

WACHTELL, LIPTON, ROSEN & KATZ

LIABILITIES UNDER THE FEDERAL SECURITIES LAWS

SECTIONS 10, 14, AND 20 OF
THE SECURITIES EXCHANGE
ACT OF 1934
AND
SECTIONS 11, 12, AND 15 OF
THE SECURITIES ACT OF 1933

PAUL VIZCARRONDO, JR.
BRADLEY R. WILSON

SEPTEMBER 2023

Paul Vizcarrondo, Jr. is Of Counsel to Wachtell, Lipton, Rosen & Katz, and Bradley R. Wilson is a partner of the firm. The authors thank their former partner, Andrew C. Houston, who helped prepare the original version of this outline in 1988.

© 2023
Wachtell, Lipton, Rosen & Katz
All rights reserved.

Table of Contents

I.	Introduction.....	1
A.	A Brief Overview of the Liability Provisions of the Securities Laws.....	1
B.	Disclosure Philosophy	3
C.	Duty to Disclose.....	3
D.	Materiality.....	7
E.	Opinion Statements.....	9
F.	“Bespeaks Caution” Doctrine and PSLRA Safe Harbors	13
G.	Federal and State Law.....	16
H.	Other Statutes Affecting Securities Law Liabilities	22
I.	Extraterritorial Application of the Federal Securities Laws	24
II.	Liabilities Under the Exchange Act.....	31
A.	Section 10(b).....	31
1.	Private Right of Action Under Rule 10b–5	32
2.	Standing.....	33
3.	Persons Liable	37
4.	Basis of Liability	38
5.	Scienter	40
6.	Reliance and Causation	41
a.	Transaction Causation	41
b.	Loss Causation.....	49
7.	Heightened Pleading Requirements Under the PSLRA.....	54
a.	Pleading Fraudulent Conduct with Particularity	54
b.	Pleading Scienter	56
c.	The Group Pleading Doctrine.....	60
8.	Remedies and Measure of Damages.....	61
9.	Statute of Limitations	62

10. Defenses	64
11. Insider Trading	66
a. The Classical Theory	66
b. The Misappropriation Theory.....	70
c. Tippee Liability	74
d. Section 20A of the Exchange Act	78
B. Section 14(a).....	78
1. Implied Private Right of Action Under § 14(a) and Rule 14a-9	79
2. Standing.....	80
3. Persons Liable	82
4. Scienter.....	83
5. Reliance and Causation	84
6. Scope of “total mix” of information.....	86
7. Heightened Pleading Requirements Under the PSLRA.....	87
8. Remedies and Measure of Damages.....	88
9. Statute of Limitations	91
C. Section 14(e).....	92
1. Implied private right of action.....	93
2. Standing.....	94
3. Persons liable.....	95
4. “In connection with”.....	96
5. Standard of culpability	97
6. Reliance and loss causation.....	98
7. Heightened pleading requirements under the PSLRA.....	101
8. Remedies and measure of damages.....	102
9. Statute of limitations.....	103
III. Liabilities Under the Securities Act.....	104
A. Overview of § 11 and § 12.....	104
1. Sections 11 and 12 Contrasted	104
2. Overlap Between § 11 and § 12	104
3. Exclusivity of § 11 or § 12 Remedies	104
4. Rule 9(b) and § 11 and § 12	105
B. Section 11	105
1. Persons Liable	106

2.	Scienter	106
3.	Defenses	107
4.	Reliance	111
5.	Measure of Damages	112
6.	Causation and Standing	113
7.	Statute of Limitations	117
8.	Contribution.....	119
C.	Section 12	119
1.	Persons Liable	121
2.	Scienter and Defenses.....	124
3.	Reliance	126
4.	Remedies and Measure of Damages.....	126
5.	Statute of Limitations	127
IV.	Secondary Liability, Contribution, and Indemnification	129
A.	Controlling Person Liability Under § 15 of the Securities Act and § 20 of the Exchange Act.....	129
1.	“Control”	129
2.	Scienter and Defenses.....	132
3.	Statute of Limitations	133
4.	Remedies and Damages.....	133
B.	Respondeat Superior	133
C.	Aiding and Abetting Versus Direct Participation	134
D.	Conspiracy	139
E.	Contribution	139
F.	Indemnification and Insurance.....	140

I

Introduction

This outline focuses on the principal bases for private damages liability under the federal securities laws. For primary liability—that is, liability imposed on those who actually make allegedly false or misleading statements—the key provisions are § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b–5 adopted thereunder, §§ 14(a) and 14(e) of the Exchange Act, and §§ 11 and 12 of the Securities Act of 1933. As interpreted by the courts, § 10(b) and Rule 10b–5 create broad liability for intentionally false and misleading statements that affect after-market trading in securities, while § 14(a) and § 14(e) govern false and misleading statements made in connection with proxy solicitations and tender offers, respectively, with the degree of culpability that courts require to establish private liability varying based on the claim and jurisdiction. Sections 11 and 12, in turn, essentially create strict liability for issuers and others in connection with public offerings. In addition, we address the provisions that create secondary liability for persons who “control” persons who are primarily liable under these provisions: § 20 of the Exchange Act, for primary liability under that Act, and § 15 of the Securities Act, for primary liability under that Act.

To be sure, there are other sections of the federal securities laws that provide for (or, at least, were once thought to provide for) private liability, but those provisions, some of which we may mention in passing, pale in importance to the provisions we address at length here. This outline does *not* address other potential sources of liability and sanction—such as federal mail and wire fraud statutes, state fraud statutes and common law remedies, RICO, and the SEC’s disciplinary powers.

A. A Brief Overview of the Liability Provisions of the Securities Laws

Oddly enough, the most significant and frequently invoked statutory basis for private liability under the securities laws—§ 10(b) of the Exchange Act—was never intended by Congress to provide for private liability. When the Seventy-third Congress wanted to provide for private liability, it expressly said so. In fact, it said so several times. As the Supreme Court has explained, there are “eight express liability provisions contained in the 1933 and 1934 Acts,”¹ and those are §§ 11, 12, and 15 of the Securities Act of 1933, and §§ 9, 16, 18, 20, and 20A of the Securities Exchange Act of 1934.

¹ *Musick, Peeler & Garrett v. Emp’rs Ins. of Wausau*, 508 U.S. 286, 296 (1993).

We do not address §§ 9, 16, and 18 of the Exchange Act here. Section 16 contains an express liability provision, § 16(b), that provides for the recovery by securities issuers of so-called “short swing” profits made by the officers, directors, or 10% stockholders of the issuer who buy and sell the issuer’s stock in a period of less than six months. But § 16(b) addresses only a narrow set of circumstances, does not provide for issuer liability, and thus we do not dwell on it in this outline.²

As for the other liability provisions Congress actually did enact in §§ 9 and 18, the judiciary’s creation of an implied right of action under § 10(b) has rendered them essentially a dead letter. Section 9(f) provides for liability for “‘manipulative practices such as wash sales, matched orders, and the like,’ but creates no liability for misrepresentations or omissions in aftermarket trading absent a prohibited manipulative practice.”³ For a number of reasons, § 10(b) and Rule 10b–5, as interpreted by the courts, have utterly supplanted § 9. Most notably, “Section 10(b) has a far broader reach and addresses situations in which there are misrepresentations or omissions that affect a security’s price, and not just situations involving active manipulation,” with the result that “[i]t is difficult to imagine any violation of § 9[] . . . that would not also fall within the broad scope of proscribed activity set forth in Rule 10b–5.”⁴

The express liability provision in § 18 of the Exchange Act perhaps comes closest to the reach that courts have given § 10(b) and Rule 10b–5, but it too has been overridden by the latter. Its primary drawback is that it is limited to allegedly misleading statements in documents required by the Exchange Act or rules thereunder to be filed with the SEC and, most importantly, requires a plaintiff to plead and prove that he actually read the document; it is not sufficient that the plaintiff relied on information ultimately derived from such a document. This “eyeball” reliance requirement is the reef on which most § 18 cases founder, and the reason that § 18 is rarely invoked.⁵

² For a comprehensive treatment of § 16(b) liability, see PETER J. ROMEO & ALAN L. DYE, SECTION 16 TREATISE AND REPORTING GUIDE §§ 8.01-8.03 (5th ed. 2019).

³ Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act*, 69 BUS. LAW. 307, 338 (2014) (quoting *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 179 (1994)).

⁴ *Id.* at 338-39 (quoting *Walck v. Am. Stock Exch.*, 565 F. Supp. 1051, 1063 (E.D. Pa. 1981)).

⁵ See, e.g., *Cohen v. Stevanovich*, 722 F. Supp. 2d 416, 433-44 (S.D.N.Y. 2010); *Cyber Media Grp. v. Island Mortg. Network, Inc.*, 183 F. Supp. 2d 559, 577-78 (E.D.N.Y. 2002); *Kennedy v. Nicastro*, 503 F. Supp. 1116, 1118 (N.D. Ill. 1980); *Ross v. Warner*, 480 F. Supp. 268, 272-73 (S.D.N.Y. 1979); *Jacobson v. Peat, Marwick, Mitchell & Co.*, 445 F. Supp. 518, 525 (S.D.N.Y. 1977); *Gross v. Diversified Mortg. Inv’rs*, 431 F. Supp. 1080, 1093 (S.D.N.Y. 1977), *aff’d mem.*, 636 F.2d 1201 (2d Cir. 1980).

The different scopes of the Securities Act and the Exchange Act are more marked in the registration and filing provisions of the Acts than in the liability provisions. Thus, both § 17 of the Securities Act and § 10 of the Exchange Act can apply to any purchase of securities, whether or not part of a public offering (although § 11 of the Securities Act pertains only to public offerings and the registration statements used therein). However, the liability provisions of the Securities Act reflect that Act’s general philosophy of protecting only purchasers, while the liability provisions of the Exchange Act protect both purchasers and sellers.

The liability provisions of the Securities Act and the Exchange Act overlap, and liability under one provision or one Act does not preclude liability under another.⁶ Actions under the securities laws are often brought under more than one section. In particular, the great majority of federal securities actions involve a claim under § 10(b)—the general antifraud provision of the Exchange Act—and Rule 10b–5 thereunder, which are by far the most important liability provision in the securities laws. Additionally, many plaintiffs attach control person liability claims (under § 15 or § 20, respectively) to the underlying Securities Act or Exchange Act claims.

B. Disclosure Philosophy

The liability provisions under discussion adopt the general disclosure philosophy of the federal securities laws: with the exception of a few provisions governing the mechanics of securities trading, all impose only requirements of fair disclosure, not requirements of substantive fairness. *See, e.g., SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) (stating that the purpose common to the securities laws was to “substitute a philosophy of full disclosure for the philosophy of caveat emptor”); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 478 (1977) (“[O]nce full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute.”).

C. Duty to Disclose

Disclosure is only required where the law imposes a duty to disclose. “Silence, absent a duty to disclose, is not misleading” under the federal securities laws. *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988).⁷

⁶ *See, e.g., Randall v. Loftsgaarden*, 478 U.S. 647, 661 (1986); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 383-87 (1983).

⁷ *See also Badger v. S. Farm Bureau Life Ins. Co.*, 612 F.3d 1334, 1342-46 (11th Cir. 2010) (finding no duty to disclose running from one party in an arm’s-length securities transaction to the shareholders of the counterparty); *Thesling v. Bioevision, Inc.*, 374 F. App’x 141, 143 (2d Cir. 2010) (“For an omission to be actionable,

Some courts have found the requisite “duty to disclose” in various provisions of SEC Regulation S–K, which imposes certain disclosure obligations on issuers in their registration statements, annual and quarterly reports, and other filings. For example, where applicable, Item 303 of Regulation S–K requires companies to, inter alia, “[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.” 17 C.F.R. § 229.303(a)(3)(ii).⁸ These courts have made clear, however, that “only those trends, events, or uncertainties that [the company] actually knows of when it” makes the relevant filing must be disclosed under Item 303, and that “[i]t is not enough” for a plaintiff to allege the company “should have known of the existing trend, event or uncertainty.” *Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 95 (2d Cir. 2016). This logic has been applied to claims pleaded under the Securities Act, notwithstanding the absence of a scienter requirement.⁹ The courts that have confronted the issue have all concluded that a failure to disclose information required under Item 303 is actionable under §§ 11 and 12(a)(2) of the Securities Act.¹⁰ But

the securities laws must impose a duty to disclose the omitted information.” (quoting *Resnik v. Swartz*, 303 F.3d 147, 154 (2d Cir. 2002)); *United States v. Schiff*, 602 F.3d 152, 162 (3d Cir. 2010) (“Absent a duty to disclose, silence is not fraudulent . . .” (citation omitted)); *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1331 (7th Cir. 1995) (“Mere silence about even material information is not fraudulent absent a duty to speak.”).

⁸ There is no bright-line rule for the portion of a company’s business that must be affected so as to render a trend or uncertainty that affects it material. While the SEC has acknowledged that an impact of less than 5% on a given line item “may provide the basis for a preliminary assumption” of immateriality, SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, 45,151 (Aug. 19, 1999), “[i]f a particular product or productline, or division or segment of a company’s business, has independent significance for investors, then even a matter material to less than all of the company’s business may be material for purposes of the securities laws.” *Hutchison v. Deutsche Bank Sec. Inc.*, 647 F.3d 479, 488 (2d Cir. 2011); see also *Silverman v. Motorola, Inc.*, 798 F. Supp. 2d 954, 966-67 (N.D. Ill. 2011) (finding a genuine dispute of material fact regarding the materiality of 3G phone disclosures where 3G phones constituted only 2.2% of overall mobile sales, but the company referred to 3G phones as “flagship products” for “some of our lead operators in the world”).

⁹ See, e.g., *Medina v. Tremor Video, Inc.*, 640 F. App’x 45, 48 (2d Cir. 2016) (affirming the dismissal of claims pleaded under §§ 11 and 15 because the court’s “precedents require allegations of specific facts from which we could draw the ‘plausible inference’ that defendants had actual knowledge of the trends or uncertainties at the time the registration statement was issued”); *Blackmoss Invs. Inc. v. ACA Capital Holdings, Inc.*, 2010 WL 148617, at *9 (S.D.N.Y. Jan. 14, 2010) (“While it is true that Section 11 claims generally do not require pleading scienter, Item 303’s requirement of knowledge requires that a plaintiff plead, with some specificity, facts establishing that the defendant had actual knowledge of the purported trend.”).

¹⁰ See, e.g., *Silverstrand Invs. v. AMAG Pharm., Inc.*, 707 F.3d 95, 102 (1st Cir. 2013) (“[A]n actionable § 11 omission may arise when a registration statement fails to comply with Item 303 . . . of Regulation S–K.”); *Panther Partners, Inc. v. Ikanos Commc’ns, Inc.*, 681 F.3d 114, 119-20 (2d Cir. 2012) (“One of the potential bases for liability under §§ 11 and 12(a)(2) is an omission in contravention of an affirmative legal disclosure requirement. In this case, Item 303 of SEC Regulation S–K provides the basis for [the] alleged disclosure obligation.”); (citation omitted) *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1296 (9th Cir. 1998) (“Allegations which would support a claim under Item 303(a)(3)(ii) are sufficient to support a claim under section 12(a)(2).”).

the case law under § 10(b) of the Exchange Act is mixed.¹¹ For several months, it appeared that the Supreme Court was poised to resolve the question whether Item 303 can create a duty to disclose for purposes of § 10(b) and Rule 10b-5, *see* Order Granting Certiorari, *Leidos, Inc. v. Ind. Pub. Ret. Sys.* (No. 16-581), 137 S. Ct. 1395 (2017), but the parties agreed to a settlement after certiorari was granted, and the case was removed from the Court’s argument calendar, *see* Order, *Leidos, Inc. v. Ind. Pub. Ret. Sys.* (No. 16-581), 138 S. Ct. 369 (2017).

Another emerging theory that warrants attention is the argument that defendants have a duty to disclose under Item 105 of Regulation S-K, formerly Item 503(c).¹² When it applies, Item 105 instructs that “[w]here appropriate,” an issuer must “provide under the caption ‘Risk Factors’ a discussion of the material factors that make an investment in the registrant or offering speculative or risky,” which discussion must be “organized logically” and “concisely explain how each risk affects the registrant or the securities being offered.” 17 C.F.R. § 229.105(a)-(b). There are relatively few decisions applying Item 105, but the Third Circuit’s recent decision in *Jaroslavicz v. M&T Bank Corp.*, 962 F.3d 701, 710-17 (3d Cir. 2020), *cert. denied*, 141 S. Ct. 1284 (2021), in which the court overturned the dismissal of an Exchange Act claim based on the omission of information allegedly required under Item 105, suggests the theory may be gaining some traction.¹³

Even if the law does not impose an affirmative obligation to disclose, a party may assume such an obligation by making voluntary statements. Thus, under the federal

¹¹ Compare *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1055-56 (9th Cir. 2014) (noting the “significant[]” differences between §§ 11 and 12(a)(2) of the Securities Act and § 10(b) of the Exchange Act and holding that “Item 303 does not create a duty to disclose for purposes of § 10(b) and Rule 10b-5”), and *Ash v. PowerSecure Int’l, Inc.*, 2015 WL 5444741, at *10-11 (E.D.N.C. Sept. 15, 2015) (adopting as “persuasive” the reasoning in *NVIDIA*), with *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 103-04 (2d Cir. 2015) (“[F]ailure to comply with Item 303 . . . can give rise to liability under Rule 10b-5 so long as the omission is material under *Basic*, and the other elements of Rule 10b-5 have been established.”), and *Beaver Cty. Emps.’ Ret. Fund v. Tile Shop Holdings, Inc.*, 94 F. Supp. 3d 1035, 1047 (D. Minn. 2015) (adopting as “persuasive” the reasoning in *Stratte-McClure*).

¹² See FAST Act Modernization and Simplification of Regulation S-K, 84 Fed. Reg. 12,674, 12,688, 12,716-17 (Apr. 2, 2019).

¹³ See also, e.g., *Flynn v. Exelon*, 2021 WL 1561712, at *7-9 (N.D. Ill. Apr. 21, 2021) (finding the plaintiff had “sufficiently alleged that” the defendants “had a duty to disclose” regulatory noncompliance under Item 105). The two courts of appeals that had previously been called upon to apply former Item 503 interpreted the regulation narrowly. See *City of Pontiac Policemen’s & Firemen’s Ret. Sys. v. UBS AG*, 752 F.3d 173, 183-84 (2d Cir. 2014) (holding that former Item 503(c) did not establish a “duty ‘to disclose uncharged, unadjudicated wrongdoing.’” (citation omitted)); *Silverstrand*, 707 F.3d at 103 (“[A] complaint alleging omissions of Item 503 risks needs to allege sufficient facts to infer that a registrant *knew*, as of the time of an offering, that . . . a risk factor existed.” (emphasis added)).

securities laws, a party that makes public statements may not omit relevant information if the information is “necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.” 17 C.F.R. § 240.10b–5(b). In other words, when a party makes a disclosure, it assumes a duty to disclose all information necessary to make its statement not misleading, including information the party would not otherwise have been required to disclose had it not made the initial disclosure. *See, e.g., In re Hi-Crush Partners L.P. Sec. Litig.*, 2013 WL 6233561, at *18 (S.D.N.Y. Dec. 2, 2013) (“The fact that a corporation has no affirmative legal obligation to disclose information under applicable SEC regulations ‘does not mark the end of our inquiry;’ the corporation may still have a duty to disclose that information in order to avoid misleading investors.” (quoting *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 365 (2d Cir. 2010))).¹⁴ Similarly, a party may have a duty “to update prior statements if the statements were true when made, but misleading or deceptive if left unrevised.” *Finnerty v. Stiefel Labs., Inc.*, 756 F.3d 1310, 1317-18 (11th Cir. 2014) (finding that a company’s statement that it would “continue to be privately held” gave rise to duty to update when the defendant began to seriously engage in merger negotiations).

To trigger this prohibition on the omission of relevant information, the statement must pertain to the same subject matter as the alleged omission, and the missing disclosure must render the statement misleading because it alters the meaning of the statement. *See Kleinman v. Elan Corp.*, 706 F.3d 145, 154 (2d Cir. 2013).¹⁵ That is, the statement “must affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists.” *Ind. Elec. Workers*

¹⁴ *See also, e.g., Caiola v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002) (holding that when a party speaks, it has a “duty to be both accurate and complete”); *Ellenburg v. JA Solar Holdings Co.*, 2010 WL 1983375, at *4 (S.D.N.Y. May 17, 2010) (holding that once an executive disclosed the substance of a financial transaction, a duty to fully disclose all the risks arose, even though there was no duty to disclose the transaction in the first place); *In re Bristol Myers Squibb Co. Sec. Litig.*, 586 F. Supp. 2d 148, 160 (S.D.N.Y. 2008) (“[E]ven an entirely truthful statement may provide a basis for liability if material omissions related to the content of the statement make it . . . materially misleading.”). *Cf. Minneapolis Firefighters’ Relief Ass’n v. MEMC Elec. Materials, Inc.*, 641 F.3d 1023, 1028-30 (8th Cir. 2011) (finding no duty to disclose merely because of prior pattern of disclosure).

¹⁵ *See also, e.g., Richman v. Goldman Sachs Grp.*, 868 F. Supp. 2d 261, 274-75 (S.D.N.Y. 2012) (finding no duty to disclose the receipt of Wells notice either to make prior disclosures regarding ongoing governmental investigations not misleading or to comply with Regulation S–K, Item 103 because, at best, notice reflected desire of SEC enforcement staff to move forward and did not necessarily indicate that charges would be filed); *McDonald v. Kinder-Morgan, Inc.*, 287 F.3d 992, 998 (10th Cir. 2002) (finding that the duty to disclose only arises where the statement made is material and the “omitted fact is material to the statement in that it alters the meaning of the statement” (quoting *In re Bos. Tech. Inc. Sec. Litig.*, 8 F. Supp. 2d 43, 53 (D. Mass. 1998))).

Pension Tr. Fund IBEW v. Shaw Grp., 537 F.3d 527, 541 (5th Cir. 2008) (quoting *Brody v. Transitional Hosps. Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002)).¹⁶

Companies, however, need not disclose any and all information about the subject matter in question. There is no “freestanding completeness requirement”; rather, “[t]o be actionable under the securities laws, an omission must be misleading.” *Brody*, 280 F.3d at 1006.¹⁷ And a company’s disclosure of information at one point in time cannot, by itself, be considered an “admission” that the information should have been disclosed at some earlier point. *See In re Yahoo! Inc., Sec. Litig.*, 2012 WL 3282819, at *12-13 (N.D. Cal. Aug. 10, 2012), *aff’d*, 611 F. App’x 387 (9th Cir. 2015).

D. Materiality

Of course, not every fact about every transaction can be disclosed. Accordingly, all of the liability provisions under discussion limit liability to *material* nondisclosure or misrepresentation. The leading case on materiality is *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), which held that a fact is material if there is “a substantial likelihood” that it would be “viewed by the reasonable investor” as “significantly alter[ing] the ‘total mix’ of information made available.” This definition, promulgated in the context of a case under § 14(a) of the Exchange Act, is now universally applied under all of the liability provisions under discussion here. *See, e.g., Basic*, 485 U.S. at 231-32 (adopting the *TSC Industries* standard of materiality in the § 10(b) and Rule 10b-5 context).¹⁸

¹⁶ *See also Winer Family Tr. v. Queen*, 503 F.3d 319, 330 (3d Cir. 2007) (finding no duty to disclose information related to a public statement arose when the statement itself was “true” and nondisclosure of additional information did not render the statement “misleading or untrue”); *In re GAP Sec. Litig.*, 1991 WL 17091, at *2 (9th Cir. Feb. 8, 1991) (no duty to disclose where a company did not make “an affirmative statement on the same subject which would be misleading absent disclosure of the information” (quoting *Vaughn v. Teledyne, Inc.*, 628 F.2d 1214, 1221 (9th Cir. 1980))).

¹⁷ This principle applies with particular force when the additional information relates to contingent future events. *See, e.g., In re Bos. Sci. Corp. Sec. Litig.*, 686 F.3d 21, 27 (1st Cir. 2012) (holding that a statement that 150 new sales representatives were being trained did not trigger a duty to disclose potential firings related to an ongoing internal investigation because “the burden and risks to management of an unlimited and general [disclosure] obligation would be extreme and could easily disadvantage shareholders in numerous ways”); *In re Bank of Am. AIG Disclosure Sec. Litig.*, 980 F. Supp. 2d 564, 583-84 (S.D.N.Y. 2013) (rejecting plaintiffs’ argument that the disclosure of a threatened suit in which the potential loss could have reached \$10 billion was required under either the federal securities laws or Accounting Standards Codification 450), *aff’d*, 566 F. App’x 93 (2d Cir. 2014).

¹⁸ *See also Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 27-28 (2011) (rejecting a bright-line test of materiality based on the statistical significance of undisclosed information, and, citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007), finding that the complaint’s allegations taken collectively sufficed to raise a reasonable expectation that discovery would reveal evidence satisfying the materiality requirement).

Although the materiality of a misstated or omitted fact is determined on a case-by-case basis, courts have developed some general principles. Relying on the “total mix” concept, for example, courts have held that false statements or omissions are not materially misleading as long as the market possessed the correct information. *See, e.g., In re Convergent Techs. Sec. Litig.*, 948 F.2d 507, 513 (9th Cir. 1991) (“[I]n a ‘fraud on the market case,’ an omission is materially misleading only if the information has not already entered the market.” (citation omitted)).¹⁹ The “truth on the market” defense, however, may not be available at the pleading stage—particularly where the defense is founded on matters outside the pleadings and not subject to judicial notice. *See, e.g., Lovallo v. Pacira Pharm., Inc.*, 2015 WL 7300492, at *9 (D.N.J. Nov. 18, 2015) (“Although ‘truth-on-the-market analysis is intensely fact specific and thus seldom appropriate at the pleading stage,’ a ‘truth on the market defense can be granted on a motion to dismiss where the company’s SEC filings . . . disclose the very information necessary to make their public statements not misleading.’” (citations omitted)).

Additionally, courts have held that actionable statements must be sufficiently “concrete” and “specific,” as opposed to “vague statement[s] that are essentially mere puffery.” *In re N. Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446, 466 (S.D.N.Y. 2000) (internal quotation marks and citations omitted).²⁰ In a similar vein, statements in a corporate code of business conduct have been found to be “‘inherently aspirational,’” “not capable of objective verification,” and therefore not actionable as a matter of law, in part because “[a] contrary interpretation . . . could turn all

¹⁹ *See also, e.g., Southland Sec. Corp. v. INSpire Ins. Sols., Inc.*, 365 F.3d 353, 367 n.10 (5th Cir. 2004) (finding that information filed with the SEC and known to the market could not have artificially inflated the stock price); *Ieradi v. Mylan Labs., Inc.*, 230 F.3d 594, 599-600 (3d Cir. 2000) (finding that failure to disclose exclusive raw material supply contracts was not material when a company disclosed in its 10-Q that it was the subject of FTC investigation for anti-competitive activity); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 515 (7th Cir. 1989) (holding that a utility company did not need to disclose the risk of future regulation or construction delay because such “hazards of its business [were] . . . apparent to all serious observers and most casual ones”).

²⁰ *See also, e.g., In re Stratasy Ltd. S’holder Sec. Litig.*, 864 F.3d 879, 882 (8th Cir. 2017) (“Stratasy’s statements that the 5G printers offer ‘unmatched speed, reliability, quality and connectivity’ are vague and nonverifiable.”); *In re Aetna, Inc. Sec. Litig.*, 617 F.3d 272, 284 (3d Cir. 2010) (“General statements about the company’s dedication to ‘disciplined’ pricing and commitment to ‘discipline and rigor’ could not have meaningfully altered the total mix of information available to the investing public.”); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 869-70 (5th Cir. 2003) (finding that statements that company’s “fundamentals are strong,” it is “making steady progress,” and its “pipeline of private transactions . . . remains strong,” are immaterial puffery); *Se. Pa. Transp. Auth. v. Orrstown Fin. Servs., Inc.*, 2015 WL 3833849, at *19 (M.D. Pa. June 22, 2015) (finding that “representations of ‘sound’ credit practices and ‘stringent’ underwriting standards are too vague to be capable of verification” and “immaterial to a reasonable investor”).

corporate wrongdoing into securities fraud.” *Retail Wholesale & Dep’t Store Union Local 338 Ret. Fund v. Hewlett-Packard Co.*, 845 F.3d 1268, 1275-77 (9th Cir. 2017) (citation omitted).²¹

Moreover, a failure to disclose alleged lapses in business judgment by a company’s directors or management will not normally render a disclosure materially misleading. *See, e.g., Gaines v. Haughton*, 645 F.2d 761, 779 (9th Cir. 1981) (“[D]irector misconduct of the type traditionally regulated by state corporate law need not be disclosed in proxy solicitations . . .”), *overruled on other grounds by Stahl v. Gibraltar Fin. Corp.*, 967 F.2d 335, 338 (9th Cir. 1992). This principle derives from *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477 (1977), discussed below (at p. 39), in which the Supreme Court held that Congress did not intend to “bring within the scope of § 10(b) instances of corporate mismanagement.”²²

Although questions of materiality are usually for the jury to decide because they require “delicate assessments of the inferences a ‘reasonable [investor]’ would draw from a given set of facts and the significance of those inferences to him,” *TSC Indus.*, 426 U.S. at 450, “if the alleged misstatements or omissions ‘are so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality, the court may rule them immaterial as a matter of law,’” *Recupito v. Prudential Sec., Inc.*, 112 F. Supp. 2d 449, 454 (D. Md. 2000) (quoting *Klein v. Gen. Nutrition Cos.*, 186 F.3d 338, 342 (3d Cir. 1999)).

E. Opinion Statements

The Supreme Court addressed the scope of potential securities law liability for statements of opinion, as distinct from statements of fact, in *Omnicare, Inc. v. Laborers District Counsel Construction Industry Pension Fund*, 575 U.S. 175 (2015). In *Omnicare*, the Court vacated a Sixth Circuit decision that had held that an issuer’s sincerely held opinion could constitute an “untrue statement of a material

²¹ *Accord Singh v. Cigna Corp.*, 918 F.3d 57, 59-60 (2d Cir. 2019) (rejecting plaintiff’s “creative attempt to recast corporate mismanagement as securities fraud” and reasoning that “banal and vague corporate statements affirming the importance of regulatory compliance” “do not invite reasonable reliance”).

²² *See, e.g., Lewis v. Chrysler Corp.*, 949 F.2d 644, 651 (3d Cir. 1991) (“While management motives . . . may have been self-serving as alleged, Chrysler’s failure to disclose management’s entrenchment scheme is not actionable under the federal securities laws.”); *Kas v. Fin. Gen. Bankshares, Inc.*, 796 F.2d 508, 513 (D.C. Cir. 1986) (“[A] plaintiff may not ‘bootstrap’ a claim of breach of fiduciary duty into a federal securities claim by alleging that directors failed to disclose that breach of fiduciary duty.”); *Kademian v. Ladish Co.*, 792 F.2d 614, 622 (7th Cir. 1986) (finding that “a plaintiff may not ‘bootstrap’ a state law claim into a federal case” by alleging that the defendants failed “to reveal . . . their impure motives”) (quoting *Panter v. Marshall Field & Co.*, 646 F.2d 271, 288 (7th Cir. 1981)); *Biesenbach v. Guenther*, 588 F.2d 400, 402 (3d Cir. 1979) (stating that a contrary “approach . . . would clearly circumvent the . . . holding in *Santa Fe*”).

fact” under § 11 of the Securities Act simply because it turned out to be wrong.²³ In rejecting this approach, the Supreme Court reasoned that because an opinion affirms simply “that the speaker actually holds the stated belief,” “a sincere statement of pure opinion” cannot constitute “an ‘untrue statement of material fact’” under § 11. *Omnicare*, 575 U.S. at 184-86.

Nevertheless, the *Omnicare* Court held that some genuinely held opinions could still be actionable under the language in § 11 that proscribes statements that have “omitted to state a material fact . . . necessary to make the statements . . . not misleading.” The Court held that omitted facts could render an opinion misleading because investors expect that an opinion “fairly aligns with the information in the issuer’s possession at the time.” *Id.* at 188-89. Accordingly, “if a registration statement omits material facts” that “conflict with what a reasonable investor would take from [the issuer’s statement of opinion], then § 11’s omissions clause creates liability.” *Id.* at 189. At the same time, the Court emphasized that it would be “no small task for an investor” to bring an opinion-based omission claim, *id.* at 194, and explained that not every fact “cutting the other way” must be disclosed, because “[a] reasonable investor does not expect that *every* fact known to an issuer supports its opinion statement.” *Id.* at 189-90. The Court also made clear that “context” matters, and that investors should be understood to take account of an opinion’s “surrounding text, including hedges, disclaimers, and apparently conflicting information,” as well as “the customs and practices of the relevant industry.” *Id.* at 190.

Although *Omnicare* involved a § 11 claim, the courts that have reached the issue have consistently held that *Omnicare*’s approach for analyzing opinion statements applies to other claims under the federal securities laws. For example, in *City of Dearborn Heights Act 345 Police & Fire Retirement Systems v. Align Tech., Inc.*, 856 F.3d 605, 616 (9th Cir. 2017), the Ninth Circuit held that the *Omnicare* framework is “equally applicable to Section 10(b) and Rule 10b-5 claims,” based on its observation that Rule 10b-5 and § 11 contain “an identical limitation of liability to ‘untrue statement[s]’ and omissions of ‘fact.’”²⁴ Likewise, in *Golub v. Gigamon*

²³ In ruling that “a defendant’s knowledge is not relevant to a strict liability claim” under § 11 “[n]o matter the framing,” *Indiana State District Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498, 505 (6th Cir. 2013), the Sixth Circuit expressly declined to follow holdings by the Second and Ninth Circuits that a statement of belief or opinion could not state a claim under the Securities Act unless the statement was both “objectively false and disbelieved by the defendant at the time it was expressed.” *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 110 (2d Cir. 2011); *accord Rubke v. Capital Bancorp Ltd.*, 551 F.3d 1156, 1162 (9th Cir. 2009) (“[M]isleading opinions . . . can give rise to a claim under section 11 only if the complaint alleges with particularity that the statements were both objectively and subjectively false or misleading.”).

²⁴ *See also, e.g., Abramson v. Newlink Genetics Corp.*, 965 F.3d 165, 174-75 (2d Cir. 2020) (applying *Omnicare* to a claim under § 10(b) and Rule 10b-5 and observing that “§ 11 of the Securities Act of 1933 . . . shares the relevant text concerning false and misleading statements with Rule 10b-5”); *Carvelli v. Ocwen Fin. Corp.*,

Inc., 994 F.3d 1102, 1107 (9th Cir. 2021), the Ninth Circuit held that *Omnicare* applies “to the section 14(a) and Rule 14a-9 context,” reasoning that “Rule 14a-9 contains a virtually identical limitation on liability.”²⁵ Meanwhile, other courts have explicitly assumed without deciding that *Omnicare* should apply outside of the § 11 context.²⁶

The Second Circuit applied *Omnicare*’s framework in *Tongue v. Sanofi*, 816 F.3d 199 (2d Cir. 2016), a case that involved both Securities Act and Exchange Act claims. Sanofi was seeking to acquire Genzyme via a tender offer (to be followed by a short-form merger) in which Genzyme’s stockholders were offered \$74 and one contingent value right (CVR) per share. The CVRs’ value was tied to the achievement of certain “milestones” by a developmental drug (Lemtrada), and the offering materials estimated “a 90% probability” that Lemtrada would timely reach the first milestone (FDA approval); it didn’t. *See id.* at 204-05. The plaintiffs alleged that the estimate was materially misleading because, while investors knew that Genzyme had relied on single-blind trials for Lemtrada, defendants had “fail[ed] to disclose the FDA’s repeated statements of concern about [Genzyme’s] use of single-blind studies.” *Id.* at 211. The Second Circuit held that the plaintiffs had not stated a claim under *Omnicare*, reasoning that “sophisticated investors” like them were “no doubt aware that projections . . . are synthesized from a wide variety of information, and that some of the underlying facts may be in tension with the ultimate projection set forth by the issuer.” *Id.* The court reached this conclusion notwithstanding its view that the plaintiffs “would have been interested in knowing about the FDA feedback, and perhaps would have acted otherwise had the feedback been disclosed.” *Id.* at 212.

While at first glance *Sanofi* seems to reflect a rather defendant-friendly view of *Omnicare*, there may be reasons to temper that assessment. First, as noted, the

934 F.3d 1307, 1322 n.7 (11th Cir. 2019) (“Because the core prohibition of Rule 10b-5(b) is worded in the exact same language as § 11, . . . we conclude that *Omnicare*’s analysis controls here.”); *Fryman v. Atlas Fin. Holdings, Inc.*, 2022 WL 1136577, at *10 (N.D. Ill. Apr. 18, 2022) (“Plaintiffs offer no explanation as to why the Court should not apply *Omnicare* to their 10b-5 claim, nor do they cite any authority calling for a different result. . . . The Court consequently finds that *Omnicare* applies to any opinion statements alleged in the FAC.”).

²⁵ *See also, e.g., Paradise Wire & Cable Defined Pension Benefit Plan v. Weil*, 918 F.3d 312, 322-23 (4th Cir. 2019) (applying *Omnicare* to a claim under § 14(a) and Rule 14a-9); *Baum v. Harman Int’l Indus., Inc.*, 408 F. Supp. 3d 70, 79 n.1 (D. Conn. 2019) (“Although *Omnicare* concerned Section 11 of the Securities Exchange Act, Section 14(a) ‘bars conduct similar to that described in § 11,’” and “Rule 14a-9’s omissions clause is nearly identical to Section 11’s.”) (emphasis added) (citation omitted).

²⁶ *See, e.g., In re Amarin Corp. PLC Sec. Litig.*, 2022 WL 2128560, at *3 n.7 (3d Cir. June 14, 2022) (“We have not yet decided whether the framework in *Omnicare* is applicable to claims under § 10(b) of the Exchange Act.”; “the statements are not actionable under the framework set forth in *Omnicare*”); *Jaroslawicz v. M&T Bank Corp.*, 962 F.3d 701, 717 & n.16 (3d Cir. 2020) (“We have not considered whether *Omnicare* applies to claims brought . . . under Section 14(a). But it is unnecessary to resolve that question here. Even assuming *Omnicare*’s holding applies, the Shareholders have failed to allege an actionably misleading opinion.”)

Second Circuit found significant the plaintiffs’ perceived sophistication and acknowledged that “a layperson, unaccustomed to the subtleties and intricacies of the pharmaceutical industry and registration statements, may have misinterpreted Defendants’ statements as evincing assurance of success.” *Id.* at 211-12. Second, the court charged the plaintiffs with knowledge of information in the public domain—including “the fact that the FDA has long made public its preference for double-blind trials”—and reasoned that they “cannot claim surprise when it is revealed that the FDA meant what it said,” “[e]specially where a complex financial instrument whose value is tied to FDA approval is involved.” *Id.* at 212-13.

The Second Circuit had a further opportunity to apply *Omnicare* in *Abramson v. NewLink Genetics Corp.*, 965 F.3d 165 (2d Cir. 2020), and reached a different result, reinstating a claim asserted under § 10(b) and Rule 10b–5. The plaintiffs in *Abramson* alleged that NewLink’s president had “misled investors by implying that no credible studies have shown resected pancreatic cancer patients to have survival rates higher than 20 months,” when in fact such studies existed. *Id.* at 176-77. The president’s statement was actionable, the court concluded, because “whether characterized as one of fact or opinion,” the statement could “lead a reasonable investor to the falsifiable conclusion that no study any knowledgeable person would find credible has shown the median survival rates of resected pancreatic cancer patients to be longer than 20 months.” *Id.* at 177. The court explained that although “speakers may reasonably form opinions in spite of ‘some fact cutting the other way,’ and have no obligation to disclose *all* contrary facts irrespective of their significance, a jury could conclude that [the president’s] confident statement and his omission of noted studies’ findings were a bridge too far.” *Id.*

In *Jaroslawicz v. M&T Bank Corp.*, 962 F.3d 701 (3d Cir. 2020), *cert. denied*, 141 S. Ct. 1284 (2021), the Third Circuit applied *Omnicare* to a claim asserted under § 14(a). *Jaroslawicz* arose from M&T’s acquisition of another financial institution, and the plaintiffs alleged that the merger partners had presented misleading opinions in their joint proxy statement: the opinion that the merger would close promptly, and the opinion that M&T’s regulatory programs were compliant with applicable law. *Id.* at 717 & n.17. Assuming without deciding that *Omnicare* was applicable, the court held that the plaintiffs had failed to allege actionably misleading opinion statements. *Id.* at 717 & n.16. First, the court rejected the argument that the challenged opinions were misleading because they proved to be incorrect, explaining that “‘a plaintiff cannot state a claim by alleging only that an opinion was wrong.’” *Id.* at 717 (quoting *Omnicare*, 575 U.S. at 194) (alterations omitted). Second, the court rejected the plaintiffs’ argument that the opinions were misleading because the joint proxy statement allegedly omitted facts about M&T’s due diligence efforts. *Id.* Because the joint proxy statement had disclosed the duration of the due diligence period, the court found that the defendants had sufficiently

“divulge[d] [the] opinion’s basis.” *Id.* at 718 (quoting *Omnicare*, 575 U.S. at 195). The court reasoned that “even if a reasonable investor would have expected the banks to conduct diligence over a longer period, the Joint Proxy provided enough information to understand what the banks did, information enough to decide how to vote.” *Id.*

F. “Bespeaks Caution” Doctrine and PSLRA Safe Harbors

Many courts have recognized the “bespeaks caution” doctrine, by which the materiality of a misstatement or omission can be negated by appropriate cautionary language in a disclosure document. *See, e.g., Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 360 (2d Cir. 2002) (affirming the dismissal of complaint where offering memoranda “not only bespeak caution, they shout it from the rooftops” with respect to the risk that securities will not be registered).²⁷ To cleanse a future or concurrent misstatement, the cautionary language must be specific; that is, it must caution against precisely the sort of risk for which the alleged misstatement or omission failed to account. *See, e.g., Paradise Wire & Cable Defined Benefit Pension Plan v. Weil*, 918 F.3d 312, 323 (4th Cir. 2019) (“When the words of a proxy statement . . . contain tailored and specific warnings about the very omissions that are the subject of the allegations, those words render the claim for relief implausible.”); *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1121 (10th Cir. 1997) (finding optimistic predictions immaterial when accompanied by “highly specific [and] very factual” cautionary statements that directly address those predictions). Moreover, the doctrine will not apply if the supposed “risk” the company identifies has in fact already materialized. *See, e.g., In re Westinghouse Sec. Litig.*, 90 F.3d 696, 709 (3d Cir. 1996) (“In our view, a reasonable investor would be very interested in knowing, not merely that future economic developments might cause further losses, but that (as plaintiffs allege) current reserves were known to be insufficient under current economic conditions.”).

Among other changes affecting cases brought under the federal securities laws, the Private Securities Litigation Reform Act of 1995 (the “PSLRA”), Pub. L. No. 104-67, 109 Stat. 737 (1995), established a statutory safe harbor for forward-looking statements in § 27A of the Securities Act and in § 21E of the Exchange Act. *See p. 22, infra* (discussing the PSLRA’s enactment). The statutory safe harbor is

²⁷ *See also, e.g., Plumbers’ Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 772 (1st Cir. 2011); *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1120 (10th Cir. 1997); *Gasner v. Bd. of Supervisors*, 103 F.3d 351, 358 (4th Cir. 1996); *Saltzberg v. TM Sterling/Austin Assocs., Ltd.*, 45 F.3d 399, 400 (11th Cir. 1995); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413-15 (9th Cir. 1994); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371-73 (3d Cir. 1993); *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1040 (6th Cir. 1991); *Polin v. Conductron Corp.*, 552 F.2d 797, 806 n.28 (8th Cir. 1977).

“based on the judicial bespeaks caution doctrine,” *Emp’rs Teamsters Local Nos. 175 & 505 Pension Tr. Fund v. Clorox Co.*, 353 F.3d 1125, 1132 (9th Cir. 2004) (citing *Helwig v. Vencor, Inc.*, 251 F.3d 540, 547-48 (6th Cir. 2001)),²⁸ and provides that a person “shall not be liable” for a forward-looking statement, inter alia, if the statement is (1) “identified as a forward-looking statement” and “accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement”; or (2) if the plaintiff fails to prove that the forward-looking statement was made with “actual knowledge . . . that the statement was false or misleading,” 15 U.S.C. §§ 77z-2(c)(1), 78u-5(c)(1).

For purposes of the statutory safe harbor, forward-looking statements include statements that “contain[] a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items,” “statement[s] of the plans or objectives of management for future operations,” and “statement[s] of future economic performance.” 15 U.S.C. §§77z-2(i)(1)(A)-(C), 78u-5(i)(1)(A)-(C). However, courts have recognized that “[t]he mere fact that a statement contains some reference to a projection of future events cannot sensibly bring the statement within the safe harbor if the allegation of falsehood relates to non-forward-looking aspects of the statement,” *In re Stone & Webster, Inc. Sec. Litig.*, 414 F.3d 187, 213 (1st Cir. 2005), and have held that “a mixed present/future statement is not entitled to the safe harbor with respect to the part of the statement that refers to the present,” *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 705 (7th Cir. 2008) (holding that a statement that sales were “still going strong” was not entitled to the safe harbor “with regard to the statement’s representation concerning current sales”).²⁹

²⁸ Courts have continued to apply the bespeaks caution doctrine notwithstanding the enactment of the PSLRA. See, e.g., *Roer v. Oxbridge Inc.*, 198 F. Supp. 2d 212, 228 (E.D.N.Y. 2001) (“These [safe harbor] provisions of the PSLRA were modeled after, but not meant to displace, the judicial bespeaks caution doctrine.”). This outcome is consistent with the intent of Congress as reflected in the legislative history. See H.R. CONF. REP. No. 104-369, at 46 (1995) (“The [PSLRA] Conference Committee does not intend for the safe harbor provisions to replace the judicial bespeaks caution doctrine or to foreclose further development of that doctrine by the courts.”).

²⁹ See also, e.g., *Spitzberg v. Hous. Am. Energy Corp.*, 758 F.3d 676, 692 (5th Cir. 2014) (holding that an oil and gas company’s statements regarding its reserves were not forward-looking insofar as they communicated information bearing upon the past testing of wells); *In re Nortel Networks Corp. Sec. Litig.*, 238 F. Supp. 2d 613, 628-29 (S.D.N.Y. 2003) (finding that various forward-looking statements were based upon fraudulent historical and current facts, and thus ineligible for safe harbor protection); *In re Viropharma, Inc. Sec. Litig.*, 2003 WL 1824914, *7 & n.12 (E.D. Pa. Apr. 7, 2003) (finding that a press release claiming that patients using a drug experienced improvement and that “our plan is to continue the path towards regulatory approval” were not forward-looking because “[t]he truth or falsity of both of these statements was determinable at the time they were made”).

Taking this principle significantly further, the Ninth Circuit has expressed the view that when a “mixed statement” is at issue, “[i]f the non-forward-looking statement is materially false or misleading, it is likely that no cautionary language—short of an outright admission of the false or misleading nature of the non-forward-looking statement—would be ‘sufficiently meaningful’ to qualify the statement for the safe harbor.”³⁰ *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1146-47 (9th Cir. 2017). Were this reasoning to become widely accepted, it would effectively deny the protections of the safe harbor to mixed statements. For the moment, however, *Quality Systems* has not gained traction outside of the Ninth Circuit.

To the extent a statement is deemed forward-looking (in whole or in part), it is entitled to protection under the first prong of the safe harbor if it is accompanied by “cautionary statements” that are “substantive and tailored to the specific future projections, estimates or opinions” at issue. *Institutional Inv’rs Grp. v. Avaya, Inc.*, 564 F.3d 242, 256 (3d Cir. 2009).³¹ But “mere boilerplate . . . does not meet the statutory standard,” because it is too “general and ubiquitous” and “not tailored to the specific circumstances of a business operation.” *In re Harman Int’l Indus., Inc. Sec. Litig.*, 791 F.3d 90, 102 (D.C. Cir. 2015).³²

³⁰ According to a recent Ninth Circuit case, a statement should be regarded as non-forward-looking if the plaintiff pleads “sufficient facts to show that the statement goes *beyond* the articulation of ‘plans,’ ‘objectives,’ and ‘assumptions’ and instead contains an express or implied ‘concrete’ assertion concerning a specific ‘current or past fact[.]’” *Wochos v. Tesla, Inc.*, 985 F.3d 1180, 1191-92 (9th Cir. 2021) (quoting *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1142, 1144 (9th Cir. 2017)). However, in *Wochos*, the court held that Tesla’s statements that it was “on track” to meet a production goal and that there were “no issues” that “would prevent” Tesla from meeting that goal were forward-looking, notwithstanding the statements’ implicit reference to “current circumstances.” *Id.* at 1192. In so doing, the court recognized that any statement regarding a company’s operating goals “reflects an implicit assertion that the goal is achievable based on current circumstances,” and reasoned that an “unadorned statement that a company is ‘on track’ to achieve an announced objective, or a simple statement that a company knows of no issues that would make a goal impossible to achieve, are merely alternative ways of declaring or reaffirming the objective itself.” *Id.*

³¹ See also, e.g., *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 734 (7th Cir. 2004) (holding that a company should disclose “the major risks [it] objectively faced when it made its forecasts”); *Ehlert v. Singer*, 245 F.3d 1313, 1320 (11th Cir. 2001) (immunizing defendants under the safe harbor because “the warnings actually given were not only of a similar significance to the risks actually realized, but were also closely related to the specific warning which Plaintiffs assert should have been given”); *In re Daktronics, Inc. Sec. Litig.*, 2010 WL 2332730, at *17 (D.S.D. June 9, 2010) (finding that a statement that “financial performance may vary significantly from quarter to quarter” was not specific enough to trigger the safe harbor protection, but a statement that there were regulatory constraints “on the rate of application for digital billboards” and “it is important that investors understand that this constraint exists” was sufficient).

³² See also, e.g., *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010) (“To avail themselves of safe harbor protection under the meaningful cautionary language prong, defendants must demonstrate that their cautionary language was not boilerplate and conveyed substantive information.”); *Southland Sec. Corp. v. IN-Spire Ins. Sols., Inc.*, 365 F.3d 353, 372 (5th Cir. 2004) (“The requirement for ‘meaningful’ cautions calls for

Noting that the two prongs of the safe harbor are presented in the disjunctive, some courts have held that “if the statement qualifies as ‘forward-looking’ and is accompanied by sufficient cautionary language, a defendant’s statement is protected regardless of the actual state of mind.” *Miller v. Champion Enters. Inc.*, 346 F.3d 660, 672 (6th Cir. 2003).³³ Other courts have suggested that the defendant’s state of mind might be relevant to determining whether the warnings given were meaningful—at least in some cases. The Second Circuit, for example, has cited the need for a “reference point by which we should judge whether an issuer has identified the factors that realistically could cause results to differ from projections,” and expressed doubt that prong one would be satisfied if the defendant “omitted a major risk that he knew about at the time he made the statement.” *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010). And the D.C. Circuit has also suggested that the defendant’s state of mind might be relevant under prong one by stating that “the safe harbor would not protect from liability a person ‘who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away.’” *In re Harman Int’l*, 791 F.3d at 102-03 (quoting *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004)).

G. Federal and State Law

Section 22(a) of the Securities Act vests the federal and state courts with concurrent jurisdiction over actions brought under that Act, and provides that “no case arising under [the Act]” that is filed in state court “shall be removed to any court of the United States.” 15 U.S.C. § 77v(a). Section 27 of the Exchange Act, by contrast, requires actions under that Act to be brought only in the federal courts. *See id.* § 78aa(a).³⁴

‘substantive’ company-specific warnings based on a realistic description of the risks applicable to the particular circumstances, not merely a boilerplate litany of generally applicable risk factors.”).

³³ *See also In re Cutera Sec. Litig.*, 610 F.3d 1103, 1112-13 (9th Cir. 2010) (rejecting as inconsistent with the plain language of the PSLRA a conjunctive reading “under which a sufficiently strong inference of actual knowledge would overcome a claim of safe harbor protection even for statements identified as forward-looking and accompanied by meaningful cautionary language”); *Southland*, 365 F.3d at 371-72 (holding that prong one “focus[es] on the defendant’s cautionary statements” while prong two focuses “on the defendant’s state of mind”); *Harris v. Ivax Corp.*, 182 F.3d 799, 803 (11th Cir. 1999) (holding that where all allegedly false statements were identified as forward-looking and accompanied by cautionary language, “the defendant’s state of mind is irrelevant”); *Desai v. Gen. Growth Proprs.*, 654 F. Supp. 2d 836, 844 (N.D. Ill. 2009) (“[U]nder the literal language of the safe harbor statute the author of any forward-looking statement—even though a deliberate falsehood—is insulated from liability so long as that statement is accompanied by some meaningful cautionary statement.”).

³⁴ Section 16 of the Securities Act and § 28(a) of the Exchange Act explicitly preserve remedies existing prior to passage of the securities acts. *See* 15 U.S.C. §§ 77p(a), 78bb(a)(2). Thus, the federal securities laws do not preclude state law actions, such as actions for common law fraud, arising out of securities transactions. Such actions can be, and often are, joined with actions brought under the liability provisions of the securities laws.

After the enactment of the PSLRA, an increasing number of plaintiffs filed actions in state rather than federal courts, often based on state law causes of action, to try to avoid the PSLRA's strictures. In the first year of the PSLRA regime, the number of securities fraud class actions filed in state courts nearly doubled. *See* Edward Brodsky, *Discovery Abuses: A Shifting Target?*, 11 White-Collar Crime Rep. (BNA) No. 7, at 1 (July/Aug. 1997). Congress responded to this trend by passing the Securities Uniform Standards Act of 1998 ("SLUSA"), which added provisions to the Securities Act (§ 16(b) & (c)) and the Exchange Act (§ 28(f)(1) & (2)) that were designed to "prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA]." *See* Pub. L. No. 105-353, § 101(a)(1), (b)(1), 112 Stat. 3227, 3227-30 (1998). However, as discussed below (at p. 20), the Supreme Court held that regardless of what Congress might have intended, nothing in SLUSA's plain language prohibits state court class actions that assert claims solely under the Securities Act.

SLUSA precludes a private party from bringing a "covered class action" in federal or state court based on state law alleging a "misrepresentation or omission of a material fact" or the use of "any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1); *see also id.* § 77p(b). The term "covered securities" in SLUSA includes those listed or authorized for listing on the New York Stock Exchange, the American Stock Exchange, or the NASDAQ Stock Market. *Id.* § 77r(b). This definition extends to options,³⁵ variable life insurance policies,³⁶ and tax-deferred variable annuities.³⁷ "Generally, a 'covered class action' involves common questions of law or fact brought on behalf of more than 50 persons or an action brought on behalf of one or more unnamed parties." *Prager v. Knight/Trimark Grp., Inc.*, 124 F. Supp. 2d 229, 231 (D.N.J. 2000) (citing 15 U.S.C. § 78bb(f)(5)(B)); *see also* 15 U.S.C. § 77p(f)(2)(A).

