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Article

***783 YOU SHOULDN'T BE REQUIRED TO PLEAD MORE THAN YOU HAVE TO PROVE [FNA1]**

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I. Introduction

Congress passed the Securities Act of 1933 (“Securities Act”) to protect investors from unscrupulous stock promoters and promote the domestic economy by establishing confidence in the market for newly-issued securities. [FN1] The Securities Act enacted civil liability provisions relating to new issues of securities that do not require proof of fraud. [FN2] The Supreme Court has held that [Federal Rule of Civil Procedure 9\(b\)](#), which requires that fraud be plead with particularity, may only be applied in the two specific instances found in the Rule, i.e. fraud or mistake. [FN3] Nevertheless, *784 some federal courts have applied the fraud pleading requirements of [Rule 9\(b\)](#) to claims brought under the civil liability provisions of the Securities Act. [FN4] Given the clear legislative intent to eliminate onerous pleading requirements, to eliminate legalistic impediments to investor recovery, and to provide a deterrent to dishonesty in the issuance of new securities, it is inappropriate to apply the harsh pleading requirements of [Rule 9\(b\)](#) to the strict liability and negligence provisions of the Securities Act of 1933. [FN5]

II. History and Purpose of the Securities Act

Following the collapse of the financial markets in the United States in October 1929, Congress enacted the Securities Act of 1933. [FN6] Previously, there was an attitude and legal climate of caveat emptor in the securities markets. However, through the Securities Act, Congress sought to encourage truth and disclosure in the purchase and sale of securities by providing a remedy of strict liability against issuers of public securities that issued materially false and misleading registration statements.

Billions of dollars worth of securities were brought to market in the 1920s, of which more than half had become completely worthless by 1933. [FN7] In signing the Securities Act into law, President Roosevelt said that Congress was putting “the burden of telling the whole truth on the seller” in order to “give impetus to honest dealing in securities and thereby bring back public confidence.” [FN8] In order to deter dishonest stock promoters, facilitate raising capital, and promote the domestic economy, new statutory civil liability provisions were written into the Securities Act. [FN9] The first, *785 Section 11, provides for strict liability and monetary damages for an issuer found to have sold securities pursuant to a materially false or misleading registration statement and lists four categories of defendants other than the issuer who are also liable. [FN10] In addition, Section 11 has no reliance requirement, nor a prima facie requirement that a plaintiff even prove damage causation; rather, a prima facie case consists solely of proving a material misstatement or omission in a registration statement or prospectus, [FN11] and the burden of proving non-causation of damages is expressly placed on defendants. [FN12] Likewise, a prima facie case under Section 12(a)(2) consists of the same elements, and provides for a remedy of rescission against a seller by those who purchased unregistered stock or who purchased stock issued pursuant to a materially false or misleading registration statement. [FN13]

In 1995, by overriding President Clinton's veto, Congress enacted the most comprehensive changes to the federal securities laws since their inception in 1933 and 1934. The Private Securities Litigation Reform Act of 1995 (PSLRA) added new procedural steps for appointment of lead plaintiffs and lead counsel for class actions brought under the Securities Act or Securities Exchange Act of 1934 (Exchange Act) and amended the pleading requirements for actions brought under the Exchange Act. [FN14] In addition to raising the requirements neces-

sary to plead scienter under the Exchange Act, [FN15] the PSLRA also requires specificity with regard to each statement alleged to be misleading and the reasons why they are misleading, and also allege facts giving rise to a strong inference of scienter. [FN16] However, Congress, despite the major revisions to private *786 actions under the securities laws, left intact the pleading requirements under the Securities Act. [FN17] The elements of a prima facie case under Section 11 or 12(a)(2) remain as they were in 1933.

Under standard rules of statutory construction, if the plain meaning of the statute is unclear, the intent of Congress should be followed. [FN18] The absence of any reference to fraud, coupled with the strict liability provisions, indicate that the plain meaning of sections 11 and 12 is that a fraud standard should not apply. Even if the plain meaning is unclear, however, the legislative history of the Securities Act makes it clear that in 1933 Congress intended to both eliminate procedural impediments to a claim [FN19] and shift the burden of proof and pleading of affirmative defenses to the defendants. [FN20] Congress, in enacting the PSLRA in 1995, was responding to concerns that courts had interpreted Rule 9(b)'s requirements concerning pleading fraud "in conflicting ways, creating distinctly different standards among the circuits." [FN21] If the concern was to make a uniform rule as to how Rule 9(b) was to be applied, and the PSLRA pleading requirements were not made applicable to the Securities Act, [FN22] Congress acknowledged that fraud pleading requirements do not apply to the Securities Act. Thus, the intent of two Congresses separated by 62 years is that fraud standards should not be applied to the Securities Act. However, despite the broad remedial and preventive purposes of the Securities Act and the clear legislative intent that fraud standards not be applied to the Securities Act, some courts have improperly required plaintiffs to plead fraud with particularity when pleading claims under Section 11 or 12(a)(2). [FN23]

*787 III. Pleading Claims Under the Securities Act

As a matter of practice, claims may be plead under the Securities Act in three ways. First, in a pure Securities Act case, the complaint may contain only claims under the Securities Act. In this type of case, the fraud pleading requirements of Rule 9(b) are rarely, if ever, applied. [FN24] Second, the complaint may contain claims under the Securities Act and some other statute, but the facts and causes of action which comprise the Securities Act claims are distinct from the other claims. [FN25] Third, the complaint may allege claims under the Securities Act and a fraud statute, but there may be one set of operative facts which is adopted wholesale for both the Securities Act claim and the other claim. The latter type of pleading is most prevalent in those cases which apply Rule 9(b) to claims under the Securities Act. [FN26]

A. Cases Rejecting Application of Rule 9(b) to the Securities Act

The cases which reject application of Rule 9(b) to Securities Act claims can be divided into two types: cases with pure Securities Act claims and cases which allege violations of both the Securities Act and Exchange Act. A prima facie case under Section 11 consists only of a plaintiff showing that he bought the security at issue and that the registration statement contained a material misstatement or omission. [FN27] Scienter and fraud are not *788 elements of a Section 11 or 12(a)(2) claim under the Securities Act. [FN28] Courts refusing to apply Rule 9(b) to a Securities Act claim are of two minds: some refuse to apply Rule 9(b) to a Securities Act claim under any circumstances, and some will not apply it so long as the Securities Act claim does not sound in fraud.

The cases are virtually unanimous that in a pure Securities Act case, Rule 9(b) should not apply. Unlike a fraud action brought under Section 10(b) of the Exchange Act, which requires a showing that defendants inten-

ded to deceive, manipulate, or defraud, “a successful action under Section 11 does not require proof of fraud, and therefore, the [Rule 9\(b\)](#) particularity requirement does not apply.” [\[FN29\]](#) There are some courts which have stated that if the Section 11 claim is “grounded in fraud,” [Rule 9\(b\)](#) will apply, but in the end, they usually hold that the Section 11 claim is not grounded in fraud and [Rule 9\(b\)](#) does not apply. [\[FN30\]](#) Absent allegations of scienter and reliance, courts are reluctant to apply the fraud pleading requirements of [Rule 9\(b\)](#) into a Securities Act claim. This reluctance is summarized succinctly by one court:

Defendants argue this absence of specific allegations of fraud is merely a ‘transparent effort to evade the requirements of [Rule 9\(b\)](#)’ by ‘stripping . . . the rhetoric of fraud’ from their Complaint The Court will not, however, read between the lines of Plaintiffs’ Complaint to discern a different motive for their claims. [\[FN31\]](#)

***789** One court recently noted that “courts which have held that 9(b) can be applicable, however, have so held in cases where there were actual allegations of fraud (including scienter and reliance) in the complaint.” [\[FN32\]](#) While this statement would have been true two years ago, this bright line demarcation is dissolving, undermining the purposes of the Securities Act.

