, is arguably confused by some language that suggested an objective reliance requirement. *See* Gohler v. Wood, 919 P.2d 561 (Utah 1996).

7. *See infra* note 95.

8. *See infra* note 96.

9. *See infra* text accompanying notes 95-100.

This Comment argues that the Uniform Act does not require reliance as an element for a state securities fraud cause of action. Part II provides some background on the issue of reliance as an element of state securities fraud, with particular emphasis on the purpose of state securities regulation to protect investors from fraud. This background is essential to gain an understanding of the policies against importing a reliance element into state securities fraud. Part III analyzes the language and objectives of the Uniform Act, revealing that reliance should not be a required element of state securities fraud causes of action based on the Act. Part III also responds to anticipated criticisms from they who would argue that reliance should be required by the Uniform Act. This Comment concludes that only when all jurisdictions that have adopted the Uniform Act properly find that reliance is not required will the goals of uniform application, deterrence of fraud and increased investor protection be fully accomplished.

II. BACKGROUND TO STATE SECURITIES LAWS

One of the primary purposes of the "anti-fraud securities laws and rules is to equalize the bargaining power of parties to securities transactions and provide equal access to all material information that could affect the value of the securities being sold."[10] Although the federal antifraud provisions administered by the Securities and Exchange Commission (the SEC) are probably more commonly recognized, state statutes on the subject existed long before the Federal Securities Act of 1933.[11] State legislation in securities fraud is commonly broader in its scope and application than federal legislation in order to further the purposes of securities regulation.[12]

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10. Daniel Blue Dean, Comment, *Securities—Underdevelopment of Securities Fraud in North Carolina Courts and the Potential Effect of the North Carolina Securities Act of 1975*, 53 N.C. L. REV. 1104, 1113 (1975); *see* Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951).

11. *See* Rosenthal v. Dean Witter Reynolds, Inc., 908 P.2d 1095, 1100 n.8 (Colo. 1995) (noting that the FTC and SEC "looked to the states, where securities regulation in the country began"); *see also* James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29 (1959) (providing a general history and commentary of the Federal Securities Act of 1933).

12. *See infra* Part III.A.2.a.

Although Kansas is often credited with enacting the first "blue sky law" in 1911,[13] Massachusetts regulated all chartered railroad companies and established filing requirements in 1852.[14] Similarly, Connecticut regulated the offering of shares in mining and oil companies as early as 1903.[15] Kansas was, however, "the first state to enact a comprehensive licensing system applicable to securities and persons engaging in the securities business."[16] The Kansas legislation also has the reputation of pioneering the "paternalistic concept"[17] of securities regulation, which is characterized by its increased protection of the common investor. Following this enactment, the paternalistic concept began to spread to other jurisdictions as "government officials in practically all of the states requested copies of the Kansas law."[18] In fact, twenty-three jurisdictions enacted similar or identical legislation within two years.[19] Thus, it is evident that from the very beginning of securities regulation, protection of the investor was foremost among the goals of such enactments.

This paternalistic concept of securities regulation has persisted in modern blue sky laws, such as the Uniform Act.[20] The

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13. *See* JOSEPH C. LONG, 1985 BLUE SKY LAW HANDBOOK 1-1 (1985). State securities laws are commonly referred to as "blue sky laws." The term is believed to have originated in Kansas, which was the first state to enact such regulations pertaining to securities. The name probably originated from early comments such as: "'[F]rauds became so barefaced that it was stated that they would sell building lots in the blue sky in fee simple.'" LOUIS LOSS & EDWARD M. COWETT, BLUE SKY LAW 7 n.22 (1958) (quoting Mulvey, *Blue Sky Law*, 36 CAN. L.T. 37 (1916)); *see also* Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917) (defining blue sky laws as those laws aimed at "speculative schemes which have no more basis than so many feet of 'blue sky'").

"No two of the state acts are identical. And the amount of variation and frequently unnecessary complexity in both substance and verbiage is staggering." LOSS & COWETT, *supra* at 18-19; *see also* RICHARD W. JENNINGS ET AL., SECURITIES REGULATION: CASES AND MATERIALS 1618-19 (7th ed. 1992) (describing the different emphases and effects of the varying state statutes); Wallace R. Bennett, *Securities Regulation in Utah: A Recap of History and the New Uniform Act*, 8 UTAH L. REV. 216, 228 (1963) (quantifying differences found in state statutes prior to the Uniform Act).

14. *See* LOSS & COWETT, *supra* note 13, at 3-4 (citing 1852 Mass. Acts 303).

15. *See id.* at 5 (citing 1903-05 Conn. Pub. Acts 196).

16. *Id.* at 7; *see also* LONG, *supra* note 13; JAMES S. MOFSKY, BLUE SKY RESTRICTION ON NEW BUSINESS PROMOTIONS 10 (1971).

17. MOFSKY, *supra* note 16, at 11; *see also* LOSS & COWETT, *supra* note 13, at 21 ("The justification for the blue sky laws must rest upon the degree of protection which they afford to the investing public."); *infra* notes 57-61 and accompanying text.

18. MOFSKY, *supra* note 16, at 11.

19. *See* LOSS & COWETT, *supra* note 13, at 10 & nn.28-29.

20. *See* Benjamin v. Cablevision Programming Invs., 499 N.E.2d 1309, 1315 (Ill. 1986) (emphasizing the paternalistic nature of the Uniform Securities Act as applied in Illinois); Space v. E.F. Hutton Co., 544 N.E.2d 67, 70 (Ill. App. Ct. 1989).

concept necessarily requires securities regulations to be construed broadly in order to increase the net of protection they provide.[21] With the paternalistic concept of securities regulation in mind, courts have been asked to address several questions that relate to the scope of such statutes. For example, courts have defined who may be held liable under particular state laws[22] and who may have standing to sue under those laws.[23] Most importantly for the purposes of this Comment, courts have discussed whether the elements of common law fraud are incorporated into state securities fraud,[24] as they often are in the federal context.[25] For example, two of the common law elements discussed in cases regarding the Uniform Act are scienter[26] and reliance.[27]

The issue of reliance as an element of state securities fraud based on the Uniform Act has been raised in several jurisdictions that have adopted the Uniform Act. Althongh many of those jurisdictions have properly declined to require an element of reliance,[28] there is also significant precedent reaching the opposite result.[29] As will be shown, this opposing precedent is

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21. *See infra* Part III.A.2.a.

22. *See* Levitz v. Warrington, 877 P.2d 1245 (Utah Ct. App. 1994).

23. *See* Zack Co. v. Sima, 438 N.E.2d 663 (Ill. App. Ct. 1982).

24. *See* Mirkin v. Wasserman, 858 P.2d 568, 580 (Cal. 1993) ("The very purpose of [the state securities law] statutes is to 'afford the victims of securities fraud with a remedy without the formidable task of proving common law fraud.'"). A common law fraud claim typically includes elements such as "that a representation was made; that it concerned an existing material fact; that it was false; that the person making the representation knew it to be false or made the statement recklessly, knowing he had insufficient knowledge on which to base the representation; that it was made to induce action; that the other party acted on it reasonably and in ignorance of its falsity; that the other party did in fact rely on the statement; that he was induced to act; and that he thereby suffered injury and damage." Young v. Taylor, 466 F.2d 1329, 1334 (10th Cir. 1972).

25. *See* Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988) ("The Court previously has addressed various . . . common-law requirements for a violation of § 10(b) or of Rule 10b-5.").

26. *See* State v. Larsen, 865 P.2d 1355 (Utah 1993); *see also* Stephen R. Sloan, Note, *Development: Recent Developments in Utah Case Law: Specific Intent to Deceive Manipulate, or Defraud Not Required for Conviction Under Securities Fraud Statute,* 1995 UTAH L. REV. 271. Scienter is defined as the "intent to defraud," which describes the requisite fault required for a cause of action under Federal Rule 10b-5. Such specific intent is not required under the Uniform Securities Act. *See Larsen*, 865 P.2d 1355.

27. *See infra* notes 95-96 (providing several examples of states deciding whether reliance is required by specific state securities acts).

28. *See infra* note 95.

29. *See infra* note 96.

erroneous for two main reasons. First, it is clearly contrary to the express requirements of the statute—particularly when examined in conjunction with the official and Draftsmen's Commentary—and it is improper for a court to add requirements to a clearly defined legislative cause of action.[30] Second, such a result is contrary to the purpose of the Uniform Act, which is to increase protection to the common investor.[31] Increasing the burden on the plaintiff beyond the explicit requirements of the statutory cause of action necessarily diminishes the probability of that plaintiff obtaining redress for harm caused.[32] Furthermore, such a requirement limits class action certification, the only practicable form of many actions for securities fraud violations.[33]

III. ANALYSIS

The following analysis explains why an examination of the statutory language, Draftsmen's Commentary, and the underlying purposes of the Uniform Act, suggests that an element of reliance should not be required. This analysis will first focus on the language of the Uniform Act providing liability for securities fraud violations. Furthermore, the ramifications of the conclusion that reliance is not a required element will be reviewed in light of the explicitly stated policy favoring uniformity and other objectives of the Uniform Act. Finally, this analysis will respond to two major criticisms of excluding reliance: first, that it creates a dichotomy between federal and state systems of securities fraud regulations; and second, that the causation requirement is eliminated without the inclusion of a reliance element.

A. Application and Purposes of the Uniform Securities Act

1. The explicit language and official commentary of the Uniform Securities Act suggest that reliance should not be a required element of securities fraud

Courts should "'interpret a statute according to its plain language, unless such a reading is unreasonably confused, inop-

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30. *See infra* text accompanying note 50.

31. *See infra* Part III.A.2.a.

32. *See* Jadoff v. Gleason, 140 F.R.D. 330, 334 (M.D.N.C. 1991) ("Failure of Plaintiffs to show reliance is grounds for dismissal of their claims.").

33. *See infra* note 155 and accompanying text.

erable, or in blatant contravention of the express purpose of the statute.'"[34] Accordingly, the analysis of any statutory cause of action should begin with the language of the relevant provisions imposing liability. Civil liability based on the Uniform Act results from joint application of two separate provisions of the Act: sections 101 and 410(a).

Section 101 is the principle provision of the Uniform Act regulating fraudulent activity in the purchase or sale of securities. Specifically, section 101 provides:

> It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly
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> (1) to employ any device, scheme, or artifice to defraud,
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> (2) 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 circumstance under which they are made, not misleading, or
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> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[35]

Although this language makes fraudulent conduct in connection with securities transactions unlawful, it is clearly devoid of any language providing for sanctions or civil liability based on its violation. Consequently, in order to bring a civil cause of action based on a violation of this provision, the potential plaintiff must show either that some other section of the Uniform Act provides for civil liability, or that such liability is implied.

This is not a problem, however, because civil liability for fraud based on the Uniform Act is specifically provided for by section 410(a). The relevant language provides:

> (a) Any person who
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> . . . .
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> (2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and

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34. Gohler v. Wood, 919 P.2d 561, 562-63 (Utah 1996) (quoting Perrine v. Kennecott Mining Corp., 911 P.2d 1290, 1292 (Utah 1996)); *see also* Schurtz v. BMW, Inc., 814 P.2d 1108, 1112 (Utah 1991).

35. UNIF. SECURITIES ACT § 101, 7B U.L.A. 516 (1958).

> who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him . . . .[36]

This section explicitly provides civil liability for fraudulent conduct in the offer or sale of securities. Furthermore, by its terms this provision does not require an element of reliance. To the contrary, the language of this statute states only three elements of a cause of action. The plaintiff is required to prove that:

> (i) defendants, in connection with the offer or sale of a security, either made an untrue statement of a material fact or omitted to state a material fact; (ii) plaintiffs did not know of the untruth or omission; and (iii) defendants knew or in the exercise of reasonable care could have learned of the untruth or omission.[37]

Only the second of these elements addresses the state of mind of the plaintiff, and it merely requires lack of knowledge of the untruth or omission.[38] Clearly, there is no explicit requirement of reliance in the statutory language of the Uniform Act.

Since the language of the Uniform Act imposing civil liability for violation of section 410(a) does not explicitly include an element of reliance,[39] justification for imposing such a requirement can only be based on an implied cause of action, as in the federal arena.[40] If a cause of action were implied based on section 101 of the Uniform Act, it is logical that reliance would be required, as it is with the federal implied right.[41] The language of the Uniform Act, however, prevents this result by explicitly prohibiting implication of any new cause of action based on the Act. Section 410(h) provides, "The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, *but this act does not create any cause of action*

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36. UNIF. SECURITIES ACT § 410(a)(2), 7B U.L.A. 643 (1958).

37. *Gohler*, 919 P.2d at 563 (interpreting the state equivalent to the Uniform Act) (citations omitted).

38. *See id.*

39. *See supra* text accompanying note 36.

40. *See* Basic Inc. v. Levinson, 485 U.S. 224 (1988); *see also infra* text accompanying note 127. Section 101 of the Uniform Act is analogous to Federal Rule 10b-5, on which a federal implied cause of action has been based. *See infra* note 77.

41. *See infra* notes 77-78.

not specified in this section."[42] Thus, the drafters clearly intended to prohibit the judicial creation of implied causes of action based on the Uniform Act,[43] and consequently precluded inclusion of a reliance element by implication.

This interpretation of the Uniform Act's language is further supported by the official and Draftsmen's Commentary to the Act, which is the primary form of legislative history available. Relating to civil liability based on section 101 of the Uniform Act, the official comment to this section states that "[t]he sanctions for the conduct which is made 'unlawful' by [section] 101" are found in other parts of the Uniform Act.[44] Specifically as it relates to civil liability, the comment states: "Section 410(h) provides that 'unlawful' conduct does not result in civil liability except as provided in [section] 410."[45] Jointly, these comments support the proposition that liability for fraudulent securities transactions is solely provided for by section 410(a), and that any implication of a cause of action is inappropriate.

The Draftsmen's Commentary to section 410(a) further supports the conclusion that reliance is not required. Section 410(a)(2) imposes liability for any "offer or [sale of] a security by means of any untrue statement."[46] Some argue that this clause may suggest implication of some degree of reliance.[47] The commentary is clear, however, that "[t]he 'by means of' clause . . . is not intended as a requirement that the buyer prove *reliance* on the untrue statement or the omission. He must show only that he *did not know of it*."[48] Therefore, the only provision of the Uni-

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42. UNIF. SECURITIES ACT § 410(h), 7B U.L.A. 643 (1958) (emphasis added).

43. "Section 410(h) . . . was intended to assure that the courts did not recognize an implied private right of action under Section 101 despite the similarity of Section 101 to Rule 10b-5 and the well-settled law recognizing such a right under Rule 10b-5." Eacho v. N D Resources, Inc., Fed. Sec. L. Rep. (CCH) ¶ 92,067, at 91,328 (D.C. May 23, 1985).

44. UNIF. SECURITIES ACT § 101, 7B U.L.A. 516 (1958) (Official Comment to § 101).

45. *Id.*

46. LOSS, *supra* note 1, at 145.

47. *See* Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225 (7th Cir. 1980) ("[T]he 'by means of' language in the statute requires some causal connection between the misleading representation or omission and plaintiff's purchase . . . ."); *see also* Roger W. Tompkins, *The Uniform Securities Act—A Step Forward in State Regulation*, 77 W. VA. L. REV. 15, 41 (1974) ("The phrase 'by means of' is unclear. Need the buyer heve relied on the untrue statement or omission, *or* must he show only that he did not know of it?").

48. LOSS, *supra* note 1, at 148 (Draftsmen's Commentary to § 410(a)) (emphasis in original).

form Act that imposes civil liability for fraudulent securities transactions is section 410(a), which–by its terms, as supported by the official and Draftsmen's Commentary–clearly does not require reliance.[49] Since the cause of action defined in the Uniform Act is expressly provided, there is no reason to further define the Act's elements. In fact, "it would be inappropriate to do so when the legislature has already [defined the elements]."[50]

2. Following the explicit language of the Uniform Securities Act by not requiring reliance will further the purposes of the Act

Even though the plain language of the Uniform Act does not require reliance, an alternative interpretation may be appropriate if the plain language is "'in blatant contravention of the express purpose of the statute.'"[51] Consequently, the analysis is not complete without identifying the purpose of the Uniform Act and verifying that the plain language interpretation is in accordance with such purposes. While it is difficult to pinpoint the primary purpose of the Uniform Act in regulating securities fraud, statutory language, official and Draftsmen's Commentary, and previous judicial opinions all help identify several important objectives of the Uniform Act. Among these objectives are protection of investors and deterrence of fraud,[52] and uniformity and correlation between related federal and state provisions.[53] Each of these objectives and considerations will be discussed as they relate to the issue of requiring an element of reliance for civil liability for securities fraud under the Uniform Act.

a. The Uniform Securities Act serves a dual purpose of protecting investors and deterring fraud. Some commentators recently observed that "[s]ecurities fraud private actions are not only a vehicle for compensating the victims of fraud, but play a tremendously important and relatively unappreciated role in deterring fraud and, perhaps more importantly, in deterring . . .

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49. *See supra* text accompanying note 36.

50. Gohler v. Wood, 919 P.2d 561, 565 (Utah 1996).

51. *Id.* at 563 (quoting Perrine v. Kennecott Mining Corp., 911 P.2d 1290, 1292 (Utah 1996)); *see also* Schurtz v. BMW, Inc., 814 P.2d 1108, 1112 (Utah 1991).

52. *See infra* Part III.A.2.a.

53. *See* LOSS, *supra* note 1, at 165 (noting that Uniform Securities Act § 415 specifically states a policy to "make uniform the law of those states which enact [the Act] and to coordinate the interpretation . . . with the related federal regulation").

reckless[ness] with the truth."[54] Clearly, the purpose of protecting the investor is furthered by deterring fraudulent securities transactions. Many jurisdictions have acknowledged the importance of deterring securities fraud. For example, one court stated that the Uniform Act's "objective was to . . . impos[e] a higher standard of ethics and responsibility upon the sellers of securities."[55] Furthermore, the importance of protecting the investor is clear in the court's statement that the Uniform Act was "intended to reduce the buyer's burden of investigation and inquiry, and make it easier for him to obtain redress on the basis of deception."[56] To the extent that it is easier for the buyer to obtain redress, the level of deterrence is increased.

Since the beginning of blue sky laws, such securities regulations have typically been paternalistic in nature.[57] The first state securities regulation promoted a "merit approach,"[58] which essentially prohibited the sale of securities representing high risk to investors, thus "advocat[ing] the protection of the common man from American industry's robber barons."[59] The paternalistic approach to securities regulation has continued in modern case law. One court suggested that securities laws "were enacted for the very purpose of protecting those who lack business acumen."[60] More recently, courts have echoed this point of view in applying the Uniform Act by adopting a broad view of the paternalistic nature of their state securities acts. One such court stated, "Just as this State has an interest in protecting

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54. HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, EMERGING TRENDS IN SECURITIES LAW xvi (1995).

55. S & F Supply Co. v. Hunter, 527 P.2d 217, 220-21 (Utah 1974).

56. *Id.* at 221; *see also* Wallace R. Bennett, *Should Utah Adopt the New Uniform Securities Act?*, 5 UTAH L. REV. 472, 492 (1957) (recognizing the increased protection that would be afforded to the investor under the Uniform Securities Act).

57. *See* MOFSKY, *supra* note 16, at 10; *see also* LOSS & COWETT, *supra* note 13, at 21 ("The justification for the blue sky laws must rest upon the degree of protection which they afford to the investing public.").

58. MOFSKY, *supra* note 16, at 10 ("[The Kansas Act] advocated a merit approach to securities and the persons engaged in the securities business."); *see* LOSS & COWETT, *supra* note 13, at 8 ("The statute introduced standards for denial of permits [required to sell securities] which must have seemed shockingly broad."). For a general discussion of "Merit Regulation" see MOFSKY, *supra* note 16, at 15-30; *see also* Charles H.B. Braisted, *Merit Regulation*, *in* BLUE SKY LAWS 1990, *supra* note 5, at 47; Jeffrey B. Bartell, *Merit Regulation and Clearing Strategy*, *in* STATE REGULATION OF CAPITAL FORMATION AND SECURITIES TRANSACTIONS 315 (Practising Law Institute 1983).

59. MOFSKY, *supra* note 16, at 10.

60. United States v. Monjar, 47 F. Supp. 421, 425 (D. Del. 1942), *aff'd*, 147 F.2d 916 (3d Cir. 1945).

those within its borders from unscrupulous conduct, it also must be concerned with and seek to prevent those within its borders from engaging in such conduct."[61]

The very language of the Uniform Act suggests a policy of protecting the investor and deterring fraud through broad application of the Uniform Act. For example, section 410(a)(1) imposes liability on any person who fraudulently "offers or sells" a security.[62] The Draftsmen's Commentary of the Uniform Act suggests that one reason liability is imposed for a mere offer to sell is because "civil liability may be the only effective sanction to enforce the prohibition against pre-effective offers,"[63] thus increasing protection of the investor. Another section of the Uniform Act that provides increased protection is section 410(g), which specifically prohibits waivers of "compliance with any provision of the Act . . . . Thus, the unsophisticated investor is protected against himself."[64]

To further the purpose of the Uniform Act of increasing protection to the investor and deterring fraud, the probability of liability should be increased, while the burden on the party seeking redress for fraudulent activity should be decreased, in relation to that required by common law. Particularly in the area of securities, where there is greater "potential for fraud and unfair dealings when insiders and sophisticated investors deal with private investors,"[65] incentives should be increased to deter such conduct. One way to create such incentives is to relax the elements of common law fraud when dealing with securities fraud.[66] Accordingly, one court found that statutes such as the antifraud provision of the Uniform Act "were enacted to protect investors by relaxing the proof requirements necessary to prevail in other common law or statutory actions."[67] Another court suggested, "This and other courts have uniformly emphasized the need to interpret this rule flexibly so as to prevent fraud. And there is no need to prove the elements of common law

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61. Benjamin v. Cablevision Programming Invs., 499 N.E.2d 1309, 1315 (Ill. 1986).
62. UNIF. SECURITIES ACT § 410(a), 7B U.L.A. 643 (1958).
63. LOSS, *supra* note 1, at 147.
64. Tompkins, *supra* note 47, at 41.
65. Dean, *supra* note 10, at 1109.
66. *See id. But see infra* note 152 and accompanying text (discussing the counterarguments to liberal construction of the Uniform Act in the interest of investor protection, particularly as the element of causation may be eliminated).
67. State v. Ross, 715 P.2d 471, 475 (N.M. Ct. App. 1986).

fraud, including positive proof of reliance."[68] These courts seem to agree that the objective of the Uniform Act is to "moderate the requirements of common law fraud, and the difficulties involved in its proof."[69] Therefore, it is consistent with the objectives of deterring fraud and protecting investors to relax the requirements of common law fraud when applying a securities fraud statute.

One of the common law requirements that has previously been relaxed in jurisdictions that have adopted the Uniform Act is the element of scienter.[70] Like scienter, reliance has also been eliminated as a requirement in blue sky laws to further increase investor protection and deter fraud.[71] Considering this history of relaxing the elements of common law fraud to further the purposes of the Uniform Act, rejecting a reliance requirement is consistent with furthering the policies of fraud prevention and investor protection.

b. Construction of the Uniform Securities Act should promote uniformity. Another one of the Uniform Act's primary purposes is to create both uniformity among the various state systems of securities regulation and uniformity with existing federal law.[72] Section 415 of the Uniform Act explicitly states this intent: "This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation."[73]

The Draftsmen's Commentary to this section suggests that it "merely express[es] a general statement of legislative policy," not a requirement "to follow a judicial or administrative precedent set by another state or by the SEC."[74] However, when ad-

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68. Resort Car Rental Sys. v. Chuck Ruwart Chevrolet, Inc., 519 F.2d 317, 321 (10th Cir. 1975) (citing Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972), Clegg v. Conk, 507 F.2d 1351 (10th Cir. 1974), and Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965)).

69. S & F Supply Co. v. Hunter, 527 P.2d 217, 221 (Utah 1974).

70. *See supra* note 26 and accompanying text.

71. *See infra* note 95 and accompanying text.

72. *See supra* note 53.

73. UNIF. SECURITIES ACT § 415, 7B U.L.A. 678 (1958); *see also* Bennett, *supra* note 56, at 492 (describing the benefits of coordinating state and federal rules within the context of the Uniform Security Act).

74. LOSS, *supra* note 1, at 165; *see also* LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 1012 & n.23 (1983); LOSS & COWETT, *supra* note 13, at 230 ("It would be difficult to think of any area of the law where there is as much pointless complexity

dressing an issue of first impression in construing the Uniform Act within a particular state, the clearly stated statutory purpose of uniformity opens a vast library of state and federal precedent for guidance. Thus, in cases where there is no "controlling precedent,"[75] it is not only permitted but recommended that courts draw on the decisions of other state and federal jurisdictions in formulating opinions.

(1) The Uniform Securities Act should be construed to facilitate coordination with related federal securities provisions. The Uniform Act explicitly states an objective to "coordinate the interpretation . . . of [the Act] with the related federal regulation."[76] However, there exists some confusion in seeking a federal provision with which to coordinate liability under the state Uniform Act. Section 101 of the Uniform Act deals primarily with fraud and is "substantially [similar to] the Securities and Exchange Commission's Rule [10b-5]."[77] The primary difference between these provisions is that civil liability under Federal Rule 10b-5 is based on an implied cause of action derived from the common law principles of fraud,[78] while liability under the state Uniform Act is explicitly provided for by section 410(a),[79] which "is almost identical with [section] 12(2) of the Securities Act of 1933."[80] Thus, the question arises whether coordination should be with section 12(2) of the Securities Act of 1933 or with the implied cause of action based on Rule 10b-5.

This query is important because a court attempting to coordinate civil liability under the Uniform Act with Rule 10b-5 would probably conclude that the Act requires an element of reliance, as has been implied in federal actions based on that rule.[81] If, on the other hand, a court coordinates civil liability as

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and where at the same time uniformity is so essential." (footnotes omitted)).

75. *See, e.g.*, Certified Issues for Order of the U.S. District Court at exhibit 19, Gohler v. Wood, 919 P.2d 561 (D. Utah 1994) (No. 92-C-181-S).

76. UNIF. SECURITIES ACT § 415, 7B U.L.A. 678 (1958).

77. LOSS, *supra* note 1, at 6; *see also* Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5(b) (1997) (modeled after 15 U.S.C. § 77q(a) (1997)).

78. *See* Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988). For a general discussion of the rise of the implied cause of action based on Rule 10b-5, see *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 729-30 (1975).

79. *See supra* text accompanying note 36.

80. UNIF. SECURITIES ACT § 410(a), 7B U.L.A. 643 (1958) (Official Comment to § 410(a)).

81. *See Levinson*, 485 U.S. 224; Price v. Griffin, 359 A.2d 582, 587-88 (D.C. 1976) (comparing the state securities fraud statute to Federal Rule 10b-5, and concluding that

provided in the Uniform Act with section 12(2) of the Securities Act of 1933, it would certainly conclude that reliance is not required to establish liability.[82]

As section 410(a) is the relevant provision imposing civil liability for fraudulent conduct related to securities transactions, it logically follows that coordination should be with the federal counterpart to this section, namely section 12(2). The Draftsmen's Commentary to the Uniform Securities Act comports with coordination of civil liability and section 12(2) of the federal act. It states: "The resemblance to [section] 12(2) of the Securities Act of 1933 . . . will . . . make for an interchangeability of federal and state judicial precedence in this very important area."[83] Specifically as it relates to importing an element of reliance, the commentary continues, "[t]he 'by means of' clause[—which is also found in section 12(2) of the federal statute—]is not intended as a requirement that the buyer prove *reliance* on the untrue statement or the omission."[84] Furthermore, several cases interpreting section 12(2)–the federal analog to section 410(a)–have held that the quoted language does not imply any

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a showing of reliance is required). *But see* Resort Car Rental Sys. v. Chuck Ruwart Chevrolet, Inc., 519 F.2d 317, 321 (10th Cir. 1975) (comparing the state statute to Federal Rule 10b-5, and still concluding that reliance is not required, stating "there is no need to prove the elements of common law fraud, including positive proof of reliance" (citing Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972))).

82. *See* Midamerica Fed. Sav. & Loan Ass'n v. Shearson/American Express Inc., 886 F.2d 1249, 1256 (10th Cir. 1989) ("Section 12(2), on the other hand, has no requirement of justifiable reliance on the part of the purchaser."); Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225 (7th Cir. 1980) ("It is well settled that § 12(2) imposes liability without regard to whether the buyer relied on the misrepresentation or omission."); Johns Hopkins Univ. v. Hutton, 297 F. Supp. 1165, 1222 (D. Md. 1968) ("[R]eliance need not be proved by the plaintiff in order to maintain an action under section 12(2)."); *cf.* Brooks v. Land Drilling Co., 574 F. Supp. 1050, 1054 (D. Colo. 1983) ("[Although p]laintiffs . . . need not prove they relied on misleading statements or material omissions in a Section 12(2) action[, t]hey must, however, prove that there was 'some causal connection between the challenged communication and the sale, even if not "decisive."'" (citation omitted) (quoting Jackson v. Oppenheim, 533 F.2d 826, 830 n.8 (2d Cir. 1976))).

83. LOSS, *supra* note 1, at 147 (Draftsmen's Commentary to the Uniform Securities Act § 410(a)).

84. *Id.* at 148; *see also supra* note 82 (citing examples of courts concluding that reliance is not required for § 12(2)); *cf.* State v. Harry, 873 P.2d 1149, 1156 (Utah Ct. App. 1994) (holding that the "in connection with" requirement of actions under Federal Rule 10(b)–which is similar to the "by means of" requirement here–should be interpreted broadly because "it encompasses any sale of a security where fraud 'touches' the transaction").

element of reliance.[85] Thus, coordination with section 12(2) of the federal act furthers the purpose of uniformity with related federal regulation, and comports with the conclusion that reliance is not a required element for civil liability.

(2) Construction of the Act should be uniform with that of other states. Although the Draftsmen's Commentary suggests that uniformity is a mere statement of policy and not required by section 415 of the Uniform Act,[86] several courts have followed this policy when deciding issues based on the Uniform Act. In *Levitz v. Warrington*,[87] the court was asked to determine the scope of section 410(a) in identifying which persons may be liable under that provision.[88] In its decision the court noted that its holding "'is in uniformity with the law in other states which . . . have adopted the Uniform Securities Act' . . . [and] is also in accord with federal court application of the corresponding section of the Federal Securities Act."[89] In another case, *State v. Larsen*,[90] the court was asked to determine whether scienter was a requirement under the Uniform Act. To support its holding that scienter was not required, the Utah Supreme Court determined that a significant majority of states do not require scienter when interpreting the relevant provision.[91]

Those two cases illustrate the primary benefit of construing a state's blue sky laws uniformly with similar acts of other states. There is great need for uniformity in the area of securities law, considering the monumental complexity that would otherwise exist. With over fifty jurisdictions, each with their own securities regulations, a lack of uniformity would make it very burdensome to sell securities that cross those jurisdictional lines.[92] Thus, in deciding the issue of whether to require reli-

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85. *See supra* note 82 and accompanying text.

86. *See supra* text accompanying note 72.

87. 877 P.2d 1245 (Utah Ct. App. 1994).

88. *See id.*

89. *Id.* at 1246 (quoting Interlake Porsche & Audi, Inc. v. Bucholz, 728 P.2d 597, 606 (Wash. Ct. App. 1986) (first omission in original)).

90. 865 P.2d 1355 (Utah 1993).

91. *See id.*; *see also* Sloan, *supra* note 26, at 276 & n.40 (citing several states as examples).

92. Professor Loss, one of the drafters of the Uniform Act, recognized the burden on the lack of uniformity in this area stating:

> It would be difficult to think of any area of the law where uniformity is so essential. Even in the general area covered by such ancient and honorable statutes as the former Negotiable Instruments Law and the former Uniform

ance, a court should consider the reasoning of other jurisdictions that have also adopted provisions similar to section 410 of the Uniform Act. At least thirty jurisdictions have substantially adopted the Uniform Act, while several others have adopted at least some portion of the Uniform Act.[93] Consequently, most jurisdictions have statutory provisions similar to section 410 of the Uniform Act.[94]

> Sales Act, interstate business did not have to conjure with the problem of concurrently satisfying several dozen regulatory authorities, not to mention a federal agency engaged in administering and developing a closely related body of federal law.

I LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 41 (3d ed. 1989) (footnote omitted).

> With 36 states, the District of Columbia, Guam, and Puerto Rico having adopted or substantially adopted the 1956 Uniform Securities Act, there is a great deal more uniformity in state securities regulation than there was before the 1956 Act. Before that Act, no two state securities statutes came close to being identical. The amount of variation and frequently unnecessary complexity in both substance and verbiage was staggering. For example, when all the permutations were charted in connection with the study that preceded the drafting of the Uniform Act, the 47 statutes were found to contain some 2,800 exemptions. This put a heavy burden on the American lawyer who undertook to prepare an issue of securities for nationwide distribution. He had to satisfy the federal statute and several dozen atate acts—all of them varying in their procedures, their exemptions, and their substantive standards—and somehow synchronize all this so that the issue could be offered simultaneously throughout the country.

Id. at 40-41 (footnotes omitted).

93. *See supra* note 5.

94. *See* ALA. CODE § 8-6-19 (1993); ALASKA STAT. § 45.55.930 (Michie 1996); ARIZ. REV. STAT. § 44-1998 (1996); ARK. CODE ANN. § 23-42-106 (Michie 1994); COLO. REV. STAT. § 11-51-604 (1987); CONN. GEN. STAT. § 36b-29 (1958); DEL. CODE ANN. tit. 6, § 7323 (1993); D.C. CODE ANN. § 2-2613 (1994); GA. CODE ANN. § 10-5-14 (1994); IDAHO CODE § 30-1446 (1996); IND. CODE § 23-2-1-19 (1995); IOWA CODE §§ 502.501-.507 (1991); KAN. STAT. ANN. § 17-1268 (1995); KY. REV. STAT. ANN. § 292.480 (Michie 1988); LA. REV. STAT. ANN. § 51:712 (West 1997); ME. REV. STAT. ANN. tit. 32, § 10605 (West 1996); MD. CODE ANN., CORPS. & ASS'NS § 11-703 (1993); MASS. GEN. LAWS ch. 110A, § 410 (1990); MICH. COMP. LAWS § 451.810 (1989); MINN. STAT. § 80A.23 (1997); MISS. CODE ANN. § 75-71-717 (1972); MO. REV. STAT. § 409.411 (1990); MONT. CODE ANN. § 30-10-307 (1996); NEB. REV. STAT. § 8-1118 (1991); NEV. REV. STAT. §§ 90.660-.700 (1996); N.H. REV. STAT. ANN. § 421-B:25 (1991); N.J. STAT. ANN. § 49:3-71 (West 1970); N.M. STAT. ANN. § 58-13B-40 (Michie 1978); N.C. GEN. STAT. § 78A-56 (1994); OKLA. STAT. tit. 71, § 408 (1991); OR. REV. STAT. § 59.115 (1995); 70 PA. CONS. STAT. ANN. § 501 (West 1995); S.C. CODE ANN. §§ 35-1-1490 to 35-1-1530 (Law Co-op. 1986); S.D. CODIFIED LAWS § 47-31A-410 (Michie 1991); TENN. CODE ANN. § 48-2-122 (1995); TEX. REV. CIV. STAT. ANN. art. 581-33 (West 1964); UTAH CODE ANN. § 61-1-22 (1997); VT. STAT. ANN. tit. 9, § 4240 (1993); VA. CODE ANN. § 13.1-522 (Michie 1993); WASH. REV. CODE § 21.20.430 (1989); W. VA. CODE § 32-4-410 (1996); WIS. STAT. § 551.59 (1996); WYO. STAT. ANN. § 17-4-122 (Michie 1997); 22 GUAM CODE ANN. § 46410 (1995); P.R. LAWS ANN. tit. 10, § 890 (1976).

The issue of whether reliance is an element under the applicable state securities fraud statutes has been addressed in several states which have adopted the language of the Uniform Act. Many of those states have determined that reliance is not an element necessary to prove liability under the Uniform Act.[95] There is some case precedent, however, requiring some degree of reliance to establish a prima facie case of state securities fraud.[96] Of those cases concluding that reliance is required,

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95. *See* Midamerica Fed. Sav. & Loan Ass'n v. Shearson/American Express Inc., 886 F.2d 1249, 1254-55 (10th Cir. 1989); Carothers v. Rice, 633 F.2d 7, 14 (6th Cir. 1980) (recognizing that the "[Kentucky blue sky act] does [not] . . . require proof of reliance upon the misrepresentation"); Alton Box Board Co. v. Goldman, Sachs and Co., 560 F.2d 916, 924 (8th Cir. 1977) (recognizing that the Missouri state act should be construed in conformity with section 12(2) of the Securities Act of 1933); Forrestal Village, Inc. v. Graham, 551 F.2d 411, 414 (D.C. Cir. 1977) (stating that the plaintiff is not required to "prove anything more than negligence"); Resort Car Rental Sys. v. Chuck Ruwart Chevrolet, Inc., 519 F.2d 317, 321 (10th Cir. 1975) (stating thet in light of the "need to interpret this rule flexibly so as to prevent fraud[,] . . . there is no need to prove the elements of common law fraud, including positive proof of reliance"); Adams v. Hyannis Harborview, Inc., 838 F. Supp. 676, 688 (D. Mass. 1993) (recognizing that "a plaintiff need not prove scienter or reliance to recover under Section 12(2) of the federal law or Section 410(a)(2) of the Massachusetts law"); Comeau v. Rupp, 810 F. Supp. 1127, 1158 (D. Kan. 1992) (stating that the only required element that shows causation "is that the misrepresentation or omission be material"); First Fed. Sav. & Loan Ass'n v. Mortgage Corp., 467 F. Supp. 943, 952 (N.D. Ala. 1979), *aff'd*, 650 F.2d 1376 (5th Cir. 1981) (construing the state statute not to include the common law elemente of fraud); Emmi v. First-Manufacturers Nat'l Bank, 336 F. Supp. 629, 638 (D. Me. 1971) (holding that "[a]llegations of material omissions or misstatements are sufficient for a prima facie case [and] plaintiff is not required to allege or prove causation"); Connecticut Nat'l Bank v. Giacomi, 699 A.2d 101, 120 n.37 (Conn. 1997); Arnold v. Dirrim, 398 N.E.2d 426, 435 (Ind. Ct. App. 1979) ("The 'by means of' clause was not intended as a requirement that the buyer prove reliance on the untrue statement or omission. . . . Thus reliance was not an element to be proven . . . ."); Everts v. Holtmann, 667 P.2d 1028, 1032 (Or. Ct. App. 1983); Bradley v. Hullander, 249 S.E.2d 486, 494 (S.C. 1978) (holding that the state statute should conform with the construction of section 12(2) of the Securities Act of 1933, which "does not require that plaintiffs show reliance, causation or that the sale would not have occurred absent the omission" (citing Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 696 & n.25 (5th Cir. 1971)); Gohler v. Wood, 919 P.2d 561 (Utah 1996); Esser Distrib. Co. v. Steidl, 437 N.W.2d 884, 886-87 (Wis. 1989) (distinguishing securities fraud from common law fraud in that reliance is not required by the relevant statutory provisions).

96. *See* Kennedy v. Josephthal & Co., 814 F.2d 798, 805 (1st Cir. 1987) (concluding that at least reasonable reliance is required for an action under the Massachusetts Securities Act which relates to Federal Rule 10b-5); Geisenberger v. John Hancock Distrib., 774 F. Supp. 1045, 1051 (S.D. Miss. 1991) (finding that the Mississippi statute "contain[s] an implicit requirement of reasonable reliance consistent with federal Rule 10b-5"); Foster v. Alex, 572 N.E.2d 1242, 1245 (Ill. App. Ct. 1991) (requiring "reasonable reliance," which is a slightly lesser standard than "justifiable reliance"); *see also* Price v. Griffin, 359 A.2d 582, 588 (D.C. 1976) (holding that "some element of reliance must be shown to demonstrate that such statements caused the

there appear to be two general approaches to their reasoning. Some of those courts seem to focus on section 101 of the Uniform Act, which is substantially similar to Federal Rule 10b-5.[97] Naturally, those courts focusing on the state analog to Rule 10b-5 conclude that some degree of reliance is required, as it is under the federal rule.[98] The problem with this approach is that it fails to consider section 410 of the Uniform Act which explicitly provides for liability and clearly does not require reliance.[99] Other courts have properly considered section 410 of the Uniform Act, but still conclude that the legislature must have intended a requirement of reliance, merely because it is required in federal securities fraud and common law fraud actions.[100] This reason-

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injury complained of"). In *Price*, however, the court acknowledges the problems of requiring reliance when suit is brought on behalf of a class of plaintiffs; in this situation, it suggests that "a showing of materiality to a reasonable shareholder" would suffice. *Id.* at 588 n.10. *But see* Eacho v. N D Resources, Inc., Fed. Sec. L. Rep. (CCH) ¶ 92,067, at 91,327-28 (D.C. May 23, 1985) (holding that although *Price* noted the similarities between the state statute and Federal Rule 10b-5, there are no implied elements to a private right of action under the state statute).

97. *See* Pelletier v. Zweifel, 921 F.2d 1465, 1511 (11th Cir. 1991) (focusing on the Georgia analog to section 101 of the Uniform Act, holding that the same elements apply as for Federal Rule 10b-5); First State Bank of Floodwood v. Jubie, 847 F. Supp. 695, 704 n.16 (D. Minn. 1993) ("[A]bsence of reliance, on a purported misrepresentation of fact, preclude[s] a recovery under [the state analog to section 101]." (citing Specialized Tours, Inc. v. Hagen, 392 N.W.2d 520, 536 (Minn. 1986))); Jadoff v. Gleason, 140 F.R.D. 330, 334 (M.D.N.C. 1991); Hubbard v. Hibbard Brown & Co., 633 A.2d 345, 349 (Del. 1993) ("[T]he similarity of [the state analog to section 101] with Rule 10b-5 evidences the General Assembly's intent that it be governed by similar principles.").

Several courts seem to presume without analysis that reliance is required. This presumption is probably a result of the courts confusing the elements of state securities fraud with traditional requirements of fraud. Perhaps no analysis of this issue was done in each of these cases because the court was able to find sufficient evidence to establish reliance. Even so, such a presumption can be fatal to a future plaintiff's claim that cannot establish reliance, such as in a class action. *See* Dinco v. Dylex Ltd., 111 F.3d 964, 971 (1st Cir. 1997) (presuming that "reasonable reliance [is] perhaps [required] for the [New Hampshire] Blue Sky claim"); Pikofsky v. Jem Oil, 607 F. Supp. 727, 735 (E.D. Wis. 1985) (finding sufficient language in a complaint to withstand an attack for failure to allege that the plaintiff "reasonably relied on [the] misrepresentations"); *see also* Kramersmeier v. Dickinson & Co., 440 N.W.2d 873, 878-79 (Iowa 1989) (identifying evidence suggesting that reliance is sufficiently satisfied in order to withstand an attack for failure te provide "proof of reliance").

98. *See supra* note 97.

99. *See supra* text accompanying note 36.

100. *See* Geisenberger v. John Hancock Dist., 774 F. Supp. 1045, 1051 (S.D. Miss. 1991) ("The Court finds that [the state analog to section 410] contain[s] an implicit requirement of reasonable reliance consistent with federal Rule 10b-5."); Lane v. Midwest Bancshares Corp., 337 F. Supp. 1200, 1210 (E.D. Ark. 1972) ("There is still a requirement of reliance . . . and the burden is on the buyer."); Vance v. Indian Hammock Hunt & Riding Club, Ltd., 403 So. 2d 1367, 1370-71 (Fla. Dist. Ct. App.

ing is problematic because it fails to consider the clear language of section 410 which does not require reliance.[101]

It is important to note that of the jurisdictions that have required reliance, many limit the element in objective terms such as "reasonable" or "justifiable."[102] These jurisdictions thus view objective reliance as a means to demonstrate materiality, which is an element specifically required by the Uniform Act.[103] Even so, it is potentially harmful to define materiality in terms of objective reliance; such a process may merely be a method of making an end run around the express language of the Uniform Act and of improperly admitting the element of reliance by way of the "back door."[104] Consequently, not only should reliance not be required at all, but materiality should not be defined in terms of reliance as some courts have attempted to do.[105]

Given the different approaches taken and conclusions reached by the courts concerning the reliance issue, it is clear that the Uniform Act is still far from its goal of uniformity in this important area. Furthermore, it is difficult to construe the Act "to effectuate its general purpose to make uniform the law of those states which enact it."[106] In spite of this difficulty, a few courts have identified and joined a majority of jurisdictions concluding that the better approach is to not require reliance.[107] As more jurisdictions follow this lead, the objective of uniformity will be reached. Indeed, a major purpose of this Comment is to assist state courts in coming to a consensus that reliance is not an element under the Uniform Securities Act.

1981) (construing a state statute based on section 410 of the Uniform Act to require "reliance upon the untrue statement").

101. *See supra* text accompanying note 36.

102. *See infra* note 173 and accompanying text.

103. *See supra* text accompanying note 36.

104. *See* IX LOSS & SELIGMAN, *supra* note 92, at 4203; *infra* text accompanying note 171.

105. *See, e.g.*, Gohler v. Wood, 919 P.2d 561, 564 (Utah 1996) (stating that the "materiality requirement 'seems to import some *objective* standard of reliance.'" (citation omitted)).

106. UNIF. SECURITIES ACT § 415, 7B U.L.A. 678 (1958); *see supra* note 73 and accompanying text.

107. *See, e.g., Gohler*, 919 P.2d at 566 ("[O]ur decision is in accord with a significant majority of other courts' interpretations of statutes which . . . were modeled after section 410(a)(2) of the Uniform Securities Act.").

B. Response to Anticipated Criticisms

Having concluded that reliance is not a required element of a securities fraud claim under the Uniform Act, it is necessary to inquire whether some alternative reasoning exists to upset this conclusion. The United States Supreme Court has stated, "When we find the terms of a statute unambiguous, judicial inquiry is complete except in rare and exceptional circumstances . . . [such as] where the application of the statute as written will produce a result 'demonstrably at odds with the intentions of its drafters.'"[108] Alternatively stated, the clear language of a statute should be controlling except when otherwise required to avoid "absurd results."[109] Thus, despite clear statutory language, some might criticize the conclusion that reliance should not be required by the Uniform Act, claiming such an interpretation creates an "absurd result." The basis for such an argument probably would rest on either the apparent discrepancy between federal and state securities fraud laws, or the perceived elimination of the causation element by not requiring fraud. This analysis concludes by responding to both of these potential criticisms.

1. Whether the lack of reliance results in a troublesome discrepancy between federal and state securities regulation

The absence of a reliance requirement for civil liability based on violations on the Uniform Act potentially results in a dichotomy between state and federal securities fraud laws. A plaintiff suing for a violation of the antifraud provisions of the Uniform Act is not required to plead or prove reliance upon a material misstatement or omission, as liability is explicitly provided by section 410(a).[110] The same plaintiff, however, is required to prove reliance in order to bring a federal suit based on Rule 10b-5.[111] Thus, suits based on federal securities fraud when compared to those based on the state Uniform Act may result in conflicting outcomes.

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108. Demarest v. Manspeaker, 498 U.S. 184, 190 (1991) (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)) (citations omitted).

109. United States v. Turkette, 452 U.S. 576, 580 (1981) (observing that "absurd results are to be avoided").

110. *See supra* note text accompanying 36.

111. *See infra* note 117.

a. Any dichotomy created between federal and state securities regulation is minimal and justified in light of the language and policies of the Uniform Act. A closer examination suggests that the difference between state and federal securities fraud is not as stark as it may first appear. In the federal context, even though courts routinely require "actual reliance" as an element of securities fraud based on Rule 10b-5, this requirement has been massaged and diminished in many circumstances. For example, in certain cases where the suit is based on a material omission, the reliance requirement has been presumed.[112] This is most commonly a result of the court's acknowledgment of the difficulty of proving reliance upon an omission. Similar to presumed reliance, application of the "fraud on the market" theory allows the plaintiff, in certain circumstances, to create a rebuttable presumption of reliance based on the market's reaction to the material misstatement or omission.[113] Furthermore, some courts have gone so far as to suggest that a showing of materiality may be sufficient to satisfy the requirement of reliance,[114] thus making the cause of action for violation of Rule 10b-5 look similar to one based on the Uniform Act, which requires materiality but not reliance. Finally, when the SEC is prosecuting a violation of Rule 10b-5, reliance is generally not required at all.[115]

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112. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

113. *See In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1419 n.8 (3d Cir. 1997) ("The 'fraud on the market' theory accords plaintiffs in Rule 10b-5 class actions a rebuttable presumption of reliance . . . ."). The "fraud on the market theory" has been defined by the Supreme Court as follows:

> Succinctly put: "The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements."

Basic Inc. v. Levinson, 485 U.S. 224, 241-42 (1988) (omission in original) (quoting Peil v. Speiser, 806 F.2d 1154, 1160-61 (3d Cir. 1986).

114. *See* Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 380-81 (2d Cir. 1974); *see also* Wong v. Thomas Bros. Restaurant Corp., 840 F. Supp. 727, 729 (C.D. Cal. 1994) ("'In order to prevail in an action for securities fraud under § 10(b) and Rule 10b-5, a plaintiff must show some causal nexus . . . [which is] most often analyzed in terms of the . . . elements of materiality or reliance.'" (quoting St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 562 F.2d 1040, 1048 (8th Cir. 1977)).

115. *See* SEC v. Rana Research, Inc., 8 F.3d 1358 (9th Cir. 1993); SEC v. Hasho, 784 F. Supp. 1059, 1106 n.11 (S.D.N.Y. 1992) ("[T]he SEC does not have the additional burden of showing . . . justifiable reliance . . . ."); SEC v. Tome, 638 F. Supp. 596, 620

Given these several examples of how the reliance requirement for a suit based on Rule 10b-5 has been massaged, a court might plausibly attempt to coordinate the provisions of the Uniform Act with Rule 10b-5 without requiring actual reliance.[116] Despite these examples of diminution of the requirement, the general principle that some reliance is required by the implied action based on Rule 10b-5 is still uniformly accepted.[117] Thus, considering the drafters' clear intent to not require reliance, the better approach is to coordinate the Uniform Act with section 12(2) of the federal statute, which clearly does not require a showing of reliance.[118]

b. Despite a possible federal/state dichotomy, it is improper to imply a right of action based on the Uniform Securities Act. A major distinction between the Uniform Securities Act and Rule 10b-5 is that while civil liability for violation of the Uniform Act is expressly provided for in most states by section 410(a),[119] civil liability for violation of the federal counterpart, Rule 10b-5, is judicially implied.[120] This distinction results in the existing dichotomy as it relates to the inclusion of an element of reliance. Since the cause of action based on the federal rule is "implied, federal courts have had to define its elements and have derived these elements, at least in part, from the common law of fraud,"[121] otherwise there would be few clear limitations to the scope of liability based on the federal rule.

Since the language of the Uniform Act imposing civil liability for violation of section 410(a) does not explicitly include an element of reliance,[122] imposing such a requirement must be based

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n.46 (S.D.N.Y. 1986) ("In an SEC enforcement action, . . . proof of . . . additional elements [such as reliance] is not required."), *aff'd*, 833 F.2d 1086 (2d Cir. 1987).

116. *See* Resort Car Rental Sys., v. Chuck Ruwart Chevrolet, Inc., 519 F.2d 317, 321 (10th Cir. 1975) (comparing the state analog to Federal Rule 10b-5, and still concluding that reliance is not required, stating "there is no need to prove the elements of common law fraud, including positive proof of reliance" (citing Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972))).

117. *See* Chill v. General Elec. Co., 101 F.3d 263, 266 (2d Cir. 1996) ("In order to state a cause of action under section 10(b) and Rule 10b-5, 'a plaintiff must plead that . . . plaintiff's reliance on defendant's action caused [plaintiff] injury.'" (quoting Acito v. IMCERA Group, Inc., 47 F.3d 47, 52 (2d Cir. 1995))).

118. *See supra* note 81 and accompanying text.

119. *See supra* text accompanying note 36.

120. *See* Basic Inc. v. Levinson, 485 U.S. 224 (1988).

121. Gohler v. Wood, 919 P.2d 561, 565 (Utah 1996).

122. *See* UNIF. SECURITIES ACT § 410(a), 7B U.L.A. 643 (1958); *see also* 15 U.S.C. § 771(2) (1994). Section 12(2) of the Securities Act of 1933 is a related federal statute.

on an implied cause of action, as it is with Federal Rule 10b-5.[123] Although the Uniform Act explicitly preserves all causes of action which existed prior to its enactment, it prohibits implication of any new cause of action other than those specifically set forth in the Uniform Act.[124] Clearly, the legislature intended that implied causes of action should not be judicially created based on the Uniform Act as they have been in the federal arena.[125] Furthermore, the explicit statutory elements in the Uniform Act provide the requisite limitations that are unavailable to the federal 10b-5 action as implied from the common law.

It is important to note that when some states adopted the Uniform Act, they deliberately deleted the clause of section 410(h) prohibiting implication of any new cause of action based on their corresponding statutes.[126] This creates the possibility of an implied cause of action for a violation of section 101, as with Federal Rule 10b-5. One of the primary justifications for permitting an implied cause of action is to cover fraud in connection with the *purchase* as well as the sale of securities.[127] Section 410(a) of the Uniform Act only allows a cause of action against "[a]ny person who offers or sells a security" in connection with fraud.[128] Section 101, however, makes it unlawful to use fraud "in connection with the offer, sale, *or purchase* of any security."[129] Therefore, if an implied action were permitted based on

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123. *See Levinson*, 485 U.S. at 230-32; *see also infra* text accompanying note 127.

124. *See supra* notes 42-45 and accompanying text.

125. "Section 410(h) . . . was intended to assure that the courts did not recognize an implied private right of action under Section 101 despite the similarity of Section 101 to Rule 10b-5 and the well-settled law recognizing such a right under Rule 10b-5." Eacho v. N D Resources, Inc., Fed. Sec. L. Rep. (CCH) ¶ 92,067, at 91,328 (D.C. May 23, 1985).

126. *See* Carothers v. Rice, 633 F.2d 7, 10 (6th Cir. 1980); Hammermon v. Peacock, 607 F. Supp. 911, 917 (D.D.C. 1985); *In re* Catanella & E.F. Hutton & Co. Sec. Litig., 583 F. Supp. 1388, 1439 (E.D. Pa. 1984); *see also* LOSS, *supra* note 74, at 1014 & n.4.

127. *See Carothers*, 633 F.2d at 14 (implying a remedy pursuant to state statute for misrepresentation in connection with the sale or purchase of securities); *see also* LOSS, *supra* note 74, at 1014 & n.4 ("One result of the deletion [of 410(h)] is the possibility of an implied action for violation of §101 . . . thus cover[ing] fraud in connection with the purchase as well as the sale of a security.").

128. UNIF. SECURITIES ACT § 410(a), 7B U.L.A. 643 (1958).

129. UNIF. SECURITIES ACT § 101(a), 7B U.L.A. 516 (1958) (emphasis added). It is interesting to note that the drafters of the Uniform Act felt that "there is no clear need to create any *civil liability* against buyers as distinct from sellers." LOSS, *supra* note 1, at 8. In fact, doing so may "disturb the general jurisprudence which has" developed in other areas of related law. *Id.*

section 101 of the Uniform Act, persons attempting to defraud in the purchase of securities may also be held liable.

However, in light of policies of broadening liability for fraud, failing to adopt the language limiting the availability of implied causes of action could result in some adverse consequences. Generally, the reason for eliminating this language from the statute has been to leave open the possibility of an implied right against fraudulent purchasers as well as those who offer or sale securities. This rationale is consistent with the policy of expanding liability to further protect persons dealing in securities.[130] However, by opening the door to increased implied rights of action, the legislature also opens the door to the improper incorporation of common law elements of fraud into the statute that are not explicitly required, thus severely limiting the statute's intended broad application. Consequently, if a particular legislature wishes to permit purchaser liability, it should follow the lead of some jurisdictions that have specifically adopted language in section 410(a) which provides for civil liability against any "person who . . . offers, sells, or *purchases* a security in violation of [the state analog to section 101]."[131] This specifically provides for purchaser liability and makes it unnecessary to expand liability by implication.

Even if a legislature has deleted the bar to implied causes of action, such deletion should not be read as an invitation to limit liability by importing common law elements into an otherwise clear statute. As discussed above, such importation is inconsistent with the purpose of allowing implied causes of action, specifically, permitting expanded liability and broader application of the Uniform Act. By importing unnecessary common law elements into the cause of action, the court actually limits application of the Act.

Refusing to imply new causes of action, or to add elements to existing statutory causes of action, is consistent with the current trend of "narrowing the number of implied remedies avail-

130. Arguably the traditional reasoning for needed increased protection may not apply in this case because sellers are typically viewed as the more sophisticated party and thus the buyer is in need of the greatest protection. *See supra* text accompanying notes 54-61.

131. UTAH CODE ANN. § 61-1-22 (1997) (state analog to § 410(a) of the Uniform Act) (emphasis added).

able."[132] Accordingly, congressional intent should play a significant role,[133] if not the determinative role,[134] in deciding whether implication of a cause of action is proper. Based on a view that implied causes of action should be limited, where a statute is clear, further implication is unnecessary and probably improper.[135] As a general principle of judicial restraint, clear statutory language should certainly prevail over what a particular judge might otherwise believe to be a better rule.

The current trend toward limiting implied causes of action provides an interesting explanation for the discrepancy that seemingly exists between liability based on Federal Rule 10b-5 and liability based on the state Uniform Act. As previously discussed, deterrence and protection of the unwary investor are clearly among the primary purposes for imposing civil liability for securities fraud.[136] Limiting, or even eliminating, the requirement of reliance would further this purpose. Although the requirement of reliance as it relates to Federal Rule 10b-5 has arguably been limited in importance, it certainly has not been eliminated.[137]

The question then logically follows: If it is proper to eliminate the requirement of reliance in the state arena, why not do so in the federal context? There are probably two main reasons why reliance remains an element of the federal rule: first, courts

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132. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 13.1 at 755 (3d ed. 1996); *see also* Kathryn A. Oberly & Stephen M. Shapiro, *The Year in Review: Significant Judicial Development*, 792 PLI/CORP 9 (1992) (noting a trend of restricting implied private rights of action by the Supreme Court starting in the mid 1970s).

One recent example of the Supreme Court reigning in the implied right of action based on section 10(b) is *Central Bank v. First Interstate Bank*, 511 U.S. 164 (1994), where the Court refused to extend liability against those who aid and abet in violation of 10b-5.

133. *See* Susan J. Stabile, *The Role of Congressional Intent in Determining the Existence of Implied Private Rights of Action*, 71 NOTRE DAME L. REV. 861 (1996); *see also* Touche Ross & Co. v. Redington, 442 U.S. 560, 575 (1979) (holding that no private right of action is implied under § 17(a) of the Securities Exchange Act of 1934, the Court stated that the "central inquiry . . . [is] whether Congress intended to create, either expressly or by implication, a private cause of action"); Marc I. Steinberg & William A. Reece, *The Supreme Court, Implied Rights of Action, and Proxy Regulation*, 54 OHIO ST. L.J. 67, 78-82 (1993).