³⁵ *See Falkowski v. Imation Corp.*, 309 F.3d 1123, 1130 (9th Cir. 2002) ("[T]he granting of an option constitutes a 'purchase or sale' under SLUSA."), *abrogated on other grounds by Kircher v. Putnam Funds Tr.*, 547 U.S. 633 (2006).

³⁶ *See Herndon v. Equitable Variable Life Ins. Co.*, 325 F.3d 1252, 1253 (11th Cir. 2003) ("We hold that . . . a variable life insurance policy is a 'covered security' under SLUSA . . ."); *see also Freeman Invs., L.P. v. Pac. Life Ins. Co.*, 704 F.3d 1110, 1114-18 (9th Cir. 2013) (holding that claims for breach of a variable life insurance contract were related to the sale of a covered security, but nevertheless not precluded by SLUSA because plaintiffs alleged a straightforward contract claim that did not rest on a misrepresentation or fraudulent omission).

³⁷ *See Patenaude v. Equitable Life Assurance Soc'y of the U.S.*, 290 F.3d 1020, 1024 (9th Cir. 2002) ("[T]he deferred tax variable annuity . . . qualifies as a 'covered security' within the meaning of SLUSA."), *abrogated on other grounds by Kircher v. Putnam Funds Tr.*, 547 U.S. 633 (2006).

Before the Supreme Court ruled on the question in 2006, the courts of appeals disagreed about whether the “in connection with” language in SLUSA was coterminous with the meaning of the nearly identical language of § 10(b). In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006), the Court ruled that SLUSA operated to preempt not only state law seller and purchaser claims, but also state law “holder” claims that alleged injury based on the prolonged retention of stock due to fraud. Though Rule 10b–5 only establishes a private cause of action under federal law for purchaser-seller claims, and that rule uses the same “in connection with” language as SLUSA, the Court ruled that the exclusion of holder claims from Rule 10b–5 was a judicially crafted limitation on private litigation, rather than an interpretation of its language. *Id.* at 80. The Court thus rejected the Second Circuit’s adoption of the *Blue Chip Stamps* standard (*see* p. 33, *infra*) to limit preclusion of holder claims under SLUSA. *Id.* at 84.³⁸

The Supreme Court again addressed the scope of SLUSA’s “in connection with the purchase or sale of a covered security” requirement in *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377 (2014), and seemingly narrowed its reach. Plaintiffs in *Troice* were victims of a Ponzi scheme who invested in certificates of deposit issued by a bank that the victims were misled to believe owned covered securities for its own account. *See id.* at 384-86. At issue was whether, under these circumstances, the fraudulent misstatements and omissions were made “in connection with the purchase or sale of covered securities.” The Supreme Court held that they were not, explaining that “[a] fraudulent misrepresentation or omission is not made ‘in connection with’ such a ‘purchase or sale of a covered security’ unless it is material to a decision by one or more individuals (other than the fraudster) to buy or to sell a ‘covered security.’” *Id.* at 387. The Court elaborated that the “in connection with” requirement demands a connection “that matters,” and that “a connection matters where the misrepresentation makes a significant difference to someone’s decision to purchase or to sell a covered security, not to purchase or to sell an uncovered security, something about which the Act expresses no concern.” *Id.* at 387-88.³⁹

³⁸ The Tenth Circuit subsequently held that claims under state law were precluded even when the state law cause of action did not require allegations of scienter or reliance, as would be required for a § 10(b) claim, and such allegations were not made. *Anderson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 521 F.3d 1278, 1285-87 (10th Cir. 2008); *see also Segal v. Fifth Third Bank, N.A.*, 581 F.3d 305, 312 (6th Cir. 2009) (rejecting the argument that “SLUSA prohibits claims only if the underlying factual allegations would otherwise give rise to an actionable claim under federal securities laws,” because “[t]hat is not what the Act says”).

³⁹ Courts have reasoned that the holding in *Troice* does not extend to cases in which plaintiffs believed they themselves were making an investment—directly or indirectly—in covered securities. *See, e.g., In re Kingate Mgmt. Ltd. Litig.*, 784 F.3d 128, 142 (2d Cir. 2015) (holding that the “in connection with” requirement was satisfied where plaintiffs purchased “uncovered shares of the offshore Funds, expecting that the Funds were investing the proceeds in S&P 100 stocks, which are covered securities”); *Hidalgo-Velez v. San Juan Asset*

Although the Supreme Court has twice spoken on SLUSA’s “in connection with” requirement, interpretive issues remain. The Second Circuit addressed two of them in *In re Kingate Management Ltd. Litigation*, 784 F.3d 128 (2d Cir. 2015): “the relationship of the alleged false conduct to the state law theory of liability,” and “the relationship of the defendant to the alleged false conduct.” *Id.* at 132. On the first issue, the court held that “state law claims that do not depend on false conduct are not within the scope of SLUSA, even if the complaint includes peripheral, inessential mentions of false conduct.” *Id.*; *see also id.* at 142-43 (stating that allegations “extraneous to the complaint’s theory of liability” “cannot be the basis for SLUSA preclusion”). On the second issue, the court held that “claims accusing the defendant of complicity in the false conduct that gives rise to liability are subject to SLUSA’s prohibition, while claims of false conduct in which the defendant is not alleged to have had any complicity are not.” *Id.* at 132.

Covered class actions brought in state court are removable to federal court, and the state law claims are subject to dismissal based on the preemption provisions in § 16(b) of the Securities Act and § 28(f)(1) of the Exchange Act. 15 U.S.C. §§ 77p(c), 78bb(f)(2). The removing party must establish that the action is “(1) a ‘covered class action,’ (2) that is based on state law, (3) alleging a misrepresentation or omission of a material fact or use of any manipulative or deceptive device or contrivance, (4) ‘in connection with’ [or ‘involving,’ for removal purposes], (5) the purchase or sale of a covered security.” *Prager*, 124 F. Supp. 2d at 231-32 (collecting cases regarding the standards).⁴⁰ Per the Supreme Court, a district court order remanding a case to state court on the ground that it was improperly removed under SLUSA is not appealable, and the removing party is therefore left to ask the

Mgmt., Inc., 758 F.3d 98, 108 (1st Cir. 2014) (“When courts are confronted with plaintiffs who allege that a misrepresentation has induced them to purchase uncovered securities, the SLUSA precludes the claim only if the circumstances of the purchase evince an intent to take an ownership interest in covered securities.”); *In re Herald*, 753 F.3d 110, 113 (2d Cir. 2014) (denying petition for panel rehearing and distinguishing *Troice* where investors in offshore funds secretly linked to Madoff Securities were “fraudulently induced” to make “at-tempted investments” in covered securities, “albeit through feeder funds”).

⁴⁰ Once a case has been removed to federal court, courts are divided on whether plaintiffs may file an amended complaint to exclude the federally preempted claim and obtain a remand to state court. The Ninth Circuit allows such amendment because of “the inequity of dismissing otherwise valid and viable state law claims on the ground that plaintiff pled—perhaps inadvertently—a cause of action that may be construed as federal in nature.” *U.S. Mortg., Inc. v. Saxton*, 494 F.3d 833, 843 (9th Cir. 2007), *abrogated on other grounds by Proctor v. Vishay Intertechnology Inc.*, 584 F.3d 1208 (9th Cir. 2009). The Seventh Circuit, on the other hand, has rejected such repleading to exclude preempted claims because to do so would be “a case not just of the plaintiff’s abandoning his federal claims but of his seeking to prevent the defendant from defending in the court that obtained jurisdiction of the case on his initiative. That is called pulling the rug out from under your adversary’s feet.” *Brown v. Calamos*, 664 F.3d 123, 131 (7th Cir. 2011).

state court to determine SLUSA’s applicability. *See Kircher v. Putnam Funds Tr.*, 547 U.S. 633, 640-42, 645-47 (2006).

Until recently, although it seemed clear that Congress had intended to do so, it was unsettled whether SLUSA had in fact modified the statutory grant of concurrent jurisdiction in the Securities Act (and the related anti-removal provision) to prohibit the prosecution in state court of class actions asserting only claims under that Act.⁴¹ The Supreme Court unanimously resolved this question in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061, 1069 (2018), and held that SLUSA “does nothing to deprive state courts of their jurisdiction to decide class actions brought under the 1933 Act.” In so holding, the Court rejected the defendants’ “various appeals to SLUSA’s purposes and legislative history,” reasoning that they “fail[ed] to overcome the clear statutory language.” *Id.*

The *Cyan* Court also addressed the argument, made by the United States as *amicus curiae*, that SLUSA had authorized the removal from state to federal court of class actions asserting only Securities Act claims. *See id.* at 1075-78. The Court held that it had not, and characterized the government’s position as an attempt to “distort[] SLUSA’s text because it thinks Congress simply must have wanted 1933 Act class actions to be litigated in federal court.” *Id.* at 1078. “SLUSA did quite a bit to ‘make good on the promise of the [PSLRA],” the Court concluded, and “[i]f further steps are needed, they are up to Congress.” *Id.* (citation omitted).

In the wake of *Cyan*, an increasing number of companies have included provisions in their corporate charters (or bylaws) that designate federal courts as the exclusive forum for claims asserted under the Securities Act. For example, in *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), the Delaware Supreme Court reversed a Chancery Court decision and held that such federal-forum provisions are facially valid under Delaware law. But this does not mean that such provisions should or will always be enforced. Rather, as the *Sciabacucchi* Court recognized, “[t]he ques-

⁴¹ Compare *Luther v. Countrywide Fin. Corp.*, 125 Cal. Rptr. 3d 716, 721 (Cal. Ct. App. 2011) (concluding that “concurrent jurisdiction” in state court over class actions alleging violations of the Securities Act “survived the amendments” in SLUSA), and *Elec. Workers Local #357 Pension & Health & Welfare Trs. v. Clovis Oncology, Inc.*, 185 F. Supp. 3d 1172, 1177-78 (N.D. Cal. 2016) (“[U]nder the plain language” of SLUSA, “only covered class actions asserting state law claims are removable (so as to allow the federal court to dismiss under the preclusion provision state law class action claims).”), with *Knox v. Agria Corp.*, 613 F. Supp. 2d 419, 425 (S.D.N.Y. 2009) (holding that, post-SLUSA, “covered class actions raising 1933 Act claims” were “exclusively for federal courts”), *abrogated by Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018).

tion of enforceability is a separate, subsequent analysis” that will need to be considered on a case-by-case basis, including by the courts of “sister states.” *Id.* at 133-34.⁴²

Two federal appellate court decisions recently addressed a somewhat related issue—namely, whether a forum selection clause in a corporation’s bylaws that purports to require stockholder derivative actions to be filed in state court is unenforceable to the extent that the underlying cause of action arises under the Exchange Act and is therefore within the exclusive jurisdiction of the federal courts.

A divided panel of the Seventh Circuit answered this question in the negative in *Seafarers Pension Plan ex rel. Boeing Co. v. Bradway*, 23 F.4th 714, 720 (7th Cir. 2022), reasoning that applying such a bylaw in these circumstances would be “checkmate for defendants,” because it would force the would-be derivative plaintiff to “raise its claims in a Delaware state court, which is not authorized to exercise jurisdiction over Exchange Act claims.” The court deemed this result “difficult to reconcile with Section 29(a) of the Exchange Act,” *id.*, which invalidates “[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision” of the Act, 15 U.S.C. § 78cc(a). But the *Seafarers* court ultimately rested its holding on Section 115 of the Delaware General Corporation Law (“DGCL”), which, the majority concluded, “does not authorize use of a forum selection bylaw to avoid what should be exclusive federal jurisdiction over a case.” 23 F.4th at 721.

A divided Ninth Circuit, sitting *en banc*, reached the opposite conclusion in *Lee v. Fisher*, 70 F.4th 1129 (9th Cir. 2023). For starters, the *Lee* majority held that applying the bylaw in these circumstances would not run afoul of § 29(a), because the

⁴² As one example, in *In re Uber Technologies, Inc. Securities Litigation*, a state court in California held that Uber’s federal-forum provision (or FFP) was enforceable and granted dismissal of a complaint asserting Securities Act claims based on the provision. The court reasoned that the FFP was “contained in [Uber’s] charter, which was approved by a majority of its shareholders,” and that the shareholder-plaintiffs offered “no evidence to show that the FFP was unexpected or unreasonable.” Order Granting Defendants’ Motion to Dismiss at 11, *In re Uber Techs., Inc. Sec. Litig.*, No. CGC-19-579544 (Cal. Super. Ct. Nov. 16, 2020). In these circumstances, the shareholder-plaintiffs “were on notice, and presumptively agreed to the terms of Uber’s Charter by purchasing the securities.” *Id.* In addition, the court found that Uber’s FFP was not unconscionable because it did “not eliminate the substantive protections provided by the Securities Act” as the claims could still be brought in federal court. *Id.* at 14. Notably also, the court held that Uber’s underwriters were likewise entitled to dismissal based on the FFP, even though they were not parties to Uber’s charter. *See id.* Other California state courts have also upheld FFPs as valid and enforceable. *See* Order Granting Defendants’ Motion to Dismiss at 4-15, *In re Dropbox, Inc. Sec. Litig.*, No. 19-CIV-05089 (Cal. Super. Ct. Dec. 4, 2020); Case Management Order and Order re: Motions to Dismiss at 27-44, *Wong v. Restoration Robotics, Inc.*, No. 18CIV02609 (Cal. Super. Ct. Sept. 1, 2020). However, the court in *Restoration Robotics* declined to extend its holding to the underwriter defendants, reasoning that as non-parties to the corporation’s charter, the underwriters could not enforce the charter’s federal-forum provision. Case Management Order at 2, *Wong* (No. 18CIV02609).

plaintiff could still “enforce [the corporation]’s compliance with the substantive obligations of [the Exchange Act] by bringing a direct action in federal court.” *Id.* at 1139; *see also id.* at 1141 (“§ 29(a) forbids only the ‘waiver of the substantive obligations imposed by the Exchange Act,’ not the waiver of a particular procedure for enforcing such duties”).⁴³ And the *Lee* court found no problem under the DGCL either, because, in the majority’s view, “Section 115’s reference to ‘internal corporate claims’ does not include federal claims.” *Id.* at 1157.

H. Other Statutes Affecting Securities Law Liabilities

On December 22, 1995, the PSLRA became law after the Senate overrode President Clinton’s veto. Pub. L. No. 104-67, 109 Stat. 737 (1995). As courts have recognized, “[t]he PSLRA was designed to curtail in numerous ways abuses in claims brought under the anti-falsity provisions of the 1933 and 1934 Acts.” *In re Kingate Mgmt. Ltd. Litig.*, 784 F.3d 128, 138 (2d Cir. 2015). Among other things, the PSLRA introduced “limitations on recoverable damages and attorneys’ fees, sanctions for frivolous litigation, stays of discovery pending resolution of motions to dismiss, numerous restrictions affecting the conduct of class actions, and onerous pleading requirements.” *Id.* Where relevant, this outline discusses changes and additions that the PSLRA made to the liability provisions of the Securities Act and the Exchange Act.

“Rather than face the obstacles set in their path by the [PSLRA], plaintiffs and their representatives began bringing class actions under state law, often in state court.” *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 82 (2006). As discussed above (at p. 17), Congress acted quickly to address this trend, which had “prevented [the PSLRA] from fully achieving its objectives,” Pub. L. No. 105-353, 112 Stat. 3227 (1998), by enacting SLUSA.

On July 30, 2002, in the wake of serious accounting abuses at several large public companies, Congress enacted the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), which represented one of the most significant revisions to United States securities laws since the New Deal. Pub. L. No. 107-204, 116 Stat. 745 (2002). Sarbanes-Oxley covers a variety of areas and seeks, among other things, to enhance public disclosure, improve the quality and transparency of financial reporting and auditing, and strengthen penalties for securities law violations. Sarbanes-Oxley provides

⁴³ The clear import of the majority’s holding is that a stockholder (at least one of a Delaware corporation) simply cannot bring a derivative disclosure-based claim under § 14(a) of the Exchange Act. *See Lee v. Fisher*, 70 F.4th 1129, 1147 (9th Cir. 2023) (“[T]he Delaware Supreme Court has concluded that an action asserting that a ‘duty of disclosure violation impaired the stockholders’ right to cast an informed vote’ is a direct action,” and therefore “the injury caused by a violation of § 14(a) gives rise to a direct action under Delaware law, not a derivative action.”).

that any violation of its provisions is considered a violation of the Exchange Act, thus availing the SEC of its full range of powers, remedies, and penalties under the Exchange Act. For example, § 304 of Sarbanes-Oxley requires a CEO or CFO to pay back certain compensation when the company's misconduct requires it to restate its financial statements due to its material noncompliance with any financial requirement under the securities laws. *See SEC v. Jenkins*, 718 F. Supp. 2d 1070 (D. Ariz. 2010) (holding that § 304's reimbursement obligation does not require that a CEO or CFO engaged in specific misconduct or was even aware of financial misconduct). Sarbanes-Oxley also expands Exchange Act remedies by providing that, in civil enforcement actions brought by the SEC, courts may grant any equitable relief that is appropriate for the protection of investors, which suggests broader court oversight of (and monetary remedies against) violators of the securities laws than was the case before Sarbanes-Oxley was enacted. *See* 15 U.S.C. § 78u(d)(5); *see also Liu v. SEC*, 140 S. Ct. 1936, 1940 (2020) (holding that "a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief permissible under § 78u(d)(5)").

With limited exceptions that are beyond the scope of this outline, Sarbanes-Oxley does not expressly create new private rights of action for violations of its provisions. *See Beckett v. Brinx Res., Ltd.*, 2014 WL 1394160, at *4-5 (D. Nev. Mar. 24, 2014) (discussing the limited nature of private rights of action created under Sarbanes-Oxley). However, Sarbanes-Oxley affects existing private rights of action under the Exchange Act by (a) lengthening the general statute of limitations applicable to private securities fraud actions (*see* p. 63, *infra*); and (b) expanding reporting and disclosure requirements, which could potentially expand the range of actions that could be alleged to give rise to private suits under § 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

On July 21, 2010, in response to the financial crisis of 2008 and 2009, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), Pub. L. No. 111-203, 124 Stat. 1376 (2010). While Dodd-Frank primarily addresses financial regulations and corporate governance issues, it also contains provisions that affect securities law liability, such as provisions that increase the exposure of credit ratings agencies under the securities laws and ones that establish new incentives and protections for whistleblowers. With respect to the specific provisions of the federal securities laws covered by this outline, Dodd-Frank amended § 20(e) of the Exchange Act to augment the SEC's authority to pursue civil enforcement actions alleging aiding and abetting of Exchange Act violations by modifying the requisite state of mind to encompass "reckless," in addition to "knowing," acts, and adding § 15(b) to the Securities Act to empower the SEC to pursue actions premised on knowingly or recklessly aiding or abetting violations of that Act. Dodd-Frank §§ 929M, 929N, 929O.

I. Extraterritorial Application of the Federal Securities Laws

In 2010, the Supreme Court overruled longstanding lower court jurisprudence and held that § 10(b) of the Exchange Act does not apply to securities transactions that take place outside the United States. *Morrison v. Nat'l Austl. Bank, Ltd.*, 561 U.S. 247, 265 (2010). The decision has been interpreted to apply to the liability provisions of the Securities Act as well.⁴⁴

Before *Morrison*, the Second Circuit had long held that “because the Exchange Act is silent as to the extraterritorial application of § 10(b), it was left to the court to ‘discern’ whether Congress would have wanted the statute to apply.” *Id.* at 255 (quoting *Morrison v. Nat'l Austl. Bank, Ltd.*, 547 F.3d 167, 170 (2d Cir. 2008)). The Second Circuit previously concluded that “neither the usual presumption against extraterritorial application nor the specific language of [the Exchange Act] show Congressional intent to preclude” extraterritorial application of the Act. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir. 1968), *rev'd on other grounds on reh'g*, 405 F.2d 215 (1968) (en banc). Following this reasoning, for over four decades, the courts of appeals applied a judicially created “conduct” and “effects” tests to determine whether sufficient domestic conduct or effects existed in a given case so as to warrant the application of the federal securities laws abroad.⁴⁵

In *Morrison*, Australian plaintiffs sued an Australian bank under § 10(b) of the Exchange Act for losses they allegedly suffered on purchases of the bank’s stock on Australian exchanges; they argued that the “conduct” test had been met because the alleged misstatements originated from a Florida subsidiary of the Australian bank. 561 U.S. at 250-53, 266. In dismissing the Australian plaintiffs’ claims, the Supreme Court categorically rejected the conduct and effects tests, and instead applied the presumption against extraterritoriality, “a ‘longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.’” *Id.* at 255-61 (quoting *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (internal quotation marks omitted)). The Court found “no affirmative indication in the Exchange Act that

⁴⁴ See, e.g., *In re Vivendi Universal, S.A., Sec. Litig.*, 842 F. Supp. 2d 522, 529 (S.D.N.Y. 2012) (applying *Morrison* to §§ 11, 12(a)(2) and 15 of the Securities Act); *SEC v. Goldman Sachs & Co.*, 790 F. Supp. 2d 147, 164 (S.D.N.Y. 2011) (applying *Morrison* to § 17(a) of that Act).

⁴⁵ See, e.g., *SEC v. Kasser*, 548 F.2d 109, 112-15 (3d Cir. 1977); *Cont'l Grain Pty., Ltd. v. Pac. Oilseeds, Inc.*, 592 F.2d 409, 421-22 (8th Cir. 1979); *Grunenthal GmbH v. Hotz*, 712 F.2d 421, 424-25 (9th Cir. 1983); *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041, 1045 (2d Cir. 1983); *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 667 (7th Cir. 1998); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 32 (D.C. Cir. 1987); *Robinson v. TCI US W. Commc'ns Inc.*, 117 F.3d 900, 906-07 (5th Cir. 1997).

§ 10(b) applies extraterritorially, and . . . therefore conclude[d] that it does not.” *Id.* at 265. Harshly noting the “difficulty of applying,” and the “unpredictable and inconsistent” results produced by, the “vague formulations” that had developed under the conduct and effects tests, Justice Scalia’s opinion for the Court observed that the “results of [the] judicial-speculation-made-law” by the lower courts—“divining what Congress would have wanted if it had thought of the situation before the court—demonstrate[d] the wisdom of the presumption against extraterritoriality.” *Id.* at 258-61.⁴⁶

In lieu of the conduct and effects tests, the Court adopted a new “transactional test,” *id.* at 269-70, that it believed was, unlike the conduct and effects tests, grounded in the text of § 10(b) and consistent with the presumption against extraterritoriality. “Section 10(b),” the Court held, “reaches the use of a manipulative or deceptive device or contrivance only in connection with the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States.” *Id.* at 273. In reaching this holding, the Court looked to the “focus” of the statute’s text and concluded that “the focus of the Exchange Act is not upon the place where the deception originated, but upon purchases or sales of securities in the United States.” *Id.* at 266.

Since *Morrison*, plaintiffs have advanced two arguments in support of allowing at least some foreign-transaction claims to proceed under § 10(b). Neither argument, however, has been accepted by the federal courts.

First, some plaintiffs have contended that a purchase or sale of a security on a foreign exchange takes place “in the United States” under *Morrison* if the purchase or sale order is made from the United States. District courts have consistently rejected this argument as “amount[ing] to nothing more than reinstatement of the conduct test” that was rejected by the Supreme Court.⁴⁷

⁴⁶ Again disagreeing with the Second Circuit, the Supreme Court held that the “extraterritorial reach of § 10(b)” raises “a merits question,” rather than a question “of subject-matter jurisdiction.” *Morrison v. Nat’l Austl. Bank, Ltd.*, 561 U.S. 247, 253-54 (2010).

⁴⁷ See, e.g., *Cornwell v. Credit Suisse Grp.*, 729 F. Supp. 2d 620, 624 (S.D.N.Y. 2010); *In re Satyam Computer Servs. Ltd. Sec. Litig.*, 915 F. Supp. 2d 450, 473-74 (S.D.N.Y. 2013); *Pope Invs. II, LLC v. Deheng Law Firm*, 2012 WL 3526621, at *6-8 (S.D.N.Y. Aug. 15, 2012); *In re UBS Sec. Litig.*, 2011 WL 4059356, at *7-8 (S.D.N.Y. Sept. 13, 2011), *aff’d sub nom. City of Pontiac Policemen’s & Firemen’s Ret. Sys. v. UBS AG.*, 752 F.3d 173 (2d Cir. 2014); *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 532-33 (S.D.N.Y. 2011), *aff’d*, 838 F.3d 223 (2d Cir. 2016); *In re Royal Bank of Scot. Grp. PLC Sec. Litig.*, 765 F. Supp. 2d 327, 336-37 (S.D.N.Y. 2011); *Plumbers’ Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*, 753 F. Supp. 2d 166, 177-78 (S.D.N.Y. 2010); *In re Société Générale Sec. Litig.*, 2010 WL 3910286, at *5-6 (S.D.N.Y. Sept. 29, 2010); *In re Alstom SA Sec. Litig.*, 741 F. Supp. 2d 469, 472 (S.D.N.Y. 2010).

Second, some plaintiffs have made an even more expansive argument that is based upon *Morrison*'s reference to transactions in securities that are "listed" on U.S. exchanges. These plaintiffs argued that whenever the home-country security of a foreign issuer was "listed" domestically (as must often be done, for example, to issue and list American Depositary Receipts ("ADRs")), trades in that security anywhere in the world would be subject to § 10(b). According to this argument, if a foreign company sponsored even a small issue of ADRs, or if it dual-listed its home-country shares on an American exchange, global class actions covering all foreign transactions in those shares would be fair game. The theory ignores the facts of *Morrison* itself, as the Australian bank defendant in that case had ADRs listed on the NYSE. 561 U.S. at 251. Not surprisingly, therefore, it has been consistently rejected as "simply contrary to the spirit of *Morrison*," *In re Royal Bank of Scot. Grp. PLC Sec. Litig.*, 765 F. Supp. 2d 327, 336 (S.D.N.Y. 2011), and as "a selective and overly-technical reading of *Morrison* that ignores the larger point of the decision," which "read in total context compel[s] the opposite result," *In re Alstom SA Sec. Litig.*, 741 F. Supp. 2d 469, 472 (S.D.N.Y. 2010).⁴⁸ The Second Circuit has voiced its agreement with these district courts and squarely rejected the so-called "listing theory," holding that "*Morrison* precludes claims brought . . . by purchasers of shares of a foreign issuer on a foreign exchange, even if those shares were cross-listed on a United States exchange." *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 176 (2d Cir. 2014).⁴⁹

In applying *Morrison*'s transactional analysis, the focus is on "where" the purchase or sale actually occurs. Transactions on an exchange presumably take place where the exchange is located, but that leaves open the question of how to determine where "the purchase or sale of any other security," *Morrison*, 561 U.S. at 273, transpires. That question arose in *Absolute Activist Value Master Fund Ltd. v. Ficeto*, 677 F.3d 60 (2d Cir. 2012), where the Second Circuit considered "under what circumstances the purchase or sale of a security that is not listed on a domestic exchange should be considered 'domestic' within the meaning of *Morrison*." *Id.* at 66-67. The court came up with a two-pronged test to answer this question. First, because "the point at which the parties become irrevocably bound is used to determine the timing of a purchase and sale," the court held "that the point of irrevocable

⁴⁸ See also, e.g., *In re BP p.l.c. Sec. Litig.*, 843 F. Supp. 2d 712, 794-95 (S.D. Tex. 2012); *In re UBS*, 2011 WL 4059356, at *5-7; *In re Infineon Techs. AG Sec. Litig.*, 2011 WL 7121006, at *3 (N.D. Cal. Mar. 17, 2011); *In re Vivendi*, 765 F. Supp. 2d at 527-31.

⁴⁹ *Accord Liu v. Siemens AG*, 763 F.3d 175, 180 (2d Cir. 2014) ("*Morrison* establishes that where a plaintiff can point only to the fact that a defendant has listed securities on a U.S. exchange, and the complaint alleges no further meaningful relationship between the harm and those domestically listed securities, the listing of securities alone is the sort of 'fleeting' connection that 'cannot overcome the presumption against extraterritoriality.'" (quoting *Morrison*, 561 U.S. at 263)).

liability can be used to determine the locus of a securities purchase or sale.” *Id.* at 68. Second, because “a ‘sale’ is ordinarily defined as ‘[t]he transfer of property or title for a price,’” the court concluded that “a sale of securities can be understood to take place at the location in which title is transferred.” *Id.* (citation omitted). Thus, “to sufficiently allege a domestic securities transaction in securities not listed on a domestic exchange, . . . a plaintiff must allege facts suggesting that [1] irrevocable liability was incurred or [2] title was transferred within the United States.” *Id.*⁵⁰ Among the factors that could be used to determine where the transaction took place, the court added, would be “facts concerning the formation of the contracts, the placement of purchase orders, the passage of title, or the exchange of money.” *Id.* at 70.⁵¹

The Second Circuit was subsequently confronted with the question whether § 10(b)’s extraterritorial reach extends to domestic “securities-based swap agreements” that are valued “based on the price movements of foreign securities.” *Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE*, 763 F.3d 198, 201-02 (2d Cir. 2014). In holding that § 10(b) does not reach such transactions—at least where the claim is based on “largely foreign conduct” and the “foreign defendants [had] no alleged involvement in plaintiffs’ transactions,” *id.* at 201—the court reasoned that while “a domestic transaction or listing is *necessary* to state a claim under § 10(b),” such a finding does “not *suffice*” to state a claim under § 10(b). *Id.* at 216. A contrary result, the Second Circuit observed, “would permit the plaintiffs, by virtue of an agreement independent from the referenced securities, to hale [foreign]

⁵⁰ *Accord, e.g., United States v. Georgiou*, 777 F.3d 125, 135 (3d Cir. 2015) (affirming a criminal conviction under § 10(b) where “foreign entities purchased and sold securities” in over-the-counter markets and “[s]everal of these purchases were executed by market makers operating within the United States”); *Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada*, 645 F.3d 1307, 1310-11 (11th Cir. 2011) (finding that an allegation that “transfer of title to . . . shares in the United States” establishes that a transaction lies within § 10(b)’s “territorial reach” on a motion to dismiss); *SEC v. Levine*, 462 F. App’x 717, 719 (9th Cir. 2011) (“[T]he Securities Act governs the Levines’ sales because the actual sales closed in Nevada when Marie Levine received completed stock purchase agreements and payments.”). *See also In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 265 (2d Cir. 2016) (finding that “the location of the Americans who acquired ordinary shares as a result of the merger” between three foreign companies “is not relevant to the question of whether the merger qualifies as a ‘domestic purchase or sale’” under *Morrison*).

⁵¹ The Second Circuit subsequently held in *City of Pontiac Policemen’s & Firemen’s Retirement System v. UBS AG*, 752 F.3d 173, 181 & n.33 (2d Cir. 2014), that “the mere placement of a buy order in the United States for the purchase of foreign securities on a foreign exchange,” “without more,” is insufficient to “allege that a purchaser incurred irrevocable liability in the United States.” *Cf. Butler v. United States*, 992 F. Supp. 2d 165, 178 (E.D.N.Y. 2014) (holding that, where foreign clients communicated investment decisions to an agent in the United States who acted on their behalf, transactions were domestic, even though foreign clients executed the contracts abroad). And in a more recent decision, the Second Circuit made clear that “using U.S. dollars and New York bank accounts” to purchase bonds issued by a foreign company is not “enough to establish a domestic transaction under *Morrison*.” *Banco Safra S.A.-Cayman Is. Branch v. Samarco Mineracao S.A.*, 849 F. App’x 289, 294-95 (2d. Cir. 2021).

participants in the market for [foreign] stocks into U.S. courts and subject them to U.S. securities laws,” even though the “relevant actions” alleged in the complaint were “predominantly [foreign].” *Id.*⁵²

The First and Ninth Circuits have rejected this necessary-but-not-sufficient approach, reasoning that it “turns *Morrison* and Section 10(b) on their heads” by “rel[ying] heavily on the foreign location of the allegedly deceptive conduct, which *Morrison* held to be irrelevant to the Exchange Act’s applicability.” *Stoyas v. Toshiba Corp.*, 896 F.3d 933, 949-50 (9th Cir. 2018) (citation omitted); *accord SEC v. Morrone*, 997 F.3d 52, 60 (1st Cir. 2021) (“The existence of a domestic transaction suffices to apply the federal securities laws under *Morrison*. No further inquiry is required.”). According to the Ninth Circuit, if a plaintiff-purchaser of ADRs could plead sufficient facts to establish that it had “incurred the liability to take and pay for” the ADRs in the United States, then it could theoretically state a claim under Section 10(b) and Rule 10b–5. *Id.* at 949, 952. But in remanding the case, the Ninth Circuit stressed that such a plaintiff would still need to establish the other elements of its claim to proceed, including the requisite connection between the fraud and its purchase. *Id.* at 951 (noting that the fraud “must ‘touch’ the sale—*i.e.*, it must be done to induce the purchase at issue” (citations omitted)). To do so, a plaintiff must plead sufficient “details about [the] ADRs” to “connect” the issuer to the securities transactions at issue, such as whether the issuer was “involved in the establishment of the ADRs” or took other “actions . . . to support” them. *Id.* at 951-52 & n.24.⁵³ This discussion suggests that notwithstanding its rejection of the Second Circuit’s reasoning in *Parkcentral*, the Ninth Circuit may not be prepared to open the door wide to securities fraud claims brought by U.S. purchasers of un-sponsored ADRs against foreign defendants.

Dodd-Frank was apparently intended to partly overrule *Morrison* by restoring a version of the conduct and effects tests in cases brought by the United States and

⁵² The Second Circuit reaffirmed this interpretation of *Morrison* in *Cavello Bay Reinsurance Ltd. v. Stein*, 986 F.3d 161, 165-67 (2d Cir. 2021) (“[E]ven if a transaction occurs in the United States, the features and incidents of the transaction may nevertheless be so foreign that it is not regulated by § 10(b).”).

⁵³ Following remand, the district court initially held that the plaintiffs had, in their amended complaint, “sufficiently alleged Toshiba’s plausible participation in the establishment of the [un-sponsored] ADR program” at issue. *Stoyas v. Toshiba Corp.*, 424 F. Supp. 3d 821, 828 (C.D. Cal. Jan. 28, 2020). However, when the district court revisited the issue in the context of the plaintiffs’ motion to certify a class of ADR purchasers, it held that the proposed lead plaintiff could not establish that it had “purchased the ADRs in a domestic transaction,” and accordingly denied the motion, because the evidence showed that the “triggering event” that caused that plaintiff to “incur irrevocable liability occurred in Japan when [the broker] acquired shares of Toshiba common stock on the Tokyo Stock Exchange.” *Stoyas v. Toshiba Corp.*, 2022 WL 220920, at *4-5 (C.D. Cal. Jan. 25, 2022). In so holding, the district court observed that the plaintiffs had “not identified a single case where the purchase or sale of *un-sponsored* ADRs constituted or qualified as a domestic transaction.” *Id.* at *5 n.9.

the SEC.⁵⁴ But whether it successfully did so is an open question. See *Parkcentral Global*, 763 F.3d at 211 n.11 (noting that “[t]he import of this amendment is unclear”). Section 929P(b) of Dodd-Frank confers upon the federal courts “jurisdiction” to hear cases brought by the United States or the SEC that involve extraterritorial elements, but as noted, *Morrison* addressed the substantive reach of § 10(b) and did not purport to limit the federal courts’ subject-matter jurisdiction. See n.46, *supra*. As a result, because Section 929P(b) does not amend any substantive provision of the securities laws, commentators predicted that courts might be “forced to find that Section 929P was ‘stillborn’ in that it conferred jurisdiction that could not be used for anything substantive . . . until a further statute were enacted.” Richard W. Painter, *The Dodd-Frank Extraterritorial Jurisdiction Provision: Was It Effective, Needed or Sufficient?*, 1 HARV. BUS. L. REV. 195, 208 (2011).⁵⁵

The first court to squarely address the issue did not so find, however, and instead held that even though “the plain language of Section 929P(b) did not explicitly overturn the core holding of *Morrison*,” because it “addresses only the jurisdiction of the courts,” “the legal context in which th[e] amendment was drafted, [the] legislative history, and the expressed purpose of the amendment all point to a congressional intent that, in actions brought by the SEC, Sections 10(b) and 17(a) should be applied to extraterritorial transactions to the extent that the conduct and effects test can be satisfied.” *SEC v. Traffic Monsoon, LLC*, 245 F. Supp. 3d 1275, 1288-94 (D. Utah 2017).⁵⁶ The Tenth Circuit recently affirmed this decision, reasoning that while Congress had situated the “Dodd-Frank amendments in the jurisdictional provisions of the securities acts,” it was clear from the “context and historical background surrounding [the] enactment of those amendments” and “the title Congress gave this section of the Dodd-Frank Act, ‘STRENGTHENING ENFORCEMENT BY THE COMMISSION,’” that “Congress undoubtedly intended that the substantive antifraud provisions should apply extraterritorially when the statutory conduct-and-effects test is satisfied.” *SEC v. Scoville*, 913 F.3d 1204, 1218 (10th Cir. 2019).

⁵⁴ See 156 CONG. REC. 12,432 (2010) (statement of Rep. Kanjorski) (stating that the purpose of § 929P(b) “is to make clear” that in actions or proceedings brought by SEC or Department of Justice, federal securities laws “may have extraterritorial application . . . irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States”).

⁵⁵ See also Genevieve Beyea, *Morrison v. National Australia Bank and the Future of Extraterritorial Application of the U.S. Securities Laws*, 72 OHIO ST. L.J. 537, 570-71 (2011) (noting that “the language of the Act as drafted does not actually” “preserve the conduct and effects tests,” and “may not have any effect on the application of Section 10(b), depending on the willingness of courts to overlook the plain language of the statute”).

⁵⁶ Other courts have expressed the view, in dicta, that Dodd-Frank “effectively reversed *Morrison* in the context of SEC enforcement actions.” E.g., *SEC v. Toure*, 2013 WL 2407172, at *1 n.4 (S.D.N.Y. June 4, 2013); see also *SEC v. Chi. Convention Ctr., LLC*, 961 F. Supp. 2d 905, 910 n.1 (N.D. Ill. 2013) (noting that “some courts have, in dicta, assumed, without analysis, that Section 929P(b) superseded *Morrison*” and collecting cases).

Courts continue to expand the reach of *Morrison*. For example, though *Morrison* dealt with civil liability, the Second Circuit has held that *Morrison*'s holding "applies equally" to criminal prosecutions under § 10(b) and Rule 10b-5, such that criminal liability under § 10(b) and Rule 10b-5 does not extend to conduct "in connection with an extraterritorial purchase or sale of securities." *United States v. Vilar*, 729 F.3d 62, 67, 70 (2d Cir. 2013).⁵⁷ Under *Vilar*, "a defendant may be convicted of securities fraud under Section 10(b) and Rule 10b-5 only if he has engaged in fraud in connection with (1) a security listed on an American exchange, or (2) a security purchased or sold in the United States." 729 F.3d at 98.⁵⁸ The significance of *Vilar*, however, would be cabined significantly if courts ultimately conclude that Congress succeeded in overruling *Morrison* with § 929P(b) of Dodd-Frank with respect to actions brought by the SEC or the United States.

⁵⁷ See also *Georgiou*, 777 F.3d at 133-37 (applying *Morrison* and affirming criminal conviction under § 10(b); citing *Vilar*); *United States v. Isaacson*, 752 F.3d 1291, 1299 (11th Cir. 2014) (assuming but not deciding that *Morrison* applies equally to criminal violations of the Exchange Act).

⁵⁸ The Second Circuit has also rejected the extraterritorial application of the "whistleblower antiretaliation" provision of Dodd-Frank. See *Liu v. Siemens AG*, 763 F.3d 175, 183 (2d Cir. 2014).

II

Liabilities Under the Exchange Act

A. Section 10(b)

Section 10(b) of the Exchange Act prohibits the use of any “manipulative or deceptive device or contrivance” in contravention of rules prescribed by the SEC “in connection with the purchase or sale” of any security or security-based swap agreement.⁵⁹ The provision is not self-effecting; § 10(b) by its terms requires the SEC to prescribe rules to implement it.

Currently, there are eleven SEC-promulgated rules in force under § 10(b), the most important of which is the general antifraud rule, Rule 10b–5. Rule 10b–5 prohibits use of any means of interstate commerce to (a) “employ any device, scheme, or artifice to defraud,” (b) make material misstatements or omissions, or (c) “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.”⁶⁰ In general, to prevail on a Rule 10b–5 claim, a plaintiff must prove that the defendant (1) made a false statement or an omission of material fact, (2) with scienter, (3) in connection with the purchase or sale of a security, (4) upon which the plaintiff justifiably relied, and (5) which proximately caused (6) the plaintiff’s economic loss.⁶¹

Rule 10b–5 under § 10(b) is by far the most important civil liability provision of the securities laws. From its issuance in 1942, liability under Rule 10b–5 was continually expanded by lower courts, especially in the Second Circuit. Although since the late 1960s the Supreme Court has placed a number of important limitations on actions under Rule 10b–5, § 10(b) and Rule 10b–5 continue to dwarf in importance other liability provisions under the securities laws.

⁵⁹ 15 U.S.C. § 78j(b).

⁶⁰ 17 C.F.R. § 240.10b–5.

⁶¹ See, e.g., *Dura Pharm. Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005); *San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Cos., Inc.*, 75 F.3d 801, 808 (2d Cir. 1996); *Bruschi v. Brown*, 876 F.2d 1526, 1528 (11th Cir. 1989); see also *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 207-08 (2d Cir. 2000) (finding that the false statement or omission must be “made in connection with the purchase or sale of securities . . . which [was] furthered through the defendant’s use of the mails or a national securities exchange”).

1. Private Right of Action Under Rule 10b-5

Essential to its importance has been the early and continued recognition of a private right of action under Rule 10b-5. Rule 10b-5 can be enforced by the SEC in injunctive and civil penalty actions, brought pursuant to § 21(d) of the Exchange Act,⁶² and by the Justice Department in actions pursuant to § 32(a) of the Exchange Act,⁶³ which imposes criminal liability for willful violations of the Exchange Act. Over the years, courts in every circuit also implied a private right of action under Rule 10b-5, notwithstanding that the Exchange Act is silent as to whether private parties could sue for violations of § 10 and its rules, in contrast to, for example, § 18 of the Exchange Act, which expressly states that they can.⁶⁴

For some time, the Supreme Court did not directly address whether there is a private right of action under Rule 10b-5, while handing down rulings on other issues in a number of private Rule 10b-5 lawsuits. In 1983, the Supreme Court, acceding to the extensive case law that had developed over the years with respect to private actions brought pursuant to Rule 10b-5, finally expressly recognized a private right of action under Rule 10b-5.⁶⁵ By contrast, § 17(a) of the Securities Act—which the SEC closely copied in writing Rule 10b-5—did not have a similar early and extensive history of supporting private actions, and while the Supreme Court has never addressed the issue, the current consensus of the lower federal courts is that no private right of action exists under § 17(a).⁶⁶

⁶² 15 U.S.C. § 78u.

⁶³ 15 U.S.C. § 78ff.

⁶⁴ 15 U.S.C. § 78r.

⁶⁵ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 n.10 (1983) (discussing the evolution of the implied private right of action); see also *Sonnenfeld v. City & Cnty. of Denver*, 100 F.3d 744, 746-47 (10th Cir. 1996) (finding that municipalities fell within the scope of § 10(b) and thus an implied right of action existed against them).

⁶⁶ Nine courts of appeals have expressly held that there is no private right of action under § 17(a) of the Securities Act. See *Maldonado v. Dominguez*, 137 F.3d 1, 6-8 (1st Cir. 1998); *Finkel v. Stratton Corp.*, 962 F.2d 169, 174-75 (2d Cir. 1992); *Newcome v. Esrey*, 862 F.2d 1099, 1107 (4th Cir. 1988) (en banc) (overruling *Newman v. Prior*, 518 F.2d 97, 99 (4th Cir. 1975)); *Corwin v. Marney, Orton Invs.*, 788 F.2d 1063, 1066 (5th Cir. 1986); *Sears v. Likens*, 912 F.2d 889, 893 (7th Cir. 1990); *Crookham v. Crookham*, 914 F.2d 1027, 1028 (8th Cir. 1990) (imposing Rule 11 sanctions against counsel for signing a § 17(a) complaint); *Krause v. Perryman*, 827 F.2d 346, 349 (8th Cir. 1987); *Carol Gamble Trust 86 v. E-Rex, Inc.*, 84 F. App'x 975, 978 n.1 (9th Cir. 2004); *In re Wash. Pub. Power Supply Sys. Sec. Litig.*, 823 F.2d 1349, 1350-58 (9th Cir. 1987) (overruling *Mosher v. Kane*, 784 F.2d 1385, 1391 n.9 (9th Cir. 1986) and *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808, 815 (9th Cir. 1981)); *Bath v. Bushkin, Gaims, Gaines & Jonas*, 913 F.2d 817, 819-20 (10th Cir. 1990), overruled on other grounds by *Rotella v. Wood*, 528 U.S. 549 (2000); *Thompson v. RelationServe Media, Inc.*, 610 F.3d 628, 652 n.25 (11th Cir. 2010) (“[T]his circuit has expressly refused to read a private right of action into § 17.” (citation omitted)). The Sixth Circuit had held that “section 17(a) implies a private cause of action only for ‘purchasers,’” see *Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 492 (6th Cir. 1990) (citing

2. Standing

In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731-32, 755 (1975), the Supreme Court held that the phrase “in connection with the purchase or sale of any security” used in Rule 10b–5 requires the plaintiff in a private action for damages under the rule to have been a purchaser or seller of securities in the transaction complained of.⁶⁷ Thus, in *Blue Chip Stamps*, the Court ruled that offerees of an unconsummated offer to purchase could not sue the offeror under the rule. But, as the Court noted, §§ 3(a)(13) and (14) of the Exchange Act define “purchase” and “sale” to include contracts to purchase or sell, and therefore holders of puts, calls, options, and other contractual rights or duties to purchase or sell securities have standing to bring actions under Rule 10b–5.⁶⁸

Further, “forced sales” of securities through short-form mergers or liquidations have been held to give rise to § 10(b) standing,⁶⁹ although this doctrine is not without controversy.⁷⁰ Conversely, existing or potential new shareholders who decide

cases), but it affirmed a district court’s holding that no private right of action exists under § 17(a), thereby indicating a possible change in view, *see Burns v. Price Waterhouse*, 48 F.3d 1219 (6th Cir. 1995) (Table).

⁶⁷ There is no requirement that there have been any purchases or sales for SEC injunctive actions or criminal actions under Rule 10b–5. *Blue Chip Stamps*, 421 U.S. at 751 n.14; *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *overruled on other grounds by McNally v. United States*, 483 U.S. 350 (1987); *SEC v. Penn Cent. Co.*, 450 F. Supp. 908, 914 (E.D. Pa. 1978).

⁶⁸ *Blue Chip Stamps*, 421 U.S. at 750-51; *see also Griggs v. Pace Am. Grp., Inc.*, 170 F.3d 877, 880 (9th Cir. 1999) (plaintiff with a contingent right to receive stock following a merger has standing to bring a Rule 10b–5 action); *Fry v. UAL Corp.*, 84 F.3d 936, 939 (7th Cir. 1996) (options traders have standing to sue under Rule 10b–5); *Deutschman v. Beneficial Corp.*, 841 F.2d 502, 508 (3d Cir. 1988) (purchaser of option contract had standing to bring a Rule 10b–5 action); *Integral Dev. Corp. v. Tolat*, 2013 WL 5781581, at *2 (N.D. Cal. Oct. 25, 2013) (plaintiff had standing because its “right of first refusal” was sufficiently similar to a contract to purchase or to sell a security). *But see Fin. Sec. Assurance Inc. v. Stephens Inc.*, 500 F.3d 1276 (11th Cir. 2007) (holding that an insurer of municipal bonds that became owner of the bonds after default has no standing to pursue § 10(b) claims against the underwriter).

⁶⁹ *See, e.g., Jacobsen v. AEG Capital Corp.*, 50 F.3d 1493, 1498-99 (9th Cir. 1995) (“[A] fraudulent scheme resulting in an intra-firm freeze-out is actionable under Rule 10b–5 as a forced sale.”); *7547 Corp. v. Parker & Parsley Dev. Partners, L.P.*, 38 F.3d 211, 226 (5th Cir. 1994) (“The federal courts have created an exception to [the purchaser-seller] rule when a[n] investor’s interest in a company is fundamentally altered through a merger, acquisition, or liquidation.”); *Bold v. Simpson*, 802 F.2d 314, 320-21 (8th Cir. 1986) (addressing the “forced seller doctrine” but declining to apply it “[i]n light of the specific facts of this case”); *Vine v. Beneficial Fin. Co.*, 374 F.2d 627, 632-35 (2d Cir. 1967) (“[A]ppellant would never be in the position of a forced seller were it not for the fraud. In essence, because of the distinctive nature of the short form merger procedure, appellee by deceiving A can cause B to become a seller.”); *Matthey v. KDI Corp.*, 699 F. Supp. 135, 139 (S.D. Ohio 1988) (“The [forced sale] doctrine has been applied primarily in cases where the corporation in which the claimant holds securities has been liquidated or merged into another corporation.”).

⁷⁰ *See, e.g., Isquith v. Caremark Int’l Inc.*, 136 F.3d 531, 535-36 (7th Cir. 1998) (expressing “doubt that the doctrine retains any validity in any class of case, even in squeeze-out cases” in light of the Supreme Court’s decision in *Santa Fe Industries*, discussed at p. 39, *infra*); *Melnyk v. Consonus, Inc.*, 2005 WL 2263950, at *3 (D. Utah Sept. 12, 2005) (noting that the doctrine “has not been adopted by the Tenth Circuit” and that it is “of

not to buy or sell shares on the basis of misrepresentations or omissions, and “shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5,” do not have standing.⁷¹ Existing shareholders, however, can bring a derivative action on behalf of the harmed corporation, if the corporation itself was a purchaser or seller.⁷²

The Supreme Court revisited the parameters of the “in connection with” requirement in *Wharf (Holdings) Ltd. v. United Int’l Holdings, Inc.*, 532 U.S. 588, 594-97 (2001), and held that the sale of an option to buy stock while secretly intending never to honor the option satisfies the requirement under § 10(b) and Rule 10b-5. The Court ruled that the relevant security was the option, *not* the underlying stock in the defendant’s cable system, and rejected the defendant’s arguments that (1) § 10(b) does not cover oral contracts of sale, (2) the plaintiff did not have standing because the alleged misrepresentation did not “relate to the value of a security purchase or the consideration paid,” and (3) plaintiff’s claim was nothing but a breach of contract claim. *Id.*

The Supreme Court again considered the scope of the “in connection with” requirement in *SEC v. Zandford*, 535 U.S. 813 (2002), a case in which the defendant broker stole money from a discretionary account he managed by selling the client’s securities and transferring the proceeds to the broker’s own account. The defendant argued that the securities “sales themselves were perfectly lawful and that the subsequent misappropriation of the proceeds, though fraudulent, is not properly viewed as having the requisite connection with the sales.” *Id.* at 820. In a unanimous decision, the Court rejected this argument and concluded that the sales and the defendant’s fraudulent practices were not independent events. *Id.* The Court held that the “in connection with” requirement is satisfied where securities sales coincide with the defendant’s overall scheme to defraud. *Id.* at 822. However, the Supreme Court was careful to state that § 10(b) “must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation” of the statute. *Id.* at 820. For example, the Court observed that *Zandford* was not a case in which “after a lawful transaction had been consummated, a broker

questionable continued validity”); *Howe v. Bank for Int’l Settlements*, 194 F. Supp. 2d 6, 27 (D. Mass. 2002) (stating that “[i]t is at least doubtful . . . whether the forced-seller doctrine retains any viability” and observing that “[t]he First Circuit has never adopted it”).

⁷¹ *Blue Chip Stamps*, 421 U.S. at 737-38; see also, e.g., *Lawrence v. Cohn*, 325 F.3d 141, 154-55 (2d Cir. 2003) (plaintiffs who alleged they were fraudulently induced to forego purchasing additional shares in a limited partnership did not satisfy the “standing requirements of *Blue Chip Stamps*”).

⁷² See, e.g., *Blue Chip Stamps*, 421 U.S. at 737-38 (citing *Schoenbaum v. Firstbrook*, 405 F.2d 215, 219 (2d Cir. 1968)).

decided to steal the proceeds and did so. Nor is it a case in which a thief simply invested the proceeds of a routine conversion in the stock market. Rather, [the defendant’s] fraud coincided with the sales themselves.” *Id.* Drawing an analogy to its reasoning in *Wharf*, the Court stated: “Similarly, in this case the SEC claims [defendant] sold [the client’s] securities while secretly intending from the very beginning to keep the proceeds. In *Wharf*, the fraudulent intent deprived the purchaser of the benefit of the sale whereas here the fraudulent intent deprived the seller of that benefit, but the connection between the deception and the sale in each case is identical.” *Id.* at 823-24.⁷³

In a more recent decision, the Second Circuit relied on *Blue Chip Stamps* to establish a bright-line rule that only parties that “bought or sold the securities about which the misstatements were made” have standing to bring suit under § 10(b) and Rule 10b–5. *See Menora Mivtachim Ins. Ltd. v. Frutarom Indus. Ltd.*, 54 F.4th 82, 88-89 (2d Cir. 2022). The plaintiffs were purchasers of shares of IFF, a U.S.-based company listed on the NYSE that had recently acquired the Israeli company Frutarom via a merger. They sued various defendants alleging that Frutarom had made material misstatements about its own business while the merger was pending and that IFF’s stock price had declined when the truth came to light after IFF closed the transaction. *See id.* at 84-85. In holding that IFF’s shareholders lacked standing, the court rejected their argument that the pending merger created a “sufficiently ‘direct relationship’ between Frutarom’s misstatements about itself and the price of IFF’s shares,” reasoning that “Section 10(b) standing does not depend on the significance or directness of the relationship between two companies.” *Id.* at 86, 88.⁷⁴

⁷³ Courts applying the “in connection with” requirement post-*Zandford* have found it to be satisfied in situations in which no securities were in fact purchased. For example, in *SEC v. Smart*, 678 F.3d 850, 857 (10th Cir. 2012), the Tenth Circuit held that where a Ponzi schemer “took investors’ money under the pretense that it would be invested in safe securities, like mutual funds[,] [t]he fact that he failed to actually buy or sell securities is not dispositive,” and affirmed entry of summary judgment for securities fraud. *See also Grippio v. Perazzo*, 357 F.3d 1218, 1223-24 (11th Cir. 2004) (holding that the plaintiff “adequately pled fraud ‘in connection with the purchase or sale of any security,’ even though he failed to identify any particular security purchased, because [the defendant] accepted and deposited [plaintiff’s] monies as payment for securities” and citing the SEC’s position in *Zandford* that Rule 10b–5 applies where a broker accepts payment for securities he never intends to deliver).

⁷⁴ The Second Circuit had previously reached a similar conclusion in *Ontario Public Service Employees Union Pension Trust Fund v. Nortel Networks Corp.*, 369 F.3d 27 (2d Cir. 2004), holding that purchasers of JDS shares did not have standing to sue Nortel for making misleading statements about its own prospects at a time when Nortel was poised to acquire a business unit from JDS in exchange for Nortel shares. *See id.* at 32-34. Although *Nortel* left open the question whether “a potential merger might require a different outcome,” on the theory that “a merger creates a far more significant relationship between two companies than does the sale of a business unit,” *id.* at 34, the *Frutarom* court expressly held that the form of the transaction was irrelevant to the standing analysis. 54 F.4th at 88 & n.7 (“The ‘direct relationship’ test in *Nortel* is dicta and, more importantly, is inconsistent with *Blue Chip Stamps* . . .”).

It remains to be seen whether courts outside the Second Circuit will adopt the holding of *Frutarom*.⁷⁵

Prior to *Blue Chip Stamps*, a number of cases held that the plaintiff in a private injunctive action under § 10(b) need not be a purchaser or seller.⁷⁶ Some courts have concluded that this line of cases does not survive *Blue Chip Stamps*,⁷⁷ while others have held that *Blue Chip Stamps* does not control private injunctive actions.⁷⁸ Several courts have also held that one who is not a purchaser or seller of securities has standing to bring a Rule 10b–5 action where the specific dangers discussed in *Blue Chip Stamps* are not present.⁷⁹

⁷⁵ See *In re CCIV/Lucid Motors Sec. Litig.*, 2023 WL 325251, at *7-9 (N.D. Cal. Jan. 11, 2023) (declining to follow *Frutarom* and reasoning that its bright-line rule is “inconsistent with Supreme Court precedent and the policy considerations with respect to standing, including the need to ensure confidence in the markets”).

⁷⁶ See, e.g., *Kahan v. Rosenstiel*, 424 F.2d 161, 173 (3d Cir. 1970); *Landy v. FDIC*, 486 F.2d 139, 156 (3d Cir. 1973); *Mut. Shares Corp. v. Genesco, Inc.*, 384 F.2d 540, 546-47 (2d Cir. 1967).

⁷⁷ See, e.g., *Cowin v. Bresler*, 741 F.2d 410, 423-25 (D.C. Cir. 1984); *W.A. Krueger Co. v. Kirkpatrick, Pettis, Smith, Polian, Inc.*, 466 F. Supp. 800, 805-06 (D. Neb. 1979); *Wright v. Heizer Corp.*, 411 F. Supp. 23, 34-35 (N.D. Ill. 1975), *aff’d in part, rev’d in part*, 560 F.2d 236 (7th Cir. 1977).

⁷⁸ See, e.g., *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *aff’d following remand*, 722 F.2d 729 (2d Cir. 1983), *overruled on other grounds by McNally v. United States*, 483 U.S. 350 (1987); *Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187, 194 (3d Cir. 1976); *Davis v. Davis*, 526 F.2d 1286, 1289-90 (5th Cir. 1976); *Granada Invs., Inc. v. DWG Corp.*, 717 F. Supp. 533, 535 (N.D. Ohio 1989), *aff’d*, 962 F.2d 1203 (6th Cir. 1992); *Warner Commc’ns, Inc. v. Murdoch*, 581 F. Supp. 1482, 1494-95 (D. Del. 1984); *Fuchs v. Swanton Corp.*, 482 F. Supp. 83, 90 (S.D.N.Y. 1979); *cf. Trump Hotels & Casino Resorts, Inc. v. Mirage Resorts, Inc.*, 140 F.3d 478, 486 (3d Cir. 1998) (finding no standing but reserving judgment on vitality of “relaxed” standing for injunctions after *Blue Chip Stamps*); *Advanced Res. Int’l, Inc. v. Tri-Star Petroleum Co.*, 4 F.3d 327, 333 (4th Cir. 1993) (noting that a narrow exception to *Blue Chip Stamps* is a situation involving “shareholder plaintiffs who claim that without injunctive relief to stop the defendants’ deceptive and unfair practices, they may in the future suffer monetary loss to their shares”); *John Labatt Ltd. v. Onex Corp.*, 890 F. Supp. 235, 247 (S.D.N.Y. 1995) (stating that injunctive relief under § 10(b) should generally be denied to targets in tender offer context).

⁷⁹ See *Grubb v. FDIC*, 868 F.2d 1151, 1161-62 (10th Cir. 1989) (holding that an individual had standing to sue under Rule 10b–5, even though the stock in question was purchased by a holding company; “First National made the alleged representations directly to Grubb before Weatherford Holding even existed, thus inducing him to involve himself in the transaction by borrowing \$625,000 to establish the holding company and personally guarantying repayment of one-half of its loan to purchase the Security State stock.”); *Norris v. Wirtz*, 719 F.2d 256, 259-61 (7th Cir. 1983) (holding that a decedent’s daughter had standing under § 10(b) and Rule 10b–5 where the co-executors of the decedent’s estate had allegedly fraudulently secured the daughter’s approval of certain share sales); *United Dep’t Stores, Inc. v. Ernst & Whinney*, 713 F. Supp. 518, 523-24 (D.R.I. 1989) (granting standing to shareholders who loaned funds to one corporation to purchase another). *But see Rayman v. Peoples Sav. Corp.*, 735 F. Supp. 842, 851 (N.D. Ill. 1990) (disapproving of the reasoning of *United Department Stores*); *Keystone Assocs. LLC v. Benjamin Fulton*, 2020 WL 3432601, at *3 (D. Del. June 23, 2020) (distinguishing *Grubb* and therefore declining to apply its reasoning), *appeal dismissed sub nom. Keystone Assocs. LLC v. Fulton*, 2020 WL 8212931 (3d Cir. Nov. 2, 2020).

3. Persons Liable

It has long been understood that the “maker” of a materially false or misleading statement will face liability under Rule 10b–5(b). In *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011), the Supreme Court held that “the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it,” and emphasized that “[w]ithout control, a person or entity can merely suggest what to say, not ‘make’ a statement in its own right.”⁸⁰ Subsequent decisions have clarified the degree of control necessary to render a defendant the “maker” of a statement for purposes of *Janus*.⁸¹ For example, some courts have applied *Janus* to hold that attorneys who had drafted corporate documents containing alleged misrepresentations may not be held liable under Rule 10b–5.⁸²

It is now also clear, after the Supreme Court’s recent decision in *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019), that persons who “disseminate false or misleading statements . . . with the intent to defraud” may be held liable under subsections (a) and (c) of Rule 10b–5 even if they “do not ‘make’ statements (as *Janus* defined ‘make’).” *Id.* at 1099. It remains to be seen how broadly courts will extend the reach of this newly recognized path to Rule 10b–5 liability. The *Lorenzo* Court drew a contrast between the petitioner, who “sent false statements directly to investors, invited them to follow up with questions, and did so in his capacity as vice president of an investment banking company,” and “actors tangentially involved in

⁸⁰ In *Janus*, the Supreme Court concluded that a holding company that created a mutual fund and acted as its investment adviser and administrator was not the “maker” of an allegedly false statement in the fund’s prospectus. 564 U.S. at 137-41 (2011); see also *Fezzani v. Bear, Stearns & Co. Inc.*, 716 F.3d 18, 25 (2d Cir. 2013) (holding that only the person who communicates a misrepresentation is liable in a private action for damages under § 10(b)).

⁸¹ See, e.g., *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 286-87 (2d Cir. 2013) (finding, in a case where defendants were accused of late trading in the mutual fund market, that even though the brokers, and not the defendants, “may have been responsible for the act of communication,” it was defendants who “retained ultimate control over both the content of the communication and the decision to late trade”); *In re Puda Coal Sec. Inc., Litig.*, 2014 WL 3427284, at *3-4 (S.D.N.Y. July 14, 2014) (holding that underwriters’ involvement in creating, approving, and disseminating a prospectus was sufficient to render them “makers” of alleged false statements under *Janus*); *In re Nevsun Res. Ltd.*, 2013 WL 6017402, at *11 (S.D.N.Y. Sept. 27, 2013) (holding that an issuer was the “maker” of allegedly false estimates under *Janus* even though such estimates were prepared by an independent engineering firm because the complaint alleged that the issuer “adopted those statements, filed them with the SEC, and thereafter repeated them to investors”).

⁸² See *Derby City Capital, LLC v. Trinity HR Servs.*, 949 F. Supp. 2d 712, 744 (W.D. Ky. 2013) (holding that attorney who prepared but did not file Schedule 13D filings could not be liable under *Janus*); *In re DVI Inc. Sec. Litig.*, 2013 WL 56073, at *7-8 (E.D. Pa. Jan. 4, 2013) (holding that a law firm that participated in drafting corporation’s public filings was not liable under *Janus*).

dissemination—say, a mailroom clerk—for whom liability would typically be inappropriate.” *Id.* at 1101.

In contrast to the plaintiff, the defendant in an action under Rule 10b–5 need not have purchased or sold securities; rather, it is enough that the defendant’s conduct occurred “in connection with” purchases or sales of securities. As the Second Circuit held in the leading case of *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968), *aff’d in part, rev’d in part*, 446 F.2d 1301 (2d Cir. 1971), this requirement is satisfied so long as the defendant’s false or misleading statements were made “in a manner reasonably calculated to influence the investing public.”⁸³

4. Basis of Liability

Rule 10b–5 is a general antifraud rule, and the range of conduct it prohibits is broad. Nonetheless, it is safe to say that the most important violations of the rule fall into three categories:

- (1) garden variety fraud in face-to-face transactions by sellers, purchasers, brokers, and others;
- (2) false or misleading statements of material fact by corporate insiders or others that affect the prices at which securities trade (included here is fraud by issuers and others in public securities offerings that may also be actionable under § 11 of the Securities Act); and
- (3) trading on material nonpublic information by corporate insiders and their tippees—“insider trading”—discussed in Section II.A.11, *infra*.

At one time it appeared that ordinary corporate mismanagement might become actionable under Rule 10b–5 if it related in some fashion to a purchase or sale of securities. *See Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 11-12 (1971). The prospect developed that state corporate law could become federalized under the aegis of Rule 10b–5.

⁸³ *See also In re Carter-Wallace, Inc. Sec. Litig.*, 150 F.3d 153, 156-57 (2d Cir. 1998) (holding that a pharmaceutical company’s technical and detailed advertisements for a new drug in sophisticated medical journals could satisfy the “in connection with” requirement if the “proof at trial establishes that the advertisements were used by market professionals in evaluating the stock of the company”), *aff’d following remand*, 220 F.3d 36 (2d Cir. 2000); *McGann v. Ernst & Young*, 102 F.3d 390, 396-97 (9th Cir. 1996) (“Plaintiffs allege that E&Y produced a fraudulent audit report for CPC, knowing that CPC would include this report in its Form 10–K filed with the SEC. If true, E&Y made false assertions ‘in a manner reasonably calculated to influence the investing public,’ and thus ‘in connection with’ securities trading” (citation omitted)).

The Supreme Court ruled out that possibility, however, in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977). There, a minority shareholder frozen out of a Delaware corporation in a short-form merger alleged a violation of Rule 10b-5 because the merger lacked a legitimate business purpose. *Id.* at 469. The Court held that the complaint should be dismissed because it alleged a breach of fiduciary duty with no element of deceit or nondisclosure. *Id.* at 473-74.

After *Santa Fe*, it appeared that breaches of fiduciary duty by corporate insiders were not actionable under Rule 10b-5 unless they involved deceit. But an important twist was placed on the *Santa Fe* doctrine by *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977). There, a subsidiary entered into certain transactions with its parent involving sales of the subsidiary's shares and announced that the transactions would benefit both the subsidiary and the parent. *Id.* at 211-12. Shareholder approval of the transactions was neither required nor sought. Plaintiff, a minority shareholder in the subsidiary, brought a shareholder's derivative suit under Rule 10b-5, claiming that in fact the transactions were designed solely to benefit the parent corporation at the expense of the subsidiary's minority shareholders. *Id.* The Second Circuit refused to dismiss the suit, holding that *Santa Fe*'s deceit requirement is satisfied in a derivative suit where the shareholders of a corporation are deceived, even if its directors are not. *Id.* at 217. Furthermore, the Second Circuit held that shareholders can prove materiality and reliance, even where they have no vote on a transaction, if, had they been given full and truthful disclosure, they could have brought an action to block the transaction under state corporation law. *Id.* at 219-20. *Goldberg* therefore suggests that shareholders can bring derivative actions under Rule 10b-5 to challenge many transactions involving sales or purchases of shares by corporations, thus reinvigorating the possibility that Rule 10b-5 could be used to make inroads into state corporation law in certain circumstances in spite of *Santa Fe*.

The Second Circuit's holding in *Goldberg* has been accepted by other circuits at various times,⁸⁴ although the Seventh Circuit has vocally refused to do so.⁸⁵

⁸⁴ See, e.g., *Estate of Soler v. Rodriguez*, 63 F.3d 45, 55-56 (1st Cir. 1995); *United States v. Margala*, 662 F.2d 622, 626 (9th Cir. 1981); *Healey v. Catalyst Recovery of Pa., Inc.*, 616 F.2d 641, 646-47 (3d Cir. 1980); *Kidwell ex rel. Penfold v. Meikle*, 597 F.2d 1273, 1292 (9th Cir. 1979), *overruled on other grounds by Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1570 (9th Cir. 1990).

⁸⁵ See, e.g., *Isquith v. Caremark Int'l*, 136 F.3d 531, 534 (7th Cir. 1998) ("*Goldberg* would allow every complaint about the mismanagement of a corporation that issues securities . . . to be shoehorned into federal court on the theory that management had defrauded the shareholders by concealing the mismanagement. This would carry the securities laws far outside their intended domain."); *LHLC Corp. v. Cluett, Peabody & Co.*, 842 F.2d 928, 931-32 (7th Cir. 1988) ("the appropriate inquiry is whether the information disclosed or withheld affected an *investment* decision"; "the securities laws do not ensure that people will receive information sufficient to

Nonetheless, the Second Circuit continues to recognize the *Goldberg* exception to the *Santa Fe* doctrine.⁸⁶

5. Scienter

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), the Supreme Court held that proof of scienter—*i.e.*, an “intent to deceive, manipulate, or defraud”—is needed to establish a violation of Rule 10b–5.⁸⁷ The Court reasoned that the language of § 10(b), which prohibits “manipulative or deceptive” conduct, limits the scope of any rule issued thereunder to conduct that would constitute fraud at common law and thus precludes any claim under Rule 10b–5 for negligent conduct. *Id.* at 199.

Since *Hochfelder*, lower courts have had to decide whether the scienter required under Rule 10b–5 includes recklessness; that is, whether making statements with reckless disregard for, or no belief in, their truth is prohibited under the rule.⁸⁸ All of the courts of appeals have held that recklessness in some form does satisfy the scienter requirement of Rule 10b–5, though some decisions suggest the recklessness must be extreme or severe.⁸⁹

make correct decisions about filing or pursuing lawsuits”); *see also SEC v. Jakubowski*, 150 F.3d 675, 680 (7th Cir. 1998) (noting that “*LHLC* and *Isquith* reject *Goldberg*”).

⁸⁶ *See, e.g., Koppel v. 4987 Corp.*, 167 F.3d 125, 134 (2d Cir. 1999); *Field v. Trump*, 850 F.2d 938, 948-49 (2d Cir. 1988).

⁸⁷ This is true for SEC injunctive actions as well as for private actions under Rule 10b–5. *See Aaron v. SEC*, 446 U.S. 680, 695 (1980).

⁸⁸ In *Hochfelder*, the Supreme Court expressly reserved on the question whether recklessness could be sufficient to establish liability under Rule 10b–5. *See* 425 U.S. at 193 n.12 (1976).

⁸⁹ *See, e.g., Schueneman v. Arena Pharms., Inc.*, 840 F.3d 698, 705 (9th Cir. 2016) (“[D]eliberate recklessness is ‘an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.’” (emphasis and citation omitted)); *In re Advanced Battery Technologies, Inc.*, 781 F.3d 638, 644 (2d Cir. 2015) (“[R]ecklessness must be conduct that is highly unreasonable, representing an extreme departure from the standards of ordinary care, not merely a heightened form of negligence.” (citations omitted)); *In re Genzyme Corp. Sec. Litig.*, 754 F.3d 31, 40 (1st Cir. 2014) (“Scienter may be pled by showing that defendants either consciously intended to defraud, or that they acted with a high degree of recklessness.” (citations omitted)); *Auto. Indus. Pension Tr. Fund v. Textron Inc.*, 682 F.3d 34, 39 (1st Cir. 2012) (finding that “negligence or puffing are not enough for scienter”); *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (requiring “[e]xtreme recklessness,” defined as “an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it” (citations omitted)); *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004) (requiring “severe recklessness”); *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 681 (6th Cir. 2004) (defining recklessness as a mental state akin to “conscious disregard”), *abrogated in part on other grounds, Frank v. Dana Corp.*, 646 F.3d 954, 961 (6th Cir. 2011); *Ottmann v. Hanger Orthopedic Grp., Inc.*, 353 F.3d 338, 344 (4th Cir. 2003) (requiring “severe recklessness [which] is, in essence, a

As discussed below, the PSLRA established a heightened pleading standard for scienter in securities fraud cases, which requires a plaintiff to plead particularized facts giving rise to a “strong inference” of the requisite intent. *See* pp. 56-60, *infra*.

6. Reliance and Causation

a. Transaction Causation

It is often stated that reliance is a necessary element of a Rule 10b–5 case,⁹⁰ or that a Rule 10b–5 plaintiff must show that the defendant’s prohibited conduct was a substantial factor in causing the transaction upon which the claim is based.⁹¹ Courts refer to this requirement as “transaction causation” or “reliance.”⁹²

The requirement of reliance or transaction causation must be carefully explained in light of the Supreme Court’s decisions in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), and *Basic Inc. v. Levinson*, 485 U.S. 224, 241-50 (1988). *Affiliated Ute* holds that where a Rule 10b–5 claim is based on omissions, rather than affirmative misrepresentations, proof of reliance is not necessary once the materiality of the omissions is shown. Although the Court did not explain its holding in this way, lower courts have generally read the case to mean that in Rule 10b–5 omission cases, there is a rebuttable presumption of reliance once materiality is established.⁹³

slightly lesser species of intentional misconduct”); *Kushner v. Beverly Enters., Inc.*, 317 F.3d 820, 828 (8th Cir. 2003) (requiring “severe recklessness”); *In re Ikon Office Solutions, Inc.*, 277 F.3d 658, 672 n.16 (3d Cir. 2002) (requiring recklessness “bordering on an intent to deceive”); *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1258 (10th Cir. 2001) (defining recklessness as “conduct that is an extreme departure from the standards of ordinary care”); *Ziamba v. Cascade Int’l, Inc.*, 256 F.3d 1194, 1202 (11th Cir. 2001) (requiring “severe recklessness”); *Searls v. Glasser*, 64 F.3d 1061, 1066 (7th Cir. 1995) (requiring “recklessness so severe that it is the functional equivalent of intent”).

⁹⁰ *See, e.g., Berkeley Inv. Grp., Ltd. v. Colkitt*, 455 F.3d 195, 222 (3d Cir. 2006); *Currie v. Cayman Res. Corp.*, 835 F.2d 780, 785 (11th Cir. 1988); *Kramas v. Sec. Gas & Oil, Inc.*, 672 F.2d 766, 770 (9th Cir. 1982).

⁹¹ *See, e.g., Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88, 92 (2d Cir. 1981); *Feinberg Testamentary Trust v. Carter*, 652 F. Supp. 1066, 1079-80 (S.D.N.Y. 1987).

⁹² *See, e.g., Grace v. Rosenstock*, 228 F.3d 40, 46-47 (2d Cir. 2000); *In re N. Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446, 455-56 (S.D.N.Y. 2000).

⁹³ *See, e.g., Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 186 (2d Cir. 2001); *Binder v. Gillespie*, 184 F.3d 1059, 1063 (9th Cir. 1999); *Grubb*, 868 F.2d at 1163; *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1118-19 (5th Cir. 1988), *vacated on other grounds sub nom. Fryar v. Abell*, 492 U.S. 914 (1989); *Lipton v. Documentation, Inc.*, 734 F.2d 740, 742 n.3 (11th Cir. 1984); *Biechele v. Cedar Point, Inc.*, 747 F.2d 209, 214-15 (6th Cir. 1984). *But see In re Volkswagen “Clean Diesel” Mktg., Sales Pracs., & Prod. Liab. Litig.*, 2 F.4th 1199, 1204-05 (9th Cir. 2021) (explaining that in cases alleging both misstatements and omissions, the *Affiliated Ute* presumption does not apply “unless the case can be characterized as one that primarily alleges omissions”).

Affiliated Ute rested on the rationale that reliance should be presumed where it is so difficult to prove that the reliance requirement threatens to render Rule 10b–5 ineffectual. Building on the same rationale in a case involving misrepresentations rather than omissions, the Supreme Court in *Basic* held that in Rule 10b–5 cases “[i]t is not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory,” which had been recognized previously by several lower courts. 485 U.S. at 250.⁹⁴ As with the *Ute* presumption, *Basic*’s fraud-on-the-market presumption is rebuttable: “Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance.” *Id.* at 248.⁹⁵

While the Court in *Basic* did not discuss in detail the particular elements of a “fraud-on-the-market theory,” it did quote and affirm the holding of the court of appeals that, in order to invoke the presumption, the plaintiff must allege and prove: (1) that a “defendant made public misrepresentations,” (2) that the misrepresentations were material, (3) that the securities involved “were traded on an efficient market,” and (4) that “the plaintiff traded the [securities] between the time the misrepresentations were made and the time the truth was revealed.” 485 U.S. at 248 n.27. The Court explained that “[a]n investor who buys or sells stock at the price set by the market does so in reliance upon the integrity of that price.” *Id.* at 247. Thus, the “fraud-on-the-market” theory requires that the securities in question are traded on an efficient market, and an event study may be required to show that the market is

⁹⁴ By adopting the fraud-on-the-market theory, the Supreme Court implicitly approved a line of lower court cases growing out of *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), in which the Ninth Circuit held that in class action suits under Rule 10b–5, reliance should be presumed, and separate proof of reliance by each class member not required, once materiality had been proven, where defendants’ conduct had an effect on the price of the relevant security in an open market. *Id.* at 906-08. The holding in *Barrack* was followed by several other circuits. See *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 362-63 (5th Cir. 1987) (adopting the Ninth Circuit’s view only as to Rule 10b–5(1) and (3) but not under 10b–5(2)); *Peil v. Speiser*, 806 F.2d 1154, 1161 (3d Cir. 1986); *Teamsters Local 282 Pension Tr. Fund v. Angelos*, 762 F.2d 522, 529 (7th Cir. 1985), *overruled on other grounds by Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385, 1387-89 (7th Cir. 1990); *Lipton*, 734 F.2d at 747; *T.J. Raney & Sons, Inc. v. Fort Cobb, Okla. Irrigation Fuel Auth.*, 717 F.2d 1330, 1332-33 (10th Cir. 1983); *Panzirer v. Wolf*, 663 F.2d 365, 368 (2d Cir. 1981), *vacated as moot sub nom. Price Waterhouse v. Panzirer*, 459 U.S. 1027 (1982); *Shores v. Sklar*, 647 F.2d 462, 469, 475 (5th Cir. 1981) (en banc), *rev’d on other grounds, Regents of the Univ. of Cal. v. Credit Suisse First Boston*, 482 F.3d 372 (5th Cir. 2007).

⁹⁵ With respect to settlement classes (as opposed to litigation classes), the Second Circuit has held that plaintiffs are not required to demonstrate that the fraud-on-the-market presumption applies at all, since settlement eliminates the need for a trial and obviates the “intractable management problems” that would result from individual issues. *In re Am. Int’l Grp., Inc. Sec. Litig.*, 689 F.3d 229, 240 (2d Cir. 2012).

efficient, as indicated by whether the “market price responds to most new, material news.”⁹⁶

Basic’s presumption of reliance facilitates class-action treatment of Rule 10b–5 cases under Fed. R. Civ. P. 23(b)(3). In particular, Rule 23(b)(3) requires, for a class to be certified, common questions of law or fact to “predominate over any questions affecting individual members.” As the Court explained in *Basic*, requiring proof of actual reliance in 10b–5 cases would cause individual issues of reliance to “overwhelm[]” the common issues, thus making certification virtually impossible. 485 U.S. at 242. The fraud-on-the-market presumption helps plaintiffs overcome this hurdle. However, courts struggled with the question whether, in a class action, the triggering elements of the fraud-on-the-market presumption must be proven at the class certification stage, or if they can be simply alleged at that point.

The Supreme Court provided an answer in *Amgen Inc. v. Connecticut Retirement Plans & Trust Funds*, 568 U.S. 455, 470-78 (2013), when it ruled that although certain fraud-on-the-market predicates must be proven at the class certification stage—namely, that (1) the alleged misrepresentations were publicly known; (2) the stock traded in an efficient market; and (3) the relevant transaction took place between the time the misrepresentations were made and the time the truth was revealed—plaintiffs need not prove the materiality of the alleged misrepresentations at the class certification stage. The Court distinguished between the materiality predicate, on the one hand, and the market efficiency and publicity predicates, on the other hand, in that the failure of common proof of market efficiency and publicity would leave open the prospect of individualized proof of reliance. Failure of common proof of materiality, however, would simply end the case for the entire class, and would not give rise to any prospect of individual questions overwhelming common ones at the merits stage. *See id.* at 473-74. Therefore, the Court concluded, proof of materiality was not necessary for class certification.⁹⁷

Two months after *Amgen* was decided, the Fifth Circuit extended its analysis by holding that, at the class certification stage, defendants may not submit evidence showing an absence of price impact to rebut the fraud-on-the-market presumption. *Erica P. John Fund, Inc. v. Halliburton Co.*, 718 F.3d 423, 435 (5th Cir. 2013),

⁹⁶ *See, e.g., In re Fed. Home Loan Mortg. Corp. (Freddie Mac) Sec. Litig.*, 281 F.R.D. 174, 180-81 (S.D.N.Y. 2012) (plaintiff could not benefit from the fraud-on-the-market presumption of collective reliance where the market reacted to news only 28% of the time).

⁹⁷ Two years before it decided *Amgen*, the Supreme Court held that securities fraud plaintiffs are not required to “prove loss causation in order to obtain class certification.” *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 807 (2011) (*Halliburton I*).

vacated and remanded, 573 U.S. 258 (2014). Instead, the Fifth Circuit held, such evidence may only be considered at the merits stage. *Id.*

The Supreme Court reversed in *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 283-84 (2014) (*Halliburton II*), and held that “to maintain the consistency of the [*Basic*] presumption with the class certification requirements of Federal Rule of Civil Procedure 23, defendants must be afforded an opportunity before class certification to defeat the presumption through evidence that an alleged misrepresentation did not actually affect the market price of the stock.” Defendants could seek to do so, the Court explained, “through direct as well as indirect price impact evidence.” *Id.* at 283. The Court, however, refused to take the larger step of jettisoning *Basic*’s fraud-on-the-market presumption altogether and “instead require every securities fraud plaintiff to prove that he actually relied on the defendant’s misrepresentation in deciding to buy or sell a company’s stock.” *Id.* at 266 (holding that principles of *stare decisis*, among other considerations, counseled in favor of retaining the *Basic* presumption).

An important question left unaddressed by *Halliburton II* is precisely *how* defendants can rebut the fraud-on-the-market presumption at the class certification stage. The Eighth Circuit considered that question in *IBEW Local 98 Pension Fund v. Best Buy Co.*, 818 F.3d 775 (8th Cir. 2016). The plaintiffs in *Best Buy* challenged two disclosures made on the same day: (1) an early morning press release announcing that the company was increasing its full-year earnings per share (EPS) guidance by ten cents, and (2) oral statements made on a conference call two hours later that “our earnings are essentially in line with our original expectations for the year” and that Best Buy was “on track to deliver and exceed our annual EPS guidance.” *Id.* at 777 (emphasis omitted). Applying the PSLRA safe harbor for forward-looking statements, the district court dismissed the claim based on the press release, but declined to dismiss the claim based on the subsequent oral statements. *Id.* at 778. Class certification thus turned on whether the oral statements had price impact. Through an event study, the defendants’ expert showed that all price impact had occurred after the press release but before the conference call, and the plaintiffs’ expert ultimately agreed that “by the time the [] conference call started, the economic substance of the alleged misrepresentations was largely reflected in Best Buy’s stock price.” *Id.* at 779-80. The plaintiffs were thus left to rely on a “price maintenance” theory of price impact—that the price impact of the oral statements was “maintaining an inflated stock price.” *Id.* at 782-83. “But that theory,” the Eighth Circuit concluded, “provided no evidence that refuted defendants’ overwhelming evidence of no price impact,” which demonstrated that “[t]he allegedly ‘inflated price’ was established by the non-fraudulent press release.” *Id.* at 783. Because the defendants had “severed any link between the alleged conference call

misrepresentations and the stock price at which plaintiffs purchased,” they had rebutted the *Basic* presumption and thereby defeated class certification. *Id.*

Other courts have been more receptive to plaintiffs who have invoked the price maintenance (or inflation maintenance) theory at the class certification stage.⁹⁸ For example, in *Waggoner v. Barclays PLC*, 875 F.3d 79, 104-05 (2d Cir. 2017), *cert. denied*, 138 S. Ct. 1702 (2018), the Second Circuit affirmed a decision certifying a class despite direct evidence, in the form of an event study, showing that the price of the securities in question “did not move in a statistically significant manner on the dates that the purported misstatements . . . were made.” This was “unsurprising,” the court explained, because the plaintiffs had “proceeded on a price maintenance theory.” *Id.* at 104.⁹⁹ Nor was it a problem that the plaintiffs “did not identify a specific date on which inflation” had entered the marketplace, *id.* at 104 n.37, because it was the defendants’ burden to “rebut the *Basic* presumption by disproving reliance by a preponderance of the evidence at the class certification stage,” *id.* at 99-103. In other words, observing that the stock price declined when the truth was allegedly revealed and arguing that price maintenance explained the lack of price movement when the alleged misstatements were made was enough to carry the day. If accepted in lieu of the more stringent approach in *Best Buy*, this broad

⁹⁸ When it comes to the merits of a securities fraud claim, the price maintenance theory permits a plaintiff to prove that a false statement caused economic harm even where the statement was “confirmatory” and had “no immediate effect on an already inflated stock price,” based on the notion that “[f]raudulent statements that prevent a stock price from falling can cause harm by *prolonging* the period during which the stock is traded at inflated prices.” *FindWhat Investor Grp. v. FindWhat.com*, 658 F.3d 1282, 1314 (11th Cir. 2011). Courts that have endorsed the theory accept that “a stock can be inflated even if the price remains the same or declines after a false statement because the price might have fallen even more” if the truth had been disclosed. *Glickenhans & Co. v. Household Int’l, Inc.*, 787 F.3d 408, 415 (7th Cir. 2015); *see also id.* at 418 (“[T]heories of ‘inflation maintenance’ and ‘inflation introduction’ are not separate legal categories.”). And they have reasoned that without the price maintenance theory, “companies could eschew securities-fraud liability whenever they actively perpetuate . . . inflation that is already extant in their stock price, as long as they cannot be found liable for whatever originally introduced the inflation.” *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 258 (2d Cir. 2016).

⁹⁹ *See also, e.g., In re BancorpSouth, Inc.*, 2017 WL 4125647, at *1 (6th Cir. Sept. 18, 2017) (denying petition for permission to appeal class certification order; “BancorpSouth maintains that it rebutted the *Basic* presumption because it demonstrated a lack of price impact at the time the alleged misrepresentations were made. But price impact may be demonstrated either at the time that the alleged misrepresentations were made, or at the time of their correction.”); *Baker v. SeaWorld Entm’t, Inc.*, 2017 WL 5885542, at *11-12 (S.D. Cal. Nov. 29, 2017) (holding that where “[p]laintiffs contend that each of the allegedly false misstatements ‘propped up [the] stock price,’” “[d]efendants cannot rebut the presumption of reliance by only arguing that the alleged misrepresentations did not affect the stock price.” (citation omitted)); *Willis v. Big Lots, Inc.*, 242 F. Supp. 3d 634, 659 (S.D. Ohio 2017) (“[T]he Court rejects the notion that a defendant can rebut *Basic*’s presumption of price impact solely by showing that there was no statistically significant price increase after a misrepresentation was made. Defendants failed to show that there was no statistically significant price impact following the corrective disclosures in this case.”).

conception of the price maintenance theory would make the presumption of reliance essentially irrebuttable and render *Halliburton II* a dead letter.

The Supreme Court once again addressed the standards that should govern class certification motions in securities fraud cases in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System*, 141 S. Ct. 1951 (2021). The plaintiffs in that case alleged that Goldman had maintained an artificially high stock price by making repeated “generic statements” about its “conflict-of-interest policies and business practices,” and that this price “inflation” had “dissipated” when the “market learned the truth about Goldman’s conflicts from a Government enforcement action and subsequent news reports.” *Id.* at 1959-60. But even though the plaintiff’s motion for class certification was based on the “inflation-maintenance theory,” the Court “expressed no view on [the theory’s] validity or its contours,” leaving those significant questions to be resolved in a future decision. *Id.* at 1959 n.1. Instead, it issued rulings on two other issues and remanded the case for further proceedings.

First, the Supreme Court held unanimously that “courts may assess the generic nature of a misrepresentation at class certification even though it also may be relevant to materiality.” *Id.* at 1960.¹⁰⁰ Per *Goldman Sachs*, where the alleged misstatement is generic, that “often will be important evidence of a lack of price impact, particularly in cases proceeding under the inflation-maintenance theory.” *Id.* at 1961. That is so, explained the Court, because where the “earlier misrepresentation is generic” and the “later corrective disclosure is specific,” there is “less reason to infer front-end price inflation . . . from the back-end price drop.” *Id.* at 1961.

Second, a divided Court held in *Goldman Sachs* that in the context of a motion to certify a class in a securities fraud case, the defendant “bears the burden of persuasion to prove lack of price impact,” and made clear that the defendant “must carry that burden by a preponderance of the evidence.” *Id.* at 1963. The Court cautioned, however, that the “allocation of the burden is unlikely to make much difference on the ground,” as it will “have bite only when the court finds the evidence in equipoise—a situation that should rarely arise.” *Id.*

Following the Supreme Court’s decision, the Second Circuit remanded the case with an instruction that the district court “consider all record evidence relevant to price impact and apply the legal standard as supplemented by the Supreme Court.” *Arkansas Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 11 F.4th 138, 143-44 (2d Cir. 2021). The district court subsequently held that the defendants had failed to establish lack of price impact and, for the third time in the case’s history, granted

¹⁰⁰ As the Supreme Court confirmed more generally, “[i]n assessing price impact at class certification, courts ‘should be open to *all* probative evidence on that question—qualitative as well as quantitative—aided by a good dose of common sense.’” *Goldman Sachs*, 141 S. Ct. at 1960.

the plaintiffs' class certification motion. *In re Goldman Sachs Grp., Inc. Sec. Litig.*, 2021 WL 5826285, at *15 (S.D.N.Y. Dec. 8, 2021).

The defendants were permitted to appeal, and this time, the Second Circuit reversed. It held that the defendants had in fact met their burden and “demonstrated, by a preponderance of the evidence, that the misrepresentations did not impact Goldman’s stock price,” and thereby “rebutted *Basic*’s presumption of reliance.” *Arkansas Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 77 F.4th 74, 105 (2d Cir. 2023). The Second Circuit observed that the district court had “pushed the inflation-maintenance theory well beyond” its limits, particularly by “allow[ing] the ‘details and severity’ of the corrective disclosure to do the work of proving front-end price impact, notwithstanding that the front-end statements are . . . ‘comfortably’ more generic than the back-end disclosures.” *Id.* at 97, 99 (internal citations omitted). The court also provided “[g]uidance moving forward,” explaining that a more “searching price impact analysis” is appropriate in cases where “(1) there is a considerable gap in front-end–back-end genericness . . . (2) the corrective disclosure does not directly refer . . . to the alleged misstatement, and (3) the plaintiff claims . . . that a company’s generic risk-disclosure was misleading by omission.” *Id.* at 102.

The Ninth Circuit somewhat reined in the fraud-on-the-market approach to reliance when it held the theory not applicable to sales of over-the-counter issues where the plaintiff failed to show an adequate number of factors associated with the efficiency of its market. *See Binder v. Gillespie*, 184 F.3d 1059, 1065 (9th Cir. 1999) (citing five factors indicative of a market’s efficiency, including high weekly trading volume and the presence of market makers and arbitrageurs). Similarly, the Second Circuit has rejected the fraud-on-the-market theory with respect to debt securities that were not shown to have traded in an efficient market, based on a district court finding (which was held to be not clearly erroneous) that an event study submitted by plaintiffs “did not support a finding of market efficiency.” *See Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.*, 546 F.3d 196, 209-11 (2d Cir. 2008).¹⁰¹ More recently, however, the Second Circuit made clear that “a plaintiff seeking to demonstrate market efficiency need not always present direct evidence of price impact through event studies,” and concluded that the district court had

¹⁰¹ *See also Unger v. Amedisys Inc.*, 401 F.3d 316, 323-25 (5th Cir. 2005) (listing several factors to determine whether the securities traded in an efficient market and acknowledging but not resolving the question of whether OTC markets are inefficient as a matter of law); *Krogman v. Sterritt*, 202 F.R.D. 467, 473-78 (N.D. Tex. 2001) (indicating that OTC markets are not *per se* inefficient, but finding market for relevant issue not efficient under particular circumstances); *cf. Epstein v. Am. Reserve Corp.*, 1988 WL 40500, at *5 (N.D. Ill. Apr. 20, 1988) (concluding that an OTC market is incapable of meeting the *Basic* definition of an efficient market).

“acted within its discretion in finding an efficient market” for American Depository Shares based on seven indirect factors. *Waggoner*, 875 F.3d at 97-99.

As indicated in *Basic*, the fraud-on-the-market theory is best applied where securities are traded in established, efficient markets, 485 U.S. at 246-47, but prior to *Basic*, several courts had extended the theory to cases involving new issues.¹⁰² Since *Basic*, several courts have continued this line of reasoning, holding that if the “fraud created the market,” reliance by each plaintiff need not be specifically shown.¹⁰³ In contrast to the fraud-on-the-market theory, which states that the investor relied on the integrity of the security’s market price, the “fraud-created-the-market” theory states that the investor relies on the integrity inherent in the very existence of a market in the security.¹⁰⁴ Thus, the theory is applied narrowly and will generally excuse a lack of specific reliance only when the plaintiff can show that the securities would have been “unmarketable” absent the defendant’s misrepresentations.¹⁰⁵ For example, certain courts apply the fraud-created-the-market

¹⁰² See, e.g., *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 723 (11th Cir. 1987) (indicating that recovery is possible on a fraud-on-the-market claim where named plaintiffs may have relied on factors other than the market’s integrity); *T.J. Raney & Sons, Inc.*, 717 F.2d at 1333 (extending theory to newly and unlawfully issued, and fraudulently marketed, securities); *Shores*, 647 F.2d at 469-70 (holding that a plaintiff could recover under Rule 10b-5 by proving that “defendants knowingly conspired to bring securities onto the market which were not entitled to be marketed” and that the plaintiff “reasonably relied on the [securities’] availability on the market as an indication of their apparent genuineness”).

¹⁰³ See, e.g., *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1122-23 (5th Cir. 1988), *vacated on other grounds sub nom. Fryar v. Abell*, 492 U.S. 914 (1989); *Ross v. Bank South, N.A.*, 885 F.2d 723, 729 (11th Cir. 1989); *Stinson v. Van Valley Dev. Corp.*, 719 F. Supp. 362, 365-66 (E.D. Pa. 1989), *aff’d mem.*, 897 F.2d 524 (3d Cir. 1990).

¹⁰⁴ See, e.g., *Alter v. DBLKM, Inc.*, 840 F. Supp. 799, 805 (D. Colo. 1993) (“Fraud-created-the-market is based on the theory that investors rely not on the integrity of the market price, but on the integrity of the market itself.” (citing *Shores*, 647 F.2d at 470)); *Stinson*, 719 F. Supp. at 365-66 (“While investors cannot be said to reasonably rely on market mechanism to reflect an accurate price in illiquid and undeveloped markets, reliance on market integrity to reflect the basic marketability of a security is not so unlikely.”).

¹⁰⁵ See, e.g., *Joseph v. Wiles*, 223 F.3d 1155, 1163-64 (10th Cir. 2000) (noting that courts “define ‘unmarketable’ strictly” and have recognized “two categories: (1) ‘economic unmarketability,’ which occurs when a security is patently worthless, and (2) ‘legal unmarketability,’ which occurs when a regulatory or municipal agency would have been required by law to prevent or forbid the issuance of the security”), *abrogated on other grounds by Cal. Pub. Empls.’ Ret. Sys. v. Anz Sec., Inc.*, 582 U.S. 497 (2017); *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 200 (6th Cir. 1990) (explaining that in a fraud-created-the-market case, the “causal connection” between the fraud and the plaintiff’s injury is “established by alleging and proving that the securities could not have been marketed at any price absent fraud”); *Hamilton Partners, Ltd. v. Sunbeam Corp.*, 2001 WL 34556527, at *11 (S.D. Fla. July 3, 2001) (“[I]n order to be entitled to a classwide presumption of reliance under this theory, Plaintiffs must establish that the debentures would have been unmarketable but for Defendants’ misrepresentations in the O.M.” (citing *Ross*, 885 F.2d at 729)).

theory only in cases where the promoter knew that the securities were worthless, hence unmarketable in the absence of the fraud.¹⁰⁶

The Seventh Circuit has renounced the fraud-created-the-market theory, *see Eckstein v. Balcors Film Investors*, 8 F.3d 1121, 1130-31 (7th Cir. 1993), as has the Third Circuit, which found that it “lacks a basis in common sense, probability, or any of the other reasons commonly provided for the creation of a presumption,” *Malack v. BDO Seidman, LLP*, 617 F.3d 743, 756 (3d Cir. 2010). The Sixth Circuit has also questioned the validity of the fraud-created-the-market theory, although it refrained from rejecting it outright. *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1160 (6th Cir. 1994). It is unclear whether or not the theory is viable in the Second Circuit.¹⁰⁷ The Eighth Circuit, meanwhile, has acknowledged the disagreement among the courts without deciding whether to accept or reject the theory. *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 321 (8th Cir. 1997).

Finally, it bears noting that Congress appears to have endorsed a version of the fraud-on-the-market theory—at least in the context of insider trading. Section 4 of the Insider Trading and Securities Fraud Enforcement Act of 1988 (codified as § 20A of the Exchange Act) makes insider traders liable to “contemporaneous” traders regardless of whether or not the plaintiff can prove reliance on any misinformation. *See* 15 U.S.C. § 78t-1(a).

b. *Loss Causation*

In addition to transaction causation, a plaintiff must provide evidence of “loss causation” in order to satisfy the causation element of a securities fraud claim.¹⁰⁸ The PSLRA memorialized this requirement in § 21D(b)(4) of the Exchange Act, which states: “In any private action arising under [the Exchange Act], the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to

¹⁰⁶ *See, e.g., Abell*, 858 F.2d at 1122 (“We hold . . . that securities meet the test of ‘not entitled to be marketed’ only where the promoters knew the enterprise itself was patently worthless.”); *Stinson*, 719 F. Supp. at 366 (adopting the “narrow standard of a rebuttable fraud-created-the-market presumption endorsed by the *Abell* court”).

¹⁰⁷ *See, e.g., In re Initial Public Offering Sec. Litig.*, 241 F. Supp. 2d 281, 377 n.143 (S.D.N.Y. 2003) (“It is unclear whether the fraud created the market theory is good law in this circuit.”); *In re Towers Fin. Corp. Noteholders Litig.*, 1995 WL 571888, at *22 (S.D.N.Y. Sept. 20, 1995) (stating that “[c]ourts in the Second Circuit have implicitly rejected the fraud created the market theory”), *report and recommendation adopted*, 936 F. Supp. 126 (S.D.N.Y. 1996).

¹⁰⁸ *See, e.g., Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 338 (2005); *In re Omnicom Grp., Inc. Sec. Litig.*, 597 F.3d 501, 509-10 (2d Cir. 2010) (explaining the principle of loss causation); *Ind. State Dist. Council of Laborers v. Omnicare, Inc.*, 583 F.3d 935, 944-45 (6th Cir. 2009) (dismissing claims for failure to plead loss causation).

violate [the Exchange Act] caused the loss for which the plaintiff seeks to recover damages.” 15 U.S.C. § 78u-4(b)(4).¹⁰⁹ In other words, “[t]o establish causation, a plaintiff must prove ‘that the economic harm that it suffered occurred as a result of the alleged misrepresentations’ and that ‘the damage suffered was a foreseeable consequence of the misrepresentation.’” *Rothman v. Gregor*, 220 F.3d 81, 95 (2d Cir. 2000) (emphasis omitted). Some courts have held that the plaintiff need not prove the misrepresentations were the sole cause of the damages and that proof they were a “substantial” contributing cause is enough.¹¹⁰

Class action plaintiffs do not need to establish loss causation in order to trigger the fraud-on-the-market presumption and obtain class certification. *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804 (2011) (*Halliburton I*), overruling *Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 597 F.3d 330 (5th Cir. 2010). Per the Supreme Court, proving loss causation is not “a precondition for invoking *Basic*’s rebuttable presumption of reliance,” because “[l]oss causation addresses a matter different from whether an investor relied on a misrepresentation . . . when buying or selling stock.” *Id.* at 812.

The courts of appeals had for some time been split on the question of how loss causation could be established in a fraud-on-the-market case. The Supreme Court resolved this split in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 342 (2005), and unanimously held that “an inflated purchase price will not itself constitute or proximately cause the relevant economic loss.” The Court reasoned that at the moment when inflated stock is purchased, “the plaintiff has suffered no loss,” because the stock owned “at that instant possesses equivalent value.” *Id.* The Court also held that even if the share price drops “after the truth makes its way into the marketplace,” this price drop does not “inevitably” prove loss causation; rather, “that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions or other events, which taken separately or together account for some or all of that lower price.” *Id.* at 342-43. Moreover, “[o]ther things being equal, the longer the time between purchase and sale, the more likely that [factors other than the misrepresentation] caused the loss.” *Id.* at 343. *Dura* also warned against using private securities actions as “broad insurance against market

¹⁰⁹ See also *Gebhardt v. ConAgra Foods, Inc.*, 335 F.3d 824, 830 n.3 (8th Cir. 2003) (noting that the PSLRA did not change pleading standards with respect to loss causation and materiality).

¹¹⁰ See *Mass. Ret. Sys. v. CVS Caremark Corp.*, 716 F.3d 229, 240 (1st Cir. 2013); *Miller v. Asensio & Co.*, 364 F.3d 223, 232 (4th Cir. 2004); see also *Semerenco v. Cendant Corp.*, 223 F.3d 165, 186-87 (3d Cir. 2000); *Caremark, Inc. v. Coram Healthcare Corp.*, 113 F.3d 645, 649 (7th Cir. 1997); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1447 n.5 (11th Cir. 1997).

losses” when they are only meant to “protect [investors] against those economic losses that misrepresentations *actually* cause.” *Id.* at 345 (emphasis added). While “conced[ing] that ordinary pleading rules are not meant to impose a great burden,” the Court held that a plaintiff must “provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind.” *Id.* at 347.¹¹¹

Post-*Dura*, plaintiffs often try to establish loss causation by “identifying a ‘corrective disclosure’”—*i.e.*, “a release of information that reveals to the market the pertinent truth that was previously concealed or obscured by the company’s fraud.” *FindWhat Inv. Grp. v. FindWhat.com*, 658 F.3d 1282, 1311 (11th Cir. 2011).¹¹² Some courts have also recognized a “materialization of risk” theory of loss causation, whereby “the truth comes out” via “events constructively disclosing the fraud.” *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 261-62 (2d Cir. 2016).¹¹³ “To be corrective, [a] disclosure need not precisely mirror the earlier misrepresentation, but it must at least relate back to the misrepresentation” *In re Williams Sec. Litig. – WCG Subclass*, 558 F.3d 1130, 1140 (10th Cir. 2009). Put differently, while “a direct admission that a previous statement is untrue” is not required, “the corrective disclosure must relate to the same subject matter as the alleged misrepresentation.” *Mass. Ret. Sys. v. CVS Caremark Corp.*, 716 F.3d 229, 240 (1st Cir. 2013). Moreover, and importantly, “loss causation may be pleaded on the theory that the truth gradually emerged through a series of partial disclosures” that collectively

¹¹¹ The Third Circuit has applied *Dura* even to markets in private securities, where *Dura* is “not directly controlling [because plaintiffs] could not simply turn around and re-sell the unregistered . . . shares they had received,” noting cryptically that it “[n]evertheless . . . believe[d] the logic of *Dura* is persuasive.” *McCabe v. Ernst & Young, LLP*, 494 F.3d 418, 433 (3d Cir. 2007); *accord Nuveen Mun. High Income Opp. Fund v. City of Alameda, Cal.*, 730 F.3d 1111, 1123 (9th Cir. 2013) (citing *McCabe* and holding that “the need to reliably distinguish among the tangle of factors affecting a security’s price is no less urgent in inefficient markets”).

¹¹² *See also, e.g., Carpenters Pension Tr. Fund of St. Louis v. Barclays PLC*, 750 F.3d 227, 233 (2d Cir. 2014) (“In order to plead corrective disclosure, plaintiffs must plausibly allege a disclosure of the fraud by which ‘the available public information regarding the company’s financial condition was corrected,’ and that the market reacted negatively to the corrective disclosure.”) (citations omitted); *Metzler Inv. GMBH v. Corinthian Colleges, Inc.*, 540 F.3d 1049, 1063 (9th Cir. 2008) (plaintiff must “allege[] that the market learned of and reacted to [the alleged] fraud, as opposed to merely reacting to reports of the defendant’s poor financial health generally”).

¹¹³ *See also, e.g., Carpenters Pension Tr. Fund*, 750 F.3d at 232-33 (holding that plaintiffs may plead loss causation either by identifying a corrective disclosure or by alleging “that the loss was foreseeable and caused by the materialization of the risk concealed by the fraudulent statement”); *Ray v. Citigroup Global Mkts., Inc.*, 482 F.3d 991, 995 (7th Cir. 2007) (“[T]he ‘materialization of the risk’ standard . . . requir[es] the plaintiff to prove that ‘it was the very facts about which the defendant lied which caused its injuries.’” (citation omitted)). *But see Ludlow v. BP, P.L.C.*, 800 F.3d 674, 689-91 & n.68 (5th Cir. 2015) (declining to decide whether “materialization of the risk can be an adequate measure of loss causation in appropriate cases” but holding that the plaintiffs’ materialization-of-the-risk theory could not support class certification because it “lumps together those who would have bought the stock at the heightened risk with those who would not have” and “presumes substantial reliance on factors other than price, a theory not supported by . . . the rationale for fraud-on-the-market theory”).

“caused the stock price deflation.” *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 260-61 (5th Cir. 2009).¹¹⁴

Applying these principles, the Eleventh Circuit has held that a presentation given by an influential hedge fund investor—based on public information—which suggested that a corporation’s assets were substantially overvalued and that the stock should be shorted did not constitute a corrective disclosure, notwithstanding that the corporation’s stock price dropped by 20% following the presentation. *See Meyer v. Greene*, 710 F.3d 1189, 1197-1200 (11th Cir. 2013). The court explained that “because the information used in the presentation had already been public for some time, the decline in the value of [the company’s] shares in the wake of [the investor’s] [p]resentation was not due to the fact that the presentation was revelatory of any fraud, but was instead due to ‘changed investor expectations’ after an investor who wielded great clout in the industry voiced a negative opinion about the Company.” *Id.* at 1200 (quoting *Dura*, 544 U.S. at 343).¹¹⁵

In that same case, the Eleventh Circuit held that the announcement of an informal SEC investigation and an SEC private order of investigation—which prompted stock price declines of 7% and 9%, respectively—were not corrective disclosures either, because the “announcement of an investigation reveals just that—an investigation—and nothing more.” *Id.* at 1201 (collecting cases). The Ninth Circuit subsequently agreed with this part of the Eleventh Circuit’s analysis and held “that the announcement of an investigation, without more, is insufficient to establish loss causation,” because “at the moment [it] is announced, the market cannot possibly

¹¹⁴ The courts of appeals are divided on the question whether the general pleading standard imposed by Fed. R. Civ. P. 8(a)(2) or the heightened pleading standard imposed by Fed. R. Civ. P. 9(b) applies to the element of loss causation. *Compare Lormand v. US Unwired, Inc.*, 565 F.3d 228, 262 (5th Cir. 2009) (citing Rule 8(a)(2) and holding that a plaintiff must “allege[] enough facts to raise a reasonable hope or expectation that discovery will reveal evidence that the elements of loss causation existed”), *with Or. Public Emps. Ret. Fund v. Apollo Group Inc.*, 774 F.3d 598, 604-05 (9th Cir. 2014) (“Rule 9(b) applies to all elements of a securities fraud action, including loss causation.”), *and Katyle v. Penn Nat’l Gaming, Inc.*, 637 F.3d 462, 471 (4th Cir. 2011) (“We review allegations of loss causation for ‘sufficient specificity,’ a standard largely consonant with Fed. R. Civ. P. 9(b)’s requirement that averments of fraud be pled with particularity.”). In either case, however, the Supreme Court made clear in *Dura* that a bare allegation that the plaintiff “paid artificially inflated prices” for securities and “suffered damages” as a result will not suffice. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 344-46 (2005).

¹¹⁵ *Accord In re Omnicom Group, Inc. Sec. Litig.*, 597 F.3d 501, 512 (2d Cir. 2010) (“A negative journalistic characterization of previously disclosed facts does not constitute a corrective disclosure of anything but the journalists’ opinions.”). The Ninth Circuit has endorsed this general principle, but declined to apply it as a “bright-line rule,” holding that “[a] disclosure based on publicly available information can . . . constitute a corrective disclosure” if the court can “plausibly infer that the alleged corrective disclosure provided new information to the market that was not yet reflected in the company’s stock price.” *In re BofI Holding, Inc. Sec. Litig.*, 977 F.3d 781, 795 (9th Cir. 2020), *cert. denied sub nom. BofI Holding, Inc. v. Houston Mun. Emps. Pension Sys.*, 142 S. Ct. 71 (2021).

know what the investigation will ultimately reveal.” *Loos v. Immersion Corp.*, 762 F.3d 880, 889-90 (9th Cir. 2014) (citing *Meyer*, 710 F.3d at 1201).¹¹⁶

The Eleventh Circuit has also held that, in order to prove loss causation, the plaintiff must separate portions of the price decline attributable to the alleged fraud from those based on other factors. See *Hubbard v. BankAtlantic Bancorp, Inc.*, 688 F.3d 713, 728-29 (11th Cir. 2012). Taking note of the “deterioration in the Florida real estate market” that occurred during the class period, the court explained that the plaintiff should have, but did not, “present evidence that would give the jury some indication, however rough, of how much of the decline in [the defendant]’s stock price resulted not from the fraud but from the general downturn in the Florida real estate market—the risk of which [the defendant] is not alleged to have concealed”—and thus granted judgment for the defendant as a matter of law. *Id.* at 729.¹¹⁷

Somewhat relatedly, the Ninth Circuit recently held that a “quick and sustained price recovery” from a “modest . . . drop” in the immediate aftermath of the alleged corrective disclosure will “refute[] the inference that the alleged concealment of this particular fact caused any material drop in the stock price.” *Wochos v. Tesla, Inc.*, 985 F.3d 1180, 1198 (9th Cir. 2021). On the other hand, the Second Circuit has held that “it is improper to offset gains that the plaintiff recovers after the fraud becomes known against losses caused by the revelation of the fraud if the stock recovers value for completely unrelated reasons.” *Acticon AG v. China Ne. Petroleum Holdings Ltd.*, 692 F.3d 34, 41 (2d Cir. 2012) (explaining that the stock had “regained its value after a period of decline”). Doing so, the court explained, “would place the plaintiff in a worse position than he would have been,” because “[i]n the absence of fraud, the plaintiff would have purchased the security at an uninflated price and would also have benefitted from the unrelated gain in stock price.” *Id.*¹¹⁸ Because it was unclear at the motion to dismiss stage “whether the

¹¹⁶ *Loos* clarified that “the announcement [of an investigation] alone *might* suffice” to establish loss causation “[t]o the extent [the] announcement contains an express disclosure of actual wrongdoing.” 762 F.3d at 890 n.3(emphasis added). The Ninth Circuit later expanded this principle in *Lloyd v. CVB Financial Corp.*, 811 F.3d 1200 (9th Cir. 2016), when it held that “the announcement of an investigation can ‘form the basis for a viable loss causation theory’ if the complaint also alleges a subsequent corrective disclosure by the defendant.” *Id.* at 1209-10 (quoting *Loos*, 762 F.3d at 890 n.3). “[A]ny other rule,” the court reasoned, “would allow a defendant to escape liability by first announcing a government investigation and then waiting until the market reacted before revealing that prior representations under investigation were false.” *Id.* at 1210.

¹¹⁷ See also, e.g., *In re Williams Sec. Litig.—WCG Subclass*, 558 F.3d 1130, 1143 (10th Cir. 2009) (“Plaintiffs have failed to present evidence suggesting that the declines in price were the result of the revelation of the truth and not some other factor. Given the evidence that the parties have presented, there is ‘simply no way for a juror to determine whether the alleged fraud caused any portion of Plaintiffs’ loss.’” (citation omitted)).

¹¹⁸ The court explained that “[s]ubject to the bounce-back limitation imposed by the PSLRA,” which is discussed below (at p. 62), “a securities fraud action attempts to make a plaintiff whole by allowing him to recover his out-of-pocket damages.” 692 F.3d at 41.

price rebounds represent[ed] the market’s reactions to the disclosure of the alleged fraud or whether they represent[ed] unrelated gains,” the court held that the price recovery was insufficient to negate the inference of economic loss. *Id.*

7. Heightened Pleading Requirements Under the PSLRA

a. *Pleading Fraudulent Conduct with Particularity*

Because § 10(b) claims sound in fraud, plaintiffs have always had to satisfy the pleading requirements of Fed. R. Civ. P. 9(b), which requires plaintiffs to plead all the elements of fraud with particularity. Under the particularity requirement, a complaint must “adequately specify the statements it claims were false or misleading, give particulars as to the respect in which plaintiff contends the statements were fraudulent, state when and where the statements were made, and identify those responsible for the statements.” *Jordan (Bermuda) Inv. Co. v. Hunter Green Invs. Ltd.*, 205 F. Supp. 2d 243, 247 (S.D.N.Y. 2002) (quoting *Cosmas v. Hassett*, 886 F.2d 8, 11 (2d Cir. 1989)).

The PSLRA both codified and extended these pleading requirements. As one court of appeals decision summarized the requirements of Fed. R. Civ. P. 9(b) and the PSLRA, the claim must: “(1) specify . . . each statement alleged to have been misleading, *i.e.*, contended to be fraudulent; (2) identify the speaker; (3) state when and where the statement was made; (4) plead with particularity the contents of the false representations; (5) plead with particularity what the person making the misrepresentation obtained thereby; and (6) explain the reason or reasons why the statement is misleading, *i.e.*, why the statement is fraudulent.” *Goldstein v. MCI WorldCom*, 340 F.3d 238, 245 (5th Cir. 2003). This is the “who, what, when, where, and how: the first paragraph of any newspaper story.” *In re CDNOW, Inc. Sec. Litig.*, 138 F. Supp. 2d 624, 640 (E.D. Pa. 2001) (quoting *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534 (3d Cir. 1999)).

Plaintiffs must also allege that the “true facts” existed at the time of the purportedly misleading statement, a requirement that “helps guard against pleading fraud by hindsight and helps prevent providing a complaint passageway through the pleading stage merely because it alleges that the allegedly fraudulent statements conflict with the current state of facts.” *In re Splash Tech. Holdings, Inc. Sec. Litig.*, 160 F. Supp. 2d 1059, 1072 (N.D. Cal. 2001) (citation omitted). In other words, “[a] plaintiff may not simply contrast a defendant’s past optimism with less favorable actual results, and then ‘contend[] that the difference must be attributable to fraud.’” *Miss. Pub. Emps.’ Ret. Sys. v. Boston Scientific Corp.*, 523 F.3d 75, 90 (1st Cir. 2008) (quoting *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1223 (1st Cir. 1996)). However, the fraud by hindsight doctrine does not apply “when plaintiffs provide[]

‘a series of factual allegations relating to a combination of developments known to the company . . . that could have provided a basis for advance knowledge of the information.’” *Id.* (quoting *Shaw*, 82 F.3d at 1224).

Moreover, “whenever plaintiffs allege, on information and belief, that defendants made material misstatements or omissions, the complaint must ‘state with particularity all facts on which that belief is formed.’” *Novak v. Kasaks*, 216 F.3d 300, 312 (2d Cir. 2000) (quoting 15 U.S.C. § 78u-4(b)(1)). Courts generally interpret the requirement of stating “all facts” loosely, and “evaluat[e] the facts alleged in a complaint to determine whether, taken as a whole, they support a reasonable belief that the defendant’s statements identified by the plaintiff were false or misleading.” *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1099 (10th Cir. 2003).

The Second Circuit added an important gloss in *Gamm v. Sanderson Farms*, 944 F.3d 455, 465 (2d Cir. 2019), holding that when a securities fraud “complaint claims that statements were rendered false or misleading through the non-disclosure of illegal activity, the facts of the underlying illegal acts must also be pleaded with particularity, in accordance with the heightened pleading requirement of [Fed. R. Civ. P.] 9(b) and the PSLRA.” In that case, the plaintiffs alleged that Sanderson Farms, a poultry processing company, made false and misleading statements by failing to disclose its alleged participation in an illegal antitrust conspiracy. *Id.* at 459-60. Relying on the language of the PSLRA and its earlier decision in *Novak*, the Second Circuit explained that the plaintiffs’ “nondisclosure and material omission claims [were] entirely dependent upon the predicate allegation that Sanderson participated in a collusive antitrust conspiracy” and, as a result, “to properly provide ‘all facts’ upon which their securities fraud claim [was] based, their allegations must also provide particularized facts about the underlying conspiracy.” *Id.* at 463-65. Applying this strict standard, the *Gamm* court affirmed the district court’s dismissal of the complaint, reasoning that the plaintiffs had failed to allege with particularity “the basic elements of an underlying antitrust conspiracy.” *Id.* at 465-66.

Finally, where allegations are made based on information allegedly obtained from confidential sources, the complaint must “describe the sources with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged or in the alternative provide some other evidence to support their allegations.” *Yates v. Mun. Mortg. & Equity, LLC*, 744 F.3d 874, 885 (4th Cir. 2014).¹¹⁹ Plaintiffs’ lawyers who make allegations

¹¹⁹ See also, e.g., *Rahman v. Kid Brands, Inc.*, 736 F.3d 237, 244 (3d Cir. 2013) (“[W]hen dealing with confidential witnesses, courts should assess the detail provided by the confidential sources, the sources’ basis of knowledge, the reliability of the sources, the corroborative nature of other facts alleged, including from other

based on confidential sources without making a reasonable investigation into the reliability of those sources may be subject to Rule 11 sanctions.¹²⁰

b. *Pleading Scierter*

Prior to the passage of the PSLRA, the level of specificity required to plead scierter under Rule 10b–5 was not uniform across the circuits. For example, the Ninth Circuit allowed plaintiffs to aver scierter generally, *see In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1545-49 (9th Cir. 1994), while the Second Circuit required plaintiffs to plead facts “that [gave] rise to a strong inference of fraudulent intent,” *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994). This “strong inference” could be supported by allegations that either (a) showed defendants had both motive and opportunity to commit fraud, or (b) constituted strong circumstantial evidence of conscious misbehavior or recklessness. *Id.*

To impose uniformity, as part of the PSLRA, Congress added § 21D(b)(2) of the Exchange Act, which requires plaintiffs in securities fraud cases to “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2). But Congress did not define what pleaded facts would suffice to give rise to a “strong inference” of scierter, and federal courts applying the new statutory requirement differed on the question whether the Exchange Act’s pleading standard for scierter was equivalent to, or stricter than, the pre-PSLRA Second Circuit standard.¹²¹

The Supreme Court provided guidance in 2007, when it ruled that in order to qualify as “strong,” “an inference of scierter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S.

sources, the coherence and plausibility of the allegations, and similar indicia,” and “[i]f, after that assessment, anonymous source allegations are found wanting . . . courts must discount them steeply.” (internal alterations omitted); *Novak*, 216 F.3d at 314 (“[T]here is no requirement that [confidential sources] be named, provided they are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged.”).

¹²⁰ *See, e.g., City of Livonia Emps.’ Ret. Sys. v. Boeing Co.*, 711 F.3d 754, 759, 762 (7th Cir. 2013) (recognizing that confidential witness allegations are sometimes a “gimmick for obtaining discovery costly to the defendants and maybe forcing settlement”).

¹²¹ The Fourth Circuit summarized the post-PSLRA—but pre-*Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007)—case law in an unpublished decision issued in 2003: “At one end of the spectrum is the relatively lenient standard espoused by the Second Circuit. Under that standard, a plaintiff may plead scierter by alleging specific facts that either (1) establish ‘both motive and opportunity to commit fraud’ or (2) constitute ‘strong circumstantial evidence of conscious misbehavior or recklessness.’ At the other end of the spectrum is the relatively strict ‘deliberate recklessness’ standard espoused by the Ninth Circuit. In between is an intermediate standard holding that motive and opportunity, while not sufficient by themselves, can be used to demonstrate conscious or reckless misconduct.” *Svezzese v. Duratek, Inc.*, 67 F. App’x 169, 172 (4th Cir. 2003) (citations omitted).

308, 313-14 (2007). The *Tellabs* Court rejected the Seventh Circuit’s standard that allowed a complaint to survive a motion to dismiss so long as a reasonable person could infer from the facts alleged that the defendant acted with the requisite intent and adopted a standard that requires courts to “consider plausible, nonculpable explanations for the defendant’s conduct, as well as inferences favoring the plaintiff.” *Id.* at 324. Under this standard, a complaint will survive a motion to dismiss “only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” *Id.* When applying the *Tellabs* analysis, courts should look at all of the facts, “taken collectively,” to determine if the plaintiff adequately pleaded scienter. *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 50 (2011).

Even after *Tellabs*, the courts of appeals continue to apply different standards for pleading scienter in 10b–5 actions. Perhaps most notably, the courts of appeals remain divided on the question of whether allegations that a defendant had a “motive and opportunity” to commit fraud, standing alone, may suffice to plead scienter. Prior to *Tellabs*, the Second, Third, and Eighth Circuits had allowed plaintiffs to plead scienter merely by alleging facts that showed that a defendant “had both motive and opportunity to commit fraud,”¹²² and the Second and Eighth Circuits have reaffirmed this view post-*Tellabs*.¹²³ The Third Circuit, by contrast, has changed course and held that “[a] showing of motive and opportunity” is not “an independent means of establishing scienter,” finding its prior case law “no longer tenable in light of *Tellabs*.” *Inst. Inv’rs Grp. v. Avaya, Inc.*, 564 F.3d 242, 276 (3d Cir. 2009). “Instead,” the Third Circuit held, allegations of motive and opportunity “are to be considered along with the other allegations in the complaint” as the court “weigh[s] culpable and nonculpable inferences.” *Id.* at 277. This is the majority view among the courts of appeals.¹²⁴

As for the question of what must be pleaded to establish motive in the first place, the courts of appeals are generally in agreement that motives “that are common to

¹²² *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 52 (2d Cir. 1995); see also, e.g., *In re Alparma Inc. Sec. Litig.*, 372 F.3d 137, 148-49 (3d Cir. 2004); *In re Navarre Corp. Sec. Litig.*, 299 F.3d 735, 746 (8th Cir. 2002).

¹²³ See, e.g., *Rand-Heart of N.Y., Inc. v. Dolan*, 812 F.3d 1172, 1177 (8th Cir. 2016); *Emps.’ Ret. Sys. of Gov’t of the Virgin Islands v. Blanford*, 794 F.3d 297, 306 (2d Cir. 2015); *Podraza v. Whiting*, 790 F.3d 828, 836 (8th Cir. 2015).

¹²⁴ See, e.g., *Local 731 I.B. of T. Excavators & Pavers Pension Tr. Fund v. Diodes, Inc.*, 810 F.3d 951, 957 (5th Cir. 2016); *Bondali v. Yum! Brands, Inc.*, 620 F. App’x 483, 492 (6th Cir. 2015); *In re Zagg, Inc. Sec. Litig.*, 797 F.3d 1194, 1206 (10th Cir. 2015); *MHC Mut. Conversion Fund, L.P. v. Sandler O’Neill & Partners, L.P.*, 761 F.3d 1109, 1121-22 (10th Cir. 2014); *FindWhat Inv’r Grp. v. FindWhat.com*, 658 F.3d 1282, 1303 (11th Cir. 2011); *Thompson v. RelationServe Media, Inc.*, 610 F.3d 628, 689 (11th Cir. 2010); *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1166 (9th Cir. 2009); *Glazer Capital Mgmt., LP v. Magistri*, 549 F.3d 736, 743 (9th Cir. 2008).

most corporate officers,” such as the desire for a company to appear profitable or the desire to maintain a high stock price, are insufficient to support a strong inference of scienter.¹²⁵ As the Second Circuit has explained, were the rule otherwise, “virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions.” *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 54 (2d Cir. 1995). Plaintiffs must therefore allege facts that a defendant stood to benefit “in some concrete and personal way from the purported fraud.” *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009). One common allegation that sometimes meets this standard is that a corporate insider was motivated to conceal the truth to facilitate his own purchase or sale of company stock while the public trading price was artificially deflated or inflated. However, courts generally agree that motive allegations of this sort will only add support to a strong inference of scienter when the insider’s trades are sufficiently alleged to have been unusual or suspicious.¹²⁶

Another frequent allegation is that senior executives must have known about an alleged fraud because it related to an important part of the company’s business. This is sometimes referred to as the “core operations” theory,¹²⁷ and the Ninth Circuit rejected the plaintiffs’ attempt to invoke it in *Curry v. Yelp Inc.*, 875 F.3d 1219 (9th Cir. 2017). After recognizing the “settled” rule that “‘corporate management’s general awareness of the day-to-day workings of the company’s business do not establish scienter,’” the *Yelp* court explained that establishing a “strong inference

¹²⁵ *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009); see also, e.g., *Anderson v. Spirit Aerosystems Holdings, Inc.*, 827 F.3d 1229, 1239 (10th Cir. 2016); *Avaya*, 564 F.3d at 279; *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618, 627 (4th Cir. 2008); *Glazer*, 549 F.3d at 748; *Ind. Elec. Workers’ Pension Tr. Fund IBEW v. Shaw Grp., Inc.*, 537 F.3d 527, 544 (5th Cir. 2008).

¹²⁶ *Doshi v. Gen. Cable Corp.*, 823 F.3d 1032, 1042 (6th Cir. 2016); *Diodes*, 810 F.3d at 960-61; *In re Level 3 Commc’ns, Inc. Sec. Litig.*, 667 F.3d 1331, 1346-47 (10th Cir. 2012); *City of Roseville Emps.’ Ret. Sys. v. Horizon Lines, Inc.*, 442 F. App’x 672, 679 n.3 (3d Cir. 2011); *Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc.*, 594 F.3d 783, 793 (11th Cir. 2010); *Avon Pension Fund v. GlaxoSmithKline PLC*, 343 F. App’x 671, 673 (2d Cir. 2009); *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1005 (9th Cir. 2009); *Cozzarelli*, 549 F.3d at 627-28; *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1253 (11th Cir. 2008); *In re Ceridian Corp. Sec. Litig.*, 542 F.3d 240, 246-47 (8th Cir. 2008); *N.J. Carpenters Pension & Annuity Funds v. Biogen IDEC Inc.*, 537 F.3d 35, 55-56 (1st Cir. 2008); *Pugh v. Tribune Co.*, 521 F.3d 686, 695 (7th Cir. 2008).

¹²⁷ See, e.g., *KBC Asset Mgmt. NV v. DXC Tech. Co.*, 19 F.4th 601, 612 (4th Cir. 2021) (rejecting argument that “because some of Defendants’ alleged misstatements related to DXC’s core operations, Defendants were more likely to know that their statements were false”); *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1000 (9th Cir. 2009) (“[W]e have previously found inadequate complaints alleging that ‘facts critical to a business’s core operations or an important transaction generally are so apparent that their knowledge may be attributed to the company and its key officers.’”).

of scienter” requires specific allegations that “form[] a nexus between the wrongful behavior and Individual Defendants’ knowledge.” *Id.* at 1226-28.¹²⁸

The Second Circuit found such a nexus in a case involving allegations that Alibaba had concealed serious threats made by China’s State Administration for Industry and Commerce (SAIC) in a “high-level,” “secret” meeting held just two months prior to Alibaba’s IPO. *Christine Asia Co. v. Ma*, 718 F. App’x 20, 23-24 (2d Cir. 2017). Crediting allegations that the Alibaba representatives who attended the meeting reported directly to the individual defendants, and taking note of the “huge potential impact” of SAIC’s threats, the panel concluded that it was “virtually inconceivable that this threat was not communicated to the senior level of Alibaba’s management,” which “powerfully support[ed] a strong inference” of scienter. *Id.*¹²⁹

The courts of appeals have adopted different standards for assessing corporate scienter. The Fifth and Eleventh Circuits have endorsed a narrow test that “look[s] to the state of mind of the individual corporate official or officials who make or issue the statement.”¹³⁰ The Second and Seventh Circuits apply a more relaxed standard, which requires the plaintiff to plead sufficient facts to establish that “someone whose intent could be imputed to the corporation acted with requisite scienter,”¹³¹ even if it is not possible to “name the individuals who concocted and disseminated the fraud.”¹³² The Sixth Circuit takes a “middle ground” approach, under which the state of mind of anyone who “uttered or issued” or was otherwise involved in preparing or approving the relevant disclosure—as well as “any high managerial

¹²⁸ See also, e.g., *Neiman v. Bulmahn*, 854 F.3d 741, 749-50 (5th Cir. 2017) (“As a general matter, ‘a pleading of scienter may not rest on the inference that defendants must have been aware of the misstatement based on their positions within the company.’”); *Fain v. USA Technologies, Inc.*, 707 F. App’x 91, 96 (3d Cir. 2017) (“We have noted before the difficulty of establishing a ‘they-must-have-known’ type inference such as this. That Defendants were in top positions at [the company], alone, is not enough.”).

¹²⁹ See also *Neiman*, 854 F.3d at 749-50 (listing “special circumstances” that “occasionally . . . permit a plaintiff to plead scienter” based on “a defendant’s position in the company,” including whether the company was small enough that “‘corporate executives would be familiar with the intricacies of day to day operations,’” and whether “the transaction at issue may have been critical to the company’s continued vitality”).

¹³⁰ *Southland Sec. Corp. v. INSpire Ins. Sols., Inc.*, 365 F.3d 353, 366 (5th Cir. 2004) (explaining that the state of mind of corporate officials who “order or approve” a statement, or “furnish information or language for inclusion therein,” may also be imputed to the corporation); accord *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1254-55 (11th Cir. 2008) (“[T]he amended complaint does not create any inference, let alone a strong one, that unnamed Home Depot officials were both responsible for issuing the allegedly false public statements and were aware of the alleged fraud.”).

¹³¹ *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 195 (2d Cir. 2008) (“[I]t is possible to raise the required inference with regard to a corporate defendant without doing so with regard to a specific individual defendant.”).

¹³² *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 710 (7th Cir. 2008) (“[I]t is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud.”)

agent or member of the board of directors who ratified, recklessly disregarded, or tolerated the misrepresentation after its utterance or issuance”—is relevant to the corporate scienter inquiry.¹³³

c. *The Group Pleading Doctrine*

Prior to passage of the PSLRA, federal courts adopted the so-called “group pleading” doctrine as a partial exception to the particularity requirements of Fed. R. Civ. P. 9(b). The doctrine allowed a plaintiff to plead securities fraud claims against multiple individuals by relying on a presumption that allegedly false and misleading “group published information”—such as prospectuses, registration statements, annual reports, and press releases—was the “collective action of [a corporation’s] officers and directors.” *In re GlenFed, Inc. Sec. Litig.*, 60 F.3d 591, 593 (9th Cir. 1995).¹³⁴ The scope of the doctrine was typically limited to corporate insiders,¹³⁵ but some courts extended it to outside directors who “participated in . . . day-to-day corporate activities, or had a special relationship with the corporation, such as participation in preparing or communicating group information at particular times.”¹³⁶

Courts have not uniformly resolved the question whether the group pleading doctrine survived the PSLRA’s passage. *See Tellabs*, 551 U.S. at 326 n.6 (acknowledging circuit split). The Third, Fifth, and Seventh Circuits have concluded that it does not, reasoning that “the PSLRA requires the plaintiffs to distinguish among those they sue and enlighten *each defendant* as to his or her particular part in the alleged fraud.” *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 364 (5th Cir. 2004).¹³⁷ The Eleventh Circuit has suggested that it agrees, stating in dictum that “to proceed beyond the pleading stage, [a plaintiff] must allege facts sufficiently demonstrating each defendant’s state of mind regarding his or her alleged violations.” *Phillips v. Scientific-Atlanta, Inc.*, 374 F.3d 1015, 1018 (11th

¹³³ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d 455, 476 (6th Cir. 2014).

¹³⁴ *See also, e.g., Luce v. Edelstein*, 802 F.2d 49, 55 (2d Cir. 1986) (“[N]o specific connection between fraudulent representations in [an] Offering Memorandum and particular defendants is necessary where . . . defendants are insiders or affiliates participating in the offer of the securities in question.”).

¹³⁵ *See, e.g., In re CellCyte Genetics Sec. Litig.*, 2009 WL 3103892, at *4 (W.D. Wash. Sept. 23, 2009); *Irvine v. ImClone Sys.*, 2003 WL 21297285, at *2 (S.D.N.Y. June 3, 2003); *In re Premiere Techs., Inc.*, 2000 WL 33231639, at *10 (N.D. Ga. Dec. 8, 2000) (collecting cases).

¹³⁶ *In re GlenFed, Inc. Sec. Litig.*, 60 F.3d 591, 593 (5th Cir. 1995); *see also, e.g., In re SmarTalk Teleservices, Inc. Sec. Litig.*, 124 F. Supp. 2d 527, 546 (S.D. Ohio 2000).

¹³⁷ *Accord Pugh*, 521 F.3d at 693-94 (“We have rejected the ‘group pleading doctrine’ . . . the plaintiffs must create a strong inference of scienter with respect to each individual defendant.”); *Winer Trust Family v. Queen*, 503 F.3d 319, 337 (3d Cir. 2007) (“[T]he group pleading doctrine is no longer viable in private securities actions after the enactment of the PSLRA.”).

Cir. 2004). But the Tenth Circuit appeared to reach the opposite conclusion in *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1254 (10th Cir. 1997), a post-PSLRA case in which the court stated (albeit without referencing the PSLRA) that “[i]dentifying the individual sources of statements is unnecessary when the fraud allegations arise from misstatements or omissions in group-published documents . . . which presumably involve collective actions of corporate directors or officers.”¹³⁸ And a number of district courts have found the group pleading doctrine to be “alive and well” notwithstanding the PSLRA.¹³⁹

Courts have likewise disagreed on what effect, if any, the Supreme Court’s decision in *Janus* had on the continued viability of the group pleading doctrine.¹⁴⁰

8. Remedies and Measure of Damages

Remedies available in private actions under Rule 10b–5 include injunctive relief as well as damages. *See, e.g., Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187, 194 (3d Cir. 1976). Where damages are sought, the measure of damages is governed by § 28(a) of the Exchange Act, which limits recovery in cases under the Exchange Act to “actual damages.” The Supreme Court has stated that the correct measure of damages under Rule 10b–5 for a defrauded seller or purchaser is the “out-of-pocket” measure—*i.e.*, the difference between the price paid or received and the true value at the time of purchase (in the absence of fraudulent conduct). *Affiliated*

¹³⁸ Other courts of appeals have referenced the issue but declined to reach it for one reason or another. *See In re Hutchinson Tech., Inc. Sec. Litig.*, 536 F.3d 952, 961 n.6 (8th Cir. 2008); *Miss. Pub. Emps.’ Ret. Sys. v. Boston Scientific Corp.*, 523 F.3d 75, 93 & n.10 (1st Cir. 2008); *City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 689-90 (6th Cir. 2005); *Dunn v. Borta*, 369 F.3d 421, 434 (4th Cir. 2004). *See also Loreley Fin. (Jersey) No. 3 Ltd. v. Wells Fargo Sec., LLC*, 797 F.3d 160, 172 n.7 (2d Cir. 2015) (“The vitality of the group pleading doctrine as to federal securities fraud is an open question in our Circuit, and one that is not before us in this case.”).

¹³⁹ *In re BISYS Sec. Litig.*, 397 F. Supp. 2d 430, 439 & n.42 (S.D.N.Y. 2005). *See also, e.g., City of Pontiac Gen. Emps.’ Ret. Sys. v. Lockheed Martin Corp.*, 875 F. Supp. 2d 359, 373-74 (S.D.N.Y. 2012) (collecting cases); *In re FirstEnergy Corp. Sec. Litig.*, 316 F. Supp. 2d 581, 599-600 (N.D. Ohio 2004); *In re Metawave Commc’ns Corp. Sec. Litig.*, 298 F. Supp. 2d 1056, 1087-89 (W.D. Wash. 2003); *In re Raytheon Sec. Litig.*, 157 F. Supp. 2d 131, 152-53 (D. Mass. 2001) (collecting cases).

¹⁴⁰ *Compare Lockheed Martin*, 875 F. Supp. 2d at 374 (holding that *Janus* “has no bearing on how corporate officers who work together in the same entity can be held jointly responsible on a theory of primary liability”), with *In re Smith Barney Transfer Agent Litig.*, 884 F. Supp. 2d 152, 165 (S.D.N.Y. 2012) (declining to follow *Lockheed Martin*; “only officers whose signatures appear on misleading statements may be liable as the ‘makers’ of those statements” in the wake of *Janus*).

Ute, 406 U.S. at 155.¹⁴¹ It is universally accepted, however, that § 28(a)'s reference to "actual damages" precludes an award of punitive damages under Rule 10b-5.¹⁴²

In creating § 21D(e) of the Exchange Act, the PSLRA adopted a cap on damages in an attempt to account for any "bounce-back" in a security's price after full or corrective disclosure is made. Under the provision, if after the corrective disclosure of unfavorable information the security recovers all or a portion of the initial price decrease, damages will be capped by the difference between the plaintiff's purchase or sale price and the mean trading price of the security over the 90-day period beginning on the date of the corrective disclosure. *See* 15 U.S.C. § 78u-4(e)(1). When the plaintiff sells or repurchases the security before expiration of the 90-day period, the plaintiff may recover no more than the difference between the purchase or sale price and the appropriate mean trading price. *See id.* § 78u-4(e)(2); *see also In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 235, 262 n.10, 273 (D.N.J. 2000), *aff'd*, 264 F.3d 201 (3d Cir. 2001).

9. Statute of Limitations

Resolving a difference of opinion among the federal courts about the correct period of limitations for private actions under § 10(b) and Rule 10b-5, the Supreme Court held in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), that the appropriate period is the one applicable to express causes of action under the federal securities laws. The Court found there was "no doubt that the contemporaneously enacted express remedial provisions represent a federal statute of limitations actually designed to accommodate a balance of interests very similar to that at stake here," *id.* at 359, and thus adopted the one-year/three-year limitation period codified for provisions that expressly allow private rights of action, such as §§ 11 and 12 of the Securities Act and § 18 of the Exchange Act. The Court also

¹⁴¹ It is accepted that, at least where the plaintiff dealt face-to-face with the defendant and the securities purchased or sold have not been re-transferred, the plaintiff may elect to sue for rescission. *See, e.g., In re Letterman Bros. Energy Sec. Litig.*, 799 F.2d 967, 972 (5th Cir. 1986); *Huddleston v. Herman & MacLean*, 640 F.2d 534, 554 (5th Cir. 1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983). However, a plaintiff seeking rescission under § 10(b) (or its monetary equivalent if true rescission is not possible) must prove both economic loss and loss causation. *See Strategic Diversity, Inc. v. Alchemix Corp.*, 666 F.3d 1197, 1207-09 (9th Cir. 2012).

¹⁴² *See, e.g., Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1139 (5th Cir. 1988), *vacated on other grounds sub nom. Fryar v. Abell*, 492 U.S. 914 (1989); *Straub v. Vaisman & Co.*, 540 F.2d 591, 599 (3d Cir. 1976); *Green v. Wolf Corp.*, 406 F.2d 291, 302-03 (2d Cir. 1968).

held that the limitation period was not subject to equitable tolling, thus overruling a long line of lower-court precedent. *Id.* at 350.¹⁴³

Sarbanes-Oxley amended 28 U.S.C. § 1658 to provide for a two-year/five-year limitations period for any “private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws.” Pub. L. 107-204, § 804; 116 Stat. 745 (2002). Thus, private actions under § 10(b) and Rule 10b-5 are now subject to a two-year statute of limitations and five-year statute of repose. *See, e.g., In re Initial Pub. Offering Sec. Litig.*, 341 F. Supp. 2d 328, 344 (S.D.N.Y. 2004).

As to when the statute of limitations period should begin to run, a majority of circuits applied an “inquiry notice” standard, with disagreement as to the precise definition of the term.¹⁴⁴ In *Merck & Co. v. Reynolds*, 559 U.S. 633, 637 (2010), a unanimous Supreme Court addressed the issue and held that the two-year statute of limitations set forth in 28 U.S.C. § 1658 begins running “(1) when the plaintiff d[oes] in fact discover, or (2) when a reasonably diligent plaintiff would have discovered, the ‘facts constituting the violation’—whichever comes first.” To prevent fraudulent actors from maneuvering to avoid liability by running out the statute of limitations, the Court defined “facts constituting the violation” to include facts demonstrating the existence of scienter.¹⁴⁵

The statute of limitations is also subject to tolling under the rule announced in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 554 (1974)—namely,

¹⁴³ *See, e.g., Hill v. Equitable Trust Co.*, 851 F.2d 691, 694, 698-99 (3d Cir. 1988); *Suslick v. Rothschild Sec. Corp.*, 741 F.2d 1000, 1001 (7th Cir. 1984); *Hackbart v. Holmes*, 675 F.2d 1114, 1120 (10th Cir. 1982).

¹⁴⁴ *See, e.g., LC Capital Partners v. Frontier Ins. Grp.*, 318 F.3d 148, 154 (2d Cir. 2003); *In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1325-26 (3d Cir. 2002); *Ritchey v. Horner*, 244 F.3d 635, 638-39 (8th Cir. 2001); *Rothman v. Gregor*, 220 F.3d 81, 97 (2d Cir. 2000); *Berry v. Valence Tech., Inc.*, 175 F.3d 699, 704 (9th Cir. 1999); *Sterlin v. Biomune Sys., Inc.*, 154 F.3d 1191, 1204 (10th Cir. 1998); *see also Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 951 (9th Cir. 2005) (stating that the Ninth Circuit has not yet determined whether actual notice or “inquiry-plus-due diligence” is the proper standard to trigger the statute of limitations and the Circuit may apply either standard depending on the case); *La Grasta v. First Union Sec., Inc.*, 358 F.3d 840, 849 (11th Cir. 2004) (refusing to hold that a substantial or sudden drop in the price of the securities “constitutes inquiry notice as a matter of law”).

¹⁴⁵ *Merck & Co. v. Reynolds*, 559 U.S. 633, 648-49 (2010) (“It would . . . frustrate the very purpose of the discovery rule in this provision . . . if the limitations period began to run regardless of whether a plaintiff had discovered any facts suggesting scienter. So long as a defendant concealed for two years that he made a misstatement with an intent to deceive, the limitations period would expire before the plaintiff had actually ‘discover[ed]’ the fraud.”); *see also City of Pontiac Gen. Emps.’ Ret. Sys. v. MBIA, Inc.*, 637 F.3d 169, 174 (2d Cir. 2011) (holding that the limitations period does not begin to run until a reasonably diligent plaintiff can plead facts constituting a securities fraud violation with sufficient detail and particularity to survive a motion to dismiss).

that “the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class who would have been parties had the suit been permitted to continue as a class action.”¹⁴⁶ But as the Supreme Court has held, this tolling rule “does not permit the maintenance of a follow-on class action past expiration of the statute of limitations,” and so if class certification is denied “beyond the time allowed by the applicable statute of limitations,” unnamed members of the failed class must either “join the action individually or file individual claims.” *China Agritech, Inc. v. Resh*, 138 S. Ct. 1800, 1804 (2018). Sanctioning a contrary result, the Court reasoned, would risk “serial relitigation” through “[e]ndless tolling,” which was “not a result envisioned by *American Pipe*.” *Id.* at 1809. As discussed further below (at p. 118), the Supreme Court held in *California Public Employees’ Retirement System v. ANZ Securities, Inc.*, 582 U.S. 497, 515-16 (2017) (“*CalPERS*”), that the Securities Act’s three-year statute of repose is not subject to *American Pipe* tolling. The Second, Sixth, and Eleventh Circuits had previously reached the same conclusion in cases involving the Exchange Act’s statute of repose,¹⁴⁷ and the Supreme Court’s holding in *CalPERS* would appear to confirm the correctness of those decisions, *see N. Sound Capital LLC v. Merck & Co.*, 702 F. App’x 75, 77 (3d Cir. 2017) (“It is now clear that . . . the *American Pipe* tolling rule cannot be invoked to toll the running of time under the statutes of repose at issue in these cases and that appellees’ Exchange Act claims therefore were untimely.” (citing *CalPERS*)).

10. Defenses

Defendants in a Rule 10b–5 action may be able to raise one or more of several defenses that turn on the conduct of the plaintiffs, such as *in pari delicto*, due diligence, estoppel, or unclean hands. In *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299 (1985), and *Pinter v. Dahl*, 486 U.S. 622 (1988), the Supreme Court held that the *in pari delicto* defense may be available to defendants in actions under § 10(b) of the Exchange Act and § 12(a)(1) (then § 12(1)) of the Securities Act, respectively. The Court formulated the standard for determining when the defense would be available in securities litigation: a defendant must show that (1)

¹⁴⁶ *American Pipe* involved the question whether an unnamed member of the proposed class could intervene as an additional individual plaintiff, even after the limitations period had expired, “after the court has found the suit inappropriate for class action status.” 414 U.S. at 552-53. The Supreme Court later extended the holding of *American Pipe* to permit all members of the proposed class, once “class certification is denied,” either “to file their own suits or to intervene as plaintiffs in the pending action.” *Crown, Cork & Seal. Co. v. Parker*, 462 U.S. 345, 353-54 (1983).

¹⁴⁷ *See SRM Global Master Fund Ltd. P’ship v. Bear Stearns Cos., L.L.C.*, 829 F.3d 173, 177 (2d Cir. 2016) (“[W]e hold that *American Pipe* tolling does not apply to § 1658(b)(2)’s five-year statute of repose.”); *Stein v. Regions Morgan Keegan Select High Income Fund, Inc.*, 821 F.3d 780, 792-95 (6th Cir. 2016) (same); *Dusek v. JPMorgan Chase & Co.*, 832 F.3d 1243, 1246-49 (11th Cir. 2016) (same).

“as a direct result of [the plaintiff’s] own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress”; and (2) barring the plaintiff’s recovery would not offend the underlying statutory policies by interfering “with the effective enforcement of the securities laws and protection of the investing public.” *Bateman Eichler*, 472 U.S. at 310-11.

The first element of the test requires the plaintiff to have been an “active, voluntary participant in the unlawful activity that is the subject of the suit.” *Pinter*, 486 U.S. at 636. Thus, in the context of a claim brought under § 12(a)(1), the mere fact that a plaintiff-buyer knew the purchased securities were unregistered is not enough to satisfy the test. *See id.* But where the plaintiff-buyer actually “induced [the defendant-issuer] not to register, he well might be precluded from obtaining § 12(1) rescission.” *Id.* at 637.¹⁴⁸ Under the second prong, the court should weigh the competing deterrent effects of allowing the defense and barring the plaintiff’s claim against the deterrent effect of denying the defense and allowing the private suit to go forward. Thus, in *Bateman Eichler* itself, the Supreme Court rejected the *in pari delicto* defense to a Rule 10b–5 action brought by a tippee against a tipper, noting that the threat of private, civil actions frequently serves as the greatest deterrent to illegal conduct by insiders. The Court concluded that “the public interest will most frequently be advanced if defrauded tippees are permitted to . . . expose illegal practices by corporate insiders.” *Bateman Eichler*, 472 U.S. at 319.¹⁴⁹

The defense of due diligence, going to the reasonableness of the plaintiff’s reliance, has been held to be available in Rule 10b–5 actions by several circuits.¹⁵⁰ Some

¹⁴⁸ *See also UCAR Int’l, Inc. v. Union Carbide Corp.*, 2004 WL 137073, at *10-16 (S.D.N.Y. Jan. 26, 2004) (applying *Bateman Eichler* and holding corporation’s claims barred by *in pari delicto* defense, where payments sought to be recovered were illegal because of a price-fixing conspiracy in which plaintiff had pled guilty), *aff’d*, 119 F. App’x 300 (2d Cir. 2004).

¹⁴⁹ *See also Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082, 1091 (2d Cir. 1997) (finding the second prong satisfied, and holding *in pari delicto* defense applicable); *Rothberg v. Rosenbloom*, 808 F.2d 252, 258 (3d Cir. 1986) (finding that “the second prong of the *Bateman Eichler* test has not been met.”).

¹⁵⁰ *See, e.g., Ashland Inc. v. Morgan Stanley & Co.*, 652 F.3d 333, 338 (2d Cir. 2011) (holding that self-described sophisticated investor was not justified in relying on financial advisor’s alleged misrepresentations when a publicly filed statement “explicitly disclosed the very liquidity risks about which appellants claim to have been misled”); *Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc.*, 343 F.3d 189, 195-96 (2d Cir. 2003) (finding reliance unreasonable where sophisticated plaintiffs relied on oral representations of a friend rather than demand representations in stock purchase agreement); *Kennedy v. Venrock Assocs.*, 348 F.3d 584, 592 (7th Cir. 2003) (finding reliance unreasonable where plaintiff failed to read or understand 20 pages in proxy statement outlining differences between Maryland and Delaware law); *Jackvony v. RIHT Fin. Corp.*, 873 F.2d 411, 416-17 (1st Cir. 1989); *Hirsch v. Du Pont*, 553 F.2d 750, 762-63 (2d Cir. 1977); *Rochez Bros., Inc. v. Rhoades*, 491 F.2d 402, 409-10 (3d Cir. 1973), *aff’d following remand*, 527 F.2d 880 (3d Cir. 1975); *Stephenson v. Paine Webber Jackson & Curtis, Inc.*, 839 F.2d 1095, 1098-99 (5th Cir. 1988) (rejecting argument that *Bateman Eichler* eliminated due diligence defense and holding that plaintiff’s failure to investigate must rise to level of recklessness to bar claim); *Aschinger v. Columbus Showcase Co.*, 934 F.2d 1402, 1408

courts hold that the exercise of due diligence by the plaintiff does not need to be pleaded in order to state a claim under Rule 10b-5, at least in a fraud-on-the-market case, while others require plaintiffs to plead reasonable reliance.¹⁵¹ Moreover, three circuits have held that a non-reliance clause in a written agreement accompanying a stock purchase or sale bars a plaintiff from asserting a claim for damages based on prior oral statements.¹⁵²

11. Insider Trading

a. *The Classical Theory*

Since the decision of the SEC in *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961), insider trading—trading by corporate insiders on the basis of material nonpublic information—has been viewed by the SEC and the courts as a violation of Rule 10b-5. Such trading “gives rise to a duty to disclose” because “a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.” *Chiarella v. United States*, 445 U.S. 222, 228 (1980). This does not mean that corporate insiders have a duty to disclose all material information to the public; rather, their duty is to either disclose or abstain from trading until disclosure takes place.¹⁵³ Under this “classical theory” of insider trading, the duty to

(6th Cir. 1991); *Molecular Tech. Corp. v. Valentine*, 925 F.2d 910, 918 (6th Cir. 1991); *Zobrist v. Coal-X, Inc.*, 708 F.2d 1511, 1516-17, 1519 (10th Cir. 1983) (stating that plaintiff’s reliance must be “justifiable” and holding that recovery was precluded by recklessness); *Ross v. Bank S., N.A.*, 885 F.2d 723, 738-39 (11th Cir. 1989); cf. *Hamilton v. Harrington*, 807 F.2d 102, 107 (7th Cir. 1986) (holding that a son could not ground a fraud claim on allegations that he was misled about the sale of his family’s business, when he was fully aware that his father wanted to sell the firm after his retirement).

¹⁵¹ *Compare Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986) (not requiring allegations of due diligence in fraud on the market case), *Maverick Fund, L.D.C. v. Comverse Tech., Inc.*, 801 F. Supp. 2d 41, 57-58 (E.D.N.Y. 2011) (finding that sophisticated investor plaintiff could invoke fraud on the market presumption because it had no duty to seek out information beyond what was publicly available and because presumption remained available to program traders relying on securities’ relative prices), and *Kline v. Henrie*, 679 F. Supp. 464, 470-71 (M.D. Pa. 1988) (not requiring allegations of due diligence in fraud on the market case), with *Harsco Corp. v. Segui*, 91 F.3d 337, 342 (2d Cir. 1996) (“The general rule is that reasonable reliance must be proved as an element of a securities fraud claim.”), and *One-O-One Enters., Inc. v. Caruso*, 848 F.2d 1283, 1286 (D.C. Cir. 1988) (“To state a claim of fraud or securities fraud upon which relief can be granted, plaintiffs’ allegations must indicate that their reliance on the allegedly fraudulent representations was reasonable.”).

¹⁵² See *Rissman v. Rissman*, 213 F.3d 381, 384 (7th Cir. 2000); *Jackvony*, 873 F.2d at 416-17; *One-O-One Enters.*, 848 F.2d at 1286-87; *McDonald’s Corp. v. Barnes*, 1993 WL 358556, at *3 (9th Cir. Sept. 14, 1993). But see *Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901, 921 (6th Cir. 2007) (refusing “[t]o erect a *per se* rule” and instead treating non-reliance clause as one of the circumstances to be taken into account in determining whether plaintiff’s reliance was reasonable); *AES Corp. v. Dow Chem. Co.*, 325 F.3d 174, 183-84 (3d Cir. 2003) (same).

¹⁵³ See, e.g., *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968) (“[A]nyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing

disclose material nonpublic information or abstain from trading “applies not only to officers, directors, and other permanent insiders of a corporation, but also to attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation.” *United States v. O’Hagan*, 521 U.S. 642, 652 (1997).¹⁵⁴ Moreover, as discussed below (at pp. 74-77), this duty to disclose or abstain will also be assumed by tippees of insiders in certain circumstances.

The Supreme Court was asked to significantly broaden the scope of the disclose-or-abstain rule in *Chiarella*, but declined to do so. In that case, an employee of a financial printer was able to guess, without being told, the names of certain takeover targets from documents being prepared at the printer. He was convicted of a criminal violation of Rule 10b–5 for having traded in the target companies’ shares prior to the takeover announcements, and that conviction was affirmed on the theory that “[t]he use by anyone of material information not generally available is fraudulent.” *Chiarella*, 445 U.S. at 231-32. The Court rejected this theory and overturned the conviction, holding that “a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information” and that only “a specific relationship between two parties” could give rise to such a duty. *Id.* at 233-35.¹⁵⁵ At the same time, the Court expressly declined to address the argument that *Chiarella* had “breached a duty to the acquiring corporation when he acted upon information that he obtained by virtue of his position as an employee of a printer employed by the corporation,” because that theory was not presented to the jury. *Id.* at 235-37.

After *Chiarella* was decided, in an effort to enhance its power to combat insider trading in the tender offer context, the SEC exercised its rulemaking authority under § 14 of the Exchange Act and promulgated Rule 14e–3. That rule applies once “any person has taken a substantial step or steps to commence, or has commenced, a tender offer,” and requires individuals in possession of material nonpublic information related to the tender offer that they know or have reason to know originated

it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.”), *cert. denied*, *Coates v. SEC*, 394 U.S. 976 (1969). This duty has been held to apply not only to registered securities, but to unregistered and delisted securities as well. *See Steginsky v. Xcelera Inc.*, 741 F.3d 365, 371 (2d Cir. 2014).

¹⁵⁴ “The basis for recognizing this fiduciary duty” for certain corporate outsiders “is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.” *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983).

¹⁵⁵ Drawing from the common law, the Court explained that “one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so,” and that such a “duty to disclose arises when one party has information ‘that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.’” *Chiarella v. United States*, 445 U.S. 222, 228 (1980) (quoting Restatement (Second) of Torts § 551(2)(a) (1976)).

with the offeror, the issuer, or anyone acting on their behalf to either disclose the information or abstain from trading—even if the trader owed no fiduciary duty of loyalty or confidentiality to the source of the information. See 17 C.F.R. § 240.14e-3(a).¹⁵⁶ Rule 14e-3 thus effectively overruled the specific result in *Chiarella* in the tender offer context.

A somewhat controversial question in the insider trading context is what constitutes trading “on the basis of” material nonpublic information. Few courts have specifically addressed whether § 10(b) and Rule 10b-5 require a causal connection between the material nonpublic information and the insider’s trading, or whether knowing possession of that information, while trading, is sufficient for liability. Courts in the Second Circuit have held that “knowing possession” of material nonpublic information is sufficient, reasoning that requiring “a causal connection between the information and the trade could frustrate attempts to distinguish between legitimate trades and those conducted in connection with inside information.” *United States v. Teicher*, 987 F.2d 112, 120-21 (2d Cir. 1993).¹⁵⁷ The Eleventh Circuit, by contrast, has ruled that the Supreme Court’s language in *Chiarella* and two other cases discussed below (*Dirks* and *O’Hagan*) suggests that there is no securities violation in the absence of a stronger causal connection. *SEC v. Adler*, 137 F.3d 1325, 1337-38 (11th Cir. 1998). More specifically, the court held that “mere knowing possession—i.e., proof that an insider traded while in possession of material nonpublic information—is not a *per se* violation,” but it does raise “a strong inference” that the insider used the information in trading, which inference the insider can attempt to rebut. *Id.* at 1337. Following the Eleventh Circuit, the Ninth Circuit has also rejected the knowing possession standard in favor of a use

¹⁵⁶ In the adopting release for Rule 14e-3, the SEC provided examples of what would constitute, in its view, substantial steps to commence a tender offer—namely “voting on a resolution by the offering person’s board of directors relating to the tender offer,” “the formulation of a plan or proposal to make a tender offer,” “arranging financing,” “preparing or directing or authorizing the preparation of tender offer materials,” and “negotiating or entering into agreements with any person to act as a dealer manager, soliciting dealer, forwarding agent or depository in connection with the tender offer.” Tender Offers, Exchange Act Release No. 17,120, 20 SEC Docket 1350, at *6 n.33 (Sept. 4, 1980); see also *SEC v. Ginsburg*, 362 F.3d 1292, 1302-04 (11th Cir. 2004) (“a meeting between executives, which was followed by due diligence procedures, [and] a confidentiality agreement” “were substantial steps for purposes of Rule 14e-3”); *SEC v. Mayhew*, 121 F.3d 44, 53 (2d Cir. 1997) (finding the “substantiality requirement” satisfied where the offeror and target “retained a consulting firm, signed confidentiality agreements, and held meetings between top officials”); *Allergan, Inc. v. Valeant Pharm. Int’l, Inc.*, 2014 WL 5604539, at *7-9 (C.D. Cal. Nov. 4, 2014) (declining to credit a contractual disclaimer that no substantial steps toward a tender offer had taken place where there was “at least a strong possibility . . . that [defendants’] actions” in hiring advisors, conducting due diligence, arranging financing, and forming a jointly owned acquisition vehicle “would lead toward and facilitate a tender offer”).

¹⁵⁷ See also, e.g., *United States v. Rajaratnam*, 719 F.3d 139, 160 (2d Cir. 2013) (holding that a jury instruction that the nonpublic information obtained by the defendant must be “a factor, however small” in his decision to trade satisfied the “knowing possession” standard); *SEC v. Thrasher*, 152 F. Supp. 2d 291, 302 (S.D.N.Y. 2001).

standard, noting that “[i]t is the insider’s use, not his possession, that gives rise to an informational advantage and the requisite intent to defraud.” *United States v. Smith*, 155 F.3d 1051, 1068 (9th Cir. 1998); *see also id.* at 1069 (refusing to adopt the *Adler* presumption in the context of a criminal prosecution).

In August 2000, the SEC promulgated Rule 10b5–1 in an attempt to end the use/possession debate. Under the rule, “a purchase or sale of a security of an issuer is on the basis of material nonpublic information for purposes of Section 10(b) and Rule 10b–5 if the person making the purchase or sale was *aware* of the material nonpublic information when the person made the purchase or sale.” 17 C.F.R. § 240.10b5–1(b) (emphasis added).¹⁵⁸ The SEC thus came down in favor of a standard similar to the “knowing possession” test, mitigated by “carefully enumerated affirmative defenses.” Selective Disclosure and Insider Trading, SEC Release No. 34–43154, 65 Fed. Reg. 51,716, 51,727 (Aug. 15, 2000) [hereinafter “Selective Disclosure and Insider Trading Release”]. The most important affirmative defense, available to both individuals and entities, provides exclusions for certain situations in which a trade resulted from a preexisting plan, contract, or instruction that was established in good faith. *See* 17 C.F.R. §§ 240.10b5–1(c)(1)(i)–(iii). This defense covers “situations in which a person can demonstrate that the material nonpublic information was not a factor in the trading decision,” which potentially includes situations such as issuers operating repurchase programs, employees adopting plans for exercising stock options, and employees acquiring “company stock through payroll deductions under an employee stock purchase plan or a Section 401(k) plan.” Selective Disclosure and Insider Trading Release, at 51,728. An additional affirmative defense is available to entities alone: an entity can avoid liability if it can demonstrate that the person making investment decisions for the entity was not aware of the information, and that the entity had implemented reasonable policies and procedures to prevent insider trading. *See* 17 C.F.R. § 240.10b5–1(c)(2).

“To plead the affirmative defense, Rule 10b5–1 requires defendants to assert the existence of a *written* plan for trading adopted before defendants became aware of the material nonpublic information.” *SEC v. Lyon*, 605 F. Supp. 2d 531, 548 (S.D.N.Y. 2009). Thus, the existence of a Rule 10b5–1 plan may not protect

¹⁵⁸ As discussed below (at p. 70), in December 2022, the SEC adopted an amended version of Rule 10b5–1. *See* Insider Trading Arrangements and Related Disclosures, SEC Release No. 34–96492, 87 Fed. Reg. 80,362, 80,365–80 (Dec. 29, 2022) [hereinafter “Insider Trading Arrangements”]. This outline quotes from the amended version of the rule.

against insider trading liability when the decision to establish the plan was made while in possession of material nonpublic information.¹⁵⁹

The SEC recently adopted amendments to Rule 10b5–1 that are “designed to significantly reduce opportunities for corporate insiders to misuse Rule 10b5–1 to trade on material nonpublic information.” *See* Insider Trading Arrangements, at 80,365. Among other changes: (i) all plans designed to qualify for the subsection (c)(1) affirmative defense (other than issuer-adopted plans) are now subject to a mandatory cooling-off period of at least 30 days following the adoption of the plan, *see id.* at 80,369-72; (ii) the availability of the affirmative defense (other than for issuer-adopted plans) is now generally conditioned on the adopting person not having another outstanding plan, contract, or instruction for the same period for open-market transactions involving any class of securities of the issuer, *see id.* at 80,376; and (iii) in addition to the existing requirement that a qualifying plan be entered into in good faith, the adopting person is now be required to *act* in good faith with respect to the plan, *see id.* at 80,380.

b. *The Misappropriation Theory*

The question reserved by the Supreme Court in *Chiarella*—whether the misappropriation of information in order to trade in securities in violation of a duty of confidentiality owed to an entity other than the issuer could provide the basis for insider trading liability—came before the Court in *Carpenter v. United States*, 484 U.S. 19 (1987). R. Foster Winans, a reporter for the *Wall Street Journal*, was co-author of the “Heard on the Street” column, which reviewed selected stocks or groups of stocks on a daily basis. Winans gave advance information on the subjects of upcoming columns to others, who traded on this information and split the profits with Winans. With one justice recusing, the Supreme Court split 4-4, which had the effect of affirming the Second Circuit’s decision upholding Winans’ criminal conviction under Rule 10b–5 on the theory that he had “misappropriate[ed] prepublication information regarding the timing and contents of the ‘Heard’ column . . . gained in the course of his employment.” 484 U.S. at 23-24.

Because the *Carpenter* Court was evenly divided and the Supreme Court’s prior decisions had failed to address the issue, a wide hole existed in Rule 10b–5’s prohibition of insider trading for persons who came into possession of inside information legitimately but then used the information to trade. Several courts of

¹⁵⁹ *See, e.g., SEC v. Mozilo*, 2010 WL 3656068, at *20 (C.D. Cal. Sept. 16, 2010) (denying summary judgment where transactions in question were made pursuant to Rule 10b5–1 trading plans because defendant was aware of material, nonpublic information at the time he adopted or amended the plans).

appeals filled this hole by recognizing the “misappropriation theory” of insider trading,¹⁶⁰ but the Fourth and Eighth Circuits rejected that theory.¹⁶¹ This conflict among the circuits was finally resolved, and the gap in the law filled, by the Supreme Court’s decision in *United States v. O’Hagan*, 521 U.S. 642 (1997).

O’Hagan involved the trades of a lawyer who had received information that one of his law firm’s (though not his own) clients, Grand Met, was planning a tender offer for Pillsbury. O’Hagan purchased Pillsbury options and common stock on the basis of this information, and after Grand Met announced its tender offer, O’Hagan sold the options and stock at a substantial profit. O’Hagan was indicted and charged with criminal violations of § 10(b), Rule 10b–5, § 14(e), and Rule 14e–3 (among other claims) and convicted on all counts. *See id.* at 647-49.

The Eighth Circuit reversed O’Hagan’s securities law convictions, reasoning that (1) trading on the basis of misappropriated nonpublic information regarding a company to which O’Hagan owed no fiduciary duty did not violate § 10(b) or Rule 10b–5, and (2) O’Hagan could not be guilty of violating Rule 14e–3 (and, in turn, § 14(e)) because the SEC had exceeded its authority in promulgating that rule. *See United States v. O’Hagan*, 92 F.3d 612, 622, 627-28 (8th Cir. 1996), *rev’d*, 521 U.S. 642 (1997).

The Supreme Court disagreed with the Eighth Circuit on both issues and reversed. First, the Court held that criminal liability under § 10(b) and Rule 10b–5 could be predicated on the “misappropriation theory,” which “outlaws trading on the basis of nonpublic information by a corporate ‘outsider’ in breach of a duty owed . . . to the source of the information.” *O’Hagan*, 521 U.S. at 652-53. “Under this theory,” the Court explained, “a fiduciary’s undisclosed, self-serving use of a principal’s information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information.” *Id.* at 652. Liability under this theory is premised on nondisclosure, and so “if the fiduciary discloses . . . that he plans to trade on the nonpublic information, there is no ‘deceptive device’ and thus no § 10(b) violation.” *Id.* at 655.¹⁶² This “disclosure

¹⁶⁰ *See, e.g., United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *aff’d following remand*, 722 F.2d 729 (2d Cir. 1983), *overruled on other grounds by McNally v. United States*, 483 U.S. 350 (1987); *Rothberg v. Rosenbloom*, 771 F.2d 818, 825 (3d Cir. 1985) (Higginbotham, J., concurring), *rev’d on other grounds after remand*, 808 F.2d 252 (3d Cir. 1986); *SEC v. Cherif*, 933 F.2d 403, 408 (7th Cir. 1991); *SEC v. Clark*, 915 F.2d 439, 449 (9th Cir. 1990).

¹⁶¹ *United States v. Bryan*, 58 F.3d 933, 944 (4th Cir. 1995); *United States v. ReBrook*, 58 F.3d 961, 964-65 (4th Cir. 1995); *United States v. O’Hagan*, 92 F.3d 612, 617 (8th Cir. 1996), *rev’d*, 521 U.S. 642 (1997).

¹⁶² In *SEC v. Dorozhko*, 574 F.3d 42, 49-51 (2d Cir. 2009), the Second Circuit held that the SEC did not need to demonstrate a breach of fiduciary duty when the defendant, a computer hacker who accessed a secure server

obligation runs to the source of the information,” which, under the facts of *O’Hagan*, was both the law firm *and* its client. *Id.* at 655 nn.6 & 7. The Court also reasoned that even though the entities that O’Hagan defrauded were not parties to his trades, O’Hagan’s deception had occurred “in connection with” securities transactions as required by § 10(b), because the “fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities.” *Id.* at 655-56. “Should a misappropriator put such information to other use,” the Court acknowledged, “the statute’s prohibition would not be implicated.” *Id.*

Second, the *O’Hagan* Court held that “insofar as it serves to prevent the type of misappropriation charged against O’Hagan,” Rule 14e-3(a) was a “proper exercise of the Commission’s prophylactic power under § 14(e).” *Id.* at 676. In so doing, the Court recognized the “proof problem that could enable sophisticated traders to escape responsibility” for insider trading, and reasoned that the broader disclose-or-abstain requirement imposed by Rule 14e-3, which “does not require specific proof of a breach of fiduciary duty,” was a “means reasonably designed to prevent’ fraudulent trading on material, nonpublic information in the tender offer context.” *Id.* (quoting 15 U.S.C. § 78n(e)). At the same time, the Court expressly left “for another day” the question whether Rule 14e-3’s “proscription of warehousing”—that is, the “practice by which bidders leak advance information of a tender offer to allies and encourage them to purchase the target company’s stock before the bid is announced”—“falls within [the SEC’s] § 14(e) authority to define or prevent fraud.” *Id.* at 672 n.17 (quoting Reply Brief).

Since *O’Hagan* was decided, courts have grappled with misappropriation theory cases in which the source of the allegedly misappropriated information was neither the employer nor the client of the defendant-trader.¹⁶³ One high profile example was the SEC’s civil case against Mark Cuban, which presented the question whether a contractual confidentiality obligation could support a misappropriation theory insider trading claim. The district court answered that general question in the affirmative, but nevertheless granted Cuban’s motion to dismiss, reasoning that

without authorization to steal pre-release earnings information, “affirmatively misrepresented himself in order to gain access to material, nonpublic information, which he then used to trade.” As the court put it, “an affirmative misrepresentation is a distinct species of fraud,” and “none of the Supreme Court opinions . . . require a fiduciary relationship as an element of an actionable securities claim under Section 10(b).” *Id.* at 49.

¹⁶³ See, e.g., *United States v. McGee*, 763 F.3d 304, 317 (3d Cir. 2014) (“a rational juror could find that a relationship of trust or confidence existed based on the parties’ history, pattern or practice of sharing confidences related to sobriety” as members of Alcoholics Anonymous); *SEC v. Yun*, 327 F.3d 1263, 1272-73 (11th Cir. 2003) (“In our view, a spouse who trades in breach of a reasonable and legitimate expectation of confidentiality held by the other spouse sufficiently subjects the former to insider trading liability.”); *SEC v. Sargent*, 229 F.3d 68, 76 (1st Cir. 2000) (holding that fiduciary duties owed by sole stockholders in a closely-held consulting firm could support a misappropriation theory claim, even where the misappropriated information did not relate to the firm’s business).

the claim could not be sustained unless the relevant agreement “impose[d] on the party who receives the information the legal duty to refrain from trading on or otherwise using the information for personal gain.” *SEC v. Cuban*, 634 F. Supp. 2d 713, 725 (N.D. Tex. 2009). The Fifth Circuit reversed and remanded, reasoning that the SEC had sufficiently alleged that Cuban had agreed not to trade, but it did not take up the question whether “a simple confidentiality agreement,” standing alone, could support a claim under the misappropriation theory. *SEC v. Cuban*, 620 F.3d 551, 555, 557 (5th Cir. 2010). The district court subsequently ruled that its articulation of the legal standard was “the law of the case,” *SEC v. Cuban*, 2013 WL 791405, at *2 n.4 (N.D. Tex. Mar. 5, 2013), and the action proceeded to trial on that basis—with Cuban ultimately prevailing.

In 2000, the SEC promulgated Rule 10b5–2 in an attempt to clarify when “certain non-business relationships, such as family and personal relationships, may provide the duty of trust or confidence required under the misappropriation theory.” Selective Disclosure and Insider Trading Release, at 51,729. The rule provides first that a duty of trust or confidence exists whenever a person “agrees to maintain information in confidence.” 17 C.F.R. § 240.10b5–2(b)(1).¹⁶⁴ It then provides that a duty of trust or confidence exists whenever “the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality.” *Id.* § 240.10b5–2(b)(2). Finally, Rule 10b5–2 establishes a rebuttable presumption that a duty of trust or confidence exists “[w]henever a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling.” 17 C.F.R. § 240.10b5–2(b)(3). The recipient can rebut this presumption by establishing that he had no reason to believe that the source of the information expected that confidentiality would be maintained, “because of the parties’ history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information.” *Id.*

¹⁶⁴ The district court in the Mark Cuban case held that “[t]o permit liability based on Rule 10b5–2(b)(1) would exceed the SEC’s § 10(b) authority to proscribe conduct that is deceptive,” because “it is the undisclosed use of confidential information for personal benefit, in breach of a duty not to do so, that constitutes the deception.” *Cuban*, 634 F. Supp. at 730-31. Another district court disagreed with this analysis, however, and held that the SEC did not exceed its rulemaking authority “by creating liability where there is a confidentiality agreement but no agreement not to trade upon the confidential information.” *United States v. Kosinski*, 2017 WL 3527694, at *5-6 (D. Conn. Aug. 16, 2017). Other challenges to the SEC’s authority to promulgate the Rule have likewise been unsuccessful. *See, e.g., McGee*, 763 F.3d at 310-16 (“We hold that Rule 10b5–2(b)(2) is a valid exercise of the SEC’s rulemaking authority.”); *United States v. Corbin*, 729 F. Supp. 2d 607, 617-19 (S.D.N.Y. 2010) (“[T]he Court finds that the SEC’s exercise of its rulemaking authority to promulgate Rule 10b5–2 under § 10(b) is far from arbitrary, capricious, or contrary to § 10(b).”); *SEC v. De La Maza*, 2011 WL 13174213, at *13-14 (S.D. Fla. Feb. 16, 2011) (same). *Cf. United States v. McPhail*, 831 F.3d 1, 7 (1st Cir. 2016) (“[W]e assume without deciding that Rule 10b5–2(b)(2) constitutes a valid exercise of administrative rulemaking.”).

While domestic partners, stepparents, and stepchildren are not covered by this provision, exchanges of information among parties of this type may still be covered by the first two provisions of Rule 10b5–2. *See* Selective Disclosure and Insider Trading Release, at 51,730.

c. *Tippee Liability*

In light of the *Chiarella* Court’s refusal to recognize a blanket prohibition on trading while in the possession of material, nonpublic information, it appeared that “tippees”—*i.e.*, individuals who received nonpublic information secondhand, as a tip—could only face liability under Rule 10b–5 if they either (a) participated in a tipping insider’s breach of fiduciary duty, or (b) received the information from a non-insider who had misappropriated it in breach of a duty owed to the source.

Dirks v. SEC, 463 U.S. 646 (1983), confirmed this. There, a securities analyst was informed by corporate insiders of a major financial scandal in a publicly traded corporation. The analyst, while making attempts to bring this information to the attention of the SEC and the press, informed certain of his clients, who were able to sell the relevant securities before the scandal became public. The analyst was censured by the SEC. *See id.* at 648-52. But the Supreme Court overturned the censure, reasoning that the analyst had received the nonpublic information from insiders who “were motivated by a desire to expose the fraud” and neither “received [a] monetary or personal benefit for revealing [company] secrets” nor intended “to make a gift of valuable information to Dirks.” *Id.* at 665-67. As the Court succinctly explained, “[i]n the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks.” *Id.* at 667.¹⁶⁵

The Supreme Court again had the occasion to address tippee liability in *Salman v. United States*, 137 S. Ct. 420 (2016). *Salman* involved a tipping chain: Maher Kara was an investment banker who shared inside information about pending mergers and acquisitions with his older brother, Michael, and Michael in turn “fed the information to others—including Salman.” Maher testified that he shared the information with Michael “to benefit him and with the expectation that [he] would trade on it,” and Michael testified that “he told Salman that the information was coming from Maher.” Salman was convicted of insider trading but challenged the conviction on the ground that the tipper (Maher) “did not personally receive money or property in exchange for the tips and thus did not personally benefit from them.” *Id.* at 423-25. The Supreme Court rejected this argument, and held that “Salman’s

¹⁶⁵ *See also* *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 311 n.21 (1985) (“A tippee generally has a duty to disclose or to abstain from trading on material nonpublic information only when he knows or should know that his insider source ‘has breached his fiduciary duty to the shareholders by disclosing the information.’” (quoting *Dirks v. SEC*, 463 U.S. 646, 660 (1983))).

conduct is in the heartland of *Dirks*'s rule concerning gifts." *Id.* at 429. "[W]hen a tipper gives inside information to 'a trading relative or friend,'" the *Salman* Court explained, "the jury can infer that the tipper meant to provide the equivalent of a cash gift. In such situations, the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds." *Id.* at 427-28 (quoting *Dirks*, 463 U.S. at 664).¹⁶⁶

The *Salman* Court also took the opportunity to abrogate, in part, *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014), in which the Second Circuit had held that the requisite benefit to the tipper could not be "inferred from a personal relationship between the tipper and tippee" absent "proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." Without commenting on the "meaningfully close personal relationship" gloss, the Supreme Court held that requiring the tipper to have "receive[d] something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends" was "inconsistent with *Dirks*." 137 S. Ct. at 428 (quoting *Newman*, 777 F.3d at 452).

The Second Circuit revisited the "gift theory" in *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018), *cert. denied*, 139 S. Ct. 2665 (2019). That case involved a hedge fund portfolio manager, Martoma, who obtained information about a potential Alzheimer's drug from a doctor (Dr. Gilman) working on the clinical trials and then traded in the shares of the pharmaceutical companies that were jointly developing the new drug. Martoma paid the doctor \$1,000 per hour for dozens of "consultations," during which he provided Martoma with confidential information about the results of the trials. *See id.* at 68-70. After he was convicted of insider trading, Martoma challenged the jury instructions on the ground that the jurors were not instructed that the "tipper and tippee must share a 'meaningfully close personal relationship' in order to find a personal benefit based on a gift of inside information to a friend." *Id.* at 72-73.

In a split decision, the court agreed with Martoma that the jury instructions were flawed but nevertheless affirmed his conviction. The error, the court explained, was "allow[ing] the jury to find a personal benefit based solely on the conclusion that Dr. Gilman tipped Martoma in order to 'develop[] or maintain[] . . . a friendship.'" *Id.* at 77-78. "A properly instructed jury," the Second Circuit continued, "would have been informed that it could find a personal benefit" on the gift theory

¹⁶⁶ *Dirks* involved the classical theory of insider trading, and there was some question whether *Salman* was better characterized as a classical or a misappropriation case. The parties had not "dispute[d] that *Dirks*'s personal-benefit analysis applies in both classical and misappropriation cases," however, and so the Court "proceed[ed] on the assumption that it does." *Salman v. United States*, 137 S. Ct. 420, 425 n.2 (2016).

“only if it also found that Dr. Gilman and Martoma shared a relationship suggesting a *quid pro quo* or that Dr. Gilman intended to benefit Martoma with the inside information.” *Id.* However, “the jury could also find a personal benefit based on either of those two factors alone,” because “[e]ach of [those] personal benefits is unaffected by *Newman*’s interpretation of the gift theory, and neither requires proof that Dr. Gilman and Martoma share any type of ‘personal relationship.’” *Id.* As such, in light of the “compelling evidence” that Dr. Gilman and Martoma had a *quid pro quo* relationship, the Second Circuit concluded that the erroneous jury instructions “did not affect Martoma’s substantial rights.” *Id.*¹⁶⁷

It is an open question whether the personal-benefit requirement applies to criminal prosecutions under the securities fraud provision in Title 18, *see* 18 U.S.C. § 1348, which Congress enacted as part of Sarbanes-Oxley. Historically, criminal prosecutions of insider trading had been based on Section 32 of the Exchange Act, which subjects persons who willfully violate that Act to criminal penalties, *see* 15 U.S.C. § 78ff(a), and it was therefore necessary for the government to prove the elements of an insider trading claim under Rule 10b–5, including the breach of a duty. Section 1348, by contrast, is a stand-alone provision of the criminal code, which makes it unlawful for a person to execute a “scheme or artifice” to “obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale” of any registered security. 18 U.S.C. § 1348(2).

In *United States v. Blaszcak*, 947 F.3d 19, 36-37 (2d Cir. 2019) (“*Blaszcak I*”), a panel of the Second Circuit declined to “graft the *Dirks* personal-benefit test onto the elements of Title 18 securities fraud,” reasoning that § 1348 was “intended to provide prosecutors with a different—and broader—enforcement mechanism to address securities fraud than what had been previously provided in the Title 15 fraud provisions.” But the Supreme Court vacated this judgment in a summary order, *Blaszcak v. United States*, 141 S. Ct. 1040 (2021), and remanded the case for further consideration in light of *Kelly v. United States*, 140 S. Ct. 1565, 1574 (2020) (reversing fraud convictions in “Bridgewater” case where a “political payback” scheme was not “aim[ed] to obtain money or property”).¹⁶⁸

¹⁶⁷ The panel in *Martoma* had previously issued another 2-1 decision in which it held that the Supreme Court’s decision in *Salman* had “fundamentally altered the analysis underlying *Newman*’s ‘meaningfully close personal relationship’ requirement such that the ‘meaningfully close personal relationship’ requirement is no longer good law.” *United States v. Martoma*, 869 F.3d 58, 69 (2d Cir. 2017), *amended and superseded by* 894 F.3d 64 (2d Cir. 2018). That prior opinion has been superseded and is no longer effective.

¹⁶⁸ *Blaszcak* presented the same issue as *Kelly*: The defendants, who were alleged to have misappropriated confidential information from the Centers for Medicare & Medicaid Services, had argued that “a government agency’s confidential information” is not “‘property’ in the hands of the agency” for purposes of § 1348. *Blaszcak I*, 947 F.3d at 30-31 (citation omitted).

On remand, a slightly reconstituted panel of the Second Circuit vacated the convictions, based on *Kelly*, albeit without the majority reaching the issue of the personal-benefit requirement. *United States v. Blaszczyk*, 56 F.4th 230, 242-45 (2d Cir. 2022) (“*Blaszczyk I*”) (“our independent review confirms that the dismissals requested by the government are required following *Kelly*”). Notably, however, two members of the panel filed a concurring opinion in which they sharply criticized *Blaszczyk I*’s decision “not to import a personal benefit element” to § 1348 as creating a “glaring anomaly”—namely, a more lax standard for criminal insider trading prosecutions than for civil claims—that “warrants further attention by Congress and the courts.” See *Blaszczyk II*, 56 F.4th at 246-50 (Walker and Kearse, JJ., concurring).

Separate and apart from *Dirks*’s personal benefit requirement is the question of the level of knowledge that tippers and tippees must possess to be held liable under Rule 10b–5. The Second Circuit addressed that question in *SEC v. Obus*, 693 F.3d 276, 287, 288-89 (2d Cir. 2012), and held that neither the tipper nor the tippee must have actual knowledge that confidential information was disclosed in breach of a duty; rather, the tipper must only have been reckless with regard to the nature of the confidential information, and the tippee must have known or “ha[d] reason to know” that the information was transmitted improperly. The latter determination, the court explained, is a “fact-specific inquiry turning on the tippee’s own knowledge and sophistication and on whether the tipper’s conduct raised red flags that confidential information was being transmitted improperly.” *Id.* at 288. On the facts of *Obus*, the court allowed charges against a tippee to proceed past summary judgment where the tippee knew the source of the information and was a “sophisticated financial player,” and where there was circumstantial evidence suggesting the tippee believed the tip was credible. *Id.* at 292-93.

A related question is the level of knowledge that a remote tippee must have regarding both the identity of the original tipper and the benefit that the original tipper obtained by disclosing the information. The Second Circuit confronted this issue in the aforementioned *Newman* decision, and held that “a tippee’s knowledge of the insider’s breach necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit.” 773 F.3d at 449-50. Applying this standard, the Second Circuit overturned the convictions of two hedge fund portfolio managers, reasoning that the government had presented no evidence that the defendants “knew that they were trading on information obtained from insiders, or that those insiders received any benefit in exchange for such disclosures, or even that [the defendants] consciously avoided learning of these facts.” *Id.* at 453. This holding in *Newman* was not affected by *Salman*, which “[did] not implicate” these issues. 137 S. Ct. at 425 n.1.

d. *Section 20A of the Exchange Act*

Section 20A of the Exchange Act, which Congress enacted as part of the Insider Trading and Securities Fraud Enforcement Act of 1988, establishes an express private right of action against insider traders. Section 20A(a) states:

Any person who violates any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable . . . to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased . . . or sold . . . securities of the same class.

15 U.S.C. § 78t-1(a). The total amount of recoverable damages under Section 20A “shall not exceed the profit gained or loss avoided in the transaction or transactions that are the subject of the violation.” *Id.* § 78t-1(b).

“Since identifying the party in actual privity with the insider is virtually impossible in transactions occurring on an anonymous public market, the contemporaneousness standard was developed to give plaintiffs a more feasible avenue by which to sue insiders.” *Buban v. O’Brien*, 1994 WL 324093, at *3 (N.D. Cal. June 22, 1994). But “[t]he ‘exact contours’ of contemporaneous trading have never been defined,” with some courts requiring the trades to have occurred on the same day, and others finding longer time periods satisfactory in certain instances. *Basile v. Valeant Pharm. Int’l, Inc.*, 2015 WL 7352005, at *5 (C.D. Cal. Nov. 9, 2015) (citing cases).

B. Section 14(a)

Section 14(a) of the Exchange Act prohibits the solicitation of a “proxy or consent or authorization in respect of” any registered and non-exempt security “in contravention of such rules and regulations as the Commission may prescribe.” 15 U.S.C. § 78n(a). The circumstances in which a company is required to solicit proxies, consents, or authorizations (in other words, votes) from its shareholders are beyond the scope of this outline, but the most common scenarios are the election of directors and requests to approve proposed mergers or other significant transactions.

Like § 10(b), this provision is not self-effecting, and therefore there can be no violation of § 14(a) absent a violation of a rule promulgated thereunder by the SEC. The most important of these is Rule 14a-9, which, with language paralleling Rule 10b-5, prohibits material misstatements or omissions in proxy solicitations. 17 C.F.R. § 240.14a-9(a).

1. Implied Private Right of Action Under § 14(a) and Rule 14a-9.

Although Congress did not expressly create such a right, it is settled law that shareholders possess a private right of action under § 14(a) and Rule 14a-9.¹⁶⁹ The Supreme Court recognized this implied right of action in *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964), a case in which a shareholder brought suit alleging that the approval of J. I. Case's merger with the American Tractor Corporation had been tainted by false and misleading proxy materials. Invoking § 14(a) and Rule 14a-9, the plaintiff sought damages and a declaratory judgment holding the merger void. *Id.* at 429-30. When the case reached the Supreme Court, the question presented was whether the Exchange Act's general jurisdictional provision (§ 27) authorizes a "federal cause of action for rescission or damages to a corporate stockholder with respect to a consummated merger which was authorized pursuant to the use of a proxy statement alleged to [be] . . . violative of § 14(a) of the Act." *Id.* at 428.

The Supreme Court answered this question in the affirmative. *See id.* at 430-31. Rather than examining whether Congress *intended* to provide a private right of action under § 14(a), the Court emphasized the fact that one of the "chief purposes" of that statutory provision was "the protection of investors," and reasoned that this "implied the availability of judicial relief where necessary to achieve that result." *Id.* at 432. Moreover, based on its assessment that the "injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done the corporation, rather than from the damage inflicted directly upon the stockholder," the *Borak* Court concluded that "a right of action exists" under § 14(a) "as to both derivative and direct causes." *Id.* at 431-32.

Over time, the Supreme Court has moved steadily away from the *Borak* Court's liberal approach to recognizing implied private rights of action in federal statutes. The Court discussed this doctrinal shift in *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), which addressed the question whether a private right of action could be implied from § 17(a) of the Exchange Act. In holding that it could not, the Court acknowledged that "in a series of cases since *Borak* we have adhered to a stricter standard for the implication of private causes of action." *Id.* at 578. Under that stricter standard, the Court explained, the "ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." *Id.*¹⁷⁰

¹⁶⁹ *See, e.g., Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1087 (1991).

¹⁷⁰ The Supreme Court subsequently described the inquiry as follows:

While *Borak*'s reasoning was jettisoned long ago, its core holding remains intact.¹⁷¹ But the implied private right of action that *Borak* recognized is not without limits. Thus, in *Virginia Bankshares*, the Supreme Court held that minority shareholders whose votes are not required to effectuate a proposed merger generally cannot pursue a private right of action under § 14(a). In so doing, the Court emphasized that the “breadth of [an implied private right of action] once recognized should not, as a general matter, grow beyond the scope congressionally intended.” *Id.* at 1102.

Moreover, the Ninth Circuit (in a divided, *en banc* decision) recently called into question the continued vitality of *Borak*'s holding that an implied private right of action exists under § 14(a) for stockholder derivative claims. *See Lee v. Fisher*, 70 F.4th 1129, 1144-49 (9th Cir. 2023). In addition to observing the Supreme Court's increasing general hostility to implied private rights of action, the Ninth Circuit invoked the Court's post-*Borak* decision in *Kamen v. Kemper Financial Services, Inc.*, 500 U.S. 90, 108 (1991) (“where a gap in the federal securities laws must be bridged by a rule that bears on the allocation of governing powers within the corporation, federal courts should [generally] incorporate *state* law into federal common law”). In the Ninth Circuit's view, in light of *Kemper*, “Delaware law is relevant for determining whether shareholders may bring a derivative action to enforce a claim under § 14(a)” (at least in the case of a Delaware corporation), and subsequent developments in Delaware law have “displaced” *Borak*'s holding that “a § 14(a) claim could be brought as a derivative action.” *Lee*, 70 F.4th at 1147 (citing Delaware authority for the proposition that an “injury caused by a violation of § 14(a) gives rise to a direct action under Delaware law, not a derivative action”).

2. Standing

Courts have consistently held that any shareholder entitled to vote on a proposed corporate action will have standing to bring suit under § 14(a) and Rule 14a-9, irrespective of whether (or how) that particular shareholder voted on the matter.¹⁷²

The judicial task is to interpret the statute Congress has passed to determine whether it displays an intent to create not just a private right but also a private remedy. Statutory intent on this latter point is determinative. Without it, a cause of action does not exist and courts may not create one, no matter how desirable that might be as a policy matter, or how compatible with the statute.

Alexander v. Sandoval, 532 U.S. 275, 286-87 (2001).

¹⁷¹ *See, e.g., Jaroslawicz v. M&T Bank Corp.*, 962 F.3d 701, 709 (3d Cir. 2020) (“[W]hile courts have since ‘adopted a far more cautious course before finding implied causes of action,’ in securities fraud actions under § 14(a) what was then is still now.” (citation omitted)).

¹⁷² *See, e.g., United Paperworkers Int'l Union v. Int'l Paper Co.*, 985 F.2d 1190, 1197-98 (2d Cir. 1993) (“We see no sound basis for denying a right of action to any shareholder who seeks to remedy the issuer's misleading statements in or omissions from proxy materials circulated in connection with a matter submitted for shareholder vote.”); *Stahl v. Gibraltar Fin. Corp.*, 967 F.2d 335, 338 (9th Cir. 1992) (“[S]hareholders . . . who do not vote their proxies in reliance on the alleged misstatements have standing to sue under section 14(a)—both before and after the vote is taken.”) (emphasis omitted).

As one court put it, “the rationale for permitting a stockholder to assert a cause of action under section 14(a) regardless of whether he actually relied upon the misleading statement is to protect the voting process as a whole from misinformation,” and is “simply a recognition that the stockholder is bound by the collective action of his other stockholders who may have been misled by the statement.” *7547 Corp. v. Parker & Parsley Dev. Partners, L.P.*, 38 F.3d 211, 230 (5th Cir. 1994).

By contrast, the question of issuer standing remains decidedly unsettled. Issuers have in the past invoked decisions such as *Studebaker Corp. v. Gitlin*, 360 F.2d 692, 694-95 (2d Cir. 1966), and *Ameribanc Investors Group v. Zwart*, 706 F. Supp. 1248, 1251-54 (E.D. Va. 1989), for the proposition that they have standing to pursue § 14(a) claims to protect their shareholders from unlawful proxy solicitations, but courts have expressed doubt as to the persuasive value of these cases in light of subsequent guidance from the Supreme Court.¹⁷³ The more recent cases do not reflect any clear consensus regarding whether (or in what circumstances) an issuer has standing, or whether, if issuer standing is deemed to exist, the issuer’s potential remedies should be limited to injunctive relief or should include monetary damages as well.¹⁷⁴

Courts are similarly divided on the question whether a proxy contestant has standing to assert claims under § 14(a) and Rule 14a-9. Some courts have held that proxy contestants may bring such claims, provided they are able to sufficiently allege a cognizable injury resulting from the alleged defect in the proxy materials.¹⁷⁵

¹⁷³ See, e.g., *In re Verso Techs., Inc.*, 2010 WL 11598054, at *28-29 (N.D. Ga. June 30, 2010) (“To the extent that *Virginia Bankshares* calls into question the more expansive reading of private rights of action under Section 14(a) discussed in *Borak*, . . . that opinion also calls into doubt the majority of the cases relied upon by the Trustee in his attempts to show standing.”); *Salomon Brothers Mun. Partners Fund, Inc. v. Thornton*, 410 F. Supp. 2d 330, 334 (S.D.N.Y. 2006) (raising question as to “*Studebaker*’s continued vitality after *Virginia Bankshares*”).

¹⁷⁴ Compare *Enzo Biochem, Inc. v. Harbert Discovery Fund, LP*, 2021 WL 4443258, at *5-7 (S.D.N.Y. Sept. 27, 2021 (“[T]he Court holds that an issuer has Article III standing to sue for monetary damages under Section 14(a) for alleged violations of Rule 14a-9.”), and *Allergan, Inc. v. Valeant Pharms. Int’l, Inc.*, 2014 WL 5604539, at *14 (C.D. Cal. Nov. 4, 2014) (concluding in the context of a preliminary injunction motion that “case law regarding an issuer’s standing to seek corrective disclosures on its shareholders’ behalf for disclosure violations under Section 13(d) and Section 14(d) support the proposition that Allergan has standing to bring Section 14(a) and Rule 14a-9 claims.”), with *Ashford Hosp. Prime Inc. v. Sessa Capital (Master) LP*, 2017 WL 2955366, at *9 (N.D. Tex. Feb. 17, 2017) (holding that issuer did not have standing to seek injunctive relief or damages because “the Court views section 14(a) as protecting those with voting rights”), and *Tenet Healthcare Corp. v. Cmty. Health Sys., Inc.*, 839 F. Supp. 2d 869, 871-72 (N.D. Tex. 2012) (concluding that issuers do not have standing to recover damages under § 14(a) “based on the focus on congressional intent mandated by *Virginia Bankshares*”).

¹⁷⁵ See, e.g., *Palumbo v. Deposit Bank*, 758 F.2d 113, 115-16 (3d Cir. 1985) (“Standing depends on injury, and we believe that one who alleges that he has been wrongfully ousted from a Board of Directors because management improperly persuaded other shareholders not to vote for him, has articulated an injury cognizable

Other courts, however, have held that would-be plaintiffs lack standing when their claims arise solely from their status as proxy contestants.¹⁷⁶

3. Persons Liable

By its terms, when a violation of Section 14(a) occurs, responsibility for that violation extends to “any person [who] . . . solicit[s] or . . . permit[s] the use of his name to solicit” the shareholders in question. 15 U.S.C. § 78n(a)(1).

Courts applying this statutory language have held that the mere “appearance of one’s name in a proxy statement” will not “trigger liability for any misstatement appearing therein,” *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 68 (D.C. Cir. 1980), and have instead required “a substantial connection between the use of the person’s name and the solicitation effort.” *Id.* (quoting *Yamamoto v. Omiya*, 564 F.2d 1319, 1323 (9th Cir. 1977)).¹⁷⁷ Applying this standard, the *Falstaff Brewing* court held that an individual (Kalmanovitz) who became Falstaff’s controlling shareholder in the transaction at issue was liable for deficiencies in the proxy materials, even though Kalmanovitz was neither an officer nor a director of the company at the time of the solicitation. *See id.* at 68-70. As the court explained, “in reality, it was Kalmanovitz who was seeking the shareholders’ votes to approve his taking control,” and therefore his “connection with the transaction was more than substantial. It was pivotal.” *Id.* at 69.

The company that distributes the allegedly deficient proxy materials, along with officers and directors who are alleged to have prepared or approved those materials,

under § 14(a).”); *Capital Real Estate Invs. Tax Exempt Fund Ltd. P’Ship v. Schwartzberg*, 929 F. Supp. 105, 108-10 (S.D.N.Y. 1996) (noting that proxy contestant would “suffer real injury if the insiders are permitted to solicit proxies on the basis of false and misleading information,” and holding that “a participant in a proxy contest may sue for injunctive relief for alleged violations of the antifraud provision of the proxy rules”).

¹⁷⁶ *See, e.g., Royal Bus. Grp., Inc. v. Realist, Inc.*, 933 F.2d 1056, 1060-62 (1st Cir. 1991) (“mere coincidence” that the proxy contestant “also enjoy[ed] shareholder status” did not suffice to confer standing, because the “plaintiffs’ posture” was “that of proxy contestants—nothing more”). *See also 7547 Corp. v. Parker & Parsley Dev. Partners, L.P.*, 38 F.3d 211, 230 (5th Cir. 1994) (“We cannot believe that the Supreme Court, in finding a private right of action under section 14(a), intended to open a Pandora’s box by extending that right to any person potentially injured by a proxy statement; otherwise, standing could be justified for disappointed potential merger partners, disgruntled employees, etc.”).

¹⁷⁷ In *Yamamoto*, the Ninth Circuit held that an individual (Lee) could not be held liable under § 14(a) simply because he was identified in the issuer’s proxy materials as the counterparty to a proposed sale of a significant company asset. The court reasoned that the “mere presence of Lee’s name in the materials . . . did not reveal any significant control by Lee over the statement, or his adoption of it that was sufficient to justify attaching liability to him.” *Yamamoto v. Omiya*, 564 F.2d 1319, 1323 (9th Cir. 1977). *Accord In re Bank of Am. Corp. Sec., Deriv., and ERISA Litig.*, 757 F. Supp. 2d 260, 294-95 (S.D.N.Y. 2010) (dismissing § 14(a) claim against corporate officer mentioned in the proxy statement on ground that his role did not “suggest[] that he had control over the [proxy statement’s] contents . . . or that he would directly benefit from the action it proposed”).

are the most common defendants in § 14(a) cases. But as *Falstaff Brewing* exemplifies, they are not the only possible defendants. Proposed acquirers¹⁷⁸ and financial advisors¹⁷⁹ are two additional examples of potential defendants in § 14(a) cases.

4. Scienter

In its 1991 decision in *Virginia Bankshares*, the Supreme Court expressly declined to reach the question whether scienter is “necessary for liability generally under § 14(a).” 501 U.S. at 1090 n.5. Over the ensuing three-plus decades, the Court has not seen fit to return to and resolve that issue.

The Second, Third, Seventh, and Ninth Circuits have reached the question, however, holding in each case that the applicable standard of liability is negligence.¹⁸⁰ The Eighth Circuit has likewise stated (albeit in dicta) that § 14(a) claims only require proof of negligence, and not scienter.¹⁸¹ No court of appeals has reached a contrary conclusion and held that scienter is an element of § 14(a) claims generally. But the Sixth and Eighth Circuits have held that proof of scienter is required to hold outside accountants liable under § 14(a),¹⁸² and the Eighth Circuit requires scienter for claims brought against outside directors.¹⁸³

¹⁷⁸ See, e.g., *Tracinda Corp. v. DaimlerChrysler AG*, 364 F. Supp. 2d 362, 392-94 (D. Del. 2005) (concluding that the acquirers were subject to liability under § 14(a) where they had “participated in the joint filing of the Proxy/Prospectus and allowed the use of their names in substantial connection with the proxy solicitation”), *aff’d*, 502 F.3d 212 (3d Cir. 2007); *Freedman v. Value Health, Inc.*, 135 F. Supp. 2d 317, 339 (D. Conn. 2001) (holding that an acquirer’s “interest in the merger and participation in preparing” the joint proxy statement was “sufficient to establish . . . liability under § 14(a)”), *aff’d*, 34 F. App’x 408 (2d Cir. 2002).

¹⁷⁹ See, e.g., *Herskowitz v. Nutri/Sys., Inc.*, 857 F.2d 179, 190 (3d Cir. 1988) (“[S]ince an investment banker rendering a fairness opinion in connection with a leveraged buyout knows full well that it will be used to solicit shareholder approval . . . we see no convincing reason for not holding it to the same standard of liability [under § 14(a)] as the management it is assisting.”); *In re Wells Real Estate Inv. Tr., Inc. Sec. Litig.*, 2010 WL 11468441, at *8-9 (N.D. Ga. Aug. 2, 2010) (concluding that financial advisors could be held liable under § 14(a) where they were “contractually bound . . . to prepare and file the [proxy at issue] and communicate with the SEC about the Proxy, if necessary” and “were prominently discussed in the Proxy”).

¹⁸⁰ See *Beck v. Dobrowski*, 559 F.3d 680, 682 (7th Cir. 2009); *Knollenberg v. Harmonic, Inc.*, 152 F. App’x 674, 682-83 (9th Cir. 2005); *Wilson v. Great Am. Indus., Inc.*, 855 F.2d 987, 995 (2d Cir. 1988); *Gould v. Am.-Hawaiian S.S. Co.*, 535 F.2d 761, 777-78 (3d Cir. 1976).

¹⁸¹ See *SEC v. Das*, 723 F.3d 943, 953-54 (8th Cir. 2013).

¹⁸² See *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 428 (6th Cir. 1980); *SEC v. Shanahan*, 646 F.3d 536, 546-47 (8th Cir. 2011). Notably, courts within the Sixth Circuit have rejected attempts by plaintiffs to expand this special requirement to parties other than outside accountants. See, e.g., *Emps. Ret. Sys. of City of St. Louis v. Jones*, 2021 WL 1890490, at *11-13 (S.D. Ohio May 11, 2021), *motion to certify appeal denied by* 2021 WL 5275827 (S.D. Ohio Nov. 12, 2021).

¹⁸³ *Shanahan*, 646 F.3d at 546-47.

That all said, to the extent that a particular § 14(a) claim sounds in fraud, courts will typically impose heightened pleading requirements with respect to that claim.¹⁸⁴

5. Reliance and Causation

Courts often state that “[t]o prevail on a Section 14(a) claim, a plaintiff must show that (1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was ‘an essential link in the accomplishment of the transaction.’” *Gen. Elec. Co. by Levit v. Cathcart*, 980 F.2d 927, 932 (3d Cir. 1992) (citing *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 385 (1970)).¹⁸⁵ Under this common formulation, the second element describes loss causation, while the third describes transaction causation—and both must be established to prove a claim.¹⁸⁶

“Transaction causation, often called reliance, is generally easier to establish than loss causation.” *Kuebler v. Vectren Corp.*, 13 F.4th 631, 637 (7th Cir. 2021). This is a consequence of the Supreme Court’s holding in *Mills* that a plaintiff in a § 14(a) case need not prove that any “particular defect” in the proxy materials “actually had a decisive effect on the voting.” 396 U.S. at 384-85. In reaching this conclusion, the *Mills* Court reasoned that “[w]here there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress,” so long as “he proves that the proxy solicitation itself . . . was an essential link in the accomplishment of the transaction.” *Id.* at 385.

This requirement of an “essential link” between the proxy solicitation and the transaction in question is clearly met when the shareholder vote obtained following that

¹⁸⁴ See, e.g., *Cal. Pub. Emps.’ Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 144-45 (3d Cir. 2004) (“While claims brought pursuant to section 14(a) of the 1934 Act do not require that scienter be pleaded, any claims brought under the 1934 Act must meet the PSLRA particularity requirements quoted above if a plaintiff elects to ground such claims in fraud.”). See also pp. 54-56, *supra*.

¹⁸⁵ See also, e.g., *Kuebler v. Vectren Corp.*, 13 F.4th 631, 637 (7th Cir. 2021); *Knollenberg*, 152 F. App’x at 682; *Bond Opportunity Fund v. Unilab Corp.*, 87 F. App’x 772, 773 (2d Cir. 2004); *Hayes v. Crown Cent. Petroleum Corp.*, 78 F. App’x 857, 861 (4th Cir. 2003).

¹⁸⁶ See, e.g., *Kuebler*, 13 F.4th at 637 (discussing elements of § 14(a) claim; “Causation in securities law consists of two components: transaction causation and loss causation.”); *Wilson v. Great Am. Indus., Inc.*, 979 F.2d 924, 931 (2d Cir. 1992) (“We recognize that loss causation or economic harm to plaintiffs must be shown [in a § 14(a) case], as well as proof that the misrepresentations induced plaintiffs to engage in the subject transaction, that is, transaction causation.”); *Edward J. Goodman Life Income Tr. v. Jabil Cir., Inc.*, 594 F.3d 783, 796-97 (11th Cir. 2010) (noting that both transaction causation and loss causation are components of a § 14(a) claim) (citing *Koppel v. 4987 Corp.*, 167 F.3d 125, 137 (2d Cir. 1999)).

solicitation was legally required to effectuate the relevant corporate action.¹⁸⁷ Whether transaction causation can be established when the plaintiff-shareholder's vote was not legally required is a more nuanced question.

The Supreme Court in *Virginia Bankshares* confronted one theory of how a proxy solicitation could be an essential link in circumstances where the votes of a particular group of shareholders were not legally required to complete the transaction at issue. The plaintiff, a minority shareholder of First American Bank of Virginia, argued that the Bank's controlling shareholder and board would not have been willing to go ahead with a proposed freeze-out merger if the minority shareholders had voted against the transaction, based on a "desire to avoid bad shareholder or public relations." *See id.* at 1100-01. However, the Court rejected this theory of causation—premised on what it characterized as the "desire for a cosmetic vote"—as "speculative" and "procedural[ly] intractab[le]." *Id.* at 1102-06.

As a second theory, the plaintiff in *Virginia Bankshares* argued that the affirmative vote of the minority shareholders was an essential link in the accomplishment of the transaction because that vote served to "insulate the merger from later attack" under applicable state law. *See id.* at 1101. As described by the Court, "this theory of causation rest[ed] upon the proposition of policy that § 14(a) should provide a federal remedy whenever a false or misleading proxy statement results in the loss under state law of a shareholder plaintiff's state remedy for the enforcement of a state right." *Id.* at 1106-07. The *Virginia Bankshares* Court ultimately sidestepped the question "whether § 14(a) provides a cause of action for lost state remedies," based on its conclusion that no such remedies had in fact been lost in the case. *Id.* at 1107. Notably, however, the Second Circuit subsequently held that a minority shareholder can establish transaction causation under § 14(a) by proving that a defect in the proxy materials "cause[d] [the] shareholder to forfeit his appraisal rights by voting in favor of the proposed corporate merger." *Wilson v. Great Am. Indus., Inc.*, 979 F.2d 924, 931 (2d Cir. 1992).

To recover damages under § 14(a), a plaintiff must also show that the "transaction that was approved through the false proxy statement was the 'direct cause of the

¹⁸⁷ *See, e.g., YRC Worldwide Inc. v. Welch*, 449 F. Supp. 3d 1053, 1067 (D. Kan. 2020) ("To meet the essential link requirement, the proxy statement must solicit 'votes legally required to authorize the action proposed.'" (quoting *Va. Bankshares*, 501 U.S. at 1102)); *Chiu v. Dipp*, 2018 WL 3455402, at *3 (D. Mass. Apr. 13, 2018) ("To establish a transactional nexus . . . , a plaintiff must allege that the underlying corporate transaction required shareholder approval.").

pecuniary injury for which recovery is sought.”¹⁸⁸ As courts have recognized,¹⁸⁹ this element of the private right of action under § 14(a) was codified in the PSLRA: “In any private action arising under this chapter [*i.e.*, the Exchange Act], the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.” 15 U.S.C. § 78u-4(b)(4).

The Third Circuit’s decision in *General Electric Co. v. Cathcart* exemplifies the circumstances in which the deficient proxy solicitation is too attenuated from the alleged economic harm to support loss causation. 980 F.2d 927 (3d Cir. 1992). There, the plaintiff argued that General Electric’s misleading proxy materials “allowed the appellees to retain their positions on the board, thus ensuring that they could continue to mismanage the company.” *Id.* at 933. But the court swiftly rejected this theory of loss causation, reasoning that the “appellees’ re-election as directors did not create any cognizable harm because the shareholders’ votes did not authorize the transactions that caused the losses.” *Id.*

6. Scope of “total mix” of information

The general definition of materiality that applies to all claims under the federal securities laws¹⁹⁰ first appeared in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), a case that arose under § 14(a) and Rule 14a-9. To reiterate, under that standard, “[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote,” and courts must examine that question in light of the “‘total mix’ of information made available” to shareholders. *Id.* at 449.

This articulation of the standard begs the question of what specific sources of information are included in the “total mix.” The Second Circuit examined that issue

¹⁸⁸ *In re NAHC, Inc. Sec. Litig.*, 2001 WL 1241007, at *22 (E.D. Pa. Oct. 17, 2001), *aff’d*, 306 F.3d 1314 (3d Cir. 2002) (quoting *Gen. Elec. Co. v. Cathcart*, 980 F.2d 927, 933 (3d Cir. 1992)). *See also, e.g., Kuebler*, 13 F.4th at 645 (“To plead loss causation, a Section 14(a) plaintiff must plead both economic loss and proximate causation.”); *In re Almost Family Inc. Sec. Litig.*, 574 F. Supp. 3d 346, 353 (W.D. Ky. 2020) (“To plead loss causation in a 14(a) claim, Plaintiffs must tie the misleading proxy statements directly to the economic harm suffered by Plaintiffs.”); *Lane v. Page*, 727 F. Supp. 2d 1214, 1228 (D.N.M. 2010) (“Loss causation refers to the causal connection between the wrongful conduct and the economic loss for which the plaintiff seeks relief, and resembles a form of proximate cause.”); *In re Tenneco Sec. Litig.*, 449 F. Supp. 528, 531 (S.D. Tex. 1978) (“In order to recover damages under 14(a) the proxy violation must have caused the economic harm alleged.”).

¹⁸⁹ *See, e.g., N.Y. City Emps.’ Ret. Sys. v. Jobs*, 593 F.3d 1018, 1023 (9th Cir. 2010), *overruled on other grounds by Lacey v. Maricopa Cty.*, 693 F.3d 896, 925-28 (9th Cir. 2012); *Resnik v. Woertz*, 774 F. Supp. 2d 614, 632 (D. Del. 2011).

¹⁹⁰ *See* Section I.D, *supra*.

in the § 14(a) context in *United Paperworkers International Union v. International Paper Co.*, 985 F.2d 1190, 1198-1200 (2d Cir. 1993), and rejected the defendant’s contention that certain press reports and an annual report previously filed with the SEC should be considered part of the total mix of information available to voting shareholders. In so doing, the court observed that the press reports were “few in number, narrow in focus, and remote in time,” and explained that “[c]orporate documents that have not been distributed to the shareholders entitled to vote on the proposal should rarely be considered part of the total mix of information reasonably available to those shareholders.” *Id.* at 1199.

Where it applies, *United Paperworkers* restricts a § 14(a) defendant’s ability to argue that proxy materials are not misleading when viewed in conjunction with other SEC filings or other public information.¹⁹¹ But a number of courts have held that *United Paperworkers* carries limited persuasive weight because it predated the widespread online availability of public SEC filings.¹⁹² And although the Second Circuit has not explicitly called the decision into question, it has strictly confined its application to the § 14(a) context.¹⁹³

7. Heightened Pleading Requirements Under the PSLRA

Courts generally agree that § 14(a) claims are subject to the PSLRA’s heightened pleading standards.¹⁹⁴ This comports with the plain language of the statute, which requires the plaintiff “[i]n any private action arising under [the Exchange Act]” that

¹⁹¹ Notably, the Second Circuit in its decision did leave § 14(a) defendants with some ammunition for future cases by acknowledging that “when the subject of a proxy solicitation has been widely reported in readily available media, shareholders may be deemed to have constructive notice of the facts reported, and the court may take this into consideration in determining whether representations in or omissions from the proxy statement are materially misleading.” *United Paperworkers Int’l Union v. Int’l Paper Co.*, 985 F.2d 1190, 1199 (2d Cir. 1993).

¹⁹² See, e.g., *United Food & Com. Workers Union Loc. 880 Pension Fund v. Chesapeake Energy Corp.*, 774 F.3d 1229, 1238 (10th Cir. 2014), *as amended nunc pro tunc* (Nov. 12, 2014) (noting that *United Paperworkers* “predated ‘the explosion in Internet availability’ of SEC filings”); *Muncy v. InterCloud Sys., Inc.*, 92 F. Supp. 3d 621, 637 (E.D. Ky. 2015) (“the holding . . . has been largely abolished because it predated mandatory filing on EDGAR and the corresponding availability of SEC documents on the internet.”).

¹⁹³ See, e.g., *Garber v. Legg Mason, Inc.*, 347 F. App’x 665, 669 (2d Cir. 2009) (“Because the instant case is not about an allegedly misleading proxy statement mailed to shareholders in connection with a shareholder vote, the fact that corporate documents and news reports were not mailed directly to potential investors is not relevant to whether they can be considered part of the total mix of information reasonably available.”).

¹⁹⁴ See, e.g., *Beck v. Dobrowski*, 559 F.3d 680, 681-82 (7th Cir. 2009) (holding the district court was “correct” in ruling that “the Private Securities Litigation Reform Act . . . is applicable to suits under section 14(a)”; *Knollenberg*, 152 F. App’x at 682 (“[T]he PSLRA pleading requirements apply to claims brought under Section 14(a) and Rule 14a-9.”); *In re NAHC, Inc. Sec. Litig.*, 306 F.3d at 1329 (agreeing with the district court’s conclusion that the “heightened pleading standard of the PSLRA” applies to the “complaint in a Section 14(a) action”).

is based on alleged misstatements or omissions to “specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, . . . [to] state with particularity all facts on which that belief is formed.” 15 U.S.C. § 78u-4(b)(1).

By contrast, there is disagreement as to whether the plaintiff in a § 14(a) case is required to plead the element of negligence with particularity. The relevant statutory provision states that “in any private action arising under [the Exchange Act]” that requires “proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” *Id.* § 78u-4(b)(2). Applying this language, the Seventh Circuit has held that the PSLRA does not require particularized pleading of negligence, because “negligence is not a state of mind,” but rather “a failure, whether conscious or even unavoidable . . . to come up to the specified standard of care.” *Beck v. Dobrowski*, 559 F.3d 680, 682 (7th Cir. 2009). Several courts have endorsed *Beck*’s conclusion.¹⁹⁵ The Eighth and Ninth Circuits notably reached the opposite conclusion, and held that particularized pleading of negligence under the PSLRA is required in § 14(a) cases, albeit those decisions pre-date *Beck* and contain relatively limited analysis of the issue.¹⁹⁶

8. Remedies and Measure of Damages

The Supreme Court has made clear that both prospective and retrospective injunctive relief is theoretically available for violations of § 14(a).¹⁹⁷ But even though “[p]ossible forms of relief will include setting aside [a] merger” (or other action) tainted by a deficient solicitation, “nothing in the statutory policy ‘requires the court to unscramble a corporate transaction merely because a violation occurred.’” *Mills*, 396 U.S. at 386. Indeed, retrospective injunctive will often be “impracticable” in such cases. *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1303 (2d Cir. 1973) (Friendly, J.). Thus, “[i]n selecting a remedy” under § 14(a), federal courts must

¹⁹⁵ See, e.g., *Enzo Biochem, Inc. v. Harbert Discovery Fund, LP*, 2021 WL 4443258, at *8 (S.D.N.Y. Sept. 27, 2021); *In re Willis Towers Watson Plc Proxy Litig.*, 439 F. Supp. 3d 704, 714-15 (E.D. Va. 2020).

¹⁹⁶ See *Little Gem Life Sciences, LLC v. Orphan Med., Inc.*, 537 F.3d 913, 917 (8th Cir. 2008) (“Little Gem first argues that the heightened pleadings standards of the PSLRA do not apply to negligent misrepresentation actions because negligence is not a state of mind. We find this argument unpersuasive and unsupported by precedent.”); *Knollenberg*, 152 F. App’x at 683 (“a Section 14(a) plaintiff must plead with particularity facts that give rise to a strong inference of negligence”) (quoting *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1267 (N.D. Cal. 2000)).

¹⁹⁷ See *Mills*, 396 U.S. at 386; *J. I. Case Co. v. Borak*, 377 U.S. 426, 434-35 (1964).

exercise the “sound discretion which guides the determinations of courts of equity.” *Mills*, 396 U.S. at 386.

Compensatory damages are another potential remedy for private plaintiffs under § 14(a). The case law addressing § 14(a) damages is relatively underdeveloped “due to the fact that in most cases either the plaintiff has been unsuccessful or has settled prior to a judgment on the merits,”¹⁹⁸ but some guidance does exist.

Out-of-pocket loss is the baseline measure of recovery in § 14(a) cases.¹⁹⁹ However, when the challenged proxy solicitation relates to a proposed merger or other corporate transaction, there may be no out-of-pocket loss at all, because the “price paid by the successful offeror” in such transactions “often exceeds the fair market value of the securities surrendered by the shareholders.”²⁰⁰ With that said, because the value of a security is not always clear—particularly when it is not publicly traded—this issue may not be susceptible of resolution at the motion to dismiss stage.²⁰¹

As an alternative, in narrow circumstances, courts will employ a benefit-of-the-bargain approach to § 14(a) damages. This involves calculating the difference between (i) the value of “what was represented as coming to” shareholders in the proxy materials, and (ii) the value of “what they actually received” in the relevant transaction.²⁰² But courts only use this approach where “misrepresentation is made . . . as to the consideration to be forthcoming upon an intended merger” or other

¹⁹⁸ 3 Thomas Lee Hazen, *Law of Securities Regulation* § 10:83 (Dec. 2021 Update).

¹⁹⁹ See, e.g., *Osofsky v. Zipf*, 645 F.2d 107, 114 (2d Cir. 1981) (discussing § 14(a) damages and characterizing “out-of-pocket loss” as the “usual and logical form of compensatory relief in tort actions”); *Goldkrantz v. Griffin*, 1999 WL 191540, at *7 (S.D.N.Y. Apr. 6, 1999) (“The normal measure of recovery is out-of-pocket damages, defined as the difference between the price paid for the security and its true value absent the fraud on the date of the transaction.”); *Maldonado v. Flynn*, 477 F. Supp. 1007, 1010 (S.D.N.Y. 1979) (holding in an “improper election” case that only the “expense of a new solicitation, strictly speaking, may be said to represent out-of-pocket losses attributable to the false proxy statements”).

²⁰⁰ *Osofsky*, 645 F.2d at 114 (observing that in this transactional context, “shareholders of a target company would hardly ever, under the out-of-pocket measure of damages, have redress”).

²⁰¹ Thus, in *Lane v. Page*, 727 F. Supp. 2d 1214, 1232 (D.N.M. 2010), the court permitted Lane to amend his complaint to allege that “because of . . . misrepresentations and omissions in the Proxy Statement, the class members voted in favor of accepting \$315.00 per share for their stock” (which was not publicly traded) “when the stock was actually worth between \$474.00 and \$1013.00 per share.” The court found this allegation sufficient to plead loss causation under § 14(a), and explained that “[w]hether Lane can produce sufficient evidence to establish the facts underlying this theory is not currently before the Court.” *Id.* at 1238-39.

²⁰² *Osofsky*, 645 F.2d at 114. The Supreme Court appeared to recognize the benefit-of-the-bargain approach in *Mills*, when it stated that “[w]here the defect in the proxy solicitation relates to the specific terms of the merger, the district court might appropriately order an accounting to ensure that the shareholders receive the value that was represented as coming to them.” 396 U.S. at 388.

transaction,²⁰³ and it is not available where the “benefit-of-the-bargain damages . . . cannot easily be determined by a comparison of the promised value of the stock with its actual market value on the effective date of the transaction.”²⁰⁴

Finally, some courts have applied the “lost opportunity” approach to § 14(a) damages in appropriate circumstances. The Third Circuit discussed this approach in *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 772 (3d Cir. 1976), a case in which the plaintiffs claimed, *inter alia*, to have been “misled as to the potential effectiveness of their voting power for bargaining purposes,” and thus deprived of the “opportunity to use the possibility of their voting in the negative as a negotiating lever in seeking a modification of the merger agreement which would be more favorable to themselves.” The plaintiffs did not claim an out-of-pocket loss, and instead contended they had been “lulled to inaction” by the defective proxy materials, which in turn resulted in the “loss of an opportunity to attempt to secure a merger agreement which would be more favorable to them.” *Id.* at 782. The court accepted this theory as viable, and held the plaintiffs were entitled to recover a portion of the additional merger premium that had been paid to other “favored defendants.” *See id.* at 782-83. The court reasoned that although it was “possible that full disclosure and correction of the defective proxy materials would not have affected the terms of the merger,” the “parties responsible for the defects should bear the risk of the uncertainty.” *Id.* Thus, the Third Circuit ruled that the plaintiffs were entitled to recover as damages their “pro rata share of the premium received by the favored defendants in the merger.” *Id.* at 783-84.

Importantly, lost opportunity damages are not available when the claimed loss is “wholly speculative.” *Id.* at 781. Courts require plaintiffs to identify “certain, fixed and demonstrable profits” that were “thwarted” by the defendants’ violations,²⁰⁵

²⁰³ *Osofsky*, 645 F.2d at 114; *accord In re Real Estate Assocs. Ltd. P’ship Litig.*, 223 F. Supp. 2d 1142, 1153 (C.D. Cal. 2002) (“plaintiffs allege that the misrepresentations at issue concerned the consideration for their securities” and therefore “may proceed under the benefit-of-the-bargain theory.”). In *Osofsky*, the proxy materials stated that if the proposed merger were consummated, target shareholders would receive a stock package worth approximately \$62.50, but the package’s actual value was roughly 4% less on the effective date. *See* 645 F.2d at 110. *Cf. Goldkrantz*, 1999 WL 191540, at *8 (“since the alleged misrepresentation concerns something other than the consideration for the merger, benefit-of-the-bargain damages are unavailable.”).

²⁰⁴ *Barrows v. Forest Labs., Inc.*, 742 F.2d 54, 59-60 (2d Cir. 1984) (“[A]ppellants’ proposed claim is based on the value the stock purportedly would have had if Forest’s true financial condition had been publicly known at the time of the transaction, clearly a speculative proposition.”); *accord Osofsky*, 645 F.2d at 114 (“giving the plaintiff benefit-of-the-bargain damages is appropriate only when they can be established with reasonable certainty”).

²⁰⁵ *See, e.g., Brown v. Brewer*, 2010 WL 2472182, at *32 (C.D. Cal. June 17, 2010) (quoting *In re Daimlerchrysler AG Sec. Litig.*, 294 F. Supp. 2d 616, 627 (D. Del. 2003)).

and do not permit recovery under this approach where the “fact of the loss, i.e., whether there was any lost opportunity at all, is wholly speculative.”²⁰⁶

9. Statute of Limitations

The Exchange Act does not expressly provide either a period of limitations or a period of repose that is applicable to claims under § 14(a). Before the enactment of Sarbanes-Oxley in 2002, courts generally borrowed the limitations periods set forth in other provision of the Exchange Act and applied a one-year limitations period and a three-year repose period to § 14(a) claims.²⁰⁷

Sarbanes-Oxley introduced an express two-year limitations period and five-year repose period for certain private rights of action under the securities laws, casting some potential doubt on whether the one- and three-year periods that most courts had previously borrowed for § 14(a) claims would continue to apply. By its terms, however, the relevant section in Sarbanes-Oxley only applies to claims that involve “fraud, deceit, manipulation, or contrivance.” 28 U.S.C. § 1658. Both the Second and Third Circuits have accordingly deemed this statutory provision inapplicable

²⁰⁶ *Tse v. Ventana Med. Sys., Inc.*, 297 F.3d 210, 220 (3d Cir. 2002). See also, e.g., *Goldkrantz*, 1999 WL 191540, at *8 (rejecting damages theory that shareholders “would have been able to negotiate a better price” on the ground that it depended on an “unduly speculative . . . chain of events”). On the other hand, “where the fact of lost opportunity is well established, it is up to the fact finder to determine the amount of the loss to the best of its ability.” *Tse*, 297 F.3d at 220.

²⁰⁷ See, e.g., *Westinghouse Elec. Corp. v. Franklin*, 993 F.2d 349, 353 (3d Cir. 1993) (finding that “Section 14(a) claims, like Section 10(b) claims, are similar and related to explicit causes of action enumerated in the Securities Exchange Act for which Congress did expressly provide” limitations periods); *Ceres Partners v. GEL Assocs.*, 918 F.2d 349, 361-62 (2d Cir. 1990) (same); see also *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360, 362 (1991), *superseded by statute*, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, *as recognized in Merck & Co. v. Reynolds*, 559 U.S. 633 (2010) (holding that a “a 1-year period after discovery combined with a 3-year period of repose,” which applies to most express causes of action in the Securities Act and the Exchange Act, are the appropriate limitations periods for the implied right of action under § 10(b) of the Exchange Act).

to § 14(a) claims, on the ground that such claims do not require proof of scienter,²⁰⁸ and a number of district courts have reached the same conclusion.²⁰⁹

C. Section 14(e)

Section 14(e) of the Exchange Act prohibits material misstatements or omissions made “in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.” 15 U.S.C. § 78n(e).²¹⁰ This provision was enacted as part of the Williams Act of 1968 in response to the “increased use of cash tender offers as a means of obtaining corporate control,” and was “designed to fill a gap in the securities laws which left ‘the cash tender offer exempt from disclosure provisions.’”²¹¹

Although the text of § 14(e) also refers to “fraudulent, deceptive, or manipulative acts or practices” in connection with tender offers, 15 U.S.C. § 78n(e), the Supreme Court has held that “[w]ithout misrepresentation or nondisclosure, § 14(e) has not

²⁰⁸ See *Dekalb Cty. Pension Fund v. Transocean Ltd.*, 817 F.3d 393, 409-10 (2d Cir. 2016) (holding that the “same three-year statutes of repose that we applied to Section 14 in *Ceres*—which are the three-year statutes of repose that, until Congress passed SOX, applied to Sections 9(f) and 18(a) [of the Exchange Act]—still apply to Section 14(a) today.”), *as amended* (Apr. 29, 2016); *In re Exxon Mobil Corp. Sec. Litig.*, 500 F.3d 189, 197 (3d Cir. 2007) (“[W]e conclude that Congress did not intend to include § 14(a) claims within the scope of § 1658(b), but rather intended that provision to apply to § 10(b) claims and other claims requiring proof of fraudulent intent.”). Although *Dekalb* technically concerned only the statute of repose applicable to § 14(a) claims post-Sarbanes-Oxley, the reasoning of that decision compels the conclusion that the previously recognized one-year limitations period would remain applicable as well, and subsequent district court decisions have consistently applied that limitations period. See, e.g., *Gould ex rel. Bank of America v. Moynihan*, 275 F. Supp. 3d 487, 501 (S.D.N.Y. 2017); *Bensinger v. Denbury Res. Inc.*, 31 F. Supp. 3d 503, 507 (E.D.N.Y. 2014).

²⁰⁹ See, e.g., *Lane*, 649 F. Supp. 2d at 1298; *Spiegel v. Siegel*, 2008 WL 151951, at *2 (S.D. Fla. Jan. 15, 2008); *In re Zoran Corp. Derivative Litig.*, 511 F. Supp. 2d 986, 1016-17 (N.D. Cal. 2007); *Virginia M. Damon Tr. v. N. Country Fin. Corp.*, 325 F. Supp. 2d 817, 823 (W.D. Mich. 2004).

²¹⁰ Concerned that a “rigid definition would be evaded,” Congress has not specified what constitutes a tender offer for purposes of the federal securities laws, leaving the courts and the SEC with “flexibility to define the term.” *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 56 (2d Cir. 1985); see also *id.* at 56-57 (discussing the factors that courts typically consider to identify tender offers). Per the SEC, in general terms, “[a] tender offer is typically an active and widespread solicitation by a company or third party . . . to purchase a substantial percentage of the company’s securities,” and the price offered is “usually at a premium to the current market price of the securities.” *Fast Answers: Tender Offer*, U.S. SEC. & EXCHANGE COMM’N, <https://www.sec.gov/fast-answers/answerstenderhtm.html> (last visited Sept. 7, 2023). The terms of the offer are fixed, and “each security holder can decide for him or herself whether to tender his or her securities.” *Id.* In many cases, the party pursuing the tender offer will condition it on a threshold percentage of the security holders agreeing to tender their securities. See *id.*

²¹¹ *Sargent v. Genesco, Inc.*, 492 F.2d 750, 769 (5th Cir. 1974) (quoting H.R. Rep. No. 90-1711, at 2813 (1968)). As the Fifth Circuit explained, prior to the enactment of § 14(e), “[i]f the method [of obtaining control] was a proxy contest, section 14(a) would apply,” and if the method was a stock-for-stock exchange, “registration under the Securities Act would be required.” *Id.* at 769 n.27.

been violated.” *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 13 (1985). It is therefore clear that nothing in § 14(e) empowers courts to “oversee the substantive fairness of tender offers,” and that the “quality of any offer is a matter for the marketplace.” *Id.* at 11-12.

1. Implied private right of action

The Department of Justice and the SEC may bring criminal prosecutions and enforcement actions under § 14(e), but the express terms of the statute do not create a private right of action for anyone.

In *Piper v. Chris-Craft Industries, Inc.*, the Supreme Court considered whether “tender offerors . . . have a cause of action for damages” under § 14(e) “on a claim that antifraud violations by other parties have frustrated the bidder’s efforts to obtain control of the target corporation.” 430 U.S. 1, 24 (1977). The *Piper* Court held that no such right of action could be implied from the statute. *Id.* at 42. But the Court expressed no view as to “[w]hether shareholder-offerees, the class protected by § 14(e), have an implied cause of action.” *Id.* at 42 n.28.²¹²

In *Emulex Corp. v. Varjabedian*, the Supreme Court seemed poised to resolve the question left unanswered in *Piper*.²¹³ After granting certiorari apparently to resolve a circuit split on the question whether § 14(e) claims require proof of scienter, as opposed to mere negligence,²¹⁴ the primary focus at oral argument was whether shareholders can even assert claims under § 14(e).²¹⁵ But the Court subsequently dismissed the writ of certiorari as improvidently granted, 139 S. Ct. 1407 (2019),

²¹² The *Piper* Court likewise did not address the “target corporation’s standing to sue” under § 14(e); rather, the Court’s “narrow holding” was “only that a tender offeror, suing in its capacity as a takeover bidder, does not have standing to sue for damages under § 14(e).” *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 42 n.28 (1977).

²¹³ See Order Granting Writ of Certiorari, *Emulex Corp. v. Varjabedian*, 139 S.Ct. 782 (Jan. 4, 2019); see also Petition for Writ of Certiorari, *Emulex Corp. v. Varjabedian*, 2018 WL 4942046, at *i (U.S. Oct. 11, 2018) (Question Presented: “Whether the Ninth Circuit correctly held . . . that Section 14(e) of the Securities Exchange Act of 1934 supports an inferred private right of action based on a negligent misstatement or omission made in connection with a tender offer.”).

²¹⁴ This circuit split is discussed below in Section II.C.5, *infra*.

²¹⁵ See, e.g., Transcript of Oral Argument, *Emulex Corp. v. Varjabedian*, 2019 WL 1642485, at *3-4 (U.S. Apr. 15, 2019) (questioning of Petitioners’ counsel by Justice Ginsburg: “It went through the trial court, court of appeals, not a word—everybody accepted there was a private right of action. And you are now making the non-existence of a private right your principal argument.”).

leaving the circuit split unresolved and the implied private right of action under § 14(e), as it has been developed by the lower courts,²¹⁶ intact—at least for now.²¹⁷

2. Standing

Although the Supreme Court has not resolved the issue, the lower federal courts have consistently held that shareholders presented with a tender offer have standing to sue under §14(e), whether or not they tendered their shares.²¹⁸ Damages and injunctive relief are each theoretically available to such shareholders, with the appropriate remedy varying based on the specific circumstances.²¹⁹ It is also widely

²¹⁶ “[L]ower courts have long permitted private litigants to pursue claims under Section 14(e), on the theory that this Court has recognized private rights of action under Section 10(b).” Brief for the United States as *Amicus Curiae, Emulex Corp. v. Varjabedian*, 2019 WL 991071, at *27 (U.S. Feb. 26, 2019). Indeed, every Court of Appeals to consider the question to date has held that there is an implied private right of action for target shareholders under § 14(e), *see, e.g., Plaine v. McCabe*, 797 F.2d 713, 718 (9th Cir. 1986); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 596 n.20 (5th Cir. 1974), while other courts have simply assumed that private shareholder actions are viable, *see, e.g., Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 361 (2d Cir. 1973) (“In enacting § 14(e), while Congress did not explicitly state that shareholders of a target company are not the only persons entitled to the protection of the securities laws from fraudulent misrepresentations, it is a fair inference that a broader standing was intended.”).

²¹⁷ If and when the Supreme Court finally tackles the question, there is substantial reason to suspect the Court may hold there is no private right of action for shareholders (or anyone else for that matter) under § 14(e). Several of the current justices appeared inclined to reach that conclusion during the oral arguments in *Emulex*, *see, e.g.*, Transcript of Oral Argument, *Emulex Corp. v. Varjabedian*, 2019 WL 1642485, at *40-47 (questioning of Respondents’ counsel by Chief Justice Roberts and Justices Gorsuch and Kavanaugh), and the DOJ and the SEC have already argued to the Court that its “current approach to private rights of action forecloses inferring such a right under Section 14(e),” Brief for the United States as *Amicus Curiae, Emulex Corp. v. Varjabedian*, 2019 WL 991071, at *29.

²¹⁸ *See, e.g., Plaine v. McCabe*, 797 F.2d at 717-18 (“Although she did not tender her shares, Plaine alleges that the false information and omissions in the proxy materials led other shareholders to tender their shares. The success of the tender offer gave Natomas the 83 per cent share in Magma that eventually allowed Natomas to accomplish the merger.”); *Smallwood*, 489 F.2d at 596 (“[U]nder Section 14(e) a plaintiff may gain standing if he has been injured by fraudulent activities of others perpetrated in connection with a tender offer, whether or not he has tendered his shares.”); *Roofers’ Pension Fund v. Papa*, 333 F.R.D. 66, 86 (D.N.J. 2019) (“Courts do not categorically exclude class members from bringing a Section 14(e) private cause of action merely based on their status as tendering or non-tendering shareholders.”); *McCloskey v. Epko Shoes, Inc.*, 391 F. Supp. 1279, 1283 (E.D. Pa. 1975) (“So long as the misrepresentation is material, the reliance of those shareholders who do tender their stock is sufficient to establish the causal connection between plaintiff’s injury and defendant’s violation of the Act.”); *see also Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 38-39 & n.25 (1977) (noting that “[t]he omission of the purchaser-seller requirement” from § 14(e) could signify that “Congress desired to protect . . . shareholder-offerees who decided not to tender their stock due to fraudulent misrepresentations by persons opposed to a takeover attempt,” but declining to resolve that issue).

²¹⁹ *See, e.g., Gearhart Indus., Inc. v. Smith Int’l, Inc.*, 741 F.2d 707, 714-16 (5th Cir. 1984) (holding that “equitable relief is available” for violations of § 14(e)); *Scheiner v. Midas, Inc.*, 2013 WL 329006, at *5-6 (N.D. Ill. Jan. 29, 2013) (explaining that “compensatory damages” are theoretically available under § 14(e) in circumstances where injunctive relief would be “moot”); *Iavarone v. Raymond Keyes Assocs.*, 733 F. Supp. 727, 731-32 (S.D.N.Y. 1990) (“[A] tender offer should not be enjoined when the proposed transaction will not cause ‘unravelable’ harm which cannot be adequately calculated and compensated for by money damages.”).

accepted by the lower federal courts that the target company has standing to sue for injunctive relief.²²⁰

As previously noted, in *Piper*, the Supreme Court held that tender offerors do *not* have standing to bring claims for damages under §14(e),²²¹ but the Court declined to decide whether the party making the offer has standing to seek an injunction.²²² Some lower federal courts have subsequently held that tender offerors can assert claims for injunctive relief under § 14(e), at least in certain cases.²²³

3. Persons liable

Section 14(e) makes it unlawful for “any person” to make a material misstatement or omission in connection with a tender offer. 15 U.S.C. § 78n(e). As the Supreme Court has observed, § 14(e) was “expressly directed at the conduct of a broad range of persons, including those engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer.” *Piper*, 430 U.S. at 24.

Courts have accordingly recognized that liability for § 14(e) violations can be imposed in appropriate cases on the tender offeror, the target company, or their respective officers and directors.²²⁴ Although the Second Circuit once held that an

²²⁰ See, e.g., *Polaroid Corp. v. Disney*, 862 F.2d 987, 1003 (3d Cir. 1988) (“A target company . . . has standing to sue, under section 14(e)’s implied right of action, to enjoin misrepresentations made by a tender offeror in connection with the offer.”); *Gulf & W. Indus., Inc. v. Great Atl. & Pac. Tea Co.*, 476 F.2d 687, 695 n.14 (2d Cir. 1973) (“A&P’s standing, as the target corporation of a tender offer, to bring suit under § 14(e) for a preliminary injunction against G&W, the offeror, is clear.”); *Allergan, Inc. v. Valeant Pharms. Int’l, Inc.*, 2014 WL 5604539, at *7 n.3 (C.D. Cal. Nov. 4, 2014) (“Multiple courts have held that the issuer of stock has standing to seek injunctive relief under the Williams Act, including under Section 14(e), on the ground that the issuer is much more likely than shareholders to have the information and the resources to act quickly in the midst of a hostile tender offer.”).

²²¹ See *Piper*, 430 U.S. at 41-42.

²²² See *id.* at 47 n.33 (expressing “no view” as to whether “a suit in equity for injunctive relief, as distinguished from an action for damages, would lie in favor of a tender offeror” under § 14(e)).

²²³ See, e.g., *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366, 370-73 (6th Cir. 1981) (holding that a “tender offeror has an implied cause of action under the Williams Act to obtain timely injunctive relief for violations of section 14(e),” reasoning that they “may often be the only party with enough knowledge and awareness [of the target] to identify nondisclosure or manipulative practices in time”); *Humana, Inc. v. Am. Medicorp, Inc.*, 445 F. Supp. 613, 615-16 (S.D.N.Y. 1977) (holding that one of two competing tender offerors had standing to seek injunctive relief where the “thrust of the complaint [was] to request increased disclosure . . . so that [target] stockholders may more intelligently choose between the competing Humana and TWA-Hilton offers”); see also *Macfadden Holdings, Inc. v. JB Acquisition Corp.*, 802 F.2d 62, 66 n.2 (2d Cir. 1986) (“Since Macfadden, in addition to its role as a competing tender offeror, was the owner of some 1.2 million shares of [target’s] common stock, it clearly may seek to enjoin an alleged violation of the Act.”).

²²⁴ See, e.g., *Chris-Craft.*, 480 F.2d at 364-69 (holding that the plaintiff had proven violations of § 14(e) by certain officers and directors of the target company as well as a tender offeror and its officers, and remanding

underwriter for a tender offeror can also be subject to liability under § 14(e) for faulty disclosures made by the tender offeror,²²⁵ the continued viability of this holding is questionable in light of the Supreme Court’s intervening decision in *Central Bank*.²²⁶

4. “In connection with”

Unlike Rule 10b-5 (*see* p. 33, *supra*), there is no purchaser-seller requirement under § 14(e).²²⁷ The absence of any such requirement explains why non-tendering shareholders can have standing to bring § 14(e) claims.²²⁸

Courts have recognized that statements made “on the eve of a tender offer” are subject to § 14(e), at least “where it appears that such an offer is likely,” reasoning that were the rule otherwise, parties “would be free to disseminate misinformation up to the effective date of the tender offer.” *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir. 1980).²²⁹ By contrast, “statements made well in advance of a subsequent

to the district court to determine the amount of damages); *Smallwood*, 489 F.2d at 598 (“Section 14(e) applies to statements by management of the target company, as well as by the tender offeror.”).

²²⁵ *See Chris-Craft*, 480 F.2d at 369-73 (“We hold that the conduct on the part of First Boston and its officers violated § 14(e).”). The court’s opinion is unfortunately less than clear in articulating the basis for this holding. *Compare id.* at 370 (“An underwriter by participating in an offering constructively represents that statements made in the registration materials are complete and accurate.”; “The representations in the registration statement are those of the underwriter as much as they are those of the issuer.”), *with id.* (“An underwriter is liable under § 14(e) as an aider and abettor of the issuer if he was aware of a material falsity in the registration statement or was reckless in determining whether material falsity existed.”).

²²⁶ *See SEC v. Tambone*, 597 F.3d 436, 448-49 (1st Cir. 2010) (en banc) (“*Chris-Craft* preceded *Central Bank* by over twenty years, and its continued vitality with respect to this section 14(e) holding is doubtful.”); *see also In re Motel 6 Sec. Litig.*, 161 F. Supp. 2d 227, 235 (S.D.N.Y. 2001) (“The Supreme Court’s clear statement [in *Central Bank*] that causes of action under the Exchange Act must be limited to those authorized by statutory language effectively bars aiding and abetting claims under § 14(e).”). *See generally* pp. 134-37, *infra*.

²²⁷ *See, e.g., In re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig.*, 467 F. Supp. 227, 242 (W.D. Tex. 1979) (“Section 14(e) does not contain the ‘in connection with the purchase or sale of any security’ language of Rule 10b-5. Hence the reasoning of the decision in [*Blue Chip Stamps*] is not directly applicable to the question of standing under 14(e).”); *McCloskey v. Epko Shoes, Inc.*, 391 F. Supp. 1279, 1281-82 (E.D. Pa. 1975) (“By not using the words ‘purchase or sale’ as used in § 10(b) of the Act it appears that one of the goals of § [14(e)] was to eliminate the purchase and sale requirement in the tender offer situation.”).

²²⁸ *See* p. 94, *supra*. As one court has explained, “many of the concerns expressed by the court in *Blue Chip* are inapposite to analysis of the 14(e) action,” because “the possibility of a boundless class of nonpurchasing or nonselling plaintiffs seeking relief . . . does not exist under section 14(e),” as “[t]he class of nontendering shareholders is limited to the persons actually confronted with the offer.” *In re Commonwealth Oil*, 467 F. Supp. at 242.

²²⁹ *See also, e.g., Hanna Min. Co. v. Norcen Energy Res. Ltd.*, 574 F. Supp. 1172, 1200 (N.D. Ohio 1982) (“[P]laintiffs are entitled to injunctive relief under section 14(e) as a remedy for misleading statements made by the defendants during the period preceding the announcement of Norcen’s tender offer for Hanna because such an offer was contemplated long before it was actually announced and reliance . . . was probable under the circumstances.”); *Applied Data Sys. Inc. v. Milgo Elec. Corp.*, 425 F. Supp. 1145, 1154 (S.D.N.Y. 1977) (“[I]t

tender offer and with no apparent relation to it” have been held not to meet § 14(e)’s “in connection with” requirement. *Sanders v. Thrall Car Mfg. Co.*, 582 F. Supp. 945, 966-68 (S.D.N.Y. 1983).

5. Standard of culpability

Until recently, each of the five Courts of Appeals to consider the question had held that § 14(e) claims require proof of scienter.²³⁰ In so holding, these circuits have relied on similarities between § 14(e) and Rule 10b-5, which, as discussed above (at p. 40), requires proof of scienter.²³¹ But the Ninth Circuit reached a different conclusion in *Varjabedian v. Emulex Corp.*, and held that negligence is the appropriate standard of culpability for § 14(e) claims premised on allegations of material misstatements or omissions.²³²

To reach this conclusion, the Ninth Circuit began by observing that § 14(e) “readily divides . . . into two clauses” that proscribe “two different offenses.”²³³ Building from there, the court reasoned that because the first clause of § 14(e) “contain[s] nearly identical wording” to § 17(a)(2) of the Securities Act—which, per the Supreme Court, requires only negligence²³⁴—misstatement and omission claims under § 14(e) should not require scienter either.²³⁵ The *Varjabedian* court also criticized the contrary holdings from other circuits that focus on similarities in language between § 14(e) and Rule 10b-5. In the Ninth Circuit’s view, although the Supreme Court did hold in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), that claims under Rule 10b-5 require scienter, that holding was not based on the Rule’s plain language, but rather on the fact that Rule 10b-5 was promulgated pursuant to a statute (§ 10(b)) that “allows the SEC to regulate *only* ‘manipulative or

would be anomalous were section[] . . . 14(e) not applicable . . . once a public announcement of an imminent tender or exchange offer was made, for numerous misstatements, omissions and half-truths could be promulgated with relative impunity until the offer was actually filed with and approved by the SEC.”).

²³⁰ See *SEC v. Ginsburg*, 362 F.3d 1292, 1297 (11th Cir. 2004); *In re Digit. Island Sec. Litig.*, 357 F.3d 322, 328 (3d Cir. 2004); *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 431 (6th Cir. 1980); *Smallwood*, 489 F.2d at 606; *Chris-Craft*, 480 F.2d at 362.

²³¹ See, e.g., *In re Digit. Island*, 357 F.3d at 328 (citations omitted) (“Section 14(e) is ‘modeled on the antifraud provisions of § 10(b) of the [Exchange] Act and Rule 10b-5,’ which require proof of scienter. Because of the similarity in the language and scope of Section 14(e) and Rule 10b-5, we have in the past construed the two consistently.”).

²³² 888 F.3d 399, 404-08 (9th Cir. 2018) (“Ultimately, because the text of the first clause of Section 14(e) is devoid of any suggestion that scienter is required, we conclude that the first clause of Section 14(e) requires a showing of only negligence, not scienter.”).

²³³ *Id.* at 404.

²³⁴ *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

²³⁵ See *Varjabedian*, 888 F.3d at 406-08.

deceptive device[s].” *Varjabedian*, 888 F.3d at 405-06 (quoting 15 U.S.C. § 78j(b)). “This rationale,” the *Varjabedian* court reasoned, “does not apply to Section 14(e), which is a statute, not an SEC Rule.” *Id.* at 406.²³⁶

In light of the Supreme Court’s order dismissing the writ of certiorari in *Varjabedian* as improvidently granted, negligence is the standard of culpability for § 14(e) claims brought within the Ninth Circuit. But *Varjabedian* remains an outlier decision, as its reasoning has not gained traction in other circuits.

6. Reliance and loss causation

It is widely accepted that detrimental reliance is an element of a claim for damages under § 14(e),²³⁷ but courts will frequently presume reliance in such cases.

For example, courts have consistently held that the *Affiliated Ute* presumption of reliance (discussed above at pp. 41-42) applies in § 14(e) cases based on material omissions.²³⁸ When misstatements, rather than omissions, are alleged, courts have extended the Supreme Court’s reasoning in *Mills* (discussed above at p. 84) to the § 14(e) context, holding that if there was a material misstatement in the tender offer materials, “it is . . . appropriate . . . to presume” that shareholders “would not have exchanged their shares at the rate offered if they had known the truth.” *Herbst v. Int’l Tel. & Tel. Corp.*, 495 F.2d 1308, 1316 (2d Cir. 1974). These courts reason

²³⁶ As the Ninth Circuit pointed out (*see id.* at 405), the Supreme Court did state in *Hochfelder* that the relevant language of Rule 10b-5, when “[v]iewed in isolation,” “could be read as proscribing . . . any type of material misstatement or omission . . . whether the wrongdoing was intentional or not.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212 (1976).

²³⁷ *See, e.g., Roofers’ Pension Fund v. Papa*, 2017 WL 1536222, at *5 (D.N.J. Apr. 27, 2017) (“Both section 10(b) and 14(e) claims include a reliance requirement.”); *Scheiner v. Midas, Inc.*, 2013 WL 329006, at *5 (N.D. Ill. Jan. 29, 2013) (“To state a claim for damages under § 14(e), a plaintiff must allege that he or she relied on misstatements to his or her detriment.”); *Wardop v. Amway Asia Pac. Ltd.*, 2001 WL 274067, at *5 (Mar. 20, 2001) (“To properly plead a cause of action pursuant to §§ 10(b) and 14(e), plaintiffs must allege detrimental reliance on defendants’ alleged misrepresentations.”); *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1369 (N.D. Tex. 1979) (“[T]his court refuses to extend standing under section 14(e) to persons who clearly did not rely on alleged misstatements.”).

²³⁸ *See, e.g., Biechele v. Cedar Point, Inc.*, 747 F.2d 209, 214-15 (6th Cir. 1984) (recognizing that “positive proof of reliance is not required for recovery in a nondisclosure case” under § 10(b) or § 14(e), but cautioning that “[t]he presumption of reliance set forth in *Affiliated Ute* is not irrebuttable”); *Basile v. Valeant Pharm. Int’l, Inc.*, 2017 WL 3641591, at *13 (C.D. Cal. Mar. 15, 2017) (“This is a [§ 14(e)] case involving a duty to disclose—accordingly *Affiliated Ute* applies.”); *In re Piedmont Off. Tr., Inc. Sec. Litig.*, 264 F.R.D. 693, 701 (N.D. Ga. 2010), *vacated on other grounds by Washtenaw Cnty. Emps. Ret. Sys. v. Piedmont Office Realty Tr., Inc.*, 422 F. App’x 868 (11th Cir. 2011) (“[T]he plaintiffs’ § 14(e) claim is that the defendants failed to disclose why the listing was no longer a basis for rejection of the tender offer. This alleged failure is an omission. Therefore, the *Affiliated Ute* doctrine applies, and reliance is presumed.”).

that, much like with a proxy solicitation, “the reliance of the individual shareholder” will frequently be irrelevant in the tender offer context, insofar as the plaintiff will suffer damage “only if significant numbers of shareholders might have acted differently if they had known the truth.” *Id.* And because “it is extremely difficult to prove how shareholders in the aggregate would have reacted if they had known the whole truth,” these courts deem it appropriate to presume reliance in such cases. *Id.*²³⁹ Finally, at least one court has applied the *Basic* presumption of reliance (discussed above at pp. 42-43) in a § 14(e) case that related to the market price of publicly traded shares.²⁴⁰

At their core, these cases stand for the basic proposition that where “reliance is possible, and even likely, but is unduly burdensome to prove, the resulting doubt” should be resolved in the plaintiff’s favor. *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir. 1980). On the other hand, “where no reliance was possible under any imaginable set of facts,” and thus any presumption of reliance would be “illogical,” the presumption does not apply. *Id.* Courts have accordingly dismissed § 14(e) claims on reliance grounds where the tender offer was withdrawn before shareholders had the opportunity to act on it.²⁴¹ Moreover, although it is widely accepted that both tendering and non-tendering shareholders have standing to assert § 14(e)

²³⁹ See also, e.g., *Plaine v. McCabe*, 797 F.2d 713, 721 (9th Cir. 1986) (citing *Mills*, in a § 14(e) case, for the proposition that a plaintiff “succeeds in proving causation once the misstatement or omission has been shown to be ‘material’”); *Panter v. Marshall Field & Co.*, 646 F.2d 271, 284 (7th Cir. 1981) (“The *Mills-Ute* presumption is essentially a rule of judicial economy and convenience, designed to avoid the impracticality of requiring that each plaintiff shareholder testify concerning the reliance element.”).

²⁴⁰ See *Roofers’ Pension Fund v. Papa*, 333 F.R.D. 66, 74, 85 n.13 (D.N.J. 2019) (considering whether to certify a class of Perrigo shareholders who held their shares during the pendency of an unsuccessful tender offer; “Because . . . assessing Mylan’s tender offer naturally involves the market price of Perrigo stock, the Court finds that applying the *Basic* presumption of reliance is appropriate.”); see also *Basile*, 2017 WL 3641591, at *12 (applying the *Affiliated Ute* presumption and therefore declining to decide whether the fraud-on-the-market presumption can apply to a claim under § 14(e)).

²⁴¹ See *Panter*, 646 F.2d at 284-86 (“[W]e hold that § 14(e) of the Williams Act does not give a damages remedy for alleged misrepresentations or omissions of material fact when the proposed tender offer never becomes effective.”); *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir. 1980) (“In the instant case, the target’s shareholders simply could not have relied upon McGraw-Hill’s statements, whether true or false, since they were never given an opportunity to tender their shares.”). In a similar vein, the Seventh Circuit has held that a shareholder “cannot use § 14(e) to challenge a statement made after a tender offer has closed.” *Walleye Trading LLC v. AbbVie Inc.*, 962 F.3d 975, 978, 979 (7th Cir. 2020) (“[T]he end of the tender offer placed Walleye outside the zone of interests protected by § 14. By May 30, when AbbVie announced the results of the Dutch auction, there was no longer any way for shareholders to participate in it.”).

claims (*see* p. 94, *supra*), a plaintiff who had actual knowledge of the alleged misrepresentation or omission before the expiration of the tender offer may be precluded from establishing detrimental reliance.²⁴²

Section 14(e) claims also require proof of loss causation; *i.e.*, a causal connection between the alleged disclosure deficiencies and the plaintiff's claimed injury.²⁴³ Thus, for example, the Supreme Court in *Burlington Northern* affirmed the dismissal of a § 14(e) claim where the plaintiff's claimed injury—the lost opportunity to tender her El Paso shares at an allegedly attractive price when Burlington Northern cancelled its initial tender offer and commenced a new tender offer on different terms—was disconnected from the alleged deficiencies in the disclosures that accompanied the second offer.²⁴⁴

It is important to note that courts generally do not require parties seeking preliminary injunctive relief under § 14(e) to demonstrate reliance or loss causation.²⁴⁵

²⁴² *See, e.g., Scheiner v. Midas, Inc.*, 2013 WL 329006, at *6 (N.D. Ill. Jan. 29, 2013) (“[A] shareholder . . . who does not tender his shares . . . but later seeks damages under § 14(e) must show that he relied on the alleged misrepresentation in not tendering. Here, Scheiner filed the present lawsuit before the deadline to tender his shares had passed, and before he could have relied”); *Wardrop v. Amway Asia Pac. Ltd.*, 2001 WL 274067, at *5 (S.D.N.Y. Mar. 20, 2001), *aff'd*, 26 F. App'x 89 (2d Cir. 2002) (“[P]laintiffs could not have relied on the alleged false and misleading representation because the information was publicly available and plaintiffs filed the complaint before the tender offer period expired.”). Notably, however, at least one court has suggested that a plaintiff that knew of the alleged misstatement or omission can still pursue a damages claim under § 14(e), on the theory that other shareholders faced with the tender offer were deceived, provided that the plaintiff's own response to the tender offer was consistent with its litigation position. *See Stark Trading v. Falconbridge Ltd.*, 2008 WL 153542, at *13 (E.D. Wisc. Jan. 14, 2008) (“A shareholder believing that the Tender Offer is founded in fraud must choose a single consistent path—either object and do not tender his shares, or tender his shares and accept what may come.”), *aff'd*, 552 F.3d 568 (7th Cir. 2009).

²⁴³ *See, e.g., Brown v. Papa Murphy's Holdings Inc.*, 2021 WL 1574446, at *4 (“The final element of a Section 14(e) claim requires a showing that the defendant caused the loss for which plaintiff seeks to recover damages.”); *Bolton v. Gramlich*, 540 F. Supp. 822, 835 (S.D.N.Y. 1982) (“unless the violation of § 14(e) caused the injury complained of, the action must fail”). *See generally* 15 U.S.C. § 78u-4(b)(4) (“In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.”).

²⁴⁴ *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 13 (1985) (“Since the deceptive and misleading acts alleged by petitioner all occurred with reference to the making of the second tender offer—when the injuries suffered by petitioner had already been sustained—these acts bear no possible causal relationship to petitioner's alleged injuries.”). As the Third Circuit had put it in its decision in the same case, “[e]ven if Burlington had made full disclosure in the January offer, this information would have made no difference to shareholders like Schreiber, whose injury had already been caused by the December rescission.” *Schreiber v. Burlington Northern, Inc.*, 731 F.2d 163, 166 (3d Cir. 1984); *see also, e.g., Bolton*, 540 F. Supp. at 836 (“The sale and termination occurred before the defendants knew how many shares would be tendered. Thus, the failure of disclosure and its possible effect of reducing the number of shares tendered cannot be causally connected to the trustees' decision to liquidate the Trust.”).

²⁴⁵ There are many examples of courts considering motions for preliminary injunctive relief under § 14(e), and concluding that the movant had demonstrated a sufficient likelihood of success on the merits, without addressing either of these elements. *See, e.g., Polaroid v. Disney*, 862 F.2d 987, 1003-06 (3d Cir. 1988); *Sonesta Int'l*

This is a sensible approach, because a party that seeks such relief is asking the court to intervene *before* shareholders have decided whether or not to tender their shares—in other words, before they have had the opportunity to rely on the problematic disclosures—and thereby prevent harm.²⁴⁶

7. Heightened pleading requirements under the PSLRA

It is well-established that the PSLRA’s heightened pleading requirements (discussed above at pp. 54-61) apply to private claims under § 14(e).²⁴⁷ With respect to the element of falsity, this result is compelled by the statute, which requires the plaintiff in “any private action” arising under the Exchange Act to “specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, . . . state with particularity all facts on which that belief is formed.” 15 U.S.C. § 78u-4(b)(1). Likewise, in the many courts that require proof of scienter in § 14(e) cases, the PSLRA is explicit in requiring the plaintiff to “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.” *Id.* § 78u-4(b)(2).

Now that it has departed from the overwhelming judicial consensus and held that proof of negligence is all that § 14(e) requires (*see* pp. 97-98, *supra*), it remains to be seen whether the Ninth Circuit will require particularized allegations of negligence in § 14(e) cases.²⁴⁸ Notably, upon remand in *Emulex*, the district court stated in dicta that § 14(e) does not require the plaintiff to plead negligence with particularity, reasoning that “[n]egligence is not a state of mind, but a standard of care.”²⁴⁹ But the Ninth Circuit did not address this aspect of the district court’s decision when

Hotels Corp. v. Wellington Assocs., 483 F.2d 247, 251 (2d Cir. 1973); *Conagra, Inc. v. Tyson Foods, Inc.*, 708 F. Supp. 257, 262-65 (D. Neb. 1989), *vacated on other grounds by* 716 F. Supp. 428 (D. Neb. 1989); *Weeks Dredging & Contracting, Inc. v. Am. Dredging Co.*, 451 F. Supp. 468, 476-79 (E.D. Pa. 1978); *Gen. Host Corp. v. Triumph Am., Inc.*, 359 F. Supp. 749, 753-58 (S.D.N.Y. 1973).

²⁴⁶ *See Sonesta Int’l Hotels*, 483 F.2d at 250 (citation omitted) (“[P]rior to consummation of the offer the court still has a variety of methods available to it for correction of the misstatements or omissions. But once the tender offer has been consummated it becomes difficult, and sometimes virtually impossible, for a court to ‘unscramble the eggs.’”).

²⁴⁷ *See, e.g., Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1166-67 (9th Cir. 2009) (applying the “PSLRA’s falsity pleading requirement” to § 14(e) claims); *In re Digit. Island Sec. Litig.*, 357 F.3d 322, 328–29 (3d Cir. 2004); *In re Piedmont Off. Tr. Inc. Sec. Litig.*, 2012 WL 12951737, at *3-5 (N.D. Ga. Aug. 27, 2012) (applying the PSLRA to § 14(e), including scienter).

²⁴⁸ *See* p. 88, *supra* (discussing this issue in the context of § 14(a) claims).

²⁴⁹ *Varjabedian v. Emulex Corp.*, 2020 WL 1847708, at *10 (C.D. Cal. Feb. 25, 2020), *aff’d sub nom. Mutza v. Emulex Corp.*, 843 F. App’x 951 (9th Cir. 2021).

it resolved the plaintiff's subsequent appeal,²⁵⁰ and therefore left the issue to be resolved in a future case.

8. Remedies and measure of damages

As discussed above (at pp. 94-95), courts have generally held that shareholders confronted with a tender offer, as well as the target company itself, have standing to seek injunctive relief under § 14(e). Indeed, § 14(e) claims are frequently litigated at the preliminary injunction stage, because it is often the case that “once the tender offer has been consummated it becomes difficult, and sometimes virtually impossible, for a court to ‘unscramble the eggs.’” *Sonesta Int’l Hotels Corp. v. Wellington Assocs.*, 483 F.2d 247, 250 (2d Cir. 1973).²⁵¹

Shareholder-plaintiffs may also seek damages under § 14(e), although damages may be difficult to prove in a particular case. The Second Circuit has held that the “measure of compensatory damages” in § 14(e) cases can be “out-of-pocket loss, the benefit of the bargain, or some other appropriate standard.” *Osofsky v. Ziff*, 645 F.2d 107, 112-114 (2d Cir. 1981).²⁵² But “[s]ince the price paid by the successful offeror . . . often exceeds the fair market value of the securities surrendered by the shareholders, defrauded shareholders” will frequently suffer no out-of-pocket loss. *Id.* at 114.²⁵³ And benefit-of-the-bargain damages are only available

²⁵⁰ See *Mutza*, 843 F. App'x at 952-53 (affirming the district court's order of dismissal on falsity grounds).

²⁵¹ See also, e.g., *Elec. Specialty Co. v. Int'l Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969) (Friendly, J.) (“[I]f a violation [of § 14(e)] has been sufficiently proved on an application for a temporary injunction, the opportunity for doing equity is not considerably better . . . than it will be later on. . . . If the filings are defective or the tender offer misleading, the court can require correction, along . . . with an opportunity to withdraw and an injunction against further solicitation until the period for withdrawal has expired.”). With that said, “[a] violation of the Williams Act will not trigger *per se* the right to equitable relief,” and a preliminary injunction may not be suitable “when the proposed transaction will not cause ‘unravelable’ harm which cannot be adequately calculated and compensated for by money damages.” *Iavarone v. Raymond James Assocs., Inc.*, 733 F. Supp. 727, 731-32 (S.D.N.Y. 1990).

²⁵² *Osofsky* also involved an alleged violation of § 14(a), and the court's discussion of damages is accordingly relevant to claims under either provision of the Exchange Act. See nn. 199-200, 202-03, *supra*, and accompanying text.

²⁵³ However, a tendering shareholder would incur out-of-pocket damages if the “price for which [the] shares were tendered” was less than the “‘genuine’ value of those shares.” *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1369 (N.D. Tex. 1979). As another example, in *Lowenschuss v. Kane*, the Second Circuit held that shareholders who had purchased shares in the market and then tendered them into an offer that was later enjoined, and ultimately never consummated, could seek to recover damages under § 14(e) on the theory that the shares they had acquired “were tied up during [a] declining market” due to the enjoined tender offer. 520 F.2d 255, 268-69 (2d Cir. 1975) (cautioning that “class members must assume the burden of proving with reasonable certainty . . . that they would have sold their shares at a particular price or time if the shares had not been frozen”).

under § 14(e) if they can be “established with reasonable certainty.” *Id.*²⁵⁴ Similarly, although the “loss of possible profit,” such as “securing a merger agreement more favorable to plaintiff” can be an appropriate measure of damages in a § 14(e) case, this approach is not available where the lost opportunity is “wholly speculative.” *Plaine v. McCabe*, 797 F.2d 713, 722 (9th Cir. 1986).²⁵⁵

9. Statute of limitations

Before the passage of the Sarbanes-Oxley Act, federal courts in § 14(e) cases looked to state law to borrow the most appropriate statute of limitations.²⁵⁶ But Sarbanes-Oxley established a two-year limitations period and a five-year repose period for any “private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws.” 28 U.S.C. § 1658(b).

By its terms, § 14(e) prohibits “fraudulent, deceptive, or manipulative acts or practices,” 15 U.S.C. § 78n(e), and thus it would appear that the limitations and repose periods set forth in Sarbanes-Oxley should apply to private claims brought under § 14(e).²⁵⁷

²⁵⁴ According to the Second Circuit, *Osofsky* presented the “limited situation” in which the benefit-of-the-bargain damages approach could be viable, because the alleged misrepresentation in the tender offer materials pertained to the “consideration to be forthcoming upon an intended merger.” *Osofsky v. Ziff*, 645 F.2d 107, 114 (2d Cir. 1981).

²⁵⁵ In *Plaine*, the Ninth Circuit reversed a district court order granting summary judgment to defendants, reasoning that the plaintiff “might be able to show that, had section 14(e) been fully complied with, the shareholders’ negotiating position would have produced a higher amount” of per share consideration in a “freeze-out merger and the earlier tender offer.” *Plaine v. McCabe*, 797 F.2d 713, 722 (9th Cir. 1986). In so doing, the court emphasized that damages might still be recoverable under this approach even if the actual price paid to shareholders was “within a range of ‘fairness.’” *Id.* at 721-22.

²⁵⁶ See, e.g., *Stull v. Bayard*, 561 F.2d 429, 431 (2d Cir. 1977) (“Section 14 of the Securities Exchange Act of 1934 prescribes no period of limitation for actions brought thereunder. In such a situation, federal courts apply those statutes of limitation of the forum state which best effectuate the policies underlying the federal statute.”).

²⁵⁷ See *Biotech. Value Fund, L.P. v. Celera Corp.*, 12 F. Supp. 3d 1194, 1199-1200 (N.D. Cal. 2013) (applying Sarbanes-Oxley periods to §14(e) claim). However, it is possible that courts in the Ninth Circuit would conclude that the Sarbanes-Oxley limitations and repose periods are not applicable to private claims under § 14(e), given the Ninth Circuit’s holding that such claims do not require proof of scienter. See pp. 97-98, *supra*.

III

Liabilities Under the Securities Act

A. Overview of § 11 and § 12

1. Sections 11 and 12 Contrasted

Sections 11 and 12 are the basic private liability provisions of the Securities Act. In keeping with the general scheme of the Securities Act, they protect only *buyers*, not sellers. The difference between the two sections is this: § 11 makes those responsible for a false or misleading registration statement liable in damages to any and all purchasers regardless of from whom they bought, while § 12 allows a purchaser to rescind his purchase of securities, or to get damages from his seller if he no longer holds the securities, if the seller used a false or misleading prospectus or false or misleading oral statements in making the sale. Section 11 deals with the “manufacturers” and “wholesalers” of securities (*i.e.*, issuers, underwriters and experts who aid them in preparing registration statements), has no privity requirement, and provides a remedy in damages. Section 12 deals with “retailers” of securities (*i.e.*, the securities dealers who sell to the general public), requires privity, and provides primarily for a remedy of rescission.

2. Overlap Between § 11 and § 12

While §§ 11 and 12 are designed to affect different participants in the securities distribution process, the two provisions overlap somewhat. Thus, anyone who buys a security directly from an issuer or underwriter that is unregistered in violation of § 5 of the Securities Act, or on the basis of false or misleading oral representations or a false or misleading prospectus, may have an action for rescission under § 12, as well as an action under § 11.²⁵⁸

3. Exclusivity of § 11 or § 12 Remedies

A buyer may not rescind or recover damages from his seller under § 12 *and* recover damages from an issuer, an underwriter, or their advisors under § 11. Nothing prevents a litigant, however, from pursuing both § 11 and § 12 actions to judgment and then electing his remedy.

²⁵⁸ See, e.g., *Sanders v. John Nuveen & Co.*, 619 F.2d 1222 (7th Cir. 1980) (finding an underwriter liable under § 12(a)(2)); *Stadia Oil & Uranium Co. v. Wheelis*, 251 F.2d 269 (10th Cir. 1957) (finding an issuer liable under § 12(a)(1)).

4. Rule 9(b) and § 11 and § 12

Sections 11 and 12 claims do not require an element of fraud to be averred in the complaint and thus, generally, pleading with particularity is not necessary. However, when the pleading “sounds in fraud,” many courts have held that the heightened pleading requirements of Fed. R. Civ. P. 9(b) must be met. *See, e.g., Cal. Pub. Emps.’ Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 144 (3d Cir. 2004) (requiring § 11 claims “based on averments of fraud” to meet the heightened pleading requirements of Rule 9(b)).²⁵⁹ Although a claim that does not sound in fraud will not be subject to the heightened pleading requirements of Rule 9(b), a one-sentence disavowment of fraud is insufficient to divorce claims that sound in fraud from their fraudulent underpinnings.²⁶⁰ Pleading with particularity pursuant to Rule 9(b) is discussed further above (at p. 54).

B. Section 11

Section 11(a) makes specified persons liable for any untrue statement of material fact in a registration statement or any omission of any material fact required to be

²⁵⁹ *See also, e.g., In re Rigel Pharm., Inc. Sec. Litig.*, 697 F.3d 869, 885-86 (9th Cir. 2012) (holding that Rule 9(b) applies to § 11 claims if the § 11 claims rely on the same alleged misrepresentations as a plaintiff’s 10(b) fraud claim); *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009) (“Where . . . a complaint employs the exact same factual allegations to allege violations of section 11 as it uses to allege fraudulent conduct under section 10(b) of the Exchange Act, we can assume that it sounds in fraud,” and Rule 9(b) applies.); *Wagner v. First Horizon Pharm. Corp.*, 464 F.3d 1273, 1277 (11th Cir. 2006) (requiring that a non-fraud securities claim be pled with particularity when fraudulent conduct is alleged to support the claim); *In re Daou Sys., Inc.*, 411 F.3d 1006, 1027 (9th Cir. 2005) (“Although section 11 does not contain an element of fraud, a plaintiff may nonetheless be subject to Rule 9(b)’s particularity mandate if his complaint ‘sounds in fraud.’”); *Kennedy v. Venrock Assocs.*, 348 F.3d 584, 593 (7th Cir. 2003) (“[I]f, while the statute . . . doesn’t require proof of fraud, only a fraudulent violation is charged, failure to comply with Rule 9(b) requires dismissal of the entire charge.”); *In re OSG Sec. Litig.*, 971 F. Supp. 2d 387, 405 (S.D.N.Y. 2013) (explaining that Rule 9(b) “applies to Section 11 claims on a case-by-case basis where they are premised on allegations of fraud, and the wording and imputations of the complaint are classically associated with fraud” (internal quotation marks omitted)); *Greer v. Advanced Equities, Inc.*, 683 F. Supp. 2d 761, 767-68 (N.D. Ill. 2010) (holding that Rule 9(b) applies to all *allegations* of fraud, not just *claims* of fraud); *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 402-03 (D. Md. 2004) (citing *Rombach v. Chang*, 355 F.3d 164, 170-71 (2d Cir. 2004), along with cases from the Third, Fifth, Seventh, and Ninth Circuits). *But see In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 272-74 (3d Cir. 2006) (declining to apply Rule 9(b) where plaintiffs expressly pled negligence and also alleged fraud), *abrogated on other grounds by Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Lewy v. SkyPeople Fruit Juice, Inc.*, 2012 WL 3957916, at *8-9 (S.D.N.Y. Sept. 10, 2012) (holding that the joinder of fraud and non-fraud claims in the same complaint against the same defendants does not necessarily mean that both claims are governed by Rule 9(b), and that plaintiffs adequately distinguished between the two types of claims in their complaint).

²⁶⁰ *Compare Cal. Pub. Emps.’ Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 160 (3d Cir. 2004) (holding that where claims clearly sound in fraud when examined as a whole, Rule 9(b) applies despite disavowment of fraud), *with Bauer v. Prudential Fin., Inc.*, 2010 WL 2710443, at *3-4 (D.N.J. June 29, 2010) (noting that the plaintiff brought only strict liability and negligence claims and disclaimed any allegation that could be construed as alleging fraud and thus holding that “the pleading requirements of Rule 8 apply”).

stated in a registration statement or necessary to make statements therein not misleading, to any person acquiring the relevant security, unless the acquiror knew of such untruth or omission at the time of the acquisition.

1. Persons Liable

If a registration statement is false or misleading, § 11(a) makes liable:

- a. the issuer;
- b. the directors of the issuer;
- c. persons named, by their consent, in the registration statement as about to become directors of the issuer;
- d. every person who signs the registration statement;
- e. every expert (e.g., accountant, engineer, appraiser, etc.) who is named by consent as having certified or prepared any part of the registration statement; and
- f. every underwriter of the relevant security.

All of the above, *except experts*, are responsible for all misstatements and omissions in the registration statement. Experts are responsible for misstatements and omissions only in those parts of the registration statement they are named as having prepared or certified.²⁶¹

2. Scierter

A § 11 plaintiff does not need to establish a defendant's scienter, or even negligence, to prove his case. *See, e.g., Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).²⁶² It ordinarily is enough if the registration statement is shown to

²⁶¹ *See, e.g., In re Lehman Bros. Mortg.-Backed Sec. Litig.*, 650 F.3d 167, 175-85 (2d Cir. 2011) (finding that ratings agencies are not underwriters under § 11); *Batwin v. Occam Networks, Inc.*, 2008 WL 2676364, at *20 (C.D. Cal. July 1, 2008) (rejecting the argument that venture capitalists who sold shares in a secondary offering could be sued as "issuers" under § 11 because "[b]y its clear language, Section 11 limits liability to signatory issuers, officers and directors, underwriters and auditors" (quoting *In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 93 F. Supp. 2d 424, 437 (S.D.N.Y. 2000))).

²⁶² *See also, e.g., Hildes v. Arthur Andersen LLP*, 734 F.3d 854, 860 (9th Cir. 2013) (noting that "Section 11 lacks a scienter requirement"); *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 495 (5th Cir. 2005) (stating that § 11's liability provisions create "'virtually absolute' liability" (quoting *Herman & MacLean*, 459 U.S. at 382)); *In re Adams Golf, Inc. Sec. Litig.*, 381 F.3d 267, 274 n.7 (3d Cir. 2004) ("Sections 11 and 12(a)(2) are virtually

have contained material misstatements or omissions.²⁶³ However, § 27A(c) of the Securities Act, added by the PSLRA, allows an exception to § 11's scienter-less liability. It provides that no liability will attach in a private action based on certain statutorily defined "forward-looking statements" unless the plaintiff proves "actual knowledge" of the false or misleading nature of the statement on the part of a natural person making the statement or on the part of an executive officer approving the statement if made on behalf of a business entity. 15 U.S.C. § 77z-2(c)(1)(B). See pp. 13-16, *supra*.

3. Defenses

An issuer has virtually no defenses under § 11: it is strictly liable for material misstatements and omissions in registration statements. See, e.g., *Herman & MacLean*, 459 U.S. at 382.²⁶⁴ However, a defendant can avoid liability by proving the plaintiff knew of the misstatements or omissions. See, e.g., *In re Initial Pub. Offering Sec. Litig.*, 483 F.3d 70, 73 n.1 (2d Cir. 2006) (noting that an issuer "can assert a defense that the plaintiff knew of the untruth or omission at the time of his or her acquisition of the security" (internal quotation marks omitted)).²⁶⁵

All other defendants have a variety of defenses under § 11(b), for all of which they bear the burden of proof. If a § 11(a) named party resigns and informs the SEC of the materially false or misleading statement before the registration statement becomes effective, he has a § 11(b) defense. In addition, if a § 11(a) named party informs the SEC and the public that a registration statement has become effective

absolute liability provisions, which do not require plaintiffs to allege that defendants possessed any scienter."); *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 435 (N.D. Ill. 1995); *In re Worlds of Wonder Sec. Litig.*, 694 F. Supp. 1427, 1434 (N.D. Cal. 1988). But see *J & R Mktg., SEP v. Gen. Motors Corp.*, 549 F.3d 384, 392 (6th Cir. 2008) (holding that while § 11 itself does not require scienter, if the claim is based on the violation of a duty to disclose imposed by an SEC regulation that requires knowledge, the plaintiff must plead scienter with respect to the alleged violation of that duty to disclose); *accord Medina v. Tremor Video, Inc.*, 640 F. App'x 45, 48 (2d Cir. 2016) (applying an "actual knowledge" requirement to a § 11 claim premised on an alleged violation of Item 303 of Regulation S-K).

²⁶³ As the Second Circuit has explained, while materiality "will rarely be dispositive in a motion to dismiss" a § 11 claim, it "remains a meaningful pleadings obstacle" whereby the court must ascertain whether there is a "substantial likelihood that disclosure of the omitted information would have been viewed by the reasonable investor as having significantly altered the total mix of information [already] made available." *In re ProShares Tr. Sec. Litig.*, 728 F.3d 96, 103 (2d Cir. 2013) (affirming dismissal after "read[ing] the prospectus cover-to-cover" and considering "whether the disclosures and representations, taken together and in context, would have misl[ed] a reasonable investor about the nature of the [securities]" (internal quotation marks omitted)).

²⁶⁴ See also, e.g., *Degulis v. LXR Biotechnology, Inc.*, 928 F. Supp. 1301, 1314 (S.D.N.Y. 1996); *Worlds of Wonder*, 694 F. Supp. at 1434; *Competitive Assocs., Inc. v. Int'l Health Scis., Inc.*, 1975 WL 349, at *17-19 (S.D.N.Y. Jan. 22, 1975).

²⁶⁵ See also, e.g., *In re Gap Stores Sec. Litig.*, 79 F.R.D. 283, 297 (N.D. Cal. 1978); *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 575 (E.D.N.Y. 1971).

without his knowledge, a § 11(b) defense is available. But the most important defense is set out in § 11(b)(3): reasonable grounds for belief in the truth of the alleged misstatements or omissions—the so-called “due diligence” defense.

Section 11(b)(3) in effect divides the registration statement into three portions: (i) parts based on statements made by official persons or in official records; (ii) parts based on statements, reports, or valuations made by experts; and (iii) all other parts. Section 11(b)(3) then gives different defenses to experts and non-experts with regard to misstatements or omissions in these different parts of the registration statement:

- a. *Experts*—With regard to parts of the registration statement based on their own statements, reports, or valuations, experts can establish a defense by showing either (i) that after reasonable investigation, they had reason to believe in the truth of their statements, reports, or valuations; or (ii) that the registration statement did not fairly represent their statements or reports. Experts have no liability for portions of the registration statement they are not named as having prepared or certified.
- b. *Non-experts*—With regard to parts of the registration statement based either on official reports or statements or on the reports or statements of experts, a non-expert can establish a defense by showing that he had no reason to believe that such statements or reports were false or misleading or were inaccurately represented in the registration statement. To this extent, non-experts are allowed to rely on experts and on official statements and reports. *See Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 688 (S.D.N.Y. 1968).²⁶⁶ With regard to other parts of the registration statement, a non-expert must show that he conducted a reasonable investigation, and that, after such investigation, he had reasonable grounds for

²⁶⁶ See also *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1421 (9th Cir. 1994) (affirming the district court’s conclusion that all defendants except the outside accounting firm were immunized from § 11 liability for errors in the financial statements); *In re Software Toolworks Inc.*, 50 F.3d 615, 623 (9th Cir. 1994) (“An underwriter need not conduct due diligence into the ‘expertised’ parts of a prospectus, such as certified financial statements.”); cf. *Herman & MacLean*, 459 U.S. at 386 n.22 (noting that certain individuals involved with preparing the registration statement, such as lawyers not acting as “experts,” nevertheless cannot be reached by a § 11 action). *But see In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 672 (S.D.N.Y. 2004) (“[W]here ‘red flags’ regarding the reliability of an audited financial statement emerge, mere reliance on an audit will not be sufficient to ward off liability.”).

believing, and did believe, that the registration statement was neither false nor misleading.

Section 11(c) sets the standard of reasonableness for both experts and non-experts as that required of a prudent man in the management of his own property. *See Leasco*, 332 F. Supp. at 576; *BarChris*, 283 F. Supp. at 688.

Cases construing § 11(b)(3) and 11(c) are few, and the leading cases are still *Leasco* and *BarChris*, which establish that whether a § 11(b)(3) defense exists must be determined on a case-by-case basis, and that the magnitude of the duty imposed will vary by party. *See Leasco*, 332 F. Supp. at 577-78; *BarChris*, 283 F. Supp. at 682-84. Nevertheless, some generalizations can be made. Management and inside directors of the issuer will be under the highest duty to investigate the truth of the registration statement; indeed, the duty is so stringent it amounts almost to absolute liability.²⁶⁷ Outside directors are under a lesser duty to investigate than are inside directors.²⁶⁸ Nevertheless, they must also investigate to some extent and cannot merely accept management's representations that the registration statement is accurate.²⁶⁹ Note that courts have articulated different tests for distinguishing between outside and inside directors, and there is no "uniform understanding of who is an outside director within the case law." *In re WorldCom, Inc. Sec. Litig.*, 2005 WL 638268, at *10 (S.D.N.Y. Mar. 21, 2005).

To effectuate the statute's purpose of providing full disclosure to investors, underwriters are placed under a more substantial duty to investigate: they cannot accept an issuer's representation of facts about itself at face value, but must make an independent attempt at verification.²⁷⁰ In *In re International Rectifier Securities Litigation*, 1997 WL 529600, at *8 (C.D. Cal. Mar. 31, 1997), the court synthesized the case law and identified the following factors as relevant to assessing the reasonableness of an underwriter's investigation: (1) whether it is familiar with the issuer's finances, management, and operations; (2) whether it had relevant industry

²⁶⁷ *See Leasco*, 332 F. Supp. at 578; *Picard Chem. Inc. Profit Sharing Plan v. Perrigo Co.*, 940 F. Supp. 1101, 1131 (W.D. Mich. 1996) (finding that under § 11, "[l]iability against the issuer of a security is almost absolute, even for innocent misstatements; other defendants may resort to a due diligence defense").

²⁶⁸ *See Leasco*, 332 F. Supp. at 578; *Goldstein v. Alodex Corp.*, 409 F. Supp. 1201, 1203 n.1 (E.D. Pa. 1976); *Laven v. Flanagan*, 695 F. Supp. 800, 812 (D.N.J. 1988) (finding that outside directors are under a "lesser obligation to conduct a painstaking investigation than an inside director with an intimate knowledge of the corporation").

²⁶⁹ *See BarChris*, 283 F. Supp. at 688; *see also Weinberger v. Jackson*, 1990 WL 260676, at *4-5 (N.D. Cal. Oct. 11, 1990); *Laven*, 695 F. Supp. at 811.

²⁷⁰ *See Leasco*, 332 F. Supp. at 581-82; *BarChris*, 283 F. Supp. at 697; *Glassman v. Computervision Corp.*, 90 F.3d 617, 628 (1st Cir. 1996) (warning that it may be "a failure of due diligence to rely solely on management representations as to the state of the company where those representations can reasonably be verified").

knowledge; (3) whether it interviewed the issuer's employees; (4) whether it interviewed the issuer's suppliers or customers or confirmed data with them; and (5) whether it obtained verification from the issuer and its outside accountant that the prospectus was accurate.

It is still something of an open question whether each member of an underwriting group must investigate separately or whether the duty to investigate can be delegated to lead underwriters. *BarChris* held that where the lead underwriter fails to establish a due diligence defense, other underwriters who relied on the lead underwriter will also be liable, but it reserved the question of whether other underwriters would be shielded from liability if the lead underwriter established a due diligence defense. 283 F. Supp. at 697 n.26. Other courts have held, however, that all underwriters may rely on a successful due diligence defense of lead underwriters to establish a § 11(b)(3) defense.²⁷¹ Moreover, a number of courts have found a lead underwriter's due diligence defense sufficiently "common" and "typical" to that of the other underwriters to meet the requirements of Fed. R. Civ. P. 23 class certification on the rationale that a finding of due diligence on the part of the lead underwriter could exonerate the others as well.²⁷²

The degree of investigation required of experts, such as accountants, is largely determined by professional standards.²⁷³

²⁷¹ See *Competitive Assocs., Inc.*, 1975 WL 349, at *19-20; *WorldCom, Inc.*, 346 F. Supp. 2d 636 & n.4, 647, 653 (analyzing multiple underwriters as a unitary entity for purposes of assessing a due diligence defense, where the underwriting group relied on diligence performed by the co-lead underwriters). But see *Obligations of Underwriters, Brokers and Dealers*, SEC Release No. 33-5275, 1972 WL 125474, at *6 (July 27, 1972) (suggesting that each underwriter must satisfy itself that the lead underwriter's investigation is sufficient); *Gap Stores*, 79 F.R.D. at 302 (finding that each underwriter "must show that he conducted a reasonable investigation of the registration statement . . . or a reasonable investigation of the [lead underwriter's] methods").

²⁷² See *In re Consumers Power Co. Sec. Litig.*, 105 F.R.D. 583, 612 (E.D. Mich. 1985) (finding typicality and noting that "[t]he underwriting syndicate members . . . sink or swim with the lead underwriter in the usual case"); *Endo v. Albertine*, 147 F.R.D. 164, 171 (N.D. Ill. 1993); *In re Activision Sec. Litig.*, 621 F. Supp. 415, 434 (N.D. Cal. 1985); *In re Intel Sec. Litig.*, 89 F.R.D. 104, 111-13 (N.D. Cal. 1981); *Gap Stores*, 79 F.R.D. at 302-03. But see *In re Sec. Am. Corp. Sec. Litig.*, 1985 WL 2266, at *6 (N.D. Ill. Aug. 9, 1985) ("[T]he duty of due diligence is imposed on all underwriters regardless of their agreements inter se.").

²⁷³ See *Monroe v. Hughes*, 31 F.3d 772, 774 (9th Cir. 1994); *Hochfelder v. Ernst & Ernst*, 503 F.2d 1100, 1108 (7th Cir. 1974), *rev'd on other grounds*, 425 U.S. 185 (1976); *Endo v. Albertine*, 863 F. Supp. 708, 728 (N.D. Ill. 1994), *aff'd sub nom. Endo v. Arthur Andersen & Co., S.C.*, 163 F.3d 463 (7th Cir. 1999); *BarChris*, 283 F. Supp. at 703; see also *Potts v. SEC*, 151 F.3d 810, 812-13 (8th Cir. 1998) (holding that even a concurring partner on an audit must adhere to norms of the accounting profession); *Adair v. Kaye Kotts Assocs.*, 1998 WL 142353, at *4-6 (S.D.N.Y. Mar. 27, 1998) (limiting an accountant's liability to the period his report appears to certify, without requiring him to disclose subsequent events).

In 1982, in connection with its adoption of the integrated disclosure system, the SEC adopted Rule 176 under the Securities Act, which sets forth certain circumstances affecting the determination of what constitutes reasonable investigation and reasonable grounds for belief under § 11. Rule 176 codifies, without elucidating, the vague guidelines established by the case law. As the release announcing the adoption of the rule stated, determination of whether a § 11(b)(3) defense has been established must ultimately be made on a case-by-case basis.²⁷⁴ Rule 176(e) provides that “when the person is a director or proposed director,” the “presence or absence of another relationship to the issuer” is one factor to be considered in determining whether that person has “[met] the standard set forth in section 11(c),” and thus makes clear that outside directors are not held as strictly liable as insiders. *See* 17 C.F.R. § 230.176(e).

The one important change effected by the rule occurs in Rule 176(h). Traditionally, underwriters have attempted to establish a § 11(b)(3) defense by conducting “due diligence.” *In re Gap Stores Sec. Litig.*, 79 F.R.D. 283, 297-98 (N.D. Cal. 1978). With the advent of integrated disclosure and registration statements, consisting in large part of incorporations by reference of Exchange Act filings with which underwriters may have had no connection, this has become more difficult. Accordingly, the SEC was urged to adopt a “safe-harbor” provision for underwriters with regard to incorporations by reference in registration statements.²⁷⁵ The SEC refused, but it adopted Rule 176(h), which makes relevant in a § 11(b)(3) inquiry whether a defendant had responsibility for documents incorporated by reference at the time they were filed. 17 C.F.R. § 230.176(h).

4. Reliance

A plaintiff, in almost all cases, need not show that he relied on statements in a registration statement to recover under § 11.²⁷⁶ Courts have interpreted § 11 to establish a presumption of reliance upon the registration statement. *See, e.g., In re Gentiva Sec. Litig.*, 932 F. Supp. 2d 352, 395 (E.D.N.Y. 2013) (“Section 11 appears to create[] a presumption that any person acquiring such security was legally

²⁷⁴ *See* Adoption of Integrated Disclosure System, Securities Act Release No. 33-6383, 1982 SEC LEXIS 2190, at *118 (Mar. 3, 1982); *see also In re WorldCom, Inc. Sec. Litig.*, 2005 WL 638268, at *4-7 (S.D.N.Y. Mar. 21, 2005) (discussing Rule 176).

²⁷⁵ *See* Adoption of Integrated Disclosure System, Securities Act Release No. 33-6383, 1982 SEC LEXIS 2190, at *117 n.98 (Mar. 3, 1982).

²⁷⁶ *See In re Constar Int'l, Inc. Sec. Litig.*, 585 F.3d 774, 783 (3d Cir. 2009); *Hutchison v. Deutsche Bank Sec. Inc.*, 647 F.3d 479, 484 (2d Cir. 2011); *Rombach v. Chang*, 355 F.3d 164, 169 n.4 (2d Cir. 2004); *Westinghouse Elec. Corp. v. '21' Int'l Holdings, Inc.*, 821 F. Supp. 212, 218 (S.D.N.Y. 1993); *Ahern v. Gaussoin*, 611 F. Supp. 1465, 1479 (D. Or. 1985); *In re Disonics Sec. Litig.*, 599 F. Supp. 447, 452 (N.D. Cal. 1984).

harmful by the defective registration statement.” (internal quotation marks omitted)).²⁷⁷ But a plaintiff who enters into a binding investment agreement before the filing of the registration statement cannot rely on this presumption. *APA Excelsior III L.P. v. Premiere Techs., Inc.*, 476 F.3d 1261, 1272 (11th Cir. 2007) (“To say that reliance is ‘presumed’ is simply not the same thing as saying that reliance is ‘irrelevant.’”).²⁷⁸ Additionally, under § 11(a), when the plaintiff buys the security after an earnings statement has been published for the issuer covering at least 12 months since the effective date of the registration statement, the plaintiff must show reliance; but he need not, by the terms of the statute, show that he actually read the registration statement.²⁷⁹

5. Measure of Damages

Under § 11(e), the measure of a plaintiff’s damages is the decline in the “value” of his securities.²⁸⁰ This is measured in one of three ways:

- (1) if the plaintiff sold the securities before filing suit, it would be entitled to recover the difference between the price paid for the securities (not to exceed the public offering price) and the price at which the plaintiff sold the securities pre-filing;

²⁷⁷ See also *Barnes v. Osofsky*, 373 F.2d 269, 272 (2d Cir. 1967); *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 634 (S.D.N.Y. 2007).

²⁷⁸ See also *Refco*, 503 F. Supp. 2d at 635 (“Section 11’s presumption of reliance is rebutted, in other words, where the plaintiffs were irrevocably committed to purchase the securities before the registration statement issued . . .”). But see *Hildes v. Arthur Andersen LLP*, 734 F.3d 854, 862 (9th Cir. 2013) (holding that a shareholder was not “irrevocably bound to exchange” his shares by a pre-registration voting agreement and that *APA Excelsior* was therefore no bar to a § 11 claim); *Gentiva*, 932 F. Supp. 2d at 395 (holding that the presumption of reliance is satisfied where the investment decision is contemplated, but not mandated, prior to the issuance of the registration statement); *Fed. Hous. Fin. Agency v. Bank of Am. Corp.*, 2012 WL 6592251, at *3 (S.D.N.Y. Dec. 18, 2012) (holding that § 11 contains no reliance requirement); *Westinghouse*, 821 F. Supp. at 218 (“Reliance is not a factor in a § 11 action, and thus impossibility of reliance can be no bar to a § 11 claim.”).

²⁷⁹ See *Hildes*, 734 F.3d at 859; *Shores v. Sklar*, 647 F.2d 462, 470 n.7 (5th Cir. 1981), *overruled on other grounds by Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994); *Gap Stores*, 79 F.R.D. at 297 n.14.

²⁸⁰ The Second Circuit has explained that the term “value” as used in § 11(e) “may not be equivalent to [the security’s] market price” while simultaneously emphasizing that “instances where the market price of a security will be different from its value are ‘unusual and rare.’” *McMahan & Co. v. Warehouse Entm’t, Inc.*, 65 F.3d 1044, 1048-49 (2d Cir. 1995). Accordingly, to adequately allege cognizable injury under § 11, it is not necessary for a plaintiff to assert a decline in the security’s market price; rather, what is needed is an allegation that the security’s value has declined. See, e.g., *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145, 165-68 (2d Cir. 2012) (holding that plaintiffs adequately pled damages under § 11 even though they had alleged no missed payments on their mortgage-backed security certificates, and a liquid market for such certificates may not have existed at the time of suit).

- (2) on the other hand, if the plaintiff continued to hold the securities when it filed suit, it would be entitled to recover the difference between the price paid for the securities (not to exceed the public offering price) and the value of the securities on the date the plaintiff filed suit; unless
- (3) the plaintiff sold the securities after it filed suit at a price higher than the value of the securities on the filing date, in which case the plaintiff would be entitled to recover the difference between the price paid for the securities (not to exceed the public offering price) and the price at which it sold the securities post-filing.²⁸¹

Section 11's method of measuring damages precludes "benefit-of-the-bargain" damages. *See McMahan & Co. v. Warehouse Entm't, Inc.*, 65 F.3d 1044, 1048 (2d Cir. 1995). In addition, any price decline before disclosure of the material misstatement may not be charged to defendants. *See id.* at 1049.²⁸² And if the price of the securities declines after the suit is filed, the plaintiff cannot recover for this further decline. *See In re Cendant Corp. Litig.*, 264 F.3d 201, 228 n.8 (3d Cir. 2001). However, when a § 11 claim is added in an amended complaint, the filing date of the § 11 suit relates back to the filing date of the initial complaint for remedy purposes.²⁸³

There is no upper limit, other than the total value of the offering in question, to the liability under § 11 of defendants other than underwriters. Under § 11(e), however, no underwriter can be liable for more than the offering value of the securities underwritten by that underwriter, unless the underwriter received special compensation from the issuer that others did not receive. Punitive damages are not recoverable under either the Securities Act or the Exchange Act.²⁸⁴

6. Causation and Standing

Under § 11(e), a plaintiff does not have to show that a decline in the value of his securities was caused by a material misstatement or omission in the registration

²⁸¹ *See* 15 U.S.C. § 77k(e).

²⁸² *See also In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 289 F. Supp. 2d 429, 437 (S.D.N.Y. 2003); *Beecher v. Able*, 435 F. Supp. 397, 407 (S.D.N.Y. 1977).

²⁸³ *See Alpern v. UtiliCorp United, Inc.*, 84 F.3d 1525, 1542-44 (8th Cir. 1996).

²⁸⁴ *See Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1284-86 (2d Cir. 1969) (Securities Act); *Green v. Wolf Corp.*, 406 F.2d 291, 302 (2d Cir. 1968) (Exchange Act).

statement.²⁸⁵ But a defendant can mitigate damages by showing that such decline was due to factors other than the misstatement or omission.²⁸⁶ This affirmative defense is referred to as “negative causation.” *In re Adams Golf, Inc. Sec. Litig.*, 381 F.3d 267, 277 (3d Cir. 2004).²⁸⁷ Since there is no causation requirement in § 11, the Third Circuit has ruled that there is no need for a determination of whether the market for a company’s stock is efficient in § 11 cases, as there would be in a § 10(b) case based on a fraud-on-the-market theory. *In re Constar Int’l, Inc. Sec. Litig.*, 585 F.3d 774, 783-85 (3d Cir. 2009).

Only purchasers, not sellers, of securities have standing under §§ 11 and 12. The Tenth Circuit has held that a “forced” sale due to a merger that changed the character of shares does not render the holder of those shares a “buyer” of a security so as to have standing under the Securities Act. *Katz v. Gerardi*, 655 F.3d 1212, 1221-23 (10th Cir. 2011).

Several courts have held that to have standing to pursue a claim under § 11, a plaintiff “must plead that [his] stock was issued pursuant to the public offering[s] alleged to be defective.” *Bernstein v. Crazy Eddie, Inc.*, 702 F. Supp. 962, 972 (E.D.N.Y. 1988), *vacated on other grounds*, 714 F. Supp. 1285 (E.D.N.Y. 1989). Most courts have held that stock purchased in a secondary market is “issued pursuant to the public offerings,” *id.*, so long as the plaintiffs can “‘trace’ their securities to the challenged registration,” *Adair v. Bristol Tech. Sys., Inc.*, 179 F.R.D. 126, 130-33 (S.D.N.Y. 1998).²⁸⁸ A plaintiff must affirmatively plead this “tracing” requirement. *Crazy Eddie, Inc.*, 702 F. Supp. at 972.

²⁸⁵ See *In re Constar*, 585 F.3d at 783 (“In a § 11 case, plaintiffs do not have the burden of proving causation . . .”); *In re Facebook, Inc. IPO Sec. & Derivative Litig.*, 986 F. Supp. 2d 487, 522 (S.D.N.Y. 2013) (explaining that “loss causation is not an element” of a § 11 claim).

²⁸⁶ See *In re Constar*, 585 F.3d at 783; *In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 274 (3d Cir. 2005) (explaining that loss causation “is an affirmative defense in section 11 cases; defendants can limit damages by showing that the plaintiffs’ losses were caused by something other than their misrepresentations”).

²⁸⁷ See also *McMahan*, 65 F.3d at 1048; *Akerman v. Oryx Commc’ns, Inc.*, 810 F.2d 336, 340 (2d Cir. 1987), *abrogated on other grounds by Pinter v. Dahl*, 486 U.S. 622 (1988); *Collins v. Signetics Corp.*, 605 F.2d 110, 114-16 (3d Cir. 1979), *overruled on other grounds by Pinter v. Dahl*, 486 U.S. 622 (1988); *Schuler v. NIVS Intellimedia Tech. Grp., Inc.*, 2013 WL 944777, at *9-10 (S.D.N.Y. Mar. 12, 2013) (finding negative causation established on a motion to dismiss where plaintiff had sold all his stock before the allegedly misrepresented facts became known).

²⁸⁸ See also *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104, 1106 (9th Cir. 2013); *Lee v. Ernst & Young, LLP*, 294 F.3d 969, 978 (8th Cir. 2002); *Joseph v. Wiles*, 223 F.3d 1155, 1159-61 (10th Cir. 2000), *abrogated on other grounds by Cal. Pub. Emps.’ Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 2042 (2017); *Barnes v. Osofsky*, 373 F.2d 269, 271-73 (2d Cir. 1967); *Feyko v. Yuhe Int’l, Inc.*, 2013 WL 3467067, at *3 (C.D. Cal. July 10, 2013) (dismissing § 11 claims because plaintiffs had not “alleged sufficient facts” showing that their shares were “traceable” to the secondary offering); *In re Complete Mgmt. Inc. Sec. Litig.*, 153 F. Supp. 2d 314, 338-

In the wake of *Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995), which limited standing under § 12(a)(2) (then § 12(2)) to securities transactions that require a prospectus (see p. 120, *infra*), some district courts restricted § 11 standing to primary purchasers from the initial offering.²⁸⁹ The Second Circuit reached the opposite conclusion in *DeMaria v. Andersen*, holding that “aftermarket purchasers who can trace their shares to an allegedly misleading registration statement have standing to sue under § 11 of the 1933 Act.” 318 F.3d 170, 178 (2d Cir. 2003). The Fifth, Eighth, Ninth, and Tenth Circuits also have refused to limit § 11 standing, post-*Gustafson*, to direct purchasers in the public offering.²⁹⁰

The Third Circuit appeared to adopt the more restrictive view of § 11 standing in *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 286 (3d Cir. 1992), a pre-*Gustafson* decision, when it stated that “[i]f plaintiffs’ shares were purchased in the secondary market, they would not be linked to a registration statement filed during the class period, and the § 11 claim would fail.” However, district courts in the Third Circuit have generally declined to read *Shapiro* as strictly foreclosing standing for aftermarket purchasers.²⁹¹

However, once other securities not issued pursuant to the allegedly defective offering enter the market via a separate offering, persons acquiring their shares in the aftermarket will not be able to trace their shares to the defective offering and thus

39 (S.D.N.Y. 2001); *Giarraputo v. UNUMprovident Corp.*, 2000 WL 1701294, at *8 (D. Me. Nov. 8, 2000); *Schwartz v. Celestial Seasonings, Inc.*, 178 F.R.D. 545, 555-56 (D. Colo. 1998); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 966-68 (C.D. Cal. 1994).

²⁸⁹ See, e.g., *McKowan Lowe & Co. v. Jasmine Ltd.*, 127 F. Supp. 2d 516, 543-44 (D.N.J. 2000), *vacated in part on other grounds*, 295 F.3d 380 (3d Cir. 2002); *Warden v. Crown Am. Realty Tr.*, 1998 WL 725946, at *2-3 (W.D. Pa. Oct. 15, 1998), *aff’d mem.*, 229 F.3d 1140 (3d Cir. 2000); *Gould v. Harris*, 929 F. Supp. 353, 358-59 (C.D. Cal. 1996), *abrogated by Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076 (9th Cir. 1999).

²⁹⁰ See *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 871-73 (5th Cir. 2003); *Lee v. Ernst & Young, LLP*, 294 F.3d 969 (8th Cir. 2002); *Joseph v. Wiles*, 223 F.3d at 1159; *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080-81 (9th Cir. 1999). Cf. *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 502 (5th Cir. 2005) (stating that aftermarket purchasers may have standing to sue, but rejecting the statistical tracing method to establish the connection between the securities purchased and the allegedly misleading registration statement).

²⁹¹ See *In re Adams Golf, Inc. Sec. Litig.*, 176 F. Supp. 2d 216, 226-28 (D. Del. 2001) (distinguishing *Shapiro* based on its “peculiar factual context” and stating that “[s]ince *Gustafson*, each Circuit Court that has addressed the issue of whether aftermarket purchases may proceed under § 11 has determined that they may, so long as the securities were traceable to an offering that was covered by the allegedly false registration statement.”), *aff’d in part, rev’d in part*, 381 F.2d 267 (3d Cir. 2004); see also, e.g., *Dartell v. Tibet, Pharms. Inc.*, 2016 WL 718150, at *4 (D.N.J. Feb. 22, 2016) (“With respect to shares in the public market, ‘tracing may be established . . . through proof that the plaintiff bought her shares in a market containing only shares issued pursuant to the allegedly defective registration statement.’” (quoting *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 31 n.1 (2d Cir. 2006))); *In re Constar Int’l, Inc. Sec. Litig.*, 2008 WL 614551, at *2 (E.D. Pa. Mar. 4, 2008) (finding that “[a]ftermarket purchasers . . . may proceed under § 11” in appropriate circumstances), *aff’d*, 585 F.3d 774 (3d Cir. 2009).

will not be able to establish a § 11 claim.²⁹² This is so because, at that point, after-market purchasers will have “no ability to separate those shares upon which standing can be based from those for which standing is improper.” *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 501 (5th Cir. 2005).

In a novel twist on this issue, the Ninth Circuit was asked to consider the traceability requirement in the context of a direct listing under a recently adopted NYSE rule. *See Pirani v. Slack Techs., Inc.*, 13 F.4th 940 (9th Cir. 2021), *cert. granted*, 143 S. Ct. 542 (Dec. 13, 2022). As the court explained, “[u]nlike in an IPO, in a direct listing the company does not issue any new shares and instead files a registration statement” that allows existing shareholders to sell their shares on an exchange. *Id.* at 944. Moreover, because “[s]hares made available by a direct listing are sold directly to the public and not through a bank,” typically “there is no lock-up agreement restricting the sale of unregistered shares,” and therefore “from the first day of a direct listing, both unregistered and registered shares” can trade in the market. *Id.* For this reason, the named plaintiff did not know (and could not hope to prove) whether he had purchased registered or unregistered shares. *See id.* at 944-45.

The majority in *Slack* nevertheless concluded that the named plaintiff had standing under both § 11 and § 12(a)(2). It reasoned that “[a]ny person who acquired Slack shares through its direct listing could do so only because of the effectiveness of its registration statement,” and that as a result, “[a]ll of Slack’s shares sold in th[e] direct listing, whether labeled as registered or unregistered, can be traced to that one registration.” *Id.* at 947. According to the majority, *Slack* did “not present the traceability problem identified . . . in cases with successive registrations,” because *Slack* involved “only one registration statement.” *Id.*; *see also id.* at 949 (“[T]he shares at issue in Slack’s direct listing, registered and unregistered, were sold ‘by means of a prospectus’ . . . that permitted the shares to be sold to the public.”).

The Supreme Court reversed in a unanimous decision. “To bring a claim under § 11,” the Court held, “the securities held by the plaintiff must be traceable to the particular registration statement alleged to be false or misleading.” *Slack Techs., LLC v. Pirani*, 143 S. Ct. 1433, 1440-41 (June 1, 2023). The Court characterized this holding as not “particularly novel,” explaining that “while direct listings are new, the question how far § 11(a) liability extends is not.” *Id.* at 1440. And as for

²⁹² *See, e.g., In re Century Aluminum*, 729 F.3d at 1108; *Krim*, 402 F.3d at 496, 500; *Davidco Inv’rs, LLC v. Anchor Glass Container Corp.*, 2006 WL 547989, at *22-23 (M.D. Fla. Mar. 6, 2006); *In re Dynegey, Inc. Sec. Litig.*, 2005 WL 807076, at *2 (S.D. Tex. Mar. 10, 2005); *In re Initial Pub. Offering Sec. Litig.*, 227 F.R.D. 65, 117-20 (S.D.N.Y. 2004), *vacated on other grounds and remanded*, 471 F.3d 24 (2d Cir. 2006). Based on this same logic, a purchaser who acquired stock between the filing of an initial registration statement and the filing of a misleading amendment has been held to be unable to trace his securities to a defective statement. *Guenther v. Cooper Life Scis., Inc.*, 759 F. Supp. 1437, 1440 (N.D. Cal. 1990).

the plaintiff's policy argument—the concern that rejecting the Ninth Circuit's approach would create a gap in § 11 liability—the Court observed that “Congress remains free to revise the securities laws at any time, whether to address the rise of direct listings or any other development.” *Id.* at 1442.

7. Statute of Limitations

Like actions brought under § 12, actions brought under § 11 are subject to the limitations period set forth in § 13 of the Securities Act. The circuits have split on the question whether a plaintiff's complaint under the Act must affirmatively plead compliance with § 13's statute of limitations. *See* p. 128, *infra*.

Regardless of the pleading requirements, actions under § 11 must be brought within one year from the time of discovery of the untrue statement or omission, or from the time such discovery should have been made by the exercise of reasonable diligence (the statute of limitations), and in no case more than three years after the security was first offered to the public (the statute of repose). *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1308 (9th Cir. 1982). Inquiry or constructive notice may be triggered by public disclosures about the financial condition of the corporation, other lawsuits alleging fraud committed by the defendants, suspension of trading in the issuer's stock, public reports of federal or state investigations of the issuer, notice that the issuer has filed for bankruptcy, or a sharp decline in the issuer's stock value.²⁹³ While any one of these events may not be determinative, the cumulative effect of two or more of them may well require that a purchaser of a registered security commence a § 11 action within one year of the relevant events. *In re Infonet Servs. Corp. Sec. Litig.*, 310 F. Supp. 2d 1106, 1114, 1116 (C.D. Cal. 2003) (finding a § 11 claim time-barred under § 13 due to ample “storm warnings” more than one year before filing).²⁹⁴

While SEC Rule 430B “permits issuers to make disclosures by prospectus supplement that previously would have required a post-effective amendment to the registration statement,” when information material to investors is provided only at the

²⁹³ *See Freidus v. Barclays Bank PLC*, 734 F.3d 132, 138 (2d Cir. 2013) (explaining that a company's corrective disclosures provide the public with constructive notice of claims, triggering the one-year statute of limitations); *In re Infonet Servs. Corp. Sec. Litig.*, 310 F. Supp. 2d 1106, 1113-14, 1116 (C.D. Cal. 2003).

²⁹⁴ *See also Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 951 (9th Cir. 2005) (stating the Ninth Circuit standard as “inquiry-plus-due diligence” and holding that notice is not triggered by “financial problems alone”); *La Grasta v. First Union Sec., Inc.*, 358 F.3d 840, 849 (11th Cir. 2004) (refusing to “adopt a bright-line rule that a certain price drop within a certain period of time constitutes inquiry notice as a matter of law”); *In re CBT Grp. PLC Sec. Litig.*, 2000 WL 33339615, at *5-7 (N.D. Cal. Dec. 29, 2000). *See generally Fogarazzo v. Lehman Bros., Inc.*, 341 F. Supp. 2d 274, 298 (S.D.N.Y. 2004) (characterizing as “extraordinary” defendant's burden for establishing that inquiry notice was triggered).

time securities are marketed to the public via lengthy prospectus supplements, the statute of limitations for § 11 liability begins anew as of the date each prospectus supplement is filed. *Fed. Hous. Fin. Agency v. UBS Ams., Inc.*, 2012 WL 2400263, at *4-5 (S.D.N.Y. June 26, 2012). The Sarbanes-Oxley statute of limitations has been held not to apply to § 11 of the Securities Act because claims based on this provision do not “sound in fraud,” as required by § 804 of Sarbanes-Oxley, but rather are based on strict liability or negligence.²⁹⁵ For purposes of the three-year statute of repose, courts have interpreted the term “offered to the public” to mean that the statute begins running for purposes of § 11 “when a registration statement containing misleading information becomes effective.” *Yates v. Mun. Mortg. & Equity, LLC*, 744 F.3d 874, 896 (4th Cir. 2014).²⁹⁶ Moreover, the fact that the plaintiff did not know that the registration statement had become effective “is of no consequence for statute of repose purposes.” *Id.* at 898.²⁹⁷

The distinction between the statute of limitations and the statute of repose is significant to the question whether *American Pipe* tolling applies to permit a plaintiff to file an action, even after the statutory period has expired, if an earlier putative class action was timely filed but dismissed before the court certified the class. *See* pp. 63-64, *supra* (discussing *American Pipe* tolling). While that tolling rule applies to the Securities Act’s one-year statute of limitations, *see, e.g., In re WorldCom Sec. Litig.*, 496 F.3d 245 (2d Cir. 2007), it does not apply to the Act’s three-year statute of repose. The Supreme Court so held in a 5-4 decision in *California Public Employees’ Retirement System v. ANZ Securities, Inc.*, 582 U.S. 497, 515-16 (2017), reasoning that “[b]ecause the *American Pipe* tolling rule is rooted in [the courts’] equitable powers, it cannot extend the 3-year period” established by § 13 of the Securities Act, which “displaces the traditional power of courts to modify statutory time limits in the name of equity.”

In the wake of the *CalPERS* decision, courts have been called upon to decide whether a plaintiff can file an amended complaint, after the statutory repose period

²⁹⁵ *See In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 431, 441 (S.D.N.Y. 2003), *vacated on other grounds and remanded*, 496 F.3d 245 (2d Cir. 2007); *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 402, 414 (S.D.N.Y. 2005) (citing cases); *Friedman v. Rayovac Corp.*, 295 F. Supp. 2d 957, 974-75 (W.D. Wis. 2003); *see also In re Enron Corp. Sec., Derivative & ERISA Litig.*, 2004 WL 405886, at *12 (S.D. Tex. Feb. 25, 2004) (stating that “where Section 11 and Section 12(a)(2) claims do not require a showing of fraudulent intent, but are based on negligence or strict liability, section 804’s enlarged statute of limitations does not apply, but Section 13 governs”).

²⁹⁶ *Accord P. Stolz Family P’ship L.P. v. Daum*, 355 F.3d 92, 99 (2d Cir. 2004) (“It certainly is true that, in the case of registered securities, the date of registration has been treated as the date that starts the running of the repose period (most relevantly in the context of § 11 claims).”).

²⁹⁷ *Accord P. Stolz*, 355 F.3d at 102-03.

has expired, to assert a claim covered by the statute. The Third Circuit has held that a plaintiff may reassert a previously dismissed claim in those circumstances, based on augmented factual allegations, so long as no final judgment was entered in the action that gave the defendants a “vested right to repose.” *Se. Pa. Transp. Auth. v. Orrstown Fin. Servs. Inc.*, 12 F.4th 337, 350-52 (3d Cir. 2021) (“*SEPTA*”) (permitting filing of an amended complaint based on the relation-back mechanism in Fed. R. Civ. P. 15(c) and rejecting argument that this application of a procedural rule violated the Rules Enabling Act).²⁹⁸ The Tenth Circuit recently reached the same conclusion, reasoning that “[o]nce a defendant’s repose has been disturbed by the bringing of a claim, a statute of repose does not protect it from the customary travails of defending the claim.” *Hogan v. Pilgrim’s Pride Corp.*, 73 F.4th 1150, 1158-59 (10th Cir. 2023). The *Hogan* court allowed, however, that “[a] claim raised for the first time in an amendment to a complaint may well be barred by the statute,” and alluded to the potential argument that a securities law claim based on a new allegedly misleading statement or omission might not be capable of assertion after the repose period has expired. *Id.* at 1157-58.²⁹⁹

8. Contribution

Section 11(f) specifically states that any person who becomes liable under § 11 may recover contribution from any other person who, if sued separately, would have been liable for the same payment, unless the person seeking contribution was guilty of *fraudulent* misrepresentation and the other person was not. *See also Ackerman v. Schwartz*, 947 F.2d 841, 845 (7th Cir. 1991) (noting that under § 11(f), “persons held liable . . . may obtain contribution from more culpable parties”). Thus, where liability is based on strict liability or negligent misrepresentation, contribution is available, but where liability is based on fraud, it may not be. By the terms of § 11(f), where contribution is available, it is on a *pro rata*-basis, as in contract, rather than a fault-basis, as in tort.

C. Section 12

Under § 12(a)(1) of the Securities Act (formerly § 12(1)), any person who offers or sells a security required to be registered under the Securities Act but not registered is liable to the person purchasing the security. Section 12(a)(1) creates a right of

²⁹⁸ In *SEPTA*, the court had ruled that prior iteration of the plaintiff’s complaint stated claims against some defendants but not others. The Third Circuit observed that the previously dismissed defendants could have sought to “vest” their right to repose by “seek[ing] a final judgment on SEPTA’s previously dismissed claims before discovery resumed . . . under Rule 54(b).” 12 F.4th at 349 n.9.

²⁹⁹ *See also Sjunde AP-Fonden v. Gen. Elec. Co.*, 417 F. Supp. 3d 379, 392 (S.D.N.Y. 2019) (“a timely raised claim based on misleading statements made before July 25, 2013, does not somehow preserve other, as-yet-unpleaded claims based on different misleading statements, even if the two sets of misleading statements were made at the same time and in the same document”).

action only for the solicitation or sale of securities in violation of § 5. *Pinter v. Dahl*, 486 U.S. 622, 641-47 (1988).

Under § 12(a)(2) (formerly § 12(2)), any person who by use of any means of interstate commerce offers or sells a security on the basis of a materially false or misleading prospectus or materially false or misleading oral statements is liable to the person purchasing from him, unless he can show that he did not know, and could not in the exercise of reasonable care have known, of the falsehood or omission. *See Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706 (2d Cir. 2011) (finding that the plaintiff adequately pleaded a violation of § 12(a)(2) by alleging that a private equity firm’s initial public offering prospectus failed to disclose material adverse trends affecting the firm’s portfolio companies). Liability can be based on a prospectus other than that required under § 5 of the Securities Act; any offering circular will do. *See, e.g., Sanders v. John Nuveen & Co.*, 619 F.2d 1222, 1227 (7th Cir. 1980) (finding commercial paper reports to be prospectuses).

In *Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995), the Supreme Court resolved a longstanding split in the circuits by holding that § 12(a)(2) (then § 12(2)) does not apply to a private contract for a secondary market sale of securities.³⁰⁰ The Court concluded that, based on an examination of both the definition of “prospectus” in § 2(10) and the provisions of § 10 (which describe the information that must be contained in a prospectus for registered securities), “the word ‘prospectus’ is a term of art referring to a document that describes a public offering of securities by an issuer or controlling shareholder.” *Gustafson*, 513 U.S. at 583-84. Thus, the Court held, a privately negotiated contract for the sale of corporate stock that included representations and warranties of the sellers that the buyers claimed were not true was not a “prospectus.” Accordingly, the buyers could not maintain a § 12(a)(2) claim.

Unlike § 11 and § 12(a)(1), which apply only to securities subject to the requirements of § 5 of the Securities Act, § 12(a)(2) applies to all securities except those exempted from the Securities Act by § 3(a)(2). The Supreme Court’s decision in *Gustafson*, however, leaves unclear the applicability of § 12(a)(2) to private placement offerings. While on its facts *Gustafson* addressed only a private contract for the sale of previously issued stock, the Court’s broad language, confining the term “prospectus” to “documents related to public offerings by an issuer or its controlling shareholders,” and stating that “the liability imposed by § 12(2) cannot attach unless there is an obligation to distribute the prospectus in the first place (or unless

³⁰⁰ Compare *Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682 (3d Cir. 1991) (holding that § 12(a)(2) is inapplicable to secondary transactions), with *Pac. Dunlop Holdings Inc. v. Allen & Co.*, 993 F.2d 578 (7th Cir. 1993) (applying § 12(a)(2) to secondary transactions), abrogated by *Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995).

there is an exemption),” 513 U.S. at 569-71, could be read to preclude suit under § 12(a)(2) by a plaintiff complaining of a misrepresentation in a private placement offering memorandum. Justice Ginsburg, in her dissent, read the Court’s decision in such a manner, stating that, according to the majority, “[c]ommunications during . . . a private placement are not ‘prospectuses’ . . . and thus are not covered by § 12(2).” *Id.* at 596 (Ginsburg, J., dissenting). Such a holding would conflict with the prior decisions of every court of appeals to consider the issue, each of which held that private placements are subject to § 12(a)(2). *See id.* at 602 (Ginsburg, J., dissenting) (citing cases).

Since *Gustafson*, a number of courts have held that § 12(a)(2) does not apply to offerings made by means of a private placement memorandum.³⁰¹ Securities that are considered private placements for the purposes of § 4(2) and Regulation D are likely to be considered private placements for purposes of § 12(a)(2) as well.³⁰² Moreover, the Second Circuit has held that a § 12(a)(2) action cannot be maintained by a plaintiff who acquires securities through a private transaction even where the marketing of the securities relied on a prospectus prepared for a public offering. *Yung v. Lee*, 432 F.3d 142, 149-50 (2d Cir. 2005).

1. Persons Liable

Section 12 states that “[a]ny person who . . . offers or sells a security” in violation of its substantive provisions “shall be liable . . . to the person purchasing such security from him.” This “privity” requirement has been interpreted to mean that underwriters could not be liable under § 12(a)(2) to persons who did not purchase from them.³⁰³ For many years, it had generally been held that an issuer that engages

³⁰¹ *See, e.g., Lewis v. Fresne*, 252 F.3d 352, 358 (5th Cir. 2001); *Maldonado v. Dominguez*, 137 F.3d 1, 8-9 (1st Cir. 1998); *Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 609 n.2 (7th Cir. 1995); *Joseph v. Wiles*, 223 F.3d 1155, 1161 (10th Cir. 2000), *abrogated on other grounds by Cal. Pub. Emps.’ Ret. Sys. v. ANZ Sec., Inc.*, 582 U.S. 497 (2017); *Vannest v. Sage, Rutty & Co.*, 960 F. Supp. 651, 655 (W.D.N.Y. 1997); *In re JWP Inc. Sec. Litig.*, 928 F. Supp. 1239, 1259 (S.D.N.Y. 1996).

³⁰² *See Brockton Ret. Bd. v. Oppenheimer Glob. Res. Private Equity Fund I, L.P.*, 2013 WL 753310, at *3-4 (D. Mass. Feb. 28, 2013).

³⁰³ *See Competitive Assocs., Inc. v. Int’l Health Scis., Inc.*, 1975 WL 349, at *15-16 (S.D.N.Y. Jan. 22, 1975); *In re Puda Coal Sec. Inc. Litig.*, 2013 WL 5493007, at *9 (S.D.N.Y. Oct. 1, 2013) (finding that, to satisfy the privity requirement, the plaintiff must have either purchased securities from a defendant or as the result of a defendant’s solicitation).

in no solicitation could not be liable under § 12(a)(2) where the securities were distributed pursuant to a firm commitment underwriting.³⁰⁴

The SEC changed the rules in 2005 to hold issuers in primary offerings liable as sellers under § 12(a)(2) even when the sales occur through underwriters. The SEC believed that “an issuer offering or selling its securities in a registered offering pursuant to a registration statement containing a prospectus that it has prepared and filed, or by means of other communications that are offers made by or on behalf of or used or referred to by the issuer can be viewed as soliciting purchases of the issuer’s registered securities,” and thus the uncertainty regarding issuer liability in a primary offering was unwarranted. *See Securities Offering Reform*, SEC Release No. 33-8591, 2005 WL 1692642, at *78 (Dec. 1, 2005). Under Rule 159A, the issuer of a security sold to a person in its primary offering or initial distribution is considered a seller under § 12(a)(2) if the securities were sold by means of any of a number of communications, which roughly include:

- (1) A preliminary prospectus or prospectus of the issuer required by Rule 424;
- (2) A free writing prospectus, as defined by Rule 405, prepared by or on behalf of the issuer or used or referred to by the issuer;
- (3) A part of any other free writing prospectus or advertisement pursuant to Rule 482 “relating to the offering and containing material information about the issuer or its securities provided by or on behalf of the issuer”; and

³⁰⁴ *See Lone Star Ladies Inv. Club v. Schlotzsky’s Inc.*, 238 F.3d 363, 370 (5th Cir. 2001) (“[A] buyer cannot recover against his seller’s seller.”); *Shaw v. Digit. Equip. Corp.*, 82 F.3d 1194, 1215-16 (1st Cir. 1996), *abrogated by statute on other grounds*, 15 U.S.C. § 78u(4)(b)(2); *Collins v. Signetics Corp.*, 605 F.2d 110, 113 (3d Cir. 1979); *Credit Suisse First Bos. Corp. v. ARM Fin. Grp., Inc.*, 2001 WL 300733, at *9-10 (S.D.N.Y. Mar. 27, 2001); *Lalor v. Omtool, Ltd.*, 2000 WL 1843247, at *7-8 (D.N.H. Dec. 14, 2000); *PPM Am., Inc. v. Marriott Corp.*, 853 F. Supp. 860, 874-75 (D. Md. 1994); *see also In re Infonet Servs. Corp. Sec. Litig.*, 310 F. Supp. 2d 1080, 1101 (C.D. Cal. 2003) (finding that serving on the board of directors and signing the prospectus and registration statement does not constitute active solicitation). *But see Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1114 (5th Cir. 1988) (“It might be said that everyone who invested in the initial offering bought from the . . . issuer.”), *vacated on other grounds sub nom. Fryar v. Abell*, 492 U.S. 914 (1989); *Milman v. Box Hill Sys. Corp.*, 72 F. Supp. 2d 220, 229-30 (S.D.N.Y. 1999) (finding allegations that the issuer and the individual defendants “received millions of dollars in profits from the Offering,” “hired the Underwriters,” and “actively promoted the Company’s stock . . . through their direct participation in the Road Show” were sufficient to establish that they were “statutory sellers under § 12”).

- (4) “Any other communication that is an offer in the offering made by the issuer to such person.”³⁰⁵

In 1988, the Supreme Court resolved a conflict that had previously existed among the circuits regarding the privity requirement under § 12(a)(1) (then § 12(1)). The Court rejected the Fifth Circuit’s requirement that the defendant be a “substantial factor” in causing the plaintiff to purchase the security, holding instead that § 12(a)(1) only applied to the “owner who passed title, or other interest in the security, to the buyer for value,” or a person “who successfully solicit[ed] the purchase, motivated at least in part by a desire to serve his own financial interest or those of the securities owner.” *Pinter*, 486 U.S. at 642, 647. “The *Pinter* Court emphasized that Section 12 liability depends on the ‘defendant’s relationship with the plaintiff-purchaser.’” *In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 93 F. Supp. 2d 424, 438 (S.D.N.Y. 2000) (quoting *Pinter*, 486 U.S. at 651).

Although the Court noted that most courts and commentators have not defined the defendant class of § 12(a)(1) differently from that of § 12(a)(2), it nonetheless declined to decide the scope of a statutory “seller” for purposes of § 12(a)(2). *Pinter*, 486 U.S. at 642 n.20. However, in the wake of the Supreme Court’s decision, the First, Second, Third, Fifth, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits have all applied *Pinter* to § 12(a)(2),³⁰⁶ and district courts in the Fourth, Tenth, and D.C. Circuits have also held that *Pinter* applies in the context of § 12(a)(2) claims, thereby providing some support for this proposition in every circuit.³⁰⁷

³⁰⁵ 17 C.F.R. § 230.159A. Some courts have held that the Supreme Court’s decision in *Pinter v. Dahl*, 486 U.S. 622 (1988) “leaves no gap for the SEC to fill” and “forecloses [its] determination [in Rule 159A] that issuers are liable as statutory sellers under § 12(a)(2).” *In re Kosmos Energy Ltd. Sec. Litig.*, 955 F. Supp. 2d 658, 670-73 (N.D. Tex. 2013); accord *In re Countrywide Fin. Corp. Mortg.-Backed Sec. Litig.*, 932 F. Supp. 2d 1095, 1118 (C.D. Cal. 2013). Other courts have rejected this argument, however, and have upheld Rule 159A as a reasonable exercise of the SEC’s rulemaking authority that is in “accord with *Pinter*’s understanding of the expansive definition of statutory seller.” *Fed. Hous. Fin. Agency for Fed. Nat’l Mortg. Ass’n v. Nomura Holding Am., Inc.*, 873 F.3d 85, 139-40 (2d Cir. 2017); accord *Nat’l Credit Union Admin. Bd. v. RBS Sec., Inc.*, 2013 WL 12320069, at *5 (C.D. Cal. Dec. 19, 2013).

³⁰⁶ See, e.g., *Shaw*, 82 F.3d at 1214; *Wilson*, 872 F.2d at 1126; *Capri v. Murphy*, 856 F.2d 473, 478 (2d Cir. 1988); *Craftmatic Sec. Litig. v. Kraftsow*, 890 F.2d 628, 636 (3d Cir. 1989); *Abell*, 858 F.2d at 1115; *Smith v. Am. Nat’l Bank & Trust Co.*, 982 F.2d 936, 941-42 (6th Cir. 1992); *Ackerman v. Schwartz*, 947 F.2d 841, 844-45 (7th Cir. 1991); *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 319 (8th Cir. 1997); *Moore*, 885 F.2d at 536; *Ryder Int’l Corp. v. First Am. Nat’l Bank*, 943 F.2d 1521, 1527-30 (11th Cir. 1991); see also *In re Twinlab Corp. Sec. Litig.*, 103 F. Supp. 2d 193, 204-05 (E.D.N.Y. 2000) (holding that an issuer could be held liable despite “firm commitment underwriting” when the issuer solicited sales of its stock for financial gain).

³⁰⁷ See, e.g., *In re Oppenheimer Rochester Funds Grp. Sec. Litig.*, 838 F. Supp. 2d 1148, 1179 n.19 (D. Colo. 2012) (explaining that in *Maher v. Durango Metals, Inc.*, 144 F.3d 1302 (10th Cir. 1998), the Tenth Circuit “applied the *Pinter* standard to a claim brought under § 12(a)(1)” and also acknowledged that *Pinter*’s “definition of a statutory seller under § 12(a)(1) ‘applie[s] to § 12(a)(2) as well’” (quoting *Maher*, 144 F.3d at 1307 n.10));

Courts applying the *Pinter* standard to § 12(a)(2) claims have generally held that lawyers and accountants who merely perform professional services without active solicitation are not “sellers” under § 12(a)(2).³⁰⁸ Similarly, a broker acting merely as an agent of the purchaser who does not engage in any solicitation may avoid § 12(a)(2) liability.³⁰⁹ Courts have not taken a uniform approach to the applicability of § 12(a)(2) to parties whose major contribution to the sale of securities is participation in the preparation of the prospectus.³¹⁰ As indicated by the cases cited above, a defendant’s liability may depend on the extent to which that party engaged in activities involving the dissemination of the prospectus over and beyond its mere preparation. Use of secondary liability concepts, discussed below (at pp. 129-39), has also attenuated somewhat the privity requirement of § 12.

2. Scier and Defenses

Under § 12(a)(1), there is no requirement that a plaintiff prove scier or even negligence: a person who sells securities in violation of the registration provisions

In re Constellation Energy Grp., Inc. Sec. Litig., 738 F. Supp. 2d 614, 632 (D. Md. 2010); *Brattain v. Alcitepe*, 934 F. Supp. 2d 119, 127 (D.D.C. 2013).

³⁰⁸ See *Ackerman*, 947 F.2d at 844-45; *Moore*, 885 F.2d at 537 (drawing a distinction between the act of solicitation and assisting in the solicitation effort and dismissing a § 12(a)(2) claim against attorneys and accountants); *Wilson*, 872 F.2d at 1126-27 (dismissing § 12(a)(2) claim against a law firm that committed a “ministerial act” of mailing and copying a private placement memorandum); *BCJJ, LLC v. LeFevre*, 2012 WL 3071404, at *32 (M.D. Fla. July 27, 2012); *Buford White Lumber Co. Profit Sharing & Sav. Plan & Trust v. Octagon Props., Ltd.*, 740 F. Supp. 1553, 1558-59 (W.D. Okla. 1989) (holding that a law firm that prepares a prospectus motivated by a desire to benefit itself and/or its client is not a “seller” or “solicitor” under (now) § 12(a)(2)).

³⁰⁹ See *Montcalm Cnty. Bd. of Comm’rs v. McDonald & Co. Sec., Inc.*, 833 F. Supp. 1225, 1233 (W.D. Mich. 1993) (finding that the collection of a commission does not convert a broker into a seller under § 12(a)(2)); *Ryder Int’l Corp.*, 943 F.2d at 1531; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng*, 697 F. Supp. 1224, 1228-29 (D.D.C. 1988).

³¹⁰ Compare *Shaw*, 82 F.3d at 1216 (“Under *Pinter*, however, neither involvement in preparation of a registration statement or prospectus nor participation in ‘activities’ relating to the sale of securities, standing alone, demonstrates the kind of *relationship between defendant and plaintiff* that could establish statutory seller status.”), *Craftmatic Sec. Litig.*, 890 F.2d at 636 (stating that an issuer is not liable under § 12 solely on the basis of its involvement in the preparation of the prospectus), *In re Westinghouse Sec. Litig.*, 832 F. Supp. 948, 985 (W.D. Pa. 1993) (“[P]reparation of financial statements and prospectuses . . . are not considered part of the solicitation process . . .”), *rev’d on other grounds*, 90 F.3d 696 (3d Cir. 1996), and *In re Gas Reclamation, Inc. Sec. Litig.*, 733 F. Supp. 713, 724 (S.D.N.Y. 1990) (finding that an agent of a surety who participated in the preparation of the prospectus is not liable under § 12(a)(2) absent evidence that he had more than minimal contact with investors), *with Capri*, 856 F.2d at 478 (deciding that general partners of coal mining venture qualify as “sellers” under § 12(a)(2) through preparation and circulation of misleading prospectus despite lack of direct communication with investors), and *Suppa v. Montano*, 1989 WL 69883, at *6 (W.D. Mo. Feb. 28, 1989) (“The Court has little difficulty determining that those who prepare and disseminate a materially false prospectus, even though they do not actually sell the security, may be held liable as an offeror under section 12(2).”).

of the Securities Act is strictly liable.³¹¹ Nor is there a requirement under § 12(a)(2) that a plaintiff prove scienter or negligence. However, under § 27A(c) of the Securities Act, which was added by the PSLRA, no liability will attach in a private action under § 12(a)(2) based on certain statutorily defined “forward-looking statements” unless the plaintiff proves “actual knowledge” of the false or misleading nature of the statement on the part of a natural person making the statement or on the part of an executive officer approving the statement if made on behalf of a business entity. 15 U.S.C. § 77z-2(c)(1)(B). *See pp. 13-16, supra.*

Generally, a plaintiff who proves that his seller made materially false or misleading statements or used a materially false or misleading prospectus, and that the plaintiff had no knowledge of any untruth or omission, has established his case under § 12(a)(2).³¹² However, defendant sellers have an affirmative defense that they neither knew nor could have known, with the exercise of reasonable care, of the untruth or omission.³¹³ The effect of this defense is to turn § 12(a)(2) into a negligence statute, with the burden on defendants to prove lack of negligence.³¹⁴

Section 12(a)(2) liability may also be avoided by way of an affirmative defense of lack of loss causation. The statute provides that if a person “proves that any portion or all of the amount recoverable under subsection (a)(2) of this section represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication . . . not being true or omitting to state a material fact . . . then such portion or amount . . . shall not be recoverable.” 15 U.S.C. § 771(b). Consequently, “[a] Section 12 defendant is liable only for depreciation that results directly from the misrepresentation at issue.” *Miller v. Thane Int’l, Inc.*, 519 F.3d 879, 892 (9th Cir. 2007). In *Miller*, the court had to decide whether shareholders suffered an actionable loss from a material misrepresentation in a prospectus when the price of the company’s stock, which traded on the

³¹¹ *See Pinter*, 486 U.S. at 638; *Raiford v. Buslease, Inc.*, 825 F.2d 351, 354 (11th Cir. 1987). However, *Pinter* makes also clear that an *in pari delicto* defense is available under § 12(a)(1) (then § 12(1)). *See pp. 64-65, supra* (discussing this defense under Rule 10b-5). Moreover, a defense of estoppel has been recognized in a § 12(a)(1) action where the plaintiff failed, until just before the expiration of the one-year statute of limitations, to assert his right under § 5 to receive a prospectus with the confirmation of his purchase of stock in an initial public offering and the market value of the shares declined precipitously in the interim. *Murken v. Barrow*, 1989 WL 168062, at *4 (C.D. Cal. Oct. 30, 1989); *cf. Straley v. Universal Uranium & Milling Corp.*, 289 F.2d 370, 372 (9th Cir. 1961). *But see In re Colonial Ltd. P’ship Litig.*, 854 F. Supp. 64, 86 (D. Conn. 1994) (noting the “split of authority on the question of whether the doctrines of equitable tolling and fraudulent concealment apply to section 12(1) claims” and citing cases going both ways).

³¹² *See In re Adams Golf, Inc. Sec. Litig.*, 381 F.3d 267, 274 (3d Cir. 2004); *Currie v. Cayman Res. Corp.*, 835 F.2d 780, 782-83 (11th Cir. 1988); *Hill York Corp. v. Am. Int’l Franchises, Inc.*, 448 F.2d 680, 695 (5th Cir. 1971), *abrogated on other grounds by Pinter v. Dahl*, 486 U.S. 622 (1988).

³¹³ *See Casella v. Webb*, 883 F.2d 805, 809 (9th Cir. 1989); *Gilbert v. Nixon*, 429 F.2d 348, 357 (10th Cir. 1970).

³¹⁴ *See Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496, 507 (5th Cir. 1990).

NASDAQ Over-the-Counter Bulletin Board rather than its National Market System, did not decline in the weeks immediately following disclosure of the correct information. In finding that the material misrepresentation in the prospectus did not cause actionable loss to the shareholders, the court held that a determination of materiality did not foreclose a loss causation defense, reasoning that a contrary ruling would render the “affirmative defense of loss causation” “a nullity.” See *Miller v. Thane Int’l, Inc.*, 615 F.3d 1095, 1101-02 (9th Cir. 2010).

Finally, an *in pari delicto* defense may be available to defendants against claims brought under § 12(a)(1). See pp. 64-65, *supra*.

3. Reliance

It is universally held that a plaintiff does not need to establish any form of reliance to recover under § 12(a)(1) or (a)(2).³¹⁵

4. Remedies and Measure of Damages

The primary remedy provided by § 12 is rescission: the plaintiff tenders his securities to the defendant and receives his purchase price, with interest, in return. Interest is computed at what the court deems an equitable rate.³¹⁶ But there are several wrinkles. First, where the plaintiff has received income—*i.e.*, dividends or interest—on his securities, this income is subtracted from the purchase price in determining what he will get upon tendering his shares. Second, where the plaintiff has, before the filing of suit, disposed of the relevant securities, and thus cannot rescind the sale, he may recover damages, measured as the difference between the purchase price and the disposal price of the securities, plus interest, and less any income from the security received by the plaintiff.³¹⁷ Of course, where the defendant is a person

³¹⁵ See, e.g., *United Food & Com. Workers Union Local 880 Pension Fund v. Chesapeake Energy Corp.*, 774 F.3d 1229, 1233 (10th Cir. 2014); *Schlesinger v. Herzog*, 2 F.3d 135, 141 (5th Cir. 1993); *Currie*, 835 F.2d at 782; *Akerman v. Oryx Commc’ns, Inc.*, 810 F.2d 336, 344 (2d Cir. 1987); *Adalman v. Baker, Watts & Co.*, 807 F.2d 359, 373 (4th Cir. 1986), *abrogated on other grounds by Pinter v. Dahl*, 486 U.S. 622 (1988); *Junker v. Crory*, 650 F.2d 1349, 1359 (5th Cir. 1981); *Sanders v. John Nuveen & Co.*, 619 F.2d 1222, 1225 (7th Cir. 1980); *Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124, 1129 (4th Cir. 1970); *Gilbert*, 429 F.2d at 356.

³¹⁶ See *Com. Union Assurance Co. v. Milken*, 17 F.3d 608, 615 (2d Cir. 1994); *Fed. Hous. Fin. Agency v. Merrill Lynch & Co.*, 903 F. Supp. 2d 274, 280 (S.D.N.Y. 2012); *SEC v. Tome*, 638 F. Supp. 638, 640 (S.D.N.Y. 1986), *aff’d*, 833 F.2d 1086 (2d Cir. 1987); *Koehler v. Pulvers*, 614 F. Supp. 829, 850 (S.D. Cal. 1985); *Scheve v. Clark*, 596 F. Supp. 592, 596 (E.D. Mo. 1984); *W. Fed. Corp. v. Davis*, 553 F. Supp. 818, 821 (D. Ariz. 1982), *aff’d sub nom. W. Fed. Corp. v. Erickson*, 739 F.2d 1439 (9th Cir. 1984); *Johns Hopkins Univ. v. Hutton*, 297 F. Supp. 1165, 1229 (D. Md. 1968), *rev’d on other grounds*, 422 F.2d 1124 (4th Cir. 1970).

³¹⁷ See, e.g., *Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028, 1036 n.8 (2d Cir. 1979); *Cady v. Murphy*, 113 F.2d 988, 990-91 (1st Cir. 1940); *Reves v. Ernst & Young*, 937 F. Supp. 834, 837 (W.D. Ark. 1996). *But see Randall v.*

from whom the plaintiff did not receive title—for example a broker (to the extent a broker can be held liable under § 12)—the result of the § 12 remedy is not rescission, strictly speaking, though it will be the equivalent to the plaintiff.³¹⁸

The PSLRA added § 12(b) of the Securities Act, which provides that if a defendant in a § 12(a)(2) action shows that all or a part of the security’s diminished value was not caused by the misstatement or omission alleged in the complaint but rather by some other cause, the plaintiff may not recover damages attributable to that other cause. 15 U.S.C. § 771(b). The defendant bears the burden of showing this absence of loss causation.³¹⁹

5. Statute of Limitations

Both § 12(a)(1) and § 12(a)(2) are subject to the limitations periods set forth in § 13 of the Securities Act. Actions under § 12(a)(1) must be brought within the shorter of one year of the date of the violation, or three years from the date the security was first offered to the public.³²⁰ Actions under § 12(a)(2) must be brought within one year of the discovery of the untruths or omissions, or one year from the time such discovery should with reasonable diligence have occurred, and in no event more than three years after the relevant sale.³²¹ Courts have held that the Sarbanes-Oxley statute of limitations does not apply to § 12, analogizing lawsuits brought under this provision to claims under § 11, which do not “sound in fraud,” as required by

Lofsgaarden, 478 U.S. 647, 659-60 (1986) (finding that § 12(a)(2) damages need not be reduced by the amount of tax benefits received from a shelter investment).

³¹⁸ Section 12 expressly provides only for remedies in rescission or damages. The Supreme Court has held, however, that in an appropriate case brought primarily for rescission or damages under § 12, ancillary relief, including injunctive relief, can be given. *Deckert v. Independence Shares Corp.*, 311 U.S. 282, 287-90 (1940); see also *In re Gartenberg*, 636 F.2d 16, 17-18 (2d Cir. 1980). Cf. *SEC v. Beisinger Indus. Corp.*, 552 F.2d 15, 18-19 (1st Cir. 1977) (“It is well established that Section 22(a) of the Securities Act of 1933 and Section 27 of the Securities Exchange Act of 1934 confer general equity powers on the district courts.” (citations omitted)).

³¹⁹ See *Lalor v. Omtool, Ltd.*, 2000 WL 1843247, at *3 (D.N.H. Dec. 14, 2000) (“As to claims under §§ 11 and 12 of the Securities Act, ‘loss causation’ is not an essential element of a viable cause of action. It is, however, an affirmative defense that may be raised by a defendant.”); *Kenilworth Partners L.P. v. Cendant Corp.*, 59 F. Supp. 2d 417, 424 (D.N.J. 1999) (“If the person who sold or offered the security can prove that all or part of the depreciation in value was caused by factors other than the false or misleading statement, he is not liable for that amount.”). But see *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 289 F. Supp. 2d 429, 437 (S.D.N.Y. 2003) (dismissing a § 12(a)(2) claim over plaintiff’s argument that defendants bear the burden of proving “negative causation,” where the absence of causation was clear from the face of the complaint).

³²⁰ See *Pollack v. Laidlaw Holdings, Inc.*, 1995 WL 261518, at *16 (S.D.N.Y. May 2, 1995).

³²¹ See, e.g., *Freidus*, 734 F.3d at 138 (providing that the one-year statute of limitations begins to run on the date a corrective disclosure—which provides constructive notice—is made); *In re Merrill Lynch*, 289 F. Supp. 2d at 432-34 (finding that §§ 11 and 12(a)(2) claims were time-barred because plaintiffs were “on inquiry notice” “more than one year before they filed their initial complaint”); *Dale v. Rosenfeld*, 229 F.2d 855, 858 (2d Cir. 1956); *Zola v. Gordon*, 685 F. Supp. 354, 360 (S.D.N.Y. 1988).

§ 804 of Sarbanes-Oxley, but rather are based on strict liability or negligence. See p. 118 & n.295, *supra*.

In 2013, the Third Circuit created a circuit split by holding that “a Securities Act plaintiff need not plead compliance with Section 13.” *Pension Tr. Fund for Operating Eng’rs v. Mortg. Asset Securitization Transactions, Inc.*, 730 F.3d 263, 271 (3d Cir. 2013). The court acknowledged that three courts of appeals had “historically held” that such plaintiffs “must plead compliance with Section 13,”³²² but noted that three other courts of appeals had “recently held that a plaintiff need not plead compliance with the statute of limitations in the Securities Exchange Act of 1934, which . . . is similar to the statute of limitations in the Securities Act.”³²³ *Id.* at 270. The Third Circuit then concluded that under its precedent, the statute of limitations is an affirmative defense, and the burden of establishing its applicability therefore rests on the defendant, not the plaintiff. See *id.* at 271.

³²² See *Davidson v. Wilson*, 973 F.2d 1391, 1402 n.8 (8th Cir. 1992) (“[C]ompliance with section 13 must be pled with specificity.”); *Anixter v. Home-Stake Prod. Co.*, 939 F.2d 1420, 1434 (10th Cir. 1991) (“Section 13 is substantive, rather than procedural; it establishe[s] an essential element to a private cause of action.” (internal quotation marks omitted)), *vacated on other grounds sub nom. Dennier v. Trippet*, 503 U.S. 978 (1992); *Cook v. Avien, Inc.*, 573 F.2d 685, 695 (1st Cir. 1978) (holding that “the plaintiff must plead and prove facts showing that he is within the statute” in a § 12(a)(2) case).

³²³ *Pension Tr. Fund for Operating Eng’rs v. Mortg. Asset Securitization Transactions, Inc.*, 730 F.3d 263, 270 (3d Cir. 2013) (citing *Johnson v. Aljian*, 490 F.3d 778 (9th Cir. 2007); *La Grasta v. First Union Sec., Inc.*, 358 F.3d 840 (11th Cir. 2004), *abrogated on other grounds by Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007); and *Trogenza v. Great Am. Commc’ns Co.*, 12 F.3d 717 (7th Cir. 1993), *abrogated on other grounds by Merck & Co. v. Reynolds*, 559 U.S. 633 (2010)).

IV

Secondary Liability, Contribution, and Indemnification

A defendant can be held secondarily liable for primary violations of the securities laws under § 15 of the Securities Act or § 20(a) of the Exchange Act, as well as by application of the common law doctrines of respondeat superior, aiding and abetting, or conspiracy.

A. Controlling Person Liability Under § 15 of the Securities Act and § 20 of the Exchange Act

Despite differences in wording, § 15 of the Securities Act and § 20(a) of the Exchange Act have always been interpreted as parallel statutes.³²⁴ Section 15 imposes secondary liability on controlling persons for primary liabilities of controlled persons under §§ 11 and 12 of the Securities Act. 15 U.S.C. § 77o. Section 20(a) imposes secondary liability on controlling persons for primary liabilities of controlled persons under any provision of the Exchange Act or any regulation promulgated thereunder. 15 U.S.C. § 78t(a). Because § 15 and § 20(a) are secondary liability provisions, establishing a primary violation is a prerequisite for liability under § 15 or § 20(a); however, the controlled person/primary violator need not be joined in an action under § 15 or § 20(a).³²⁵

1. “Control”

“Control” is defined as “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise,” 17 C.F.R. § 230.405, but determining exactly who meets this standard requires a case-by-case assess-

³²⁴ See, e.g., *Pharo v. Smith*, 621 F.2d 656, 673 (5th Cir. 1980), *on reh’g in part*, 625 F.2d 1226 (5th Cir. 1980); *Durham v. Kelly*, 810 F.2d 1500, 1503 (9th Cir. 1987).

³²⁵ See, e.g., *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1170 n.47 (D.C. Cir. 1978); *Kemmerer v. Weaver*, 445 F.2d 76, 78-79 (7th Cir. 1971) (holding that action may continue against controlling persons when suit against controlled persons dismissed on procedural grounds); *Keys v. Wolfe*, 540 F. Supp. 1054, 1061-62 (N.D. Tex. 1982), *rev’d on other grounds*, 709 F.2d 413 (5th Cir. 1983); *Primavera Familienstiftung v. Askin*, 1996 WL 580917, at *2 (S.D.N.Y. Oct. 9, 1996); *McCarthy v. Barnett Bank*, 750 F. Supp. 1119, 1126 (M.D. Fla. 1990); see also *In re Stone & Webster, Inc., Sec. Litig.*, 424 F.3d 24, 27 (1st Cir. 2005) (holding that the dismissal of Rule 10b-5 claims against individual defendants “is in no way incompatible” with a plaintiff’s right to establish their secondary liability under § 20(a) as controlling persons of a liable corporation).

ment. Certainly controlling shareholders, directors, and even lenders *can* be controlling persons, provided they have the power or potential power to influence the activities of the controlled person.³²⁶

The circuits remain split as to whether a plaintiff must establish that the defendant was a “culpable participant” in the alleged violation in order to qualify as a “controlling person” for purposes of § 15 and § 20(a). The Second and Third Circuits adhere to the “culpable participant” test—at least with respect to § 20(a)³²⁷—which requires the plaintiff to show not only that controlling person had direct or indirect influence over the decision-making process of the controlled person, but also that the defendant actually participated in the alleged primary violation.³²⁸ Although the Sixth Circuit has not adopted the “culpable participant” standard, district courts in the circuit have consistently required it.³²⁹

³²⁶ See, e.g., *No. 84 Employer-Teamster Joint Council Pension Tr. Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 945-46 (9th Cir. 2003) (finding a *prima facie* showing of control had been made where the two largest stockholders controlled 57.4% of the total voting power and “had some of their own officers seated on” the corporation’s board); *Paracor Fin., Inc. v. Gen. Elec. Capital Corp.*, 96 F.3d 1151, 1162-63 (9th Cir. 1996) (discussing standards for finding lenders and directors to be “controlling persons”); *Arthur Children’s Trust v. Keim*, 994 F.2d 1390, 1396-97 (9th Cir. 1993) (directors); *In re Gaming Lottery Sec. Litig.*, 1998 WL 276177, at *8 (S.D.N.Y. May 27, 1998) (officers), *vacated on other grounds sub nom. Pecarsky v. Galaxiworld.com Ltd.*, 249 F.3d 167 (2d Cir. 2001); *Stern v. Am. Bankshares Corp.*, 429 F. Supp. 818, 824 (E.D. Wis. 1977) (directors); *Klapmeier v. Telecheck Int’l, Inc.*, 315 F. Supp. 1360, 1361 (D. Minn. 1970) (stating that a “majority shareholder might as a matter of law be held to ‘control’ the entity regardless of his actual participation in management decisions and the specific transaction in question”). *But see In re Lehman Bros. Mortg.-Backed Sec. Litig.*, 650 F.3d 167, 187 (2d Cir. 2011) (finding that rating agencies were not controlling persons of banks that issued rated securities because “providing advice that the banks chose to follow does not suggest control”).

³²⁷ Multiple district courts in the Second Circuit have held that the “culpable participant” element does not apply to claims under § 15 of the Securities Act. See, e.g., *In re Vivendi Universal, S.A.*, 381 F. Supp. 2d 158, 187-88 (S.D.N.Y. 2003) (holding that culpable participation is not an element required to establish a *prima facie* case of control person liability pursuant to § 15); *In re Deutsche Telekom AG Sec. Litig.*, 2002 WL 244597, at *5-6 (S.D.N.Y. Feb. 20, 2002) (same); *In re Indep. Energy Holdings PLC Sec. Litig.*, 154 F. Supp. 2d 741, 769-70 (S.D.N.Y. 2001) (same) (collecting cases), *abrogated on other grounds by In re Initial Public Offering Sec. Litig.*, 241 F. Supp. 2d 281, 393-97 (S.D.N.Y. 2003); *In re Twinlab Corp. Sec. Litig.*, 103 F. Supp. 2d 193, 207-08 (E.D.N.Y. 2000) (concluding that because “claims under Sections 11 and 12 of the Securities Act sound in strict liability . . . the concept of culpability would not apply” to claims under § 15).

³²⁸ See, e.g., *ATSI Commc’ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 108 (2d Cir. 2007); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1472-73 (2d Cir. 1996); *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 185 (3d Cir. 1981), *overruled on other grounds by In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537 (3d Cir. 1988) (en banc); *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 890 (3d Cir. 1975).

³²⁹ See, e.g., *Sanders Confectionery Prods., Inc. v. Heller Fin., Inc.*, 973 F.2d 474, 486 (6th Cir. 1992) (declining to state whether culpable participation is required); *In re FirstEnergy Corp. Sec. Litig.*, 316 F. Supp. 2d 581, 600-01 (N.D. Ohio 2004) (requiring culpable participation and finding that plaintiffs had sufficiently pled a § 20(a) claim); *D.E. & J. Ltd. P’ship v. Conaway*, 284 F. Supp. 2d 719, 750 (E.D. Mich. 2003) (requiring “culpable participation,” but dismissing § 20(a) allegations for lack of primary violation), *aff’d*, 133 F. App’x 994 (6th Cir. 2005); *In re Telxon Corp. Sec. Litig.*, 133 F. Supp. 2d 1010, 1032 (N.D. Ohio 2000); *Yadlosky v.*

In contrast to the above courts, the Fifth, Seventh, Eighth, and Tenth Circuits reject the “culpable participant” test, and merely require the plaintiff to show that the defendant “actually participated in (*i.e.*, exercised control over) the operations of the corporation in general . . . [and] that the defendant possessed the power to control the specific transaction or activity upon which the primary violation is predicated, but he need not prove that this latter power was exercised.” *Metge v. Baehler*, 762 F.2d 621, 631 (8th Cir. 1985) (citation omitted).³³⁰ The Fourth and Eleventh Circuits’ test for “controlling person” differs only slightly from this formulation; in those circuits, the relevant inquiry is whether a defendant “had the power to control the general affairs of the entity primarily liable at the time the entity violated the securities laws . . . [and] had the requisite power to directly or indirectly control or influence the specific corporate policy which resulted in the primary liability.”³³¹ The Ninth Circuit likewise does not require the plaintiff to “show that the defendant was a culpable participant in the violation,” although in that circuit, a controlling person may prove lack of scienter as a good faith defense. *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000).³³²

The First Circuit and D.C. Circuit have not settled whether the plaintiff is required to allege culpable participation to state a claim under § 20(a).³³³ District courts in

Grant Thornton, L.L.P., 120 F. Supp. 2d 622, 631 (E.D. Mich. 2000); *Ballan v. Upjohn Co.*, 814 F. Supp. 1375, 1389 (W.D. Mich. 1992).

³³⁰ See also, e.g., *Maher v. Durango Metals, Inc.*, 144 F.3d 1302, 1305, 1306 n.8 (10th Cir. 1998) (rejecting “culpable participant” standard, but recognizing and declining to address circuit split on whether actual control over general affairs or potential control is required to make out *prima facie* case); *Harrison v. Dean Witter Reynolds, Inc.*, 79 F.3d 609, 614 (7th Cir. 1996); *Abbott v. Equity Grp., Inc.*, 2 F.3d 613, 619-20 (5th Cir. 1993).

³³¹ *Brown v. Enstar Grp., Inc.*, 84 F.3d 393, 396 (11th Cir. 1996); see also *In re Mutual Funds Inv. Litig.*, 566 F.3d 111, 130 (4th Cir. 2009) (applying the test from *Brown v. Enstar*), *rev’d on other grounds by Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135 (2011).

³³² The Ninth Circuit curiously stated in *In re Daou Systems, Inc. Securities Litigation*, 397 F.3d 704, 725, *amended by* 411 F.3d 1006 (9th Cir. 2005), that “a plaintiff must allege that the individual defendants had power or influence over the company and that the individual defendants were culpable participants in the company’s alleged illegal activity.” On denial of rehearing, however, the Ninth Circuit issued an amended opinion and struck these words from its prior opinion without explanation. See *Daou*, 411 F.3d at 1029-30; see also, e.g., *Giel v. Gen. Motors Acceptance Corp.*, 384 F. App’x 605, 606 (9th Cir. 2010) (“[Plaintiff] was not required to prove culpable participation as part of his *prima facie* case.”).

³³³ See, e.g., *Aldridge*, 284 F.3d at 85 (1st Cir. 2002) (declining to adopt or reject “culpable participant” standard but affirming dismissal due to lack of allegations showing actual exercise of control); *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1170 n.49 (D.C. Cir. 1978) (noting, but not resolving, the “variety of interpretations” regarding the plaintiff’s burden under § 20(a)).

the First Circuit have reached a variety of results,³³⁴ while more recent cases in the D.C. Circuit generally require allegations of culpable participation.³³⁵

Finally, some courts have suggested that a plaintiff may not simultaneously assert § 10(b) and § 20(a) claims against the same defendant.³³⁶ The Sixth Circuit noted this line of authority in one case but did not settle the question.³³⁷

2. Scierter and Defenses

Neither § 15 nor § 20(a) by its terms contains any scienter, or even negligence, requirement. But § 15 states that the controlling person is not liable if he had no knowledge or reason to know the facts that establish the liability of the controlled person. 15 U.S.C. § 77o. And § 20(a) states that the controlling person is not liable if he acted in good faith and did not induce the acts on which the liability of the controlled person is founded. 15 U.S.C. § 78t(a). The courts have uniformly held that these are affirmative defenses to be pleaded and proved by defendants.³³⁸ As discussed above, however, courts adopting the “culpable participant” standard will also require a plaintiff to prove some culpability as part of his *prima facie* case, before the burden of proving good faith shifts to the defendant.

³³⁴ See, e.g., *In re Stone & Webster, Inc., Sec. Litig.*, 253 F. Supp. 2d 102, 135 (D. Mass. 2003) (expressing uncertainty as to whether “culpable participant” standard is required, but finding it was met in the case at hand); *Neely v. Bar Harbor Bankshares*, 270 F. Supp. 2d 50, 53-54 (D. Me. 2003) (refusing to apply “culpable participant” standard); *In re Lernout & Hauspie Sec. Litig.*, 208 F. Supp. 2d 74, 90-91 (D. Mass. 2002) (finding possession and exercise of control sufficient).

³³⁵ See, e.g., *In re Fannie Mae Sec. Litig.*, 905 F. Supp. 2d 63, 70 n.15 (D.D.C. 2012) (“Because . . . there is no evidence that [the defendant] ‘culpably participated’ in any underlying securities law violation, she . . . is entitled to summary judgment on plaintiffs’ claims . . . under Section 20(a) of the Exchange Act”); *In re Fannie Mae Sec. Litig.*, 503 F. Supp. 2d 25, 43-46 (D.D.C. 2007) (noting the split in authority and concluding that plaintiffs are required to plead culpable participation). But see *In re Baan Co. Sec. Litig.*, 103 F. Supp. 2d 1, 24 (D.D.C. 2000) (finding ability to control sufficient, even if actual exercise of control not shown), *aff’d*, 245 F. Supp. 2d 117, 128 n.13 (D.D.C. 2003).

³³⁶ See, e.g., *In re Capstead Mortg. Corp. Sec. Litig.*, 258 F. Supp. 2d 533, 566 (N.D. Tex. 2003); *Lemmer v. Nu-Kote Holding, Inc.*, 2001 WL 1112577, at *12 (N.D. Tex. 2001), *aff’d*, 71 F. App’x 356 (5th Cir. 2003); *Kalnit v. Eichler*, 85 F. Supp. 2d 232, 246 (S.D.N.Y. 1999). Cf. 183 A.L.R. Fed. 141 § 2[b] (2003) (“It is a frequent practice to plead in the alternative that a defendant is both a primary violator and a controlling person of primary violators, although, as some courts have noted, one cannot simultaneously be both.”).

³³⁷ See *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 697 n.4 (6th Cir. 2004), *abrogated in part on other grounds by Frank v. Dana Corp.*, 646 F.3d 954 (6th Cir. 2011).

³³⁸ See, e.g., *Kaplan v. Rose*, 49 F.3d 1363, 1382-83 (9th Cir. 1994), *overruled on other grounds by City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech., Inc.*, 856 F.3d 605 (9th Cir. 2017); *Marbury Mgmt., Inc. v. Kohn*, 629 F.2d 705, 716 (2d Cir. 1980); *Gould v. Am.-Hawaiian S.S. Co.*, 535 F.2d 761, 779 (3d Cir. 1976).

In cases involving brokers, courts routinely impose a strict duty to supervise and find liability under § 15 or § 20(a) if supervision is negligent.³³⁹ In other contexts, however, no duty to supervise is imposed, and something like a scienter standard reigns.³⁴⁰

3. Statute of Limitations

The statute of limitations governing a claim against a controlling person under § 15 or § 20(a) is the same as that which governs the underlying claim against the controlled person.³⁴¹

4. Remedies and Damages

A controlling person found liable under § 15 or § 20(a) is jointly and severally liable for any damages for which the controlled person is liable. *See* 15 U.S.C. §§ 77o, 78t(a). Thus, the measure of damages that can be assessed against a controlling person under §§ 15 and 20(a) varies with the underlying claims or possible claims against the controlled person. Although the PSLRA generally imposes proportionate liability instead of joint and several liability when the defendant did not knowingly violate the Exchange Act, 15 U.S.C. § 78u-4(f)(2), the Eleventh Circuit has determined that the PSLRA did not restrict or amend the joint and several liability provision of § 20(a). *Laperriere v. Vesta Ins. Grp., Inc.*, 526 F.3d 715, 726 (11th Cir. 2008).

B. Respondeat Superior

The common law doctrine of respondeat superior is well-accepted and holds an employer secondarily liable for the wrongful acts of its employee committed within the scope of employment. Prior to 1994, several circuits explicitly declared the doctrine of respondeat superior applicable under the federal securities laws, with

³³⁹ *See, e.g., Carpenter v. Harris, Upham & Co.*, 594 F.2d 388, 394 (4th Cir. 1979); *Henricksen v. Henricksen*, 640 F.2d 880, 886-87 (7th Cir. 1981).

³⁴⁰ *See, e.g., Sharp v. Coopers & Lybrand*, 649 F.2d 175, 185 (3d Cir. 1981) *overruled on other grounds by In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537 (3d Cir. 1988) (en banc); *Zweig v. Hearst Corp.*, 521 F.2d 1129, 1134-35 (9th Cir. 1975) *overruled on other grounds by Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990). *But see Drobbin v. Nicolet Instrument Corp.*, 631 F. Supp. 860, 885-86 (S.D.N.Y. 1986) (construing *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir. 1980), to hold that the standard for controlling person liability is “mere negligence”).

³⁴¹ *See, e.g., Klock v. Lehman Bros. Kuhn Loeb, Inc.*, 584 F. Supp. 210, 216 (S.D.N.Y. 1984); *Hill v. Equitable Trust Co.*, 562 F. Supp. 1324, 1341 (D. Del. 1983).

no circuit expressly holding that the securities laws supplant liability under the doctrine.³⁴²

The precedential force of these cases, to the extent they involve a claim based on secondary liability under Rule 10b-5, is questionable after the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994). *Central Bank*, which is discussed further below (at p. 135), rejected the availability of aiding and abetting liability under § 10(b), although the decision's impact on agency theories of liability remains somewhat unclear. A majority of courts have held that respondeat superior liability under § 10(b) remains viable, in spite of *Central Bank*,³⁴³ while some courts have held that the doctrine is no longer applicable in securities law cases after *Central Bank*.³⁴⁴

C. Aiding and Abetting Versus Direct Participation

Prior to the Supreme Court's ruling in *Central Bank*, a majority of the courts of appeals had held that civil liability could be imposed on those who aided and abetted primary violations of the securities laws.³⁴⁵ The major disagreement among these courts concerned the conditions under which inaction could be viewed as actionable assistance. Several courts had ruled that inaction could lead to liability

³⁴² See, e.g., *In re Atl. Fin. Mgmt., Inc. Sec. Litig.*, 784 F.2d 29, 35 (1st Cir. 1986); *Marbury Mgmt.*, 629 F.2d at 716; *Paul F. Newton & Co. v. Tex. Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980); *Holloway v. Howerdd*, 536 F.2d 690, 694-95 (6th Cir. 1976); *Henricksen*, 640 F.2d at 887; *Commerford v. Olson*, 794 F.2d 1319, 1323 (8th Cir. 1986); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-77 (9th Cir. 1990) (en banc); see also *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 884 (3d Cir. 1975) (holding that respondeat superior is applicable in certain securities cases, such as broker-dealer fraud).

³⁴³ See, e.g., *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001) (holding that *Central Bank* did not shield business entities from being held liable for misstatements of their agents); *AT & T Co. v. Winback & Conserve Program, Inc.*, 42 F.3d 1421, 1430-32 (3d Cir. 1994) (concluding, based on detailed comparison of aiding and abetting liability and agency liability, that *Central Bank* did not preclude the latter); *Elbit Sys., Ltd. v. Credit Suisse Grp.*, 917 F. Supp. 2d 217, 227 (S.D.N.Y. 2013) (holding that respondeat superior survived *Central Bank* as a theory of liability); *In re Lernout & Hauspie Sec. Litig.*, 230 F. Supp. 2d 152, 172-73 (D. Mass. 2002) (“[A]gent liability remains a viable theory of liability after *Central Bank* . . .”); *Gabriel Capital, L.P. v. NatWest Fin., Inc.*, 122 F. Supp. 2d 407, 430-31 (S.D.N.Y. 2000) (concluding that agency liability survived *Central Bank*, but holding that “a principal can be liable under § 10(b) for the misrepresentations of its agent only if the person to whom the misrepresentations were made knows that the agent is acting under the actual or apparent authority of the principal”), *abrogated on other grounds by In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281 (S.D.N.Y. 2003); cf. *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353 (5th Cir. 2004) (sustaining a respondeat superior liability claim without referring to *Central Bank*).

³⁴⁴ See, e.g., *In re Fidelity/Micron Sec. Litig.*, 964 F. Supp. 539, 543-44 (D. Mass. 1997).

³⁴⁵ See, e.g., *Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1126-28 (5th Cir. 1988); *Orloff v. Allman*, 819 F.2d 904, 907 (9th Cir. 1987); *Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983).

only when there was an independent duty to act,³⁴⁶ while others had ruled that inaction could be the basis of aiding and abetting liability where there was a specific intent to further the primary violation of the securities laws.³⁴⁷ Although most of these cases arose under § 10(b), courts had also approved aiding and abetting theories in § 11 and § 12 cases as well.³⁴⁸

The Supreme Court swept away all of these precedents in 1994, when it decided *Central Bank*. There, the Court held that § 10(b) would not support a cause of action for aiding and abetting, 511 U.S. at 191, and suggested in dictum that no aiding and abetting liability would lie under any of the liability provisions of the Securities and Exchange Acts. In particular, the Court noted that had Congress intended the securities laws to encompass aiding and abetting behavior, it would have expressly so provided, and held that in the absence of any mention of such behavior, courts should not infer a cause of action. *See id.* at 183-85.³⁴⁹

Following *Central Bank*, courts grappled with whether parties traditionally subject to liability under an aiding and abetting theory, such as accountants and lawyers, may be made subject to primary liability for their role in preparing misleading information.³⁵⁰ The Supreme Court provided guidance on the question in *Janus*

³⁴⁶ *See, e.g., SEC v. Rogers*, 790 F.2d 1450, 1459 (9th Cir. 1986); *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731, 740 (10th Cir. 1974); *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973).

³⁴⁷ *See, e.g., Nat'l Union Fire Ins. Co. v. Turtur*, 892 F.2d 199, 206-07 (2d Cir. 1989); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1127 (5th Cir. 1988); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 36 (D.C. Cir. 1987); *Armstrong*, 699 F.2d at 91; *IIT v. Cornfeld*, 619 F.2d 909, 927 (2d Cir. 1980), *abrogated by Morrison v. Nat'l Austl. Bank, Ltd.*, 561 U.S. 247 (2010); *Rochez Bros.*, 527 F.2d at 889.

³⁴⁸ *See, e.g., Drexel Burnham Lambert, Inc. v. Am. Bankers Ins. Co.*, 1989 WL 168012, at *2 (E.D.N.C. Nov. 8, 1989) (reasoning that the Supreme Court had “specifically declined to address aider and abettor secondary liability” in *Pinter v. Dahl*, 486 U.S. 622 (1988), and following the court’s own “prior orders upholding aiding and abetting liability under [then] Section 12(2)”; *In re Caesars Palace Sec. Litig.*, 360 F. Supp. 366, 378 (S.D.N.Y. 1973) (holding that aiders and abettors are “not necessarily excluded from the imposition of [then] § 12(2) liability”). *But see Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1126-27 (2d Cir. 1989) (rejecting aiding and abetting liability under then § 12(2) based on *Pinter*).

³⁴⁹ In response to the SEC’s complaint that its enforcement authority was significantly diminished as a result of the *Central Bank* decision, Congress in enacting the PSLRA created § 20(e) of the Exchange Act, which expressly authorizes the SEC to bring actions against those who knowingly aid or abet primary violations for either an injunction or a civil money penalty. 15 U.S.C. § 78t(e). In 2010, Dodd-Frank added § 15(b) of the Securities Act to empower the SEC to bring claims against “any person that knowingly or recklessly provides substantial assistance to another person in violation of another provision” of the Act. 15 U.S.C. § 77o(b). These provisions do not grant private rights of action for aiding and abetting, and thus the core holding of *Central Bank* remains intact.

³⁵⁰ *Compare Ponce v. SEC*, 345 F.3d 722, 737-38 (9th Cir. 2003) (accountant/auditor who “played a major role in preparing and certifying [client’s] financial statements” liable as aider and abettor), *with Pac. Inv. Mgmt. Co. v. Mayer Brown, LLP*, 603 F.3d 144, 155 (2d Cir. 2010) (rejecting a “creator standard for secondary actor liability under Rule 10b-5” and holding that “secondary actors can be held liable . . . for only those statements that are explicitly attributed to them”), *and Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001)

Capital Group, Inc. v. First Derivatives Traders, 564 U.S. 135, 142 (2011), and held that liability under Rule 10b–5(b) may only be imposed on the “maker” of the statement alleged to be materially false or misleading. The “maker of a statement,” the Court explained, “is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not ‘make’ a statement in its own right.” *Id.* Accordingly, a company that created a mutual fund and acted as its investment adviser was not the maker of an allegedly false statement in the fund’s prospectus. *See id.* at 137-38.

In another effort to circumvent *Central Bank*’s limitation on secondary liability, plaintiffs advanced a theory that secondary actors, such as investment banks, that had no duty to disclose and did not participate in preparing a corporation’s financial statements could nonetheless be held liable as primary violators under Rule 10b–5 as participants in a “scheme to defraud.”³⁵¹ The Supreme Court considered that theory for private actions under Rule 10b–5, and appeared to reject it, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008).

In *Stoneridge*, Charter, a cable operator, overpaid defendant Scientific-Atlanta for the purchase of cable boxes, and in exchange, Scientific-Atlanta overpaid for advertising that it purchased from Charter. *See id.* at 154. As a result, Charter accounted for the advertising revenue as income while capitalizing the equal and offsetting cable box expense, thus boosting its operating cash flow numbers for the year to meet investor expectations. *See id.* at 154-55. Scientific-Atlanta also fraudulently backdated the contracts and fabricated documents to imply that the transactions occurred in the ordinary course of business, thus acting with knowing or reckless disregard of Charter’s intent to defraud investors by making it unlikely that its auditors would connect the transactions and recognize the lack of economic substance. *See id.* The Court held that the defendants were not liable because they “had no duty to disclose; and their deceptive acts were not communicated to the public. No member of the investing public had knowledge, either, actual or presumed, of [defendants’] deceptive acts during the relevant times.” *Id.* at 159. The Court explicitly rejected the argument that “in an efficient market investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect.” *Id.* at 160. The Court reached this conclusion based on

(“[F]or a secondary actor, such as a law firm or accounting firm . . . to be primarily liable under § 10(b) and Rule 10b–5, the alleged misstatement or omission upon which a plaintiff relied must have been publicly attributable to the defendant at the time that the plaintiff’s investment decision was made.”).

³⁵¹ *See, e.g., Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1049 (9th Cir. 2006), *cert. granted, judgment vacated sub nom. Avis Budget Grp., Inc. v. Cal. State Teachers’ Ret. Sys.*, 552 U.S. 1162 (2008), and *vacated sub nom. Simpson v. Homestore.com, Inc.*, 519 F.3d 1041 (9th Cir. 2008).

(1) a fear that otherwise “the implied cause of action would reach the whole marketplace in which the issuing company does business,” *id.*, (2) a common-law torts argument that Charter severed the chain of proximate cause because “nothing [Defendants] did made it necessary or inevitable for Charter to record the transactions as it did,” *id.* at 160-61, (3) a fear that private litigation would invade “areas already governed by functioning and effective state-law guarantees,” *id.* at 161, (4) an *exclusio unius* argument that Congress foreclosed private actions for secondary liability by amending § 104 of the PSLRA in the wake of *Central Bank* to grant express enforcement power to the SEC for secondary liability but not to private litigants, *id.* at 162-63, and (5) a fear that private actions would raise the costs of doing business and discourage overseas firms from doing business in the United States, *id.* at 163-64.

Following *Stoneridge*, some commentators believed that it was unclear whether the decision would apply to investment banks, accountants, lawyers or other defendants who act “in the investment sphere” because the opinion includes an observation that “[u]nconventional as the arrangement was, it took place in the marketplace for goods and services, *not in the investment sphere.*” *Id.* at 166 (emphasis added). This phrase led these commentators to wonder whether scheme liability might still attach to actors with financial or legal expertise.³⁵² Such concerns appear largely unfounded.³⁵³

The Supreme Court’s decision in *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019), complicates matters. *Lorenzo* held that those who do not “make” but instead “disseminate” materially false or misleading statements may face primary liability under subsections (a) or (c) of Rule 10b–5. *Id.* at 1099. *Lorenzo*, an investment banker, sent prospective investors in a debenture offering two e-mails that “he understood to contain material untruths,” *id.* at 1101, and “invited [them] to ‘call with any questions,’” *id.* at 1099. *Lorenzo*’s boss had “supplied the content and ‘approved’ the messages,” and the Court “took [the] case on the assumption that *Lorenzo* was not a ‘maker’ under subsection (b) of Rule 10b–5.” *Id.* at 1099-1100. Presented with these unique facts and circumstances, the Court upheld *Lorenzo*’s liability as a primary violator of Rule 10b–5, reasoning that he had “‘employ[ed]’ a ‘device,’

³⁵² See, e.g., Michael L. Rugen, *Stoneridge and Enron—Are Secondary Actors Free From Liability for Securities Fraud?*, 13 No. 20 ANDREWS’ SEC. LITIG. & REG. REP. 3; Kaye Scholer, *Supreme Court Rejects “Scheme Theory” of Liability and Curbs Investor Suits Against Secondary Actors*, http://www.kayescholer.com/in-the-market/publications/client_alerts/2008003.

³⁵³ The Second Circuit has held that whether conduct occurred in the “investment sphere” is “not dispositive or materially relevant” under *Stoneridge*. *Pac. Inv. Mgmt. Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 160 (2d Cir. 2010) (finding that *Stoneridge* foreclosed scheme liability claim brought against primary counsel to company that committed fraud); see also *In re DVI, Inc. Sec. Litig.*, 639 F.3d 623, 646-47 (3d Cir. 2011) (adopting the Second Circuit’s analysis), *abrogated on other grounds by Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455 (2013).

‘scheme,’ and ‘artifice to defraud’ within the meaning of subsection (a) of the Rule,” and “‘engage[d] in a[n] act, practice, or course of business’ that ‘operate[d] . . . as a fraud or deceit’ under subsection (c) of the Rule.” *Id.* at 1101.

Responding to the dissent’s claim that “applying subsections (a) or (c)” to Lorenzo’s conduct would “render . . . *Janus* . . . ‘a dead letter,’” the *Lorenzo* Court explained that “*Janus* would remain relevant (and preclude liability) where an individual neither *makes* nor *disseminates* false information—provided, of course, that the individual is not involved in some other form of fraud.” *Id.* at 1103. Courts will continue to be called upon to interpret this proviso and determine what other “form[s] of fraud” may support primary liability for secondary actors under subsections (a) and (c) of Rule 10b–5.³⁵⁴

The Tenth Circuit—the first court of appeals to consider this issue post-*Lorenzo*—endorsed a broad interpretation of subsections (a) and (c) of Rule 10b–5 that permits liability where a defendant knowingly fails to correct another person’s false or misleading statements. *Malouf v. SEC*, 933 F.3d 1248, 1259-63 (10th Cir. 2019), *cert. denied*, 140 S. Ct. 1551 (2020). In so holding, the *Malouf* court rejected the defendant’s argument that imposing liability based on a mere failure to correct “obliterate[d] the distinction” between maker liability and scheme liability “because the failure to correct is inseparable from the misstatements themselves.” *Id.* at 1259. The panel based its conclusion on *Lorenzo*, which, it observed, “expressly held that a person could incur liability” under, *inter alia*, subsections (a) and (c) “when the conduct involves another person’s false or misleading statement.” *Id.* at 1260.

The Second Circuit reached a different conclusion in *SEC v. Rio Tinto plc*, 41 F.4th 47, 52-54 (2d Cir. 2022), and affirmed the dismissal of a scheme liability claim premised on an allegation that the defendants had “failed to prevent misleading statements from being disseminated by others.” Deeming itself bound by the court’s prior decision in *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005), the panel held that “misstatements and omissions alone are not enough for scheme liability.” *Rio Tinto*, 41 F.4th at 53-54. To rule otherwise, the panel reasoned, would cause the “scheme subsections [to] swallow the misstatement subsections,” and “allow private litigants to repackage their misstatement claims as scheme liability claims” and thereby evade the PSLRA’s heightened pleading requirements. *Id.* at 54-55. Finally, in discussing what might suffice to establish scheme liability, the panel observed that “*Lorenzo* tells us that dissemination is one example of something extra that makes a violation a scheme,” and left open the

³⁵⁴ The Supreme Court distinguished *Stoneridge* on the ground that it involved “*undisclosed* deceptions upon which the plaintiffs could not have relied,” as contrasted with *Lorenzo*’s “direct transmission of false statements to prospective investors intended to induce reliance.” *Lorenzo v. SEC*, 139 S. Ct. 1094, 1104 (2019).

possibility that scheme liability could attach based on “allegations that a corporate officer concealed information from auditors,” or otherwise engaged in the “corruption of an auditing process.” *Id.* at 54.

D. Conspiracy

A few courts have invoked conspiracy theories to hold peripheral defendants liable in civil suits under the securities laws for the primary violations of others. All of these cases arise under § 10(b) of the Exchange Act, and none discusses the conspiracy theory in detail.³⁵⁵

In light of the Supreme Court’s holding in *Central Bank*, the availability of conspiracy as a theory of liability is in doubt,³⁵⁶ and numerous courts have held that the *Central Bank* rationale forecloses conspiracy liability.³⁵⁷ A few courts, however, have found that conspiracy liability does survive *Central Bank*.³⁵⁸

E. Contribution

As noted, § 11 of the Securities Act expressly provide a right to contribution, and the Supreme Court has held that there is a right to pro rata contribution for liability imposed under the § 10(b) implied private cause of action. *Musick, Peeler & Garrett v. Emp’rs Ins. of Wausau*, 508 U.S. 286, 298 (1993).³⁵⁹ Prior to *Musick, Peeler*,

³⁵⁵ See *Herpich v. Wilder*, 430 F.2d 818, 819 (5th Cir. 1970); *Shell v. Hensley*, 430 F.2d 819, 827 n.13 (5th Cir. 1970); *Dasho v. Susquehanna Corp.*, 380 F.2d 262, 267 n.2 (7th Cir. 1967); *Tex. Cont’l Life Ins. Co. v. Dunne*, 307 F.2d 242, 249 (6th Cir. 1962); *Kardon v. Nat’l Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946).

³⁵⁶ See *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 200 n.12 (1994) (Stevens, J., dissenting) (“The Court’s rationale would sweep away the decisions recognizing that a defendant may be found liable in a private action for *conspiring* to violate § 10(b) and Rule 10b-5.”).

³⁵⁷ See, e.g., *Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin*, 135 F.3d 837, 842 (2d Cir. 1998); *In re GlenFed, Inc. Sec. Litig.*, 60 F.3d 591, 592 (9th Cir. 1995); *Farey-Jones v. Buckingham*, 132 F. Supp. 2d 92, 102-03 (E.D.N.Y. 2001); *In re Faleck & Margolies, Ltd.*, 1995 WL 33631, at *12 (S.D.N.Y. Jan. 27, 1995); *Otto v. Variable Annuity Life Ins. Co.*, 1995 WL 121519, at *1 (N.D. Ill. Mar. 16, 1995); *In re Cypress Semiconductor Sec. Litig.*, 891 F. Supp. 1369, 1381 (N.D. Cal. 1995), *aff’d mem. sub nom. Eisenstadt v. Allen*, 113 F.3d 1240 (9th Cir. 1997); *Upton v. McKerrow*, 887 F. Supp. 1573, 1580 (N.D. Ga. 1995).

³⁵⁸ See, e.g., *Wenneman v. Brown*, 49 F. Supp. 2d 1283, 1289 n.3 (D. Utah 1999); *Trafton v. Deacon Barclays de Zoete Wedd Ltd.*, 1994 WL 746199, at *25 (N.D. Cal. Oct. 19, 1994) (holding that *Central Bank* does not extend to conspiracy claims).

³⁵⁹ See also *Asdar Grp. v. Pillsbury, Madison & Sutro*, 99 F.3d 289, 295-96 (9th Cir. 1996) (holding that for contribution actions the then one-year/three-year statute of limitation is measured from the time the party seeking contribution pays a judgment in an amount that exceeds its liability).

some courts held that there is no right of contribution under § 12(a)(2) of the Securities Act.³⁶⁰ In light of the Supreme Court’s decision, however, these decisions will likely be ultimately overruled.

The PSLRA, through § 21D(f) of the Exchange Act, instituted proportionate rather than joint and several liability for any violation that is not “knowingly committed” by a “covered person.” 15 U.S.C. § 78u-4(f)(2). The term “covered person” is defined as one liable under either the Exchange Act or, in the case of outside directors, under § 11 of the Securities Act. *Id.* § 78u-4(f)(10)(C). The provision also creates an explicit right of contribution: “covered persons” have an explicit right to contribution from (1) other “covered persons” held proportionately or jointly and severally liable, or (2) any other person responsible for the violation. *Id.* § 78u-4(f)(5). Moreover, for purposes of § 21D(f) only, “reckless conduct by a covered person shall not be construed to constitute a knowing commission of a violation of the securities laws by that covered person.” *Id.* § 78u-4(f)(10)(B). A defendant is liable for an uncollectible share in proportion to his share, up to 50 percent of the dollar amount of the defendant’s original proportionate share. If an individual plaintiff has a net worth of \$200,000 or less and the judgment is equal to more than 10 percent of her net worth, all defendants are jointly and severally liable for the uncollectible share. *See id.* § 78u-4(f)(4).

F. Indemnification and Insurance

The Third Circuit has stated that “indemnification runs counter to the policies underlying the [Securities] and [Exchange] Acts,” found “no indication that Congress intended that indemnification be available under the Acts,” and “held that there is no implied right to seek indemnification under the federal securities laws.” *Eichenholtz v. Brennan*, 52 F.3d 478, 483-84 (3d Cir. 1995). Other federal courts have overwhelmingly agreed.³⁶¹ Courts have also held that private contracts that

³⁶⁰ *See Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1104-06 (4th Cir. 1989) (en banc); *In re Prof'l Fin. Mgmt., Ltd.*, 683 F. Supp. 1283, 1285-86 (D. Minn. 1988).

³⁶¹ *See, e.g., In re U.S. Oil & Gas Litig.*, 967 F.2d 489, 495 (11th Cir. 1992) (“Indemnification claims are not cognizable under the Securities Acts of 1933 and 1934.”); *First Golden Bancorporation v. Weiszmann*, 942 F.2d 726, 728-29 (10th Cir. 1991) (“Courts have rejected indemnity for a variety of securities violations because indemnity contravened ‘the public policy enunciated by the federal securities laws.’”); *Riverhead Sav. Bank v. Nat'l Mortg. Equity Corp.*, 893 F.2d 1109, 1116 (9th Cir. 1990) (“Indemnification is not available under federal securities laws.”); *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1105 (4th Cir. 1989) (stating that recognizing “a right of action for indemnification would frustrate [§12(a)(2)]’s goal of encouraging diligence and discouraging negligence in securities transactions”); *King v. Gibbs*, 876 F.2d 1275, 1281 (7th Cir. 1989) (“[T]here is nothing in the language of Section 10(b) or Rule 10b-5 from which the right to indemnification can be inferred,” “nor is there any indication in the extensive legislative history surrounding the 1934 Act that Congress intended that indemnification be available under the statute.”); *cf. Arden Way As-*

provide for indemnification, a common feature in securities underwriting agreements, for example, are unenforceable with respect to violations of the federal securities laws—at least where the party seeking indemnification engaged in *knowing* misconduct.³⁶²

No similar prohibitions attach to the use of insurance for liabilities under the securities laws, and nothing prevents repayment of the expenses of a successful defense of a suit under the securities laws.

socs. v. Boesky, 664 F. Supp. 863, 865 (S.D.N.Y. 1987) (finding indemnification available if liability is vicarious or imputed); *Thomas v. Duralite Co.*, 386 F. Supp. 698, 727-28 (D.N.J. 1974) (permitting indemnification action by employer against violating employee), *aff'd in part, vacated in part on other grounds*, 524 F.2d 577 (3d Cir. 1975); *deHaas v. Empire Petroleum Co.*, 286 F. Supp. 809, 816 (D. Colo. 1968) (same), *aff'd in part, vacated in part on other grounds*, 435 F.2d 1223 (10th Cir. 1970).

³⁶² In *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), the Second Circuit refused to “tolerate indemnity” in a case “where the underwriter [had] committed a sin graver than ordinary negligence,” because doing so “would encourage flouting the policy of the common law and the Securities Act.” Other federal courts have extended the holding in *Globus* to deny contractual indemnification to securities defendants that were merely negligent. See, e.g., *Eichenholtz v. Brennan*, 52 F.3d 478, 484-85 (3d Cir. 1995) (holding that “th[e] policy against allowing indemnification extends to violations . . . where the underwriter is merely negligent in the performance of his duties”); *Franklin v. Kaypro Corp.*, 884 F.2d 1222, 1232 (9th Cir. 1989) (stating that “contractual indemnity clauses” “are invalid because they are against the policy” of § 11(f)); *Credit Suisse First Boston, LLC v. Intershop Comm ’cns AG*, 407 F. Supp. 2d 541, 547 (S.D.N.Y. 2006) (“[C]ourts in this district and elsewhere readily extend *Globus*’s reasoning to preclude indemnification in cases involving negligent misrepresentations.”). One district court, however, has held that “with regard to Section 12(a) liability,” where “defendants may be found liable although not found to have been actively attempting to defraud plaintiffs,” a party “may recover indemnity” from its co-defendants “if the [other] defendants are found significantly more liable for the violation.” *Adalman v. Baker, Watts & Co.*, 599 F. Supp. 752, 754-55 (D. Md. 1984), *aff'd in part and rev'd in part on other grounds*, 807 F.2d 359 (4th Cir. 1986).