B. Cases Involving Securities Act and Exchange Act Claims

Pleading multiple claims in a single complaint is encouraged because it conserves judicial resources. Each claim must, however, ultimately stand alone. As noted above, both Exchange Act claims (requiring scienter) and Securities Act claims (with no scienter requirement) can be alleged in the same complaint. Thus, plaintiffs are in the position of alleging fraudulent conduct in the same complaint in which they seek recovery for non-fraudulent conduct. This has caused some courts to require that all causes of action in the complaint be pleaded according to the fraud requirements of 9(b). However, most courts are willing to distinguish between the two claims. The First Circuit noted:

Although the complaint does assert that defendants actually possessed the information that they failed to disclose, those allegations cannot be thought to constitute ‘averments of fraud’ absent any claim of scienter and reliance. Otherwise, any allegation of nondisclosure of material information would be transformed into a claim of fraud for purposes of [Rule 9\(b\)](#). [\[FN33\]](#)

Those courts which refuse to apply [Rule 9\(b\)](#) to a Securities Act claim, even when Exchange Act claims are also alleged, rely upon the lack of a scienter requirement for a Securities Act claim. One court has noted the quandary defendants face when arguing that Section 11 claims are grounded in fraud, because the defendants invariably argue that plaintiffs have plead fraud in their Section 11 claims, but the fraud claims are not ***790** adequately plead. While the court acknowledged that “this is not an outright contradiction,” it stated, “it does call the argument into question.” [\[FN34\]](#)

The Eighth Circuit recently noted:

[Rule 9\(b\)](#) imposes a heightened pleading requirement for allegations of fraud and mistake; but, as we noted above, § 11 does not require proof of fraud for recovery. The Supreme Court has held that federal courts may not apply the heightened pleading standard of [Rule 9\(b\)](#) outside the two specific instances - fraud and mistake - explicitly found in the Rule. [\[FN35\]](#)

The court noted that the plaintiffs did not allege in their Section 11 claim that the defendants were liable for

fraudulent or intentional conduct. [FN36] Further, the court added that even if plaintiffs had alleged such conduct, it could be stripped from the claim as “mere surplusage.” [FN37] Other courts analyzing whether Rule 9(b) applies to a Section 11 claim view the question similarly, holding that Rule 9(b) never applies to Section 11 claims. [FN38]

*791 Without deciding the issue, the Tenth Circuit has assumed that even if the Third Circuit's Shapiro analysis of grounding in fraud applied, Rule 9(b) would not apply to the Section 11 claim at issue. [FN39] The court reasoned that the Section 11 claim tracked the negligence language in the due diligence defense and fraud is not an element of a prima facie case under Section 11. [FN40] The second reason (i.e., that fraud is not an element of a Section 11 claim) would seem to resolve the issue by eliminating the need to search the complaint for fraud allegations.

One way to avoid having a Section 11 claim sound in fraud is to specifically disavow any claims of fraud in the Section 11 claims. [FN41] The *792 efficacy of fraud disclaimers was given careful treatment in *In re Number Nine Visual Technology Corp. Securities Litigation*. [FN42] The plaintiffs included a line in their Section 11 claim stating that the claim disavowed all allegations of fraud in the complaint. The court found that giving effect to such disclaimers would “minimize litigation costs by ensuring that plaintiffs need file only one complaint and one civil action to pursue their securities claims.” [FN43] The court noted that plaintiffs use such disclaimers at their peril: “Because the Class specifically disavows pertinent evidence with respect to its Section 11 claim regarding inventory obsolescence, the Court dismisses the Section 11 claim on that issue even though the Section 10(b) claim survives.” [FN44] Thus, the complaint was upheld on the count which required satisfaction of a higher pleading standard (scienter) and dismissed on the strict liability count. At the other end of the spectrum, one court refused to give any credence to the disclaimers when the Securities Act claims adopted paragraphs alleging a fraudulent scheme “except to the extent (they) . . . sound in fraud.” [FN45] No court has ever held that such disclaimers are necessary to plead a claim under the Securities Act, nor should one ever so hold, given the prima facie pleading requirements under the Securities Act.

C. Cases Applying Rule 9(b) to the Securities Act

Most cases applying Rule 9(b) to Securities Act claims are cases which also allege fraud claims under Section 10(b) of the Exchange Act. In many cases, plaintiff's counsel incorporate a common set of facts for both the Section 11 and Section 10(b) claims. [FN46] This sort of pleading, while it has *793 the virtue of economy, has led some courts to conclude that the Securities Act claims sound in fraud and are subject to the fraud pleading requirements. [FN47]

1. The Early Precedents

At the circuit court level, application of Rule 9(b) to Securities Act claims is a relatively recent phenomenon. In the early 1990's, two frequently cited circuit court cases were decided, *Sears v. Likens* [FN48] and *Shapiro v. UJB Financial Corp.* [FN49] A very small body of case law at the district court level preceded *Sears*. The first known case to precede *Sears* is *Competitive Associates, Inc. v. Fire Fly Enterprise, Inc.* [FN50] With virtually no discussion at all, the court applied Rule 9(b) to claims under sections 11, 12(2), and 17(a) of the Securities Act, but the court proceeded to hold that the complaint described the prospectus and missing information with particularity. [FN51] This case was followed six years later by *Todd v. Oppenheimer & Co.* in which the plaintiffs did not contest the applicability of Rule 9(b) to the allegations of fraud. [FN52] The court also cited a Southern District of New York case from 1974, *Schoenfeld v. Giant Stores Corp.*, [FN53] *794 to support the

proposition that a Section 12 claim sounding in fraud is subject to [Rule 9\(b\)](#). [\[FN54\]](#) A reading of Schoenfeld does not seem to support this proposition, as it states Section 11 is not restricted by the rule of particularity. [\[FN55\]](#)

In *McFarland v. Memorex Corp.*, the court held, with no analysis, that a complaint alleging both Securities Act and Exchange Act claims sounded entirely in fraud and [Rule 9\(b\)](#) would apply to all claims alleged. [\[FN56\]](#) *Moran v. Kidder Peabody & Co.* applied [Rule 9\(b\)](#) to a Section 12(2) claim with minimal discussion, but relied in part on *Todd*, which as discussed supra rested its holding in part on a concession by plaintiffs and in part on a misreading of the Schoenfeld case. [\[FN57\]](#)

The last shot in the battle in the 1980's was fired by *In re Elscint, Ltd. Securities Litigation*, [\[FN58\]](#) which is occasionally cited for the proposition that [Rule 9\(b\)](#) can be applied to the Securities Act. [\[FN59\]](#) However, the holding of *Elscint* is that the plaintiffs had not pled that the accounting defendant was within the statutory class of defendants under Section 11. [\[FN60\]](#) Although the plaintiffs alleged the auditor provided services to the issuer and assisted in preparing periodic reports, there were no allegations that any certified report was included in the registration statement. [\[FN61\]](#)

The five cases from the 1970s and 1980s, which in effect created a rule of law with little or no justification and even less analysis, took on a life of their own in the early 1990s. In *In re Chaus Securities Litigation*, the court, relying on *Moran* and *Competitive Associates*, also held Section 11 and 12(2) claims sounding in fraud are subject to [Rule 9\(b\)](#). [\[FN62\]](#) One court, citing *Elscint*, adopted the sound in fraud rule despite what it found to be a convincing argument to the contrary. [\[FN63\]](#)

The most considered opinion of its time with regard to the sound in fraud rule was *Lucia v. Prospect Street High Income Portfolio, Inc.*, which [*795](#) examined most of the preceding cases applying the sound in fraud rule. [\[FN64\]](#) However, the plaintiffs in *Lucia* alleged both fraud and non-fraud claims, and the court ultimately held “that fraud, not negligence, lies at the core of the complaint,” and applied [Rule 9\(b\)](#) to all claims, including those under the Securities Act. [\[FN65\]](#) Perhaps the most confusing case is *Drexel Burnham Lambert Group, Inc. v. Microgenesy, Inc.* [\[FN66\]](#) The opinion begins its analysis by stating “(t)o the extent that plaintiffs need not allege fraud or scienter in actions brought under Section 12 of the Securities Act, [Rule 9\(b\)](#) is inapplicable.” [\[FN67\]](#) The opinion then states “(i)f a Section 12(2) claim is based on fraud, however, that claim must comply with the pleading requirements of [Rule 9\(b\)](#).” [\[FN68\]](#) The confusion in this opinion arises because a Section 12(2) claim is never based on fraud and plaintiffs need not ever allege fraud or scienter.

2. The Circuit Precedents

Following these district court opinions, the circuit courts entered the fray in the 1990s. The first case to apply the sound in fraud rule at the circuit level was *Sears v. Likens*. [\[FN69\]](#) The actual holding in *Sears* is that the securities at issue were “exempt from the provisions of the Securities Act,” and *Sears* never mentioned whether the complaint sounded in fraud or not. [\[FN70\]](#) Nevertheless, until recently *Sears* was commonly cited for the [*796](#) proposition that [Rule 9\(b\)](#) can be applied to Securities Act claims. [\[FN71\]](#) The plaintiffs in *Sears* alleged claims under sections 5, 12(1), 12(2), 15, and 17(a) of the Securities Act. [\[FN72\]](#) The case involved the sale of real estate and bank assets by a bank and a proxy statement sent to bank shareholders describing the sales and offering shareholders the chance to dissolve the bank. [\[FN73\]](#) There was no registration statement or prospectus involved in the case. [\[FN74\]](#) The court noted that the Securities Act claims were brought on the grounds that securities were offered and sold by means of a false prospectus, but that plaintiffs “have not alleged that a

'prospectus' or 'securities' existed in this case.” [FN75] Even had plaintiffs alleged a prospectus was involved, the court found that securities issued or guaranteed by a state bank are exempt from the Securities Act. [FN76] Having disposed of the Securities Act claims on two separate basis, the Sears court continued on, in clear dictum, to state that the plaintiffs failed to satisfy Rule 9(b) in detailing the fraudulent activity. [FN77] The court offered no justification for why Securities Act claims should be subject to Rule 9(b) nor did it state that the plaintiffs had alleged fraud in their Securities Act claims.

In Shapiro v. UJB Financial Corp., the court reasoned that although “Rule 9(b) would not appear to apply to claims that a defendant negligently violated §§ 11 and 12(2),” if there was not a hint in the allegations that defendants were negligent in violating sections 11 and 12(2), the claims were “grounded in fraud rather than negligence (and) Rule 9(b) applies.” [FN78] The plaintiffs in Shapiro had incorporated all the Section 10(b) factual *797 allegations into their Section 11 and 12(2) claims, and repeatedly averred to defendant's intentional, knowing, or reckless misrepresentations. [FN79] Thus, the court held the complaint was “devoid of allegations that defendants acted negligently in violating sections 11 and 12(2).” [FN80] However, the court ignored the pleading requirements of the Securities Act, which do not require allegations of negligence. [FN81] The court further reasoned there was not even a mixture of negligent and fraudulent allegations, and “(t)he only reasonable conclusion that (could) be drawn (was) that (the) plaintiffs charge(d) (the)defendants with fraud.” [FN82] On Section 11 claims, however, it is the defendants who are charged under the statute with pleading and proving affirmative defenses concerning knowledge. [FN83] Therefore, the court was in effect shifting the burden of proof from the defendants to the plaintiffs.

From these modest beginnings, in which one circuit court was searching for a hint of negligence to avoid applying Rule 9(b) to a Securities Act claim and one circuit court never directly addressing Rule 9(b)'s application to the Securities Act, Sears and Shapiro have created a snow ball effect where now some courts search for a hint of fraud in order to apply Rule 9(b). The Ninth Circuit precedents also rest on dubious underpinnings, resulting in confusion over Rule 9(b)'s application to the Securities Act. In In re Stac Electronics Securities Litigation, [FN84] the Ninth Circuit, while discussing In re Glenfed Inc. Securities Litigation, [FN85] stated that the Ninth Circuit in Glenfed had affirmed a district court's dismissal of both Securities and Exchange Act claims, including Section 11 claims, for failure to satisfy Rule 9(b). [FN86] While literally true, Glenfed never discussed whether Rule 9(b) should be applied to Securities Act claims. Instead, the court applied Rule 9(b) to the Securities Act claims without citing any rationale for doing so. [FN87]

*798 The Stac panel then stated “we now clarify that the particularity requirements of Rule 9(b) apply to claims brought under Section 11 when, as here, they are grounded in fraud rather than negligence.” [FN88] To support this holding the court cited to both Shapiro and Melder v. Morris. [FN89] Neither Sears nor Melder stands for this proposition. At most, as previously discussed, the application of Rule 9(b) to the Securities Act in Sears is at best dictum, [FN90] a reading which is reinforced by recent holdings by district courts in the Seventh Circuit which refuse to read Sears broadly. [FN91] Melder's holding, in a footnote, states that the Securities Act claims involved therein were subject to Rule 9(b) “in light of the complaint's wholesale adoption of the allegations under the securities fraud claims for purposes of the Securities Act claims.” [FN92] The Fifth Circuit recently clarified its holding in Melder. In Lonestar Ladies Investment Club v. Schlotzsky's, Inc., the Fifth Circuit adopted the Nationsmart analysis, limiting Melder to cases in which there were wholesale adoptions of the fraud claims in the Section 11 claims. [FN93]

3. The Legacy of Shapiro, Sears, Melder, and Stac

The early cases cited as applying [Rule 9\(b\)](#) to Securities Act claims either do so with little or no analysis or do not actually so hold when scrutinized carefully. The statement in *Sears* is dictum at best. In *Shapiro* and *Melder* there were wholesale adoptions of fraud claims in the Securities Act counts, and *Stac* relies on those three cases for its holding. Upon these shaky foundations, a small body of case law has developed *799 which applies [Rule 9\(b\)](#) to Securities Act claims. None of these cases scrutinize the cases on which they base their holdings. In fact, in most instances they go well beyond the holdings of the cases cited.

The propriety of applying [Rule 9\(b\)](#) to claims sounding in fraud may be debated endlessly if the complaint contains other causes of action and is inartfully pleaded. But to reason that there would be a viable Section 11 claim but for the plaintiffs alleging more than is required seems ill-reasoned. Until recently, no court had held that a case with only Securities Act claims could be grounded in fraud. However, in *Schoenhaut v. American Sensors, Inc.*, plaintiffs plead only Securities Act claims. [FN94] Nevertheless, the court found that the plaintiffs alleged fraudulent intent and thus had to comply with the requirements of [Rule 9\(b\)](#). [FN95]

In *re Anchor Gaming Securities Litigation*, the court also applied [Rule 9\(b\)](#) to a pure Securities Act case. [FN96] The court held “the Complaint is rife with insinuations and suggestions that Defendants purposefully omitted and misstated material information, intending to benefit therefrom Plaintiffs' Complaint could have been drafted to simply allege, without embellishment, that the Prospectus contained materially false or misleading statements or omissions.” [FN97] The *Anchor Gaming* court cited to *Stac*, *Melder*, *Shapiro*, and *Sears* for support. [FN98] The *Anchor Gaming* court acknowledged the plaintiffs' argument that [Rule 9\(b\)](#) should never apply to the Securities Act, but stated that *Stac*, the controlling authority, contained no such caveat. [FN99] In so holding, the *Anchor Gaming* court went well beyond *Stac*, in which fraud claims were plead along with the Securities Act claims.

The court in *re N2K Inc. Securities Litigation*, citing *Melder*, *Stac*, and *Shapiro*, among others, stated in dictum that [Rule 9\(b\)](#) can be applied to Securities Act claims sounding in fraud. [FN100] Unlike *Anchor Gaming*, there was no discussion of whether this is proper in a pure Section 11 case. Likewise, in *Rhodes v. Omega Research, Inc.*, the court cited to *Melder*, and *Stac* in holding [Rule 9\(b\)](#) should be applied to a pure Securities Act *800 case. [FN101] The court held the plaintiffs “do not say so directly,” but imply knowledge in the complaint by defendants that could be equated to scienter. [FN102] The analysis thus has truly come full circle, from searching for a hint of negligence to avoid applying [Rule 9\(b\)](#), to searching for an implication of scienter so that [Rule 9\(b\)](#) could be applied. [FN103]

IV. Conclusion.

The sound in fraud rationale for applying the stringent [Rule 9\(b\)](#) fraud **pleading requirements** to a strict liability and negligence claim in which the defendants have the burden of **proving** a lack of negligence is a judicially-created rule with no basis in legislative intent, legislative history, or public policy. Both the in terrorem effect intended to strengthen the capital markets, the domestic economy, and the chance of investors receiving compensatory damages are weakened when courts create artificial barriers and shift the burdens of proof and pleading from the defendants to the plaintiffs.

Due to the nature of a claim involving a false or misleading prospectus in the issuance of new securities under the Securities Act, the particularity requirements of [Rule 9\(b\)](#) are never appropriate in such cases. The what, where, why, and when are self-explanatory in a Securities Act claim: the prospectus (where) was issued on a certain date (when) to raise money for the issuer and generate fees for the underwriters (why). The what will de-

pend on the claims alleged in each particular case. The who reveals why [Rule 9\(b\)](#) should never be applied to a Securities Act claim. The prospectus is a group effort: the collective work product of the issuer, its lawyers and accountants, and the underwriters (and their lawyers). It is impossible for an outsider to identify who is responsible for a particular statement in a prospectus. When all is said and done, no doubt even the *801 participants could not identify who wrote what with certainty. [\[FN104\]](#) It is in recognition of this that the Securities Act creates statutory liability for certain classes of defendants, regardless of authorship. [\[FN105\]](#)

By making a plaintiff **plead** fraud with particularity, courts typically describe the same reasons for applying [Rule 9\(b\)](#) to Securities Act claims: providing defendants with adequate notice of the charges and preventing fishing expeditions. [\[FN106\]](#) Fraud does not have to be **proven** for a Section 11 claim to be successful, therefore there is no need for a defendant to be put on notice of the fraud. Likewise, plaintiffs who **plead** claims under the Securities Act are not hoping that discovery will allow them to find a fraud claim, since proof of fraud is unnecessary for the successful prosecution of a Securities Act claim.

The cases applying [Rule 9\(b\)](#) to the Securities Act do not balance the public policy considerations of the Securities Act against those underlying [Rule 9\(b\)](#). [\[FN107\]](#) The in terrorem effect of the Securities Act, which was intended by Congress to promote the integrity of the financial markets, is eviscerated if courts erect procedural barriers contrary to the legislative intent and legislative history of the Securities Act, and if the Securities Act does not function as envisioned our economy will eventually be endangered due to a lack of confidence in the ability to raise capital. Even so, as described above, the who, what, when, where, and why are self-evident in a case involving a prospectus, assuming an actionable *802 misstatement or omission is alleged, and a defendant is on enough notice to begin preparing his defense. Likewise, the chances of investor compensation are diminished if courts impose a higher pleading standard than Congress intended. [\[FN108\]](#)

Careful pleading which distinguishes between the factual predicates and legal theories underlying each cause of action should eliminate uncertainty as to whether [Rule 9\(b\)](#) applies to Securities Act claims. Even absent such measures, however, applying [Rule 9\(b\)](#) to a Securities Act claim violates the statutory scheme of federal securities regulation. In passing the Securities Act and enacting a standard of absolute liability against the issuer, Congress attempted to insure the highest level of conduct for public offerings. If, in offering securities to the public, a defendant's conduct is so bad it surpasses mere negligence and amounts to fraud, the especially egregious conduct should not be rewarded by circumventing Congressional intent and making it more difficult to satisfy the **pleading requirements** of the Securities Act. [\[FN109\]](#) If anything, the more egregious the conduct, the less stringent the **pleading** standard should be under the Securities Act. As one court recently noted: “(i)t is illogical to **require** plaintiffs to **plead** more than they would have to **prove** to succeed on a § 11 claim standing alone.” [\[FN110\]](#)

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[\[FN1\]](#). 77 Cong. Rec. 937 (1933).

[FN2]. See 15 U.S.C. §§ 77k, 771(a)(2) (1994 & Supp. V 1999).

[FN3]. *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993).

[FN4]. See *infra* notes 46-93 and accompanying text.

[FN5]. See William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 *Yale L.J.* 171, 173-74, 176 (1933).

[FN6]. 15 U.S.C. §§ 77a-77bbbb (1994 & Supp. V 1999).

[FN7]. J. Hicks, *Civil Liabilities: Enforcement and Litigation Under the 1933 Act*, § 4.01(1), at 4-6 (1994).

[FN8]. 77 *Cong. Rec.* 937 (1933).

[FN9]. For some time after the Securities Act was enacted, there was debate over whether a third provision, Section 17, provided for a private cause of action. Most courts today hold that it does not. See *Maldonado v. Dominguez*, 137 F.3d 1, 7 (1st Cir. 1998); *Newcome v. Esrey*, 862 F.2d 1099, 1107 (4th Cir. 1988); *Currie v. Cayman Res. Corp.*, 835 F.2d 780, 784-85 (11th Cir. 1988); *In re Washington Pub. Power Supply Sys. Sec. Litig.*, 823 F.2d 1349, 1358 (9th Cir. 1987) (*en banc*); *Deviries v. Prudential-Bache Sec., Inc.*, 805 F.2d 326, 328 (8th Cir. 1986); *Landry v. All Am. Assurance Co.*, 688 F.2d 381, 389 (5th Cir. 1982). But see *Wexner v. First Manhattan Co.*, 902 F.2d 169, 174 (2d Cir. 1990) (issue must be reexamined); *Ray v. Karris*, 780 F.2d 636, 641 n.3 (7th Cir. 1985) (quoting *Peoria Union Stock Yards v. Penn Mutual Life Ins.*, 698 F.2d 320, 323 (7th Cir. 1983)) (question is open in Seventh Circuit).

[FN10]. 15 U.S.C. § 77k (1994 & Supp. V 1999).

[FN11]. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983). An issuer is held to a strict liability standard under section 11, with no opportunity to present affirmative defenses. See 15 U.S.C. § 77k(a)-(b). The other defendants are the signers of the registration statement, any director or partner at the time of the offering, any person named in the registration statement as being or about to become a director or partner, authors of expertized portions of the prospectus, and the underwriter. *Id.* § 77k(a)(1)-(5). Those defendants have the affirmative defense of due diligence available to them (i.e., that after reasonable investigation he had grounds to believe there were no material misstatements or omissions). *Id.* § 77k(b).

[FN12]. 15 U.S.C. § 77k(e).

[FN13]. *Id.* § 77l.

[FN14]. *Id.* §§ 77z-1, 78u-4.

[FN15]. *Id.* § 78u-4 (Supp. V 1999). The substantive law was not changed, leaving the required level of proof at trial unchanged. See *Davis v. USN Comm., Inc.*, 73 F. Supp 2d 923, 937 (N.D. Ill. 1999), *Miller v. Material Sci. Corp.*, 9 F. Supp. 2d 925, 926-27 (N.D. Ill. 1998).

[FN16]. 15 U.S.C. § 78u-4(b)(1)-(2).

[FN17]. See *Giarraputo v. UNUMProvident Corp.*, No. Civ. 99-301-PC, 2000 WL 1701294, at *9 (D. Me. Nov. 8, 2000) (stating that heightened pleading requirements of PSLRA in Exchange Act do not have parallel provi-

sions in Securities Act).

[FN18]. See [Sutton v. United Air Lines, Inc.](#), 527 U.S. 471, 481-82 (1999).

[FN19]. See [Douglas & Bates](#), *supra* note 5, at 174 (“Satisfaction of the common-law requirements of fraud raised almost insurmountable barriers to recovery.”).

[FN20]. See *id.* at 176 (“(S)ection 11 fills a long felt need in so far as it shifts the burden of proof.”).

[FN21]. R. Rep. No. 104-369, at 41 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 740.

[FN22]. Other provisions of the PSLRA are applicable to both the Securities and Exchange Acts. See, e.g., 15 U.S.C. §§ 77z-1(a)(2)-(3), 78u-4(a)(2)-(3) (Supp. V 1999) (parallel provisions concerning plaintiff certifications, appointment of lead plaintiffs, selection of lead counsel, restrictions on plaintiffs); *id.* §§ 77z-1(c), 78u-4(c) (sanctions for abusive litigation); *id.* §§ 77z-1(d), 78u-4(d) (defendant's right to written jury interrogatories).

[FN23]. See *infra* notes 46-93 and accompanying text.

[FN24]. The first recorded case to apply [Rule 9\(b\)](#) in such circumstances was [Schoenhaut v. American Sensors, Inc.](#), 986 F. Supp. 785, 795 (S.D.N.Y. 1997). See *infra* note 94 and accompanying text. [Rule 9\(b\)](#) was applied to claims under section 11, 12, and 17 of the Securities Act in [Competitive Associates, Inc. v. Fire Fly Enterprise, Inc.](#), 59 F.R.D. 336, 337-38 (S.D.N.Y. 1972), but it is not clear if the section 17 claims were 17(a)(1) claims, which require proof of scienter, or section 17(a)(2) or (3) claims, which do not require proof of scienter. See [Aaron v. SEC](#), 446 U.S. 680, 701-02 (1980) (stating sections 17(a)(2) and 17(a)(3) do not require proof of scienter).

[FN25]. Most commonly, claims under both the Securities Act and section 10(b) of the Securities Exchange Act of 1934 are pled in the same complaint. See [Ellison v. Am. Image Motor Co.](#), 36 F. Supp. 2d 628, 635, 638 (S.D.N.Y. 1999); see also [Sloane Overseas Fund, Ltd. v. Sapiens Int'l Corp.](#), 941 F. Supp. 1369, 1372 (S.D.N.Y. 1996).

[FN26]. See [Ellison](#), 36 F. Supp. 2d at 639. (“(Plaintiff) incorporates by reference into the § 12(a)(1) claim each of the preceding allegations in the complaint, which unambiguously sound in fraud.”); [Neubauer v. Eva-Health USA, Inc.](#), 158 F.R.D. 281, 284 n.1 (S.D.N.Y. 1994) (holding that section 12(2) claim incorporated allegations of fraud, so court applied [Rule 9\(b\)](#)). Even under such circumstances, courts do not necessarily apply [Rule 9\(b\)](#). See [Gould v. Marlon](#), No. CV-S-86-968-LDG, 1987 WL 34631, at *7 (D. Nev. Aug. 29, 1987) (pleading one set of operative facts, but “the specific allegations of Count I may be read to state a distinct section 11 claim”).

[FN27]. [Herman & MacLean v. Huddleston](#), 459 U.S. 375, 381-82 (1983).

[FN28]. *Id.*

[FN29]. [Ross v. Warner](#), 480 F. Supp. 268, 271, 273 (S.D.N.Y. 1979) (citations omitted). One court parsed the complaint, inquiring as to the scienter allegations of each defendant. [In re Websecure, Inc. Sec. Litig.](#), 182 F.R.D. 364, 367 (D. Mass. 1998) (finding “no allegation that the underwriters themselves actually possessed the information” not disclosed in the prospectus and holding [Rule 9\(b\)](#) did not apply to them). Even so, the Websecure court would have refused to read 9(b) into Section 11 against the other defendants absent claims of scienter

and reliance in the complaint. *Id.*

[FN30]. See, e.g., *In re Cendant Corp. Litig.*, 60 F. Supp. 2d 354, 364 (D.N.J. 1999); *Copland v. Grumet*, No. Civ. A. 96-3351 MLP, 1998 WL 256654, at *3-4 (D.N.J. Jan. 9, 1998) (“(S)ection 11 claims not grounded in allegations of scienter are not subject to Rule 9(b)'s pleading requirements.”); *Degulis v. LXR Biotech, Inc.*, 928 F. Supp. 1301, 1310 (S.D.N.Y. 1996) (stating that the fact that certain acts underlied both Securities Act and fraud claims did not mean Rule 9(b) would apply); *In re New York City Shoes Sec. Litig.*, No. Civ. A. 87-4677, 1988 WL 80125, at *6 (E.D. Pa. July 8, 1988), *aff'd*, 884 F.2d 1384 (1989).

[FN31]. *Kensington Capital Mgmt. v. Oakley, Inc.*, No. SACV 97-808GLTEEX, 1999 WL 816964, at *2 (C.D. Cal. Jan. 14, 1999); see also *In re Ziff-Davis, Inc.*, No. 98 CIV 7158 SWK, 2000 WL 877006, at *2-3 (S.D.N.Y. June 30, 2000) (stating complaint alleged only section 11 claims and fraud standard would not be applied).

