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FROM CONCEIVABLE TO IMPOSSIBLE: THE HURDLES PLAINTIFFS MUST OVERCOME WHEN PLEADING SECTION 11 AND SECTION 12(A) SECURITIES CLAIMS

INTRODUCTION

After the stock market crashed in 1929, Congress took measures to protect investors in securities markets.¹ Concerned about manipulation and deception in these markets,² and based on President Roosevelt's New Deal platform,³ Congress enacted the Securities Act of 1933 (Securities Act)⁴ and the Securities Exchange Act of 1934 (Exchange Act),⁵ which regulate securities markets through mandatory disclosure.⁶ In order to ensure accurate disclosures,⁷ this new legislation included a number of measures—among them, § 10(b) of the Exchange Act (§ 10(b)), and § 11 and § 12(a) of the Securities Act (§ 11 and § 12(a), respectively).⁸

Section 10(b) makes it unlawful to “use or employ” any manipulation or deception in connection with the purchase or sale of securities.⁹ Pursuant to this section, the Securities and Exchange Commission (SEC) promulgated Rule 10b-5, which describes the range of conduct prohibited by § 10(b).¹⁰ In 1971, the Supreme Court established a private right of action against those who engaged in conduct prohibited by Rule 10b-5.¹¹ Plaintiffs in these private securities actions must state their claims of fraud with particularity, per Rule 9(b) of the Federal Rules of Civil Procedure (FRCP)¹² and, after 1995, § 21D(b)(1) of the Private Securities Litigation Reform Act (PSLRA).¹³

Unlike § 10(b), which requires some form of fraudulent intent,¹⁴ § 11 and § 12(a) impose strict liability for material misstatements.¹⁵ Specifically,

1. See Ronald J. Colombo, *Cooperation with Securities Fraud*, 61 ALA. L. REV. 61, 65 (2009).

2. See *id.* at 65–66.

3. See *id.* at 65.

4. Ch. 38, 48 Stat. 74 (current version at 15 U.S.C. §§ 77a–77aa (2006)).

5. Ch. 404, 48 Stat. 881 (current version at 15 U.S.C. §§ 78a–78mm (2006)).

6. See Colombo, *supra* note 1.

7. See *id.*

8. Securities Act of 1933 §§ 11, 12(a), 15 U.S.C. §§ 77k, 77l(a) (2006); Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006).

9. 15 U.S.C. § 78j(b).

10. See 17 C.F.R. § 240.10b-5 (2010); Colombo, *supra* note 1, at 66.

11. Colombo, *supra* note 1, at 67 (citation omitted).

12. FED. R. CIV. P. 9(b).

13. Private Securities Litigation Reform Act of 1995 § 21D(b)(1), 15 U.S.C. § 78u-4(b)(1) (2006). The Supreme Court further heightened the level of specificity with which a plaintiff must allege securities fraud through its interpretation of provisions of the PSLRA in both *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 346 (2005), and *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007).

14. See 15 U.S.C. § 78j(b).

15. See Securities Act of 1933 §§ 11, 12(a), 15 U.S.C. §§ 77k, 77l(a) (2006).

§ 11 creates civil liabilities for false information contained in a registration statement.¹⁶ Likewise, § 12(a) establishes civil liabilities against those who offer or sell securities based on untrue statements of material facts contained in prospectuses¹⁷ and other communications.¹⁸ Neither § 11 nor § 12(a) requires scienter;¹⁹ a plaintiff must only show that the untrue statements were material.²⁰ However, while no intent on the part of the defendant is required for claims arising under § 11 and § 12(a), courts have often applied the heightened pleading standards necessary for a § 10(b) action to § 11 and § 12(a) claims.²¹

Furthermore, recent Supreme Court decisions, *Bell Atlantic Corp. v. Twombly* and *Ashcroft v. Iqbal*, have increased the burden of pleading on plaintiffs in all civil suits, making it exceedingly difficult for private securities claims to survive a motion to dismiss under Rule 12(b)(6) of the FRCP (Rule 12(b)(6) motion).²² Previously, a pleading demonstrating that an alleged claim was conceivable based on a set of facts would suffice.²³ However, after *Twombly* and *Iqbal*, plaintiffs must show that allegations are at least plausible according to the pled facts.²⁴ While the PSLRA was

16. *See id.* § 77k. Per § 2(a)(8) (and by reference, § 6) of the Securities Act, a “registration statement” is a statement filed with the SEC in connection with the registration of securities. *See id.* §§ 77b(a)(8), 77f.

17. In general, a “prospectus” is “any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security.” *Id.* § 77b(a)(10).

18. *See id.* § 77l(a).

19. Scienter is the “mental state embracing intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193–94 n.12 (1976). *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) (“If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his prima facie case.”); *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 659 (S.D.N.Y. 2004) (“Section 12 turns on status, not scienter: It imposes liability without requiring ‘proof of either fraud or reliance.’” (quoting *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 582 (1995))).

20. *See* discussion *infra* Parts I.B–C. *See also infra* note 34 and accompanying text.

21. *See, e.g., Rombach v. Chang*, 355 F.3d 164, 170–71 (2d Cir. 2004); *In re Bare Escentuals, Inc. Sec. Litig.*, No. C 09-3268 PJH, 2010 WL 3893622, at *13 (N.D. Cal. Sept. 30, 2010).

22. *See generally* FED. R. CIV. P. 12(b)(6); *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

23. *See Conley v. Gibson*, 355 U.S. 41, 45–46 (1957).

24. *See Iqbal*, 129 S. Ct. at 1944; *Twombly*, 550 U.S. at 570.

[After *Twombly* and *Iqbal*,] pleadings must undergo a test not for factual detail, but for factual . . . convincingness. . . . Because plausibility requires the plaintiff to plead particularized facts and maybe even some evidence, the federal pleading product will usually not look much different from a complaint in a heightened-fact-pleading regime.

Kevin M. Clermont & Stephen C. Yeazell, *Inventing Tