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## A Post-Santa Fe Blueprint for Courts in Rule 10b-5 - Actions for Breach of Fiduciary Duty: *Kidwell v. Meikle*

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# COMMENTS

A POST-*Santa Fe* BLUEPRINT FOR COURTS IN RULE 10b-5 ACTIONS FOR BREACH OF FIDUCIARY DUTY: *Kidwell v. Meikle*, 597 F.2d 1273 (9th Cir. 1979)

Pursuant to the Securities Exchange Act of 1934,<sup>1</sup> the Securities and Exchange Commission adopted SEC Rule 10b-5.<sup>2</sup> Introduced without much fanfare in 1942, the Rule's potential effect was not then fully appreciated.<sup>3</sup> There is no question that over the years the courts have interpreted the broad language of rule 10b-5 expansively,<sup>4</sup> and while a great deal of the law governing securities matters is reflected in circuit court opinions, the Supreme Court has recently undertaken an active role in determining the scope of rule 10b-5.<sup>5</sup> In the recent case of *Santa Fe Industries, Inc. v. Green*,<sup>6</sup> the Supreme Court held that a breach of fiduci-

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1. 15 U.S.C. § 78j(b)(1976) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

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(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. 17 C.F.R. § 240.10b-5 (1978) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

3. 1 A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10B-5 § 2.2 at 19-20 (1967).

4. See, e.g., *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964).

5. Bloomenthal, *Introductory Survey*, 8 SEC. L. REV. xii, xii-xiii (1976). See, e.g., *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

6. 430 U.S. 462 (1977).

ary duty, unsupported by an allegation of manipulation or deception, is not actionable under rule 10b-5.<sup>7</sup> A number of courts have had the opportunity to interpret the *Santa Fe* decision and to formulate tests to determine if plaintiffs have alleged sufficient deception or manipulation to fall within the ambit of rule 10b-5;<sup>8</sup> yet there is an apparent conflict among the circuits as to the proper application of *Santa Fe*. This Comment will examine the approach taken recently by the Ninth Circuit Court of Appeals<sup>9</sup> where the court formulated a blueprint for courts to follow in this area.<sup>10</sup>

### I. BEFORE *Santa Fe*

In an early case, *Birnbaum v. Newport Steel Corp.*,<sup>11</sup> the Second Circuit stated that section 10(b) was aimed specifically at the type of misrepresentation associated with the sale or purchase of securities rather than "fraudulent mismanagement of corporate affairs."<sup>12</sup> *Birnbaum* has subsequently been interpreted in varying ways by the same court,<sup>13</sup> and it has

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7. *Id.* at 473-74.

8. *Compare* *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978) with *Kidwell v. Meikle*, 597 F.2d 1273 (9th Cir. 1979) and *Wright v. Heizer Corp.*, 560 F.2d 236 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978).

9. *Kidwell v. Meikle*, 597 F.2d 1273 (9th Cir. 1979).

10. The question of whether the rule or the statute creates a private right of action is apparently settled at this time. These private actions, notwithstanding the fact that there is no mention of them in the rule or statute, were first allowed in *Kardon v. National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa. 1947). The Supreme Court never addressed the issue until many years after the *Kardon* case. Then, in *Superintendent of Ins. v. Banker's Life & Cas. Co.*, the Court found that a private cause of action was implied under section 10(b). 404 U.S. 6, 13 n.9 (1971).

11. 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

12. *Id.* at 464. *Birnbaum* is primarily known for its establishment of the purchaser-seller requirement.

13. *Compare* *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964) with *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964). Although these cases were decided by the same court within a month of each other, the results were not entirely consistent. In *O'Neill*, the Civil Aeronautics Board had ordered a re-exchange of shares between Pan American Airlines and National Air Lines. Plaintiff, a stockholder of National, alleged that National's board of directors arranged the exchange so as to perpetuate their control over the corporation, which allegedly was not in the best interests of the corporation. 339 F.2d at 766-67. The circuit court affirmed the trial court's dismissal of the action stating that there was "no serious claim of deceit, withheld information or misstatement of material fact." *Id.* at 767. The court specifically relied on *Birnbaum* and held there must be an "allegation of facts amounting to deception." *Id.* at 768.

Less than one month earlier, in *Ruckle*, the same court was faced with a derivative action brought by a disgruntled stockholder to enjoin a corporation from issuing and selling securities to the president of the corporation. The alleged fraud centered around the withholding of the latest financial statements of the company from the minority members of the board

led to much confusion as to whether to allow an action under rule 10b-5 where there is only a breach of fiduciary duty and no allegation of misrepresentation or nondisclosure. There followed a gradual loosening of the strict *Birnbaum* interpretation of rule 10b-5, and it became evident that a transaction could be considered a fraud within the reach of rule 10b-5<sup>14</sup> even though not satisfying all the traditional requirements of deceit.<sup>15</sup>

In *Schoenbaum v. Firstbrook*,<sup>16</sup> the Second Circuit established what was interpreted by many commentators as a new standard of "fairness," by which actions could be brought for a breach of a fiduciary duty under rule 10b-5.<sup>17</sup> In *Schoenbaum*, the plaintiffs brought a derivative action alleging that the defendants, knowing the true value of the stock, used their control of the corporation to acquire 500,000 shares of the corporation's stock at a grossly undervalued price shortly before a public an-

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of directors. 339 F.2d at 26. Although the court did not say the holding was based on a breach of fiduciary duty, the court stated that "[t]here can be no more effective way to emasculate the policies of the federal securities laws than to deny relief solely because a fraud was committed by a director rather than by an outsider." *Id.* at 29. The confusion which followed in the wake of these apparently conflicting cases and their interpretation of *Birnbaum* has not been fully settled by *Santa Fe*. *E.g.* *Kidwell v. Meikle*, 597 F.2d 1273 (9th Cir. 1979); *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

14. *See, e.g.*, *Shell v. Hensley*, 430 F.2d 819 (5th Cir. 1970); *Pappas v. Moss*, 393 F.2d 865 (3d Cir. 1968).

15. W. PROSSER, *HANDBOOK ON THE LAW OF TORTS* 685 (4th ed. 1971). These traditional requirements of deceit include (1) a false representation, usually one of fact, made by the defendant; (2) knowledge or belief by the defendant that the representation is false, *i.e.* scienter; (3) an intention by the defendant to induce the plaintiff to act or refrain from acting in reliance upon the misrepresentation; (4) justifiable reliance by the plaintiff; and (5) damages to the plaintiff caused by the reliance. *Id.* at 685-86.

16. 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969).

17. *E.g.*, Comment, 55 VA. L. REV. 1103, 1113-16 (1969). The validity of the *O'Neill* holding, *supra* note 13, was, thus, seriously questioned. *See Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 379 (2d Cir. 1974).

The holding in *Schoenbaum* became known as "new fraud," or an approach based on the fairness of the transaction. *See Popkin v. Bishop*, 464 F.2d 714, 719 (2d Cir. 1972). The case signalled an awareness that the courts would be receptive to the idea that minority stockholders in conflict of interest transactions are very vulnerable to securities frauds which would not be a threat to the ordinary stockholder. In apparent support of this position, the Supreme Court, in *Superintendent of Ins. v. Banker's Life & Cas. Co.*, 404 U.S. 6, 10 (1971), found the company was "injured as an investor through a deceptive device which deprived it of any compensation for the sale of its valuable block of securities" because a group of investors bought the company and then used company assets to pay for the transaction. A theory of "new fraud" was adopted in other circuits. *See Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970); *Pappas v. Moss*, 393 F.2d 865 (3d Cir. 1968); *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967).

nouncement of an oil discovery.<sup>18</sup> It has been suggested that the court could have decided the case by simply disregarding the corporate fiction and "[viewing] the transaction as a fraud on the shareholders."<sup>19</sup> Instead, the court enunciated a broader rule than was necessary to reach the same result. In essence, the court found that if the controlling shareholder caused the corporation to issue shares to him at an unfair price, a fraud was perpetrated despite the absence of deception.<sup>20</sup>

Four years hence, in *Popkin v. Bishop*,<sup>21</sup> the Second Circuit was once again faced with the issue of whether or not there must be an allegation of misrepresentation or nondisclosure for an action to lie under rule 10b-5.<sup>22</sup> The court dismissed plaintiff's complaint in *Popkin* finding that, although the court in *Schoenbaum* focused on improper self-dealing, it "did not eliminate nondisclosure as a key issue in Rule 10b-5 cases."<sup>23</sup> Full and correct information was given by the majority stockholder in *Popkin* and since the court felt the securities laws and rules were "designed principally to impose a duty to disclose and inform rather than to become enmeshed in passing judgments on information elicited"<sup>24</sup> no action was found to lie. Thus, the *Popkin* court appeared to limit the applicability of *Schoenbaum*. Further distinguishing the two cases, the court in *Popkin* found that there was nondisclosure in *Schoenbaum*,<sup>25</sup> and that the federal interest was satisfied when all information necessary for the stockholders to make an informed decision was disclosed.<sup>26</sup>

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18. 405 F.2d at 217-18.

19. Bloomenthal, *From Birnbaum to Schoenbaum: The Exchange Act and Self-Aggrandizement*, 15 N.Y.L.F. 332, 347 (1969). This approach would have adopted the dissent of Judge Hays in the case when it was before the three-judge panel. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 214-15 (2d Cir. 1968) (Hays, J., dissenting).

20. 405 F.2d at 219-20. In his dissent, Judge Medina foreshadowed what was to become a policy ground for the Supreme Court in *Santa Fe*:

For the result [of the majority's holding] is to transform a simple cause of action against directors for waste or the use of bad judgment in the sale of corporate assets into a federal securities fraud case by judicial fiat. In my opinion the Congress never intended the Securities Exchange Act of 1934 to be interpreted so broadly as this.

*Id.* at 220.

21. 464 F.2d 714 (2d Cir. 1972).

22. In *Popkin*, the plaintiff was seeking injunctive relief on the ground that the exchange ratios in the proposed merger between Bell Intercontinental Corporation and its two subsidiaries into the Equity Corporation were grossly inadequate. A joint proxy statement had been issued which fully explained the merger and Equity's position as controlling stockholder. *Id.* at 716.

23. *Id.* at 719.

24. *Id.* at 719-20.

25. *Id.* at 719. Also, in *Schoenbaum*, prior stockholder approval was not required. *Id.*

26. *Id.* at 719-20.

It was not clear in the *Popkin* decision whether the Second Circuit had retreated to the position of requiring all the traditional elements of fraud<sup>27</sup> to be alleged in order to establish a cause of action under rule 10b-5. What was clear, however, was that the Supreme Court had begun a restrictive interpretation of the rule's provisions. In *Blue Chip Stamps v. Manor Drug Stores*,<sup>28</sup> the Supreme Court addressed the issue of whether to uphold the "purchaser-seller" rule of *Birnbaum*<sup>29</sup> with respect to implied rights of action under section 10(b).<sup>30</sup> Ever since the *Birnbaum* case was decided, the trend of the courts had been to relax the strict "purchaser-seller" rule established by that case.<sup>31</sup> The Supreme Court put a halt to this trend in *Blue Chip* by stating that "[t]he longstanding acceptance by the courts, coupled with Congress' failure to reject *Birnbaum's* reasonable interpretation of the wording of § 10(b), wording which is directed toward injury suffered 'in connection with the purchase or sale' of securities, argues significantly in favor of acceptance of the *Birnbaum* rule by this Court."<sup>32</sup> Thus, the Supreme Court relied on the fact that Congress had not changed the law after the interpretation given section 10(b) by the Second Circuit in *Birnbaum*.<sup>33</sup> *Blue Chip* was a precursor of

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27. See note 15 *supra*.

28. 421 U.S. 723 (1975).

29. See note 12 *supra*.

30. 421 U.S. at 751-52. *Blue Chip*, before the action was brought, provided trading stamps to retailers, and ninety percent of its shares were owned by nine retailers. *Id.* at 725. The government brought an antitrust suit, and a consent decree was entered, by which *Blue Chip* was to be reorganized into a new company. *Id.* at 725-26. The holdings of the shareholders in the old company were to be reduced, and the new company was to offer a substantial number of its shares of common stock to retailers who had previously used the stamp service but were not stockholders in the old company. Plaintiffs alleged that the prospectus prepared and distributed by the new company was "materially misleading in its overly pessimistic appraisal of *Blue Chip's* status and future prospects." *Id.* at 726. Plaintiffs alleged this was purposefully done to discourage participation so the stock could later be resold at a higher price, and that the class before the Court was injured because it failed to purchase the stock. *Id.* at 726-27.

31. Some cases have established that where a corporation issues its own stock it can be considered a "seller" for purposes of rule 10b-5, and derivative suits may therefore be brought on its behalf if it was defrauded. See, e.g., *Dasho v. Susquehanna*, 380 F.2d 262, 266 (7th Cir.), cert. denied, 389 U.S. 977 (1967); *Ruckle v. Roto Am. Corp.*, 339 F.2d 24, 27 (2d Cir. 1964); *Hooper v. Mountain States Sec. Corp.*, 282 F.2d 195, 203 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961). For a complete rejection of the "purchaser-seller" requirement, see *Eason v. General Motors Acceptance Corp.*, 490 F.2d 654 (7th Cir. 1973). See generally, Löwenfels, *Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268, 272-77 (1968).

32. 421 U.S. at 733 (citation omitted).

33. The Court also relied on other sections of the law, which expressly created private remedies, in denying plaintiff's standing to sue under section 10(b), including section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a)(1976), *Id.* at 733-34 n.6; sections 11(a) and 12 of the 1933

decisions to follow.

Indeed, less than one year after deciding *Blue Chip*, the Supreme Court decided *Ernst & Ernst v. Hochfelder*.<sup>34</sup> In *Hochfelder*, the Court enunciated the rule that no action will lie under rule 10b-5 without an allegation of scienter, *i.e.*, the intent to deceive, manipulate, or defraud on the part of the defendant.<sup>35</sup> In reaching its decision, the Court interpreted section 10(b) narrowly. The Court discussed in great detail the legislative and administrative histories as well as the precise wording of the statute itself.<sup>36</sup> Special attention was directed to the word "manipulative";<sup>37</sup> the Court stated that "[i]t is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."<sup>38</sup> The *Hochfelder* Court found it particularly important to interpret the statute narrowly because they were dealing with a judicially implied liability,<sup>39</sup> and for that reason, following the statutory language was a paramount consideration.<sup>40</sup> Thus, since plaintiff's cause of action rested on the "negligent nonfeasance"<sup>41</sup> of Ernst & Ernst, there was no cause of action under section 10(b).<sup>42</sup>

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Act, 15 U.S.C. §§ 77k-77l (1976); and section 18 of the 1934 Act, 15 U.S.C. § 78r (1976). *Id.* at 735-36.

Recognizing that a private cause of action under section 10(b) was implied by the courts, the Court said "[i]t would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action." *Id.* at 736 (citation omitted).

34. 425 U.S. 185 (1976).

35. *Id.* at 193. The defendant, Ernst & Ernst, an accounting firm, was retained to audit a brokerage firm's books and records. Plaintiffs had invested in a securities scheme which later turned out to be fraudulent. The fraud, perpetrated by Nay, the president of the brokerage firm, consisted of Nay promising plaintiffs high-yield returns from escrow accounts which, in fact, did not exist. After Nay's suicide, the details of the fraud became known through his suicide note. *Id.* at 188-89. Plaintiffs filed an action under rule 10b-5 alleging that Ernst & Ernst aided and abetted Nay's fraudulent scheme by improper auditing procedures. *Id.* at 190. Plaintiffs alleged that if Ernst & Ernst had conducted a proper audit, it would have uncovered the fraud.

36. *Id.* at 194-211.

37. *Id.* at 199.

38. *Id.* (citation omitted).

39. See note 10 *supra*.

40. 425 U.S. at 200-01.

41. *Id.* at 190.

42. In so holding, the Court stated that "[w]hen a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances—the commonly understood terminology of intentional wrongdoing—and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct." *Id.* at 214.

The Supreme Court, by its decisions in *Blue Chip* and *Hochfelder*, has effectively limited the class of plaintiffs with viable causes of action under section 10(b).<sup>43</sup> These cases put a halt to the lower courts' trend toward expansion of plaintiff's rights under the securities law.<sup>44</sup> Further evidence of the Court's reluctance to interpret implied rights broadly was contained in a case which did not deal specifically with securities law. In *Cort v. Ash*,<sup>45</sup> the Supreme Court enunciated four factors which must be considered in determining whether or not a private remedy is implicit in a federal statute which does not expressly provide one. The first factor is whether the plaintiff is "one of the class for whose *especial* benefit the statute was enacted."<sup>46</sup> The Court decided that the protection of the plaintiff in *Cort* was "at best a secondary concern."<sup>47</sup> The similarity to *Blue Chip* cannot be avoided because the Court there refused to imply a cause of action for a party who had not purchased a security, finding that the congressional intent under section 10(b) was to protect only purchasers and sellers.<sup>48</sup>

The second inquiry in *Cort* is whether there is "any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one."<sup>49</sup> Although it has been recognized that a private cause of action may be implied under section 10(b),<sup>50</sup> this second factor may allow courts to examine whether Congress intended for a particular plaintiff to be in the protected class. Thus, there could be an even further restriction of access to the courts by way of section 10(b).

The third factor requires the Court to consider whether it is necessary to imply a remedy to effect the underlying purpose of the legislative scheme.<sup>51</sup> It is not clear if this factor, even though not explicated, entered into the Court's consideration of *Blue Chip* and *Hochfelder*, and therefore required their finding that an extension of the securities law in those cases was unnecessary.

Finally, the Court considered whether the cause of action was one traditionally relegated to state law so that an inference of a federal cause of

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43. See generally, Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings*, 65 GEO. L.J. 891, 892 (1977).

44. *Id.* at 900.

45. 422 U.S. 66 (1975). This suit involved an action for illegal campaign contributions to a presidential campaign. See generally, Comment, 17 B.C. INDUS. & COM. L. REV. 53 (1975).

46. 422 U.S. at 78 (citation omitted).

47. *Id.* at 81.

48. 421 U.S. at 727-31.

49. 422 U.S. at 78.

50. See note 10 *supra*.

51. 422 U.S. at 78.



action would be "inappropriate."<sup>52</sup> The Court found that corporations were creatures of state law, and stockholders invested their money with the understanding that state law would apply, except where federal laws required a different right or obligation.<sup>53</sup> This fourth factor was not mentioned in *Blue Chip* or *Hochfelder* but was nonetheless, more evidence of the Court's limiting of the class of plaintiffs under section 10(b), and it was prophetic of what followed shortly thereafter.

The thrust of the Supreme Court's holdings in *Blue Chip* and *Hochfelder*, in conjunction with *Cort*, was clearly to limit the application of rule 10b-5. Thus, the Second Circuit's decision that "no allegation or proof of misrepresentation or nondisclosure is necessary"<sup>54</sup> in actions for breaches of fiduciary duty under rule 10b-5 was clearly ripe for reversal.<sup>55</sup> The Supreme Court rejected the Second Circuit's interpretation of rule 10b-5 in *Santa Fe Industries, Inc. v. Green*,<sup>56</sup> and it continued its policy of strictly interpreting section 10(b).<sup>57</sup>

The Supreme Court pointed out that the Second Circuit opinion erroneously relied on interpretation of "fraud" in Supreme Court cases dealing with areas outside the scope of the 1934 Act.<sup>58</sup> Instead, the Court said the proper place for determining what constitutes an action for fraud under rule 10b-5 is to examine the language of the statute itself.<sup>59</sup> The

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52. *Id.*

53. *Id.* at 84.

54. *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283, 1287 (2d Cir. 1976).

55. The court stated that a broad interpretation of the law was necessary to accomplish the purpose for which it was intended. The purpose, in the eyes of the Second Circuit, was to protect the minority shareholders from the majority. *Id.*

56. 430 U.S. 462 (1977). Under Delaware law, DEL. CODE ANN. tit. 8, § 253(a)(1974), a parent company with more than 90% of the stock of a subsidiary could cause a merger with the subsidiary by approval of the parent company's board of directors. This "short-form" merger required that the parent pay cash for the minority shareholders' shares. No notice or consent of the minority stockholders was required to effect the merger, but within ten days after the merger the minority shareholders are to be notified, and any dissatisfied shareholder may petition the Delaware Court of Chancery for payment of a fair value for his shares. *Santa Fe Industries, Inc.* acquired control of 95% of Kirby Lumber Company, and subsequently pursued the short-form merger. An independent appraisal of Kirby's assets was made and Santa Fe offered the minority stockholders \$150 per share. *Id.* at 465-66. The minority stockholders claimed the shares were worth at least \$772 per share and that a fraudulent appraisal had been made, and therefore, Santa Fe was in violation of rule 10b-5. *Id.* at 467.

57. This policy was first enunciated in *Hochfelder*, 425 U.S. 185; see notes 34-42, *supra* and accompanying text.

58. 430 U.S. at 471-72. See 533 F.2d at 1290.

59. 430 U.S. at 472. The Court at this point referred back to its opinions in *Blue Chip* and *Hochfelder*.

Court felt the Second Circuit's finding that all breaches of fiduciary duty in connection with a securities transaction are actionable fraud would "add a gloss to the operative language of the statute quite different from its commonly accepted meaning."<sup>60</sup> Thus, the Court found that a claim under rule 10b-5 could not be successfully maintained without an allegation that the conduct was "manipulative" or "deceptive."<sup>61</sup>

The actions by the defendants in *Santa Fe* were held not to be deceptive or manipulative because the minority shareholders were given all the information necessary for them to make a decision whether to accept the price offered, or to reject the offer and proceed in the Delaware Court of Chancery for an appraisal.<sup>62</sup> In a footnote of far-reaching proportions,<sup>63</sup> the Court answered the minority stockholders' claim that since no prior notice was given of the merger, there was a material nondisclosure.<sup>64</sup> Under Delaware law, the minority stockholders were not required to be given notice prior to the merger, and they could only seek an appraisal remedy; they could not have enjoined the merger.<sup>65</sup> That being the case, the Court said the disgruntled shareholders failed to indicate how they would have acted differently had there been prior notice of the merger.<sup>66</sup> Therefore, the nondisclosure in that case was not a "material" nondisclosure.<sup>67</sup>

The Second Circuit relied on a number of cases<sup>68</sup> to reach their decision, but the Supreme Court found them inapposite to the principal case because all of them included some element of deception in order to come within the ambit of rule 10b-5.<sup>69</sup> The Court also found that there was no "manipulation" involved in *Santa Fe* because the actions did not fit within the traditional meaning of the word; a word which was classified as

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60. *Id.*, quoting *Hochfelder*.

61. *Id.* at 473-74.

62. *Id.* at 474.

63. *Id.* at 474 n.14. See, Comment, 91 HARV. L. REV. 1874, 1885-93 (1978).

64. 430 U.S. at 474 n.14.

65. DEL. CODE ANN. tit. 8, § 253 (1974).

66. 430 U.S. at 474 n.14.

67. The test for materiality was set forth in *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) as "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." The Court in *TSC Industries* was deciding a case under the proxy rules but the same definition was referred to in *Santa Fe*. 430 U.S. at 474 n.14.

68. See, e.g., *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971); *Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968).

69. 430 U.S. at 474-75.

a "term of art."<sup>70</sup> If Congress had intended to include the activities alleged in *Santa Fe* within section 10(b),<sup>71</sup> the Court felt that they would certainly not use a word with such a commonly accepted meaning.<sup>72</sup>

In the final portion of its opinion in *Santa Fe*,<sup>73</sup> the Court intimates that it would have reached the same result, regardless of whether the language of the statute was dispositive of the case.<sup>74</sup> There were basically two reasons for this. The first paralleled the third factor enunciated in *Cort*,<sup>75</sup> i.e., a private cause of action should not be implied where it is "unnecessary to ensure the fulfillment of Congress' purposes' in adopting the Act."<sup>76</sup> Having found earlier in the decision that the disclosure was full and fair, the Court said that "the fairness of the terms of the transaction is at most a tangential concern of the statute."<sup>77</sup>

The second reason the Court considered focused upon whether the cause of action was one that was traditionally relegated to state law,<sup>78</sup> a major ingredient in the *Cort* test.<sup>79</sup> The Court classified the facts of this case as mere "corporate mismanagement,"<sup>80</sup> and said that such matters are traditionally matters of state law.<sup>81</sup> There was a reluctance by the Court to federalize a great deal of corporate conduct which had previ-

70. *Id.* at 476. "The term [manipulation] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Id.*

71. The Court classified the activities involved here as an instance of "corporate mismanagement." *Id.* at 477.

72. *Id.*

73. Justices Blackmun and Stevens did not join in Part IV of the opinion because they felt it was "unnecessary" to the holding of the case. *Id.* at 480-81.

74. *Id.* at 477.

75. See note 51 *supra*, and accompanying text.

76. 430 U.S. at 477, quoting *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 (1977).

77. 430 U.S. at 478.

78. *Id.*

79. See note 52 *supra*, and accompanying text. One commentator has suggested that this reason was one of the major reasons why the Court did not allow a broadening of the scope of section 10(b) in *Santa Fe*. Note, 8 SETON HALL L. REV. 762, 790 (1977).

80. 430 U.S. at 477.

81. *Id.* at 479-80. As noted previously, note 56 *supra*, when the Court decided *Santa Fe* under established Delaware law, the minority shareholder's only alternative to accepting the cash offered was to seek an appraisal of the fair value of the shares. See *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (1962). Subsequent to the *Santa Fe* decision, however, the Delaware court decided that under a long-form merger, an appraisal was not the sole remedy when the only purpose of the merger was elimination of minority interest. *Singer v. Magnavox, Inc.*, 380 A.2d 969 (Del. 1977). *But cf.* *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977) (merger made primarily to advance business purpose of the majority stockholder). It is not clear at this time whether short-form mergers will be subject to the same test. See generally, Note, 8 SETON HALL L. REV. 712 (1977).

ously been left to the states. This did not mean state law would control where Congress has created a federal remedy, but the Court did not feel the *Santa Fe* case called for such a federal remedy.<sup>82</sup> The Court was obviously concerned that a wide variety of cases normally left to the states would be brought under rule 10b-5, and there existed a "danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5."<sup>83</sup> Also, the Court feared that directors of corporations would not know what responsibilities they had, nor to whom these responsibilities were owed.<sup>84</sup> Because laws differ from state to state, the federal courts would be required to federalize the fiduciary duty in order to promote uniformity throughout the country.<sup>85</sup> Clearly, the Court desired to avoid such a result.<sup>86</sup>

## II. BEYOND *Santa Fe*

In the wake of *Santa Fe*, many courts have been faced with a myriad of problems to which *Santa Fe* may apply, and the lower courts have interpreted the case in different ways.<sup>87</sup> The difference of opinion on how to interpret *Santa Fe* is nowhere clearer than between the Second Circuit<sup>88</sup> on the one hand, and the Seventh<sup>89</sup> and Ninth<sup>90</sup> Circuits on the other.<sup>91</sup>

82. 430 U.S. at 478.

83. *Id.* at 479, quoting *Blue Chip*.

84. *Id.*

85. *Id.* at 479 n.16.

86. For a discussion of the continuing viability of "new fraud," *supra* note 17, see Jacobs, *How Santa Fe Affects 10b-5's Proscriptions Against Corporate Mismanagement*, 6 SEC. REG. L.J. 3, 16-20 (1978).

87. Compare *O'Brien v. Continental Ill. Nat'l Bank & Trust Co.*, 593 F.2d 54 (7th Cir. 1979) (holding that *Santa Fe* instructed courts to be reluctant in applying rule 10b-5 and that plaintiffs had chosen to delegate their decision-making power to the bank; additionally, abuse of discretion found to be a state cause of action); *Biesenbach v. Guenther*, 588 F.2d 400 (3d Cir. 1978) (failure to disclose a breach of fiduciary duty is not a misrepresentation sufficient to constitute a violation of section 10(b); to hold otherwise would circumvent the holding of *Santa Fe*); *Rodman v. Grant Foundation*, 460 F. Supp. 1028 (S.D.N.Y. 1978) (failure to disclose actual subjective purpose in connection with stock dealings is not a violation of rule 10b-5); and *Maldonado v. Flynn*, 448 F. Supp. 1032 (S.D.N.Y. 1978) (disclosure made to disinterested directors held sufficient disclosure for Act, and involved a state cause of action which the court did not want to federalize contra to spirit of *Santa Fe*) with *SEC v. Parklane Hosiery Co.*, 558 F.2d 1083 (2d Cir. 1977) (distinguished *Santa Fe* because stockholders may have been able to enjoin the merger under state law); *Healey v. Catalyst Recovery of Pa., Inc.*, 463 F. Supp. 740 (W.D. Pa. 1979) (availability of injunctive relief enough to distinguish *Santa Fe*); and *Kaye v. Pantone, Inc.*, 78 F.R.D. 657 (S.D.N.Y. 1978) (plaintiff's allegation that there was no full and complete disclosure found enough to distinguish *Santa Fe*).

88. *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

89. *Wright v. Heizer Corp.*, 560 F.2d 236 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066

As will be explained below, depending on which test prevails, a number of causes of action under section 10(b) could be lost by plaintiffs claiming a breach of fiduciary duty.

The Second Circuit in *Goldberg v. Meridor*<sup>92</sup> was faced with an action by a minority stockholder of a subsidiary alleging that a parent corporation, saddled with debt, forced its profitable subsidiary to purchase shares of the parent company at an inflated price.<sup>93</sup> Because the directors failed to disclose the transaction in advance, the minority shareholders of the subsidiary brought an action under rule 10b-5. The court reviewed its cases decided before *Santa Fe*<sup>94</sup> and decided that the Supreme Court had done nothing to upset those prior decisions. The court then found that an action could have been maintained by the plaintiff under state law to enjoin the parent company from forcing the subsidiary to buy the parent company's stock at an unfair price.<sup>95</sup> Without even determining the likelihood of plaintiff winning such an injunction, the court said it would not dismiss the complaint.<sup>96</sup> By finding injunctive relief to be available,<sup>97</sup> the court distinguished *Goldberg* from *Santa Fe* in which the Supreme Court found there was nothing the minority stockholders could have done had they known of the "freeze-out" merger in advance.<sup>98</sup>

In *Wright v. Heizer Corporation*,<sup>99</sup> the Seventh Circuit took a somewhat different approach to a similar problem. In that case, the defendant, a controlling stockholder, demanded and received security for a loan he made to the company.<sup>100</sup> Like the Second Circuit in *Goldberg*, the *Wright*

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(1978).

90. *Kidwell v. Meikle*, 597 F.2d 1273 (9th Cir. 1979).

91. *See also Healey v. Catalyst Recovery of Pa.*, — F.2d — (3d Cir. 1980).

92. 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978).

93. *Id.* at 211.

94. *Id.* at 215.

95. *Id.* at 219-20.

96. *Id.* at 220-21.

7. In dissent, Judge Meskill disagreed with the majority's holding because the plaintiff failed to allege what course of action he would have taken had he known of the alleged fraud before it took place. Judge Meskill felt such an allegation must be made because of *Santa Fe*. 567 F.2d at 224 (Meskill, J., dissenting). Also, because of the possible conflicts of law question which could have been involved in a state injunctive action due to the multinational corporate defendants, Judge Meskill was not convinced that New York law should even determine the availability of injunctive relief. *Id.* at n.9.

98. 430 U.S. at 474 n.14.

99. 560 F.2d 236 (7th Cir. 1977), *cert. denied*, 434 U.S. 1066 (1978). The *Wright* court was faced with five very complex transactions. Only the fifth transaction, where the defendant obtained a pledge of company assets before he would make a loan to the company, will be considered for purposes of this comment.

100. The security was all of the stock of Talent and Residuals, Inc., which provided ad-

court looked first to see whether an action would have existed under state law to enjoin the pledge transaction.<sup>101</sup> The court found such an action would exist but took an additional step: they looked to the facts of the case and the applicable state law governing the transaction in question to see if the state court would have actually enjoined the pledging of the assets of the company.<sup>102</sup> The transaction was found to be unfair according to state law and, therefore, the defendant was in violation of rule 10b-5 by failing adequately to alert the minority stockholders.<sup>103</sup>

### III. A BLUEPRINT FOR FUTURE COURTS

Just recently, the Ninth Circuit formulated what can be viewed as a blueprint for future courts to follow in this area of rule 10b-5 actions after *Santa Fe*. The facts in *Kidwell v. Meikle*<sup>104</sup> were important to the decision entered by the court and deserve explication at this point. The board of directors of an Idaho non-profit membership corporation ("resort"), because of financial difficulties, voted to sell its assets and transfer its liabilities to a Wyoming corporation in exchange for a minority interest in the Wyoming corporation. The Idaho corporation had been formed to operate a ski resort for its members on U.S. Forest Service land. Two years later, a for-profit corporation ("sister" corporation) was organized to build housing at the foot of the slopes, and thirty-two members of the resort became stockholders in the sister corporation. The resort's members and board were not informed of this development, nor were they aware that some of the shareholders included the founder of the resort, the attorney for both corporations, and some members of the resort's board. The sister corporation then obtained a lease for twenty-five years on the condominium lodge which the resort owned. The resort was to operate the lodge year round, which was alleged to be very disadvantageous to the resort. The sister corporation did agree to retire a loan which was used to build the lodge. The members who were not allowed to participate in the sister corporation were very vocal in their opposition to the entire arrangement.

Later, an Ohio businessman made an offer to buy the assets and assume the liabilities of the resort. Subsequently, the offer was extended to

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vertising agencies with complex bookkeeping and payroll services for ensuring proper payment to actors who appeared in commercials. 560 F.2d at 241. Note that no shareholder approvals were required in this case under the applicable law.

101. *Id.* at 250-51.

102. *Id.*

103. *Id.*

104. 597 F.2d 1273 (9th Cir. 1979).

include the purchase of the sister corporation. At about this time, the resort was having financial difficulties, and it was characterized as "about out of business"<sup>105</sup> by its auditor. On account of these dire financial straits, Idaho law allowed the corporation's assets to be sold without shareholder approval.<sup>106</sup> Nonetheless, a stockholder meeting was held for an advisory vote. Fewer than one-half of the stockholders attended the meeting. The plaintiffs alleged that the members were not informed that some directors of the resort were shareholders of the sister corporation, that one director may have served as counsel to both corporations, and that some directors had assumed personal liability for corporate debts. Had a vote been required under state law, the proposal to sell the assets would have been defeated because less than two-thirds of those present voted in favor of the sale.

Negotiations continued, and eventually the Ohio businessman bought the resort. The decision to sell came from the board on an eight to seven vote. Four of the directors who voted to sell the assets were shareholders in the sister corporation, and two directors in the majority had assumed personal liability for the resort's debts. The court dismissed a number of parties for various reasons<sup>107</sup> and then proceeded to an examination of *Santa Fe*.

The *Kidwell* court recognized that *Santa Fe* was clearly a limitation on the applicability of rule 10b-5 but stated it did not mean "that every breach of fiduciary duties is necessarily immune from invocation of the rule."<sup>108</sup> The court then reinforced that statement by referring to the decisions in *Goldberg* and *Wright*. Thus, the court found "there is room for Rule 10b-5 liability after *Santa Fe Industries* even when the only deceived parties are shareholders who are not entitled to vote on the transaction in question, and even though there may be a breach of fiduciary duty under state law."<sup>109</sup> The deciding factor for the court, as it was

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105. *Id.* at 1279.

106. IDAHO CODE § 30-145(2)(1976).

107. The Attorney General of Idaho and the beneficiaries of the resort were dismissed because they lacked standing under *Blue Chip* since none of them were purchasers or sellers of securities. 597 F.2d at 1286-87. Two directors of the resort who were suing on behalf of the residual charitable, recreational and educational beneficiaries were also dismissed because the Federal Rules of Civil Procedure did not allow for that type of director derivative suit, and because they were not purchasers or sellers under *Blue Chip*. *Id.* at 1288. The plaintiffs also sought mandamus against certain federal officials and agencies, alleging that they participated in the violation of rule 10b-5. The court found the action premature because it was based on contingencies, and it was therefore not ripe for adjudication. *Id.* at 1288-89.

108. *Id.* at 1291.

109. *Id.* at 1292.

for the other circuits in *Goldberg* and *Wright*, was the existence of state law remedies as the distinguishing factor from *Santa Fe*. In the instant case, shareholders of the resort may have been able to bring a derivative action to enjoin the sale of the resort's assets had all the facts been presented.<sup>110</sup> Therefore, the first part of the court's test is to be the availability of an action under state law.