[FN32]. *Griffin v. PaineWebber Inc.*, 84 F. Supp. 2d 508, 513 (S.D.N.Y. 2000), dismissed in part by No. 99 CIV. 2292 (VM), 2001 WL 740764, *4 (S.D.N.Y. June 29, 2001).

[FN33]. *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1223 (1st Cir. 1996); see also *Feiner v. §§ & C Tech.*, 11 F. Supp. 2d 204, 212 (D. Conn. 1998) (holding that plaintiffs could plead that defendants failed to disclose information in defendants' possession, but absent allegations of an intent to deceive, Rule 9(b) would not apply).

[FN34]. *In re S. Pac. Funding Corp. Sec. Litig.*, 83 F. Supp. 2d 1172, 1175-76 (D. Or. 1999).

[FN35]. *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 315 (8th Cir. 1997).

[FN36]. *Id.*

[FN37]. *Id.* The court went further:

The only consequence of a holding that Rule 9(b) is violated with respect to a § 11 claim would be that any allegations of fraud would be stripped from the claim. The allegations of innocent or negligent misrepresentation, which are at the heart of a § 11 claim, would survive. *Id.*; see also *In re Prison Realty Sec. Litig.*, 117 F. Supp. 2d 681, 688 (M.D. Tenn. 2000) (quoting *In re NationsMart Corp. Sec. Litig.*, 130 F.3d at 315); *In re Sirrom Capital Corp. Sec. Litig.*, 84 F. Supp. 2d 933, 939 (M.D. Tenn. 1999) (same). The Fifth Circuit recently stated:

Where averments of fraud are made in a claim in which fraud is not an element, an inadequate averment of fraud does not mean that no claim has been stated. The proper route is to disregard averments of fraud not meeting Rule 9(b)'s standard and then ask whether a claim has been stated.

Lone Star Ladies Inv. Club v. Schlotzsky's Inc., 238 F.3d 363, 368 (5th Cir. 2001). In other words, the Fifth Circuit, like the Eighth Circuit, will disregard averments of fraud as mere surplusage.

[FN38]. See *In re Bankamerica Corp. Sec. Litig.*, 78 F. Supp. 2d 976, 987 (E.D. Mo. 1999) (stating Rule 9(b) does not apply to claims under section 11 because such a claim does not require proof of fraud), *aff'd*, No. 00-2255, 2001 U.S. App. LEXIS 19035 (8th Cir. Aug. 24, 2001); *In re Sirrom Capital Corp.*, 84 F. Supp. 2d at 937-38 (stating fraud is not a necessary element of section 11 and cannot be read into the statute); *In re In-Store Adver. Sec. Litig.*, 878 F. Supp. 645, 650 (S.D.N.Y. 1995) (“This court finds that ‘(b)ecause proof of fraud is not necessary to prevail on a Section 11 claim . . . Rule 9(b) does not apply to a Section 11 claim.’” (citations omitted)); *Nelson v. Paramount Communications, Inc.*, 872 F. Supp. 1242, 1246 (S.D.N.Y. 1994) (law in district is that Rule 9(b) does not apply to section 11 claims); *In re College Bound Consol. Litig.*, No. 93 Civ. 2348 (MBM), 1994 WL 172408, at *3 (S.D.N.Y. May 4, 1994) (defendant “appears to be under the misapprehension, that the pleading of plaintiffs' Section 11 claim is governed by the strict requirements of Federal Rule of Civil

Procedure Rule 9(b), rather than the minimal requirements of Rule 8(a)"); *In re AnnTaylor Stores Sec. Litig.*, 807 F. Supp. 990, 1003 (S.D.N.Y. 1992) (stating that since plaintiffs discover any claim of fraud, the need not comply with Rule 9(b)); *In re Jiffy Lube Sec. Litig.*, 772 F. Supp. 258, 260 (D. Md. 1991) ("Section 11 sounds in negligence, not fraud and, therefore, is not subject to the particularity requirements of Fed. R. Civ. P. 9(b)."); *Schneider v. Traweek*, No. CV-88-0905 RG (Kx), 1990 U.S. Dist. LEXIS 15563, at *29 (C.D. Cal. Sept. 5, 1990) (stating that claims arising under the Securities Act of 1933 sound in negligence, not fraud, so the requirements of 9(b) does not apply); *Steiner v. Southmark Corp.*, 734 F. Supp. 269, 278 (N.D. Tex. 1990) (holding that section 11 violations need not be pleaded with specificity required by Rule 9(b), even when section 10(b) claims are also plead); *In re Consumers Power Co. Sec. Litig.*, 105 F.R.D. 583, 594-95 (E.D. Mich. 1985) ("(A)llegations of fraud do not convert or contaminate the separate § 11 claims, (o)nly a defendant facing the particular threat that is posed by, an accusation of fraud may invoke the protection of Rule 9(b)"); see also *Cooperman v. Individual, Inc.*, No. Civ. A. 96-12272-DPW, 1998 WL 953726, at *7 (D. Mass. May 27, 1998) ("plaintiffs do not need to allege knowing and intentional falsehood in order to establish a § 11 claim"), *aff'd*, 171 F.3d 43 (1st Cir. 1999); *FDIC v. Nat'l Sur. Corp.*, 434 F. Supp. 61, 64 (E.D.N.Y. 1977) (stating claims based on mismanagement or negligence not subject to Rule 9(b)); *Billet v. Storage Tech. Corp.*, 72 F.R.D. 583, 585 (S.D.N.Y. 1976) (fraud need not be alleged under sections 11 and 12 and Rule 9(b) is inapplicable to them); *Schoenfeld v. Giant Stores Corp.*, 62 F.R.D. 348, 350 (S.D.N.Y. 1974) (section 11 not restricted by rule of particularity).

[FN39]. See *infra* notes 78-83, and accompanying text.

[FN40]. *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1251-52 (10th Cir. 1997); see also *Neuberger v. Shapiro*, No. Civ. A. 97-7947, 1998 WL 408877, at *5 (E.D. Pa. July 17, 1998); *In re Phar-Mor, Inc. Litig.*, 848 F. Supp. 46, 50 (W.D. Pa. 1993) (section 12(2) claim alleged negligence and tracked statutory language, so Rule 9(b) would not apply).

[FN41]. See *In re Marion Merrell Dow, Inc. Sec. Litig.*, No. 92-0609-CV-W-6, 1993 WL 393810, at *11 (W.D. Mo. Oct. 4, 1993) (disclaiming any allegation of fraud as sufficient). Compare *In re Stac Elec. Sec. Litig.*, 89 F.3d 1399, 1405 n.2 (9th Cir. 1996) (holding section 11 claim sounded in fraud despite disclaimers), cert. denied sub nom, 520 U.S. 1103 (1997), and *In re Ikon Office Solutions, Inc. Sec. Litig.*, 66 F. Supp. 2d 622, 635 (E.D. Pa. 1999) (finding disclaimers insufficient), with *In re First Merch. Acceptance Corp. Sec. Litig.*, No. 97 C 2715, 1998 WL 781118, at *11 (N.D. Ill. Nov. 4, 1998) (finding disclaimers sufficient) and *In re AnnTaylor Stores Sec. Litig.*, 807 F. Supp. 990, 1003 (S.D.N.Y. 1992) (same).

[FN42]. 51 F. Supp. 2d 1, 12-25 (D. Mass. 1999).

[FN43]. *Id.* at 13.

[FN44]. *Id.* at n.10. The section 11 claims for inventory obsolescence were supported only by an eventual charge for obsolete inventory, whereas the 10(b) claims were supported by allegations of widespread industry knowledge of obsolescence. *Id.* at 26.

[FN45]. *In re Ultrafem Inc. Sec. Litig.*, 91 F. Supp. 2d 678, 690-91 (S.D.N.Y. 2000).

[FN46]. See, e.g., *Ellison v. Am. Image Motor Co.*, 36 F. Supp. 2d 628, 639 (S.D.N.Y. 1999) (stating that wholesale incorporation of fraud claims into 12(a)(1) claim resulted in application of Rule 9(b)); *L.L. Capital Partners, L.P. v. Rockefeller Ctr. Prop., Inc.*, 921 F. Supp. 1174, 1183 (S.D.N.Y. 1996) (finding that a complaint

alleged scienter as part of section 12(2) claim); [Fisk v. SuperAnnuities, Inc](#), 927 F. Supp. 718, 726 (S.D.N.Y. 1996) (following [L.L. Capital Partners](#)); [Goldsmith v. Tech. Solutions Co.](#), No. 92 C 4374, 1994 WL 323317, at *5 (N.D. Ill. June 27, 1994) (stating that plaintiffs incorporated by reference fraud allegations under section 10(b) into count alleging violation of section 11). It is relatively easy to avoid this. In [In re Cendant Corp. Litigation](#), the section 11 claim was plead before the other claims and did not incorporate allegations of fraud and scienter. 60 F. Supp. 2d 354, 364 (D.N.J. 1999). The court held the section 11 claim was limited to negligence and refused to apply [Rule 9\(b\)](#). *Id.*

[FN47]. Not all courts take this view. In [Seidel v. Public Service Co. of New Hampshire](#), the plaintiffs incorporated identical language from the fraud allegations into the Securities Act claims. 616 F. Supp. 1342 (D.N.H. 1985). Nevertheless, the court held “the mere fact that each of Counts II through V purports to incorporate earlier allegations of fraud does not serve to require that with respect to claims grounded on sections 11 and 12 of the 1933 Act such specificity of pleading is required.” *Id.* at 1357.

[FN48]. See generally 912 F.2d 889 (7th Cir. 1990).

[FN49]. See generally 964 F.2d 272 (3d Cir.), cert. denied, 506 U.S. 934 (1992).

[FN50]. See generally 59 F.R.D. 336 (S.D.N.Y. 1972).

[FN51]. *Id.* at 337-38. However, the court also held that as the complaint was plead on information and belief, the plaintiffs were required to state the facts on which their belief is founded, and they did not do so. *Id.* at 338.

[FN52]. 78 F.R.D. 415, 419 (S.D.N.Y. 1978). It is difficult to fathom why a plaintiff would agree that [Rule 9\(b\)](#) applies to Securities Act claims, but the same concession was made 18 years later in [Geiger v. Solomon-Page Group, Ltd.](#), in which the plaintiffs did “not dispute that all of the claims should be tested under [Rule 9\(b\)](#)” and the court obliged. 933 F. Supp. 1180, 1189 (S.D.N.Y. 1996).

[FN53]. 62 F.R.D. 348 (S.D.N.Y. 1974).

[FN54]. *Todd*, 78 F.R.D. at 419 n.4.

[FN55]. 62 F.R.D. at 350-51.

[FN56]. 493 F. Supp. 631, 635 (N.D. Cal. 1980).

[FN57]. 609 F. Supp. 661, 665 (S.D.N.Y. 1985), *aff'd*, 788 F.2d 3 (2d Cir. 1986).

[FN58]. 674 F. Supp. 374 (D. Mass. 1987).

[FN59]. See, e.g., [In re Computervision Corp. Sec. Litig.](#), 869 F. Supp. 56, 63 (D. Mass. 1994); [Hershey v. MNC Fin., Inc.](#), 774 F. Supp. 367, 376 (D. Md. 1991).

[FN60]. 674 F. Supp. at 384.

[FN61]. *Id.*

[FN62]. No. 88 Civ. 8641, 1990 WL 188921, at *10 (S.D.N.Y. Nov. 20, 1990).

[FN63]. See *Haft v. Eastland Fin. Corp.*, 755 F. Supp. 1123, 1132-33 (D.R.I. 1991). The court did correctly cite Schoenfeld as standing for the proposition that [Rule 9\(b\)](#) does not apply to section 11. *Id.* at 1132.

[FN64]. 769 F. Supp. 410, 416 (D. Mass. 1991).

[FN65]. *Id.* at 416-17. The court did not examine those cases not applying [Rule 9\(b\)](#) to the Securities Act, see supra note 38, but the court seemed to limit its inquiry to cases within the First Circuit. One court followed Lucia and Moran, but the statement is dictum because the court held the complaint failed to identify any false statements in a prospectus and, thus, never had to apply the particularity requirements. See *Ferber v. Travelers Corp.*, 785 F. Supp. 1101, 1111 & n.17 (D. Conn. 1991).

[FN66]. 775 F. Supp. 660 (S.D.N.Y. 1991).

[FN67]. *Id.* at 666.

[FN68]. *Id.* (citing *Moran v. Kidder Peabody & Co.*, 609 F. Supp. 661, 665 (S.D.N.Y. 1985), *aff'd*, 788 F.2d 3 (2d Cir. 1986) and *In re Chaus Sec. Litig.*, (1990 Transfer Binder) Fed. Sec. L. Rep. (CCH) ¶ 95,646 at 98,003, 1990 WL 188921 (S.D.N.Y. Nov. 20, 1990)); see also *UBS Asset Mgmt. (New York) Inc. v. Wood Gundy Corp.*, 914 F. Supp. 66, 71 (S.D.N.Y. 1996) (relying on *Microgenesys* and *Moran* and stating “(w)here claims of fraud are asserted, claims alleged to arise out of the same conduct are considered to sound in fraud and are subject to the same pleading requirements under [Rule 9\(b\)](#)”).

[FN69]. See generally 912 F.2d 889 (7th Cir. 1990).

[FN70]. *Id.* at 892. One district court recently noted that the *Sears* court “was not asked to, nor did it, determine whether [Rule 9\(b\)](#) properly applied to § 11 claims, which do not require scienter for liability.” *In re First Merchs. Acceptance Corp. Sec. Litig.*, No. 97-C2715, 1998 WL 781118, at *11 (N.D. Ill. Nov. 4, 1998). Another district court recently stated “(w)hile *Sears* applied [Rule 9\(b\)](#) to §§ 12 and 15 claims under the Securities Act, *Sears* did not determine whether [Rule 9\(b\)](#) properly applied to those claims.” *Danis v. USN Communs., Inc.*, 73 F. Supp. 2d 923, 932 (N.D. Ill. 1999).

[FN71]. See, e.g., *Goldsmith v. Tech. Solutions Co.*, No. 92-C4374, 1994 WL 323317, at *5 (N.D. Ill. June 27, 1994).

[FN72]. *Sears*, 912 F.2d at 892.

[FN73]. *Id.* at 891.

[FN74]. *Id.* at 892.

[FN75]. *Id.*

[FN76]. *Id.* (citing 15 U.S.C. § 77c(a)(2)).

[FN77]. *Id.* at 892-93.

[FN78]. 964 F.2d 272, 288 (3d Cir. 1992). In *In re Westinghouse Securities Litigation*, the Third Circuit noted that a section 12(2) claim that sounds in fraud must be plead with particularity, relying on *Shapiro*. 90 F.3d 696, 717 (3d Cir. 1996). However, the court noted the plaintiffs did not incorporate the fraud allegations into the sec-

tion 12(2) count, as did the plaintiffs in Shapiro, but since the district court did not rest its decision on the application of Rule 9(b), the circuit panel's analysis of Shapiro and the possible application of Rule 9(b) ended there. *Id.* The Third Circuit thus left open the question of whether it would apply Rule 9(b) if the fraud allegations were not incorporated into the Securities Act claims.

[FN79]. Shapiro, 964 F.2d at 288.

[FN80]. *Id.*

[FN81]. See *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999).

[FN82]. Shapiro, 964 F.2d at 287. In so holding, the Shapiro court did not cite to any of the district court decisions that preceded it on this issue.

[FN83]. 15 U.S.C. § 77k(b) (1994).

[FN84]. 82 F.3d 1480 (9th Cir. 1996), withdrawn, 89 F.3d 1399 (1996) (affirming prior decision on other grounds, but holding that proposition still valid).

[FN85]. 60 F.3d 591 (9th Cir. 1995).

[FN86]. *In re Stac*, 82 F.3d at 1487.

[FN87]. The court simply stated “(t)he district court's judgment dismissing the primary liability claims (1933 and 1934 Acts) and ‘control person’ liability claims against the outside directors . . . is affirmed because the complaint does not satisfy Fed. R. Civ. P. 9(b).” *In re Glenfed*, 60 F.3d at 592. There is no discussion of why Rule 9(b) would apply to a Securities Act claim. See also *McFarland v. Memorex Corp.*, 493 F. Supp. 631, 636 (N.D. Cal. 1980) (applying Rule 9(b) to claims under sections 11, 12, 15, and 17 of the Securities Act without discussing why it was doing so).

[FN88]. 82 F.3d at 1487. The court in *In re Southern Pacific Funding Corp. Securities Litigation*, acknowledged the *Stac* decision, but distinguished it because in *Stac* the defendant failed to disclose knowledge about a material item, whereas the case before it involved negligence. 83 F. Supp. 2d 1172, 1175-76 (D. Or. 1999). Had the Southern Pacific plaintiffs alleged what was alleged in *Shaw*, that there was a deliberate failure to disclose material information, it seems the court would have applied Rule 9(b).

[FN89]. *Id.* (citing *Melder v. Morris*, 27 F.3d 1097 (5th Cir. 1994)).

[FN90]. *Sears v. Likens*, 912 F.2d 889, 892-93 (7th Cir. 1990).

[FN91]. See, e.g., *Bankers Trust Co. v. Old Republic Ins. Co.*, 959 F.2d 677, 683 (7th Cir. 1992).

[FN92]. 27 F.3d at 1100 n.6. Melder further stated that “(w)hen 1933 Securities Act claims are grounded in fraud rather than negligence as they clearly are here, Rule 9(b) applies.” *Id.* (citing Shapiro and Sears as examples).

[FN93]. 238 F.3d 363, 368-69 (5th Cir. 2001).

[FN94]. 986 F. Supp. 785, 790 (S.D.N.Y. 1997).

[FN95]. *Id.* at 795 (citing *Melder v. Morris*, 27 F.3d 1097, 1100 n.6 (5th Cir. 1994)).

[FN96]. 33 F. Supp. 2d 889, 892 (D. Nev. 1999).

[FN97]. *Id.* at 893.

[FN98]. *Id.* at 892.

[FN99]. *Id.* at 892 n.3.

[FN100]. 82 F. Supp. 2d 204, 210 n.10 (S.D.N.Y. 2000); see also *Castlerock Mgmt., Ltd. v. Ultralife Batteries, Inc.*, 68 F. Supp. 2d 480, 485-86 (D.N.J. 1999) (relying on Shapiro and Stac to hold a pure Securities Act complaint can be subject to Rule 9(b)).

[FN101]. 38 F. Supp. 2d 1353, 1359-61 (S.D. Fla. 1999). The court also relied on *Shaw v. Digital Equipment Corp.* *Id.* Shaw states that if the complaint alleges “a unified course of fraudulent conduct” Rule 9(b) will apply to the Securities Act claims. *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1223 (1st Cir. 1996).

[FN102]. *Rhodes*, 38 F. Supp. 2d at 1361.

[FN103]. The *Rhodes* court also made the odd comment that the Private Securities Litigation Reform Act of 1995 (PSLRA) was intended to eliminate meritless claims. *Id.* at 1358. However, as noted supra Part III, the stricter pleading requirements of the PSLRA do not apply to the Securities Act, so the court’s reliance on the PSLRA as a basis for applying Rule 9(b) to the Securities Act would seem to be obviously in error.

[FN104]. Section 12(a)(2) of the Securities Act allows claims for oral communications. When such claims are alleged, which do not involve a written prospectus, there is an argument to be made that the pleading requirements of Rule 9(b) may apply so defendants have notice of the misrepresentations.

[FN105]. One court recently lumped all defendants together for “who” purposes and held claims concerning a false prospectus met the who, what, when, where test of Rule 9(b). See *Evergreen Fund, Ltd. v. McCoy*, No. 00-C-0767, 2000 WL 1693963, at *5 (N.D. Ill. Nov. 6, 2000). It is interesting to compare the sound in fraud analysis of *Evergreen Fund*, which finds the fraud allegations “merely form the background for the plaintiffs’ allegations,” *id.*, with *Anchor Gaming*, which took background facts which could be read to allege fraud and held the whole complaint sounded in fraud. 33 F. Supp. 2d 889, 893 (D. Nev. 1999).

[FN106]. See, e.g., *Segemen v. Weidner* 780 F.2d 727, 731 (9th Cir. 1985) (stating that the policy considerations for applying rule 9(b) are giving defendants adequate notice to allow them to defend against the charge, deterring the filing of complaints “as a pretext for discovery of unknown wrongs (which) protects potential defendants--especially professionals . . . from the harm that comes from being charged with the commission of fraudulent acts” and prohibiting plaintiffs “from unilaterally imposing upon the court, the parties and society enormous social and economic costs absent some factual basis”).

[FN107]. See, e.g., *Hershey v. MNC Fin., Inc.*, 774 F. Supp. 367, 375-76 (D. Md. 1991) (considering only policy reasons behind Rule 9(b) and not those underlying the Securities Act).

[FN108]. See *Douglas & Bates*, supra note 5, at 172 (“(A)s legislative history has shown, that the mere requirement that the truth about securities be told is ineffective unless the penalties are so severe as to make it im-

provident not to tell it.”).

[FN109]. The issuer is strictly liable, regardless of the negligence of the people through which it acts.

[FN110]. *In re First Merchs. Acceptance Corp. Sec. Litig.*, No. 97 C 2715, 1998 WL 781118, at *11 n.6 (N.D. Ill. Nov. 4, 1998); see also *In re Leslie Fay Cos. Sec. Litig.*, 835 F. Supp. 167, 173 (S.D.N.Y. 1993) (**requiring** plaintiffs to **plead** more than they have to **prove** is nonsensical). The utter illogic of the opposite rule is exemplified by the court's holding in *Krieger v. Gast*, in which the court said “where fraud is alleged, the claim should be tested under Rule 9(b)'s **requirements** even if the claim may be established without proof of fraud.” No. 4:99-CV-86, 2000 WL 288442, at *6 (W.D. Mich. Jan. 21, 2000).

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