134. *See* Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979). *But see* Cort v. Ash, 422 U.S. 66 (1975) (suggesting several factors other than intent that should enter into the analysis of whether or not to imply a private right of action).

135. *See* Gohler v. Wood, 919 P.2d 561, 565 (Utah 1996).

136. *See supra* Part III.A.2.a.

137. *See supra* text accompanying notes 112-17.

are hesitant to eliminate the causation element altogether, even in the area of securities fraud;[138] and second, courts often balk at further expanding application of an implied cause of action when the trend is toward limiting such implied causes of action.[139] There is a tug-of-war between the general policy of limiting the scope of implied causes of action and the policy of increasing protection to the investor. As a result, reliance is still required by Rule 10b-5, but it has been manipulated in several ways that increase investor protection.[140]

It is interesting to note that Professor Louis Loss, one of the drafters of the Uniform Act, acknowledged the dichotomy created by permitting an implied cause of action at the federal level, while barring all implied liability at the state level. Concerning this dichotomy, Professor Loss wrote:

> At the federal level, there is room for the recognition of implied liabilities . . . . But, given a statute like the Uniform Securities Act in which careful attention was paid to the scope of civil liability in the interest of specificity and predictability, there is no room for implying liabilities which are not expressly created.[141]

Given the general policy of limiting implied rights of action, coupled with the explicit language of the Uniform Act, it is improper to judicially impose additional elements such as reliance as some courts have done.[142] Any resulting discrepancy between federal and state liability is of minimal concern in light of the

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138. *See infra* notes 152-53 (explaining some commentators argue that if causation were eliminated in this area, anti-securities fraud legislation would become a form of "investor insurance"). *But see infra* Part III.B.2 (arguing that the refusal to require an element of reliance is arguably not an abrogation of causation due to the application of other liability limiting doctrines with a causal relationship).

139. *See supra* text accompanying note 132.

140. In light of the general trend of limiting judicially implied causes of action, the better approach to eliminate the reliance requirement in the federal context is for Congress to adopt language similar to UNIF. SECURITIES ACT § 410(a), 7B U.L.A. 643 (1958), which should explicitly provide liability for violations of Rule 10-b5. This would allow Congress to eliminate the confusion that currently exists concerning the importance of the reliance requirement in implied 10b-5 actions. *See supra* text accompanying notes 112-17.

141. 3 LOUIS LOSS, SECURITIES REGULATION 1649 n.100 (2d ed. 1961). Furthermore, this discrepancy, if it is to be cured, must be corrected by legislative action at the federal level clarifying the terms of the civil liability for federal securities fraud.

142. *See* Gohler v. Wood, 919 P.2d 561, 565 (Utah 1996) ("[T]his court has no need to define these elements. Indeed, it would be inappropriate to do so when the legislature has already done so.").

clear requirements of the Uniform Act and the policies furthered by its application.

2. *Whether the lack of reliance results in the elimination of causation*

a. Reliance helps establish causation in fraud. In spite of the policy reasons for not requiring reliance to establish a securities fraud claim,[143] reliance has persisted as a necessary element to prove liability under Federal Rule 10b-5.[144] One reason for this persistence is the importance of reliance in establishing causation.[145] In fact, some have criticized the elimination of the reliance element as disposing of "a causal connection between the plaintiff's injury and the defendant's misrepresentations."[146]

In response to this type of criticism, some courts have held that no causation is required at all under the Uniform Act.[147] There is considerable support for this argument in light of the general policy of increasing investor protection and deterring fraud.[148] Furthermore, this argument is potentially supported by correlation of the Uniform Securities Act with related federal regulations. As previously noted, section 410(a) of the Uniform Act is modeled after section 12(2) of the Securities Act of 1933, thus providing "interchangeability of federal and state judicial precedence in this very important area."[149] There is substantial

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143. *See supra* Part III.A.2.a.

144. *See* Basic Inc. v. Levinson, 485 U.S. 224 (1988); *see also supra* text accompanying notes 112-17.

145. This is consistent with the purpose of reliance in the case of common law fraud. *See supra* note 2.

146. *Gohler*, 919 P.2d at 568 (Russon, J., dissenting).

147. *See* Emmi v. First-Manufacturers Nat'l Bank, 336 F. Supp. 629, 638 (D. Me. 1971) (holding that "[a]llegations of material omissions or misstatements are sufficient for a prima facie case [and] plaintiff is not required to allege or prove causation"); Bradley v. Hullander, 249 S.E.2d 486, 494 (S.C. 1978) (stating that the state statute should conform to the construction of Section 12(2) of the Securities Act of 1933, which "does not require that plaintiffs show reliance, causation or that the sale would not have occurred absent the omission" (quoting Aronson v. TPO, Inc., 410 F. Supp. 1375 (S.D.N.Y. 1976))).

148. *See supra* Part III.A.2.a. By analogy, causation is routinely not required in the case of consumer protection based on almost identical reasoning. *See, e.g.*, Zekman v. Direct Am. Marketers, Inc., 675 N.E.2d 994, 997 (Ill. App. Ct. 1997) ("The purpose of the Consumer Fraud Act is to protect consumers against fraud and unfair or deceptive acts and practices in the conduct of trade or commerce. . . . It is well settled that reliance is no longer a requirement under the Act.").

149. LOSS, *supra* note 1, at 147 (Draftsmen's Commentary te the Uniform Securities Act).

precedent suggesting that no causal connection is required under section 12(2) of the Securities Act.[150] This conclusion, however, is limited by some precedent suggesting that at least "some causal" relationship must be established.[151]

An interpretation of securities fraud liability that entirely eliminates the need for causation has been criticized by several courts and commentators, because it may create a system of investor insurance.[152] The concern is that in the zeal to increase protection of the unwary investor from fraudulent misstatements and omissions, courts may unfairly compensate for bad investments where there is no link between the fraud and the investor's decision to purchase or sell the security. These concerns are particularly raised in the area of Rule 10b-5 liability, where courts have arguably relaxed the requirement of actual reliance to the point that it plays only a minor role in establishing causation as compared to its previous importance.[153] However, it is possible to maintain the causation necessary to avoid creating "investor insurance" without retaining the element of reliance, which can be detrimental in its own right, particularly in the area of class actions.[154]

b. Privity and materiality may replace reliance as satisfying the necessary causal link between the plaintiff's injury and the

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150. *See* Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 696 & n.25 (5th Cir. 1971); Demarco v. Edens, 390 F.2d 836, 841 (2d Cir. 1968).

151. Brooks v. Land Drilling Co., 574 F. Supp. 1050, 1054 (D. Colo. 1983) ("[Although p]laintiffs . . . need not prove they relied on misleading statements or material omissions in a Section 12(2) action[, t]hey must, however, prove that there was 'some causal connection between the challenged communication and the sale, even if not "decisive."'" (citation omitted)).

152. *See* Grigsby v. CMI Corp., 765 F.2d 1369, 1376 (9th Cir. 1985) ("Nor were the protections of Section 10(b) and Rule 10b-5 intended to establish a scheme of investors' insurance." (citing List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir. 1965)); Shores v. Sklar, 647 F.2d 462, 469 n.5 (5th Cir. 1981) ("Doing away with the conventional reliance requirement in a 10b-5(2) case, therefore, could establish a scheme of investors' insurance."); Julie A. Herzog, *Fraud Created The Market: An Unwise and Unwarranted Extension of Section 10(b) and Rule 10b-5*, 63 GEO. WASH. L. REV. 359, 362 (1995) ("Proof of reliance is necessary to avoid turning the rule into a 'scheme of investor's insurance' or a mechanism for recovery of losses whenever an investment turns sour." (footnote omitted)).

153. *See* John Schmidt, Comment, *The Fraud-Created-The-Market Theory: The Presumption of Reliance in the Primary Issue Context*, 60 U. CIN. L. REV. 495, 498 (1991) ("Reliance is an essential element of a private action under rule 10b-5. Reliance is required . . . to ensure that the securities laws do not expose defendants to unlimited liability or become a scheme of investor's insurance.").

154. *See infra* note 155 and accompanying text.

misrepresentation. Due to the previously discussed concerns of eliminating the element of causation entirely, the courts should interpret the fraud provision of the Uniform Act as requiring some degree of causation. However, the required causation should be established with some liability-narrowing doctrine other than reliance, such as privity or materiality. One clear advantage to establishing causation by some means other than reliance is that it avoids the inherent problems of requiring actual reliance in a class action, the form of many securities fraud suits.[155] Furthermore, it does not require the courts to rule contrary to the clear language and policies of the Uniform Act by requiring reliance to satisfy causation.

(1) Privity may satisfy causation for purposes of securities fraud. One jurisdiction that recently addressed the causation issue determined that the requirement of privity is sufficient to satisfy the "necessary link between the alleged misrepresentation and the plaintiff's injury."[156] The court based its conclusion on the state analog to section 410(b) of the Uniform Act, which specifies those individuals which may be held liable under section 410(a).[157]

One criticism of permitting the causal relationship to be established by privity is the potentially broad scope of persons who may be liable under the Uniform Securities Act.[158] One

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155. The Second Circuit has "suggested that there might be separate trials on the issue of reliance after determination of the common issues, but this suggestion is simply an absurdity in the typical class action, where there may be 1,000 or 10,000 or even 100,000 members of the class." JENNINGS, *supra* note 13, at 1238 (citing Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968) (discussing application of Federal Rule 10b-5)). The difficulties of certifying a class when actual reliance is required is illustrated by *Margolis v. Caterpillar, Inc.*, 815 F. Supp. 1150, 1153 (C.D. Ill. 1991) ("[A] determination on the individual issues of reliance raised by these claims would probably subsume any common questions. . . . [B]ecause common issues would not predominate over the questions concerning individual reliance, . . . class certification . . . is inappropriate."). Another possible solution to the class action problem is that if reliance is required, perhaps it may be satisfied by the "fraud on the market" theory, as has been done in the federal context. *See* Basic Inc. v. Levison, 485 U.S. 224 (1988); Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489, 507 (1995) (stating that "the fraud-on-the-market theory . . . create[s] a presumption of reliance which facilitates [the] use of the class action mechanism" (footnotes omitted)).

156. Gohler v. Wood, 919 P.2d 561, 566 (Utah 1996).

157. *See id.*

158. Section 410(b) of the Uniform Act provides:

> Every person who directly or indirectly controls a seller liable, . . . every partner, officer, or director of such a seller, every person occupying a similar

judge argued that the enumerated persons in section 410(b) is so broad that "a plaintiff may also bring a cause of action against a defendant with whom there was no privity."[159] This criticism is easily addressed when considering that the enumerated list of those who are potentially liable merely takes into account "well-established principles of agency law."[160]

The concept of limiting liability by establishing causation through the doctrine of privity has also been applied to section 12(2) of the Federal Securities Act, the federal analog to section 410(a).[161] Again, correlation between section 410 of the Uniform Act and section 12(2) calls for application of federal precedent to issues arising under the Uniform Act.[162] Although the list of individuals who may be held liable under the Uniform Act is arguably expansive, case law suggests that similar individuals have been held liable under section 12(2) of the Federal Securities Act while still not requiring proof of reliance.[163] Such a result is consistent with the general policy of broadly interpreting the Uniform Act to maximize the protection to the investor and deterrence of fraud.[164] Furthermore, even when causation is required, it is merely "some causal connection" which is sought.[165] Therefore, even an expansive list of persons potentially liable, that takes into account principles of agency, still

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> status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable . . . .

UNIF. SECURITIES ACT § 410(b), 7B U.L.A. 643 (1958).

159. *Gohler*, 919 P.2d at 568 (Russon, J., dissenting) (emphasis omitted).

160. *Id.* at 566 n.6.

161. *See* Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 692-93 (5th Cir. 1971); Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964); *see also* Hoover v. E. F. Hutton & Co., Fed. Sec. L. Rep. (CCH) ¶ 97,654, at 98,486 (E.D. Penn. June 24, 1980) ("Section 12(2) has been construed to require privity between plaintiff and defendants as a predicate for liability."); Martin I. Kaminsky, *An Analysis of Securities Litigation Under Section 12(2) and How It Compares with Rule 10b-5*, 13 HOUS. L. REV. 231, 247 (1976).

162. *See supra* Part III.A.2.b.1.

163. *See* Lennerth v. Mendenhall, 234 F. Supp. 59, 64 (N.D. Ohio 1964) (holding a broker liable).

164. *See generally supra* Part III.A.2.a.

165. Brooks v. Land Drilling Co., 574 F. Supp. 1050, 1054 (D. Colo. 1983) ("[Although p]laintiffs . . . need not prove they relied on misleading statements or material omissions in a Section 12(2) action[, t]hey must, however, prove that there was 'some causal connection between the challenged communication and the sale, even if not "decisive."'" (citation omitted) (quoting Jackson v. Oppenheim, 533 F.2d 826, 830 n.8 (2d Cir. 1976))).

provides the required connection between the misstatement and the injury without unnecessarily limiting the statute's intended broad scope.

(2) Materiality may satisfy causation for purposes of securities fraud. Although privity may provide the necessary basis to establish causation, the element of materiality is probably more commonly used.[166] As specifically provided in the Uniform Securities Act, the untrue statement or omission must involve a *material* fact.[167] "Although different courts in different contexts have rephrased the test [of materiality], it still retains substantially the same meaning."[168] A fact is material if "a buyer or seller of ordinary intelligence and prudence would think [it] to be of some importance in determining whether to buy or sell."[169]

Some courts have suggested that this definition of materiality "seems to import some [element] of reliance."[170] Professor Loss, however, warns against taking this conclusion too far: "[T]o be sure, some element of reliance (which is subjective) is inherent in the concept of materiality (which is an objective 'reasonably prudent person' concept). But . . . that element should not be permitted to come in the back door by way of a definition of materiality."[171] Several courts that have erroneously required an element of reliance have done so through sloppy analysis of the "materiality" requirement.[172]

Perhaps recognizing the potential block to legitimate recovery that a requirement of actual reliance would impose, some courts try to objectify a judicially imposed reliance element by

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166. *See* Comeau v. Rupp, 810 F. Supp. 1127, 1158 (D. Kan. 1992) ("[R]eliance . . . is not an element that appears on the face of [the statute]. . . . Rather, the only possible 'causation' element . . . is that the misrepresentation or omission be material."); *Brooks*, 574 F. Supp. at 1054. Materiality may even be used to show causation in a case of omission or non-disclosure based on Federal Rule 10b-5, which requires actual reliance in a case of an affirmative statement. In such a case, "a plaintiff need not show reliance . . . but must still show that the facts in question were material." Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 381 (2d Cir. 1974).

167. *See supra* note text accompanying 36.

168. *Brooks*, 574 F. Supp. at 1055.

169. S & F Supply Co. v. Hunter, 527 P.2d 217, 221 (Utah 1974).

170. *Id.*

171. IX LOSS & SELIGMAN, *supra* note 92, at 4203 (footnote omitted).

172. *See Hunter*, 527 P.2d at 221; *see also* Kramersmeier v. R.G. Dickinson & Co., 440 N.W.2d 873, 878-79 (Iowa 1989) (searching the facts to find evidence suggesting reliance would be sufficiently satisfied instead of making it clear that the requirement of "material misrepresentation" does not require "proof of reliance").

stating it in terms of "reasonable" or "justifiable" reliance.[173] At least one court, in holding that reliance is not required, subsequently confused its holding by defining "materiality" in terms of an objective form of reliance.[174] This confusion was the result of prior precedent which suggested that materiality "seems to import some objective standard of reliance."[175] Although such modification to reliance, such as "reasonableness," moves toward a materiality concept, there is still an inherent danger that actual reliance may sneak in through the "back door" with such analysis.[176] Therefore, the best approach to avoiding confusion and still requiring objective causation in securities fraud is to define materiality in its traditional form without mention of reliance at all.

Although the element of materiality provides the necessary causation, it is limited by the objective standard. This limitation is consistent with the policy of furthering the prevention of fraud and protecting investors through broad application of the Uniform Act.[177] Furthermore, such an interpretation of the requirement is consistent with related federal regulations.[178] Even in a cause of action under Federal Rule 10b-5, which traditionally requires more showing of causation than section 12(2), materiality has been sufficient to satisfy the requirement.[179] Therefore,

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173. *See, e.g.*, Kennedy v. Josephthal & Co., Inc., 814 F.2d 798, 805 (1st Cir. 1987) (concluding that at least reasonable reliance is required for an action under the Massachusetts Securities Act, which relates to Federal Rule 10b-5); Geisenberger v. John Hancock Distrib., 774 F. Supp. 1045, 1051 (S.D. Miss. 1991) (finding that the Mississippi statuta "contain[s] an implicit requirement of reasonable reliance consistent with federal Rule 10b-5"); Foster v. Alex, 572 N.E.2d 1242, 1245 (Ill. App. Ct. 1991) (requiring "reasonable reliance," which is a slightly lesser standard than "justifiable reliance").

174. *See* Gohler v. Wood, 919 P.2d 561, 564 (Utah 1997).

175. *Hunter*, 527 P.2d at 221.

176. *See* IX LOSS & SELIGMAN, *supra* note 92, at 4203; *supra* text accompanying note 171. In one jurisdiction, while construing a state statute based on section 410 of the Uniform Act, the court quoted language that suggested that materiality "seems to import some objective standard of reliance." Vance v. Indian Hammock Hunt & Riding Club, Ltd., 403 So. 2d 1367, 1371 (Fla. Dist. Ct. App. 1981) (quoting *Hunter*, 527 P.2d at 221). From this language, the court was "persuaded that . . . in order for a fact to be a 'material' fact . . . the party claiming to have sustained loss, injury, or damage has the burden to show reliance upon the untrue statement." *Id.* at 1370-71. This is a good example of how a court may jump from reasonable reliance to actual reliance, confirming Professor Loss's concern that some might be inclined to improperly let reliance in the "back door."

177. *See supra* Part III.A.2.a.

178. *See supra* note 82.

179. *See supra* note 166 and accompanying text.

when a showing of some causal connection between the omission or misstatement and the injury is required, it should be found through the doctrines of materiality or privity and not through the overly burdensome doctrine of reliance.

IV. CONCLUSION

The language of the Uniform Securities Act is clear and does not impose an element of reliance for securities fraud–accordingly, reliance should not be required. In addition, the plain language of the statute furthers the Uniform Act's objectives. Given the well-established paternalistic objective of the Uniform Act, its purpose is best furthered by increasing both the protection to the investor and the liability of any person who wished to perpetrate fraud in the securities market. Refusing to require the element of reliance as part of the prima facie case of securities fraud would certainly further this purpose. Furthermore, such a broad application of the Uniform Act would not eliminate causation as many have suggested, rather the limitations resulting from such doctrines as materiality and privity are sufficient to establish the requisite causal connection. Thus, the concern that the rejection of an element of reliance is a rejection of all notions of causation is not well founded.

Consequently, those jurisdictions that have not yet faced this issue should carefully consider the language of the Uniform Act, the Draftsmen's Commentary, and the overall purposes of the Uniform Act that are furthered by not requiring reliance, and not insert additional requirements into the clear language of the statute. Other jurisdictions that have already held that reliance is required by the Uniform Act should scrutinize those holdings in light of the analysis outlined in this Comment and adjust accordingly. Recently, one court held that reliance is "a familiar element for the common law claim [of fraud], and perhaps, but less clearly so, for the Blue Sky claim [of fraud based on the Uniform Act]."[180] This is an example of one court on the verge of incorrectly imposing an element of reliance, without any analysis, on a state securities fraud claim based on the Uniform Act. Rather than presume a requirement of reliance, merely because the cause of action is based on some type of fraud—all jurisdictions faced with this issue should hold closely to the elements as

180. Dinco v. Dylex Ltd., 111 F.3d 964, 971 (1st Cir. 1997) (citations ommited).

explicitly provided by the Uniform Act, which clearly do not require reliance. Only in this way can the goal of uniformity, deterrence of fraud, and protection of investors in this important area be fully obtained.

David O. Blood