After deciding the Idaho courts would have entertained a suit for breach of fiduciary duty against the directors who voted for the sale of the resort's assets to the Ohio businessman, the court applied the second part of its blueprint: was it a material fact which was not disclosed?<sup>111</sup> In its approach to this problem, the court used the oft-quoted language from *TSC Industries, Inc. v. Northway, Inc.*,<sup>112</sup> i.e., was there "a substantial likelihood that [its] disclosure . . . would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."<sup>113</sup> The court had no difficulty in deciding that a reasonable minority shareholder would want to know if four directors had some ownership in the sister corporation in deciding whether to bring an action to enjoin the transactions in state court.<sup>114</sup>

The third part of the court's test deals with causation. The court points out that the trial court on remand should presume that since the nondisclosure was material, there was reliance by the minority stockholders. This follows the holding of *Affiliated Ute Citizens v. United States*.<sup>115</sup> But the court hastens to add the caveat that such a presumption does "not dispose of the entire element of causation in the Rule 10b-5 suit,

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110. The court said the minority stockholders "reasonably could have brought a well-pleaded derivative suit to block the sale of [the resort's] assets." *Id.* at 1292. IDAHO CODE § 30-142 makes directors of a corporation fiduciaries who may not appropriate corporate assets for their own gain. In *Weatherly v. Weatherby Lumber Co.*, 94 Idaho 504, 492 P.2d 43 (1972), the Idaho court had found that a managing director-shareholder of a corporation was liable for not telling his brother and sister, also shareholders, that he was negotiating to sell the company before he bought their shares. Also cited by the court in *Kidwell* was *Hanny v. Sunnyside Ditch Co.*, 82 Idaho 271, 353 P.2d 406 (1960) and a later case in which the Idaho court granted injunctive relief. *Knutsen v. Frushour*, 92 Idaho 37, 436 P.2d 521 (1968).

111. 597 F.2d at 1293.

112. 426 U.S. 438 (1976).

113. *Id.* at 449.

114. 597 F.2d at 1293. The court mentioned the fact there may have been other actions a minority stockholder could have taken besides the directors' conflict of interest, but it chose to leave that task to the district court on remand. *Id.*

115. 406 U.S. 128 (1972). In that case, the Supreme Court, realizing the difficulty of proving reliance on undisclosed facts, said the withholding of a material fact "establish[ed] the requisite element of causation in fact." *Id.* at 154.



however."<sup>116</sup> The court noted the difference between bringing the suit in state court on the one hand, and winning the suit on the other. Because of *Santa Fe*, the court in *Kidwell* felt forced to hold that a minority stockholder cannot recover on behalf of the corporation merely because there could have been a cause of action in state court.<sup>117</sup> Thus,

[f]ollowing the Court's discussion [in *Santa Fe*] of the primacy of state law in remedying breaches of fiduciary duty, we hold that no relief is available to [the minority shareholder] here under Rule 10b-5 unless a minority member would have *succeeded* in getting permanent injunctive relief, or damages in excess of an appraisal remedy, in the state-law action.<sup>118</sup>

This is where the court differs from the holding in *Goldberg*. In *Goldberg*, all that was necessary to show was that a state cause of action could be maintained whereas the court in *Kidwell* required the plaintiff to show he would have been able to prevail in a state-law proceeding before relief can be obtained under rule 10b-5. Although it is a question of fact whether the action would have succeeded, the court instructed the trial court to decide as a matter of law any legal issues which would have arisen had a suit in fact been brought.<sup>119</sup>

The next step for the court was a reminder to the trial court to apply the scienter requirement of *Hochfelder*.<sup>120</sup> Negligent conduct is not enough for rule 10b-5 actions; therefore, the defendants could not be held liable for not disclosing facts they did not know, even if they were negligent in not discovering the facts.<sup>121</sup>

The last portion of the blueprint is the determination of which defendants owed the duty to disclose material facts to the minority shareholders.<sup>122</sup> The same court had already set forth five factors which were to be considered in defining the scope of a defendant's duties in a rule 10b-5 action in *White v. Abrams*.<sup>123</sup> There the court, struggling with the problem of trying to fit the duty into the concept of scienter, enunciated a five-prong approach which was to be flexible in order to meet varied fac-

116. 597 F.2d at 1294.

117. *Id.*

118. *Id.* (emphasis added). The court is referring to the second factor in Part IV of the Supreme Court's *Santa Fe* decision, discussed at notes 78-86 *supra*, and accompanying text.

119. *Id.* The court compared this approach to that of a judge in an action for attorney malpractice. *See, Wellman v. Jellison*, 593 F.2d 876, 878-79 (9th Cir. 1979); *Chocktoot v. Smith*, 280 Or. 567, 571 P.2d 1255 (1977).

120. 597 F.2d at 1294. *See* notes 34-42 *supra*, and accompanying text.

121. 597 F.2d at 1294.

122. *Id.*

123. 495 F.2d 724 (9th Cir. 1974).

tual contexts.<sup>124</sup> The factors set forth in *White* are:

the relationship of the defendant to the plaintiff, the defendant's access to the information as compared to the plaintiff's access, the benefit that the defendant derives from the relationship, the defendant's awareness of whether the plaintiff was relying upon their relationship in making his investment decisions and the defendant's activity in initiating the securities transaction in question.<sup>125</sup>

Following this approach, the court found that a number of defendants were properly dismissed by the trial court, but that the directors who maintained a fiduciary relationship and had interests in the sister corporation owed a duty to disclose the information to the shareholders.<sup>126</sup>

#### IV. BENDING *Santa Fe*?

Despite the Supreme Court's broad policy statement in *Santa Fe* that it did not want to "federalize" causes of action which were traditionally relegated to state law,<sup>127</sup> it may be that the lower courts have continued to find causes of action under rule 10b-5 for breaches of fiduciary duty, albeit by using a different approach. The approach capitalizes on footnote fourteen<sup>128</sup> of the *Santa Fe* decision which indicates there was not a material nondisclosure in that case because the plaintiffs failed to indicate there what action they would have taken had they been informed of the freeze-out merger in advance. Of course, at the time of the *Santa Fe* decision, there was nothing a minority stockholder could do to prevent the merger if the statutory requirements were met by the 90% stockholder.<sup>129</sup> The circuit courts in *Goldberg*, *Wright* and *Kidwell* relied heavily on the availability of state remedies as a major factor in establishing liability under rule 10b-5 for breaches of fiduciary duty, although their interpretations varied markedly as to whether the availability of a state action or the ability to prevail in a state action is the proper test.<sup>130</sup>

In *Santa Fe*, as there was no allegation of a material misrepresentation

124. *Id.* at 734-35.

125. 495 F.2d at 735-36 (footnotes omitted). The court alerts the reader to compare *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964) with *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964). See note 13 *supra*. See especially the court's accompanying footnotes. 495 F.2d at 735-36 nn.16-18.

126. 597 F.2d at 1297. The directors of the resort who did not own shares in the sister corporation did not owe a duty to disclose under rule 10b-5. *Id.*

127. 430 U.S. at 478. See notes 78-82 *supra*, and accompanying text.

128. 430 U.S. at 474 n.14.

129. See note 56 *supra*.

130. See notes 95, 101, and 117 *supra*, and accompanying text.

or nondisclosure, the Court dismissed the action under rule 10b-5. In *Goldberg*, *Wright* and *Kidwell*, there were allegations that material information had not been disclosed. Although taking different routes to reach what was essentially the same result, the circuit courts found room for actions under rule 10b-5 for breaches of fiduciary duty.<sup>131</sup> The only difference between the circuits is the effect to be given the availability of remedies under state law. The *Goldberg* court believed that it was necessary only for the plaintiff to demonstrate that the state court would have entertained a suit to enjoin the questioned activity of the defendants.<sup>132</sup> But in *Wright*, and more forcefully in *Kidwell*, the courts felt that because of the constraints of *Santa Fe*, it was necessary not only to show there existed a state cause of action but, indeed, that they would have prevailed in such an action at state law before an action for breach of fiduciary duty can fall within the reach of rule 10b-5.<sup>133</sup>

It has been suggested the *Goldberg* court was correct in its interpretation of *Santa Fe*.<sup>134</sup> It is submitted that the opposite is true. The *Kidwell* court was correct in finding that the minority member would have to have succeeded in getting permanent injunctive relief in a state action before rule 10b-5 would apply. The policy underlying *Santa Fe* was not to expand the class of plaintiffs under rule 10b-5 where the cause of action was essentially a state concern. The complaints alleged in *Kidwell* were, in essence, a breach of fiduciary duty. *Santa Fe* made clear that "the existence of a particular state-law remedy is not dispositive of the question whether Congress meant to provide a similar federal remedy."<sup>135</sup> In other words, simply because a plaintiff could bring an action in state court, he is not precluded from seeking a federal remedy. But in *Santa Fe*, the Court was unable to delineate where state law controlled and where fed-

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131. *Goldberg v. Meridor*, 567 F.2d at 218; *Wright v. Heizer Corp.*, 560 F.2d at 248; *Kidwell v. Meikle*, 597 F.2d at 1292.

132. See note 95 *supra*, and accompanying text.

133. See note 117 *supra*, and accompanying text.

134. See Comment, 91 HARV. L. REV. 1874, 1894-98 (1978). That comment dealt only with a comparison of *Goldberg* and *Wright* but the same arguments could easily be applied to *Kidwell*. The reasons set forth by that commentator include his opinion that the approach taken by *Wright* would allow the federal courts to apply rule 10b-5 only if the transaction involving deception would be considered unfair by the state courts. Instead, it is argued, the judicial focus should have been aimed at the deception itself. Also, the *Goldberg* approach would allow the questions of materiality and causation to be settled as a matter of law, which in the opinion of the commentator would be a better result than having the federal court predict what the outcome would have been in a state court. It was further contended that the approach taken in *Goldberg* was better because it allowed for more stability and predictability.

135. 430 U.S. at 478.

eral law began.<sup>136</sup> The Court was, therefore, unwilling to bring activities traditionally left to state regulation within the purview of the federal courts by way of rule 10b-5 because to do so would be to create a "federal fiduciary principle."<sup>137</sup>

Another reason the approach taken in *Kidwell* is proper is the *Santa Fe* Court's reluctance to federalize a substantial part of the law where state policies of corporate regulation would be overturned without a clear indication of congressional intent.<sup>138</sup> As in *Cort v. Ash*,<sup>139</sup> the Court would not involve itself in what was essentially a state concern without *express* intent by Congress.<sup>140</sup> These concerns are what properly influenced the Ninth Circuit in *Kidwell*. Another consideration, although not mentioned in *Kidwell*, is the threat of "vexatious litigation" which was a concern of the Supreme Court in *Santa Fe*.<sup>141</sup> With the federal courts already overburdened, this must have been considered by the Ninth Circuit in following the spirit of *Santa Fe*.

The Ninth Circuit was confronted with the following policy decision: is it desirable to require a plaintiff to prove he would have prevailed in a state law action before the courts will allow a rule 10b-5 action for breach of fiduciary duty? Mindful of the strong policy of *Santa Fe* against the federalization of what are essentially state interests, the Ninth Circuit in *Kidwell* properly felt constrained by *Santa Fe* to hold that plaintiff must have been able to prevail in the state law action.

## V. CONCLUSION

Although it appears the circuit courts have relied too heavily on footnote fourteen of the Supreme Court's decision in *Santa Fe*, it is submitted that the approach taken by the circuits in *Wright* and *Kidwell* represents a truer adherence to the spirit of *Santa Fe*. The policy against federalizing what are essentially state causes of action, the desire not to become entangled in vexatious litigation, and the reluctance to imply a

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136. *Id.*

137. *Id.* at 478-79. The Court pointed out that one possible difficulty could arise where some states allow for short-form mergers and others do not. Therefore, it would be necessary to depart from a state standard of fiduciary duty to "ensure uniformity within the federal system." *Id.* at 479 n.16.

138. *Id.* at 479.

139. See notes 45-53 *supra*, and accompanying text.

140. 430 U.S. at 479. Again, note that private actions under rule 10b-5 are implied, as they were not expressly created by Congress. See note 10 *supra*. See also the discussion of implied causes of action under federal statutes in *Cort v. Ash*, notes 45-53 *supra*, and accompanying text.

141. 430 U.S. at 479.

federal cause of action absent clear congressional intent to do so were correctly interpreted by the *Kidwell* court as evidencing a reluctance to extend further the reach of rule 10b-5. The Supreme Court has not deemed it desirable to end the split of authority among the circuits as to which test to apply. If certiorari is granted, however, to a future case, the blueprint enunciated by the Ninth Circuit in *Kidwell* best follows the spirit of *Santa Fe*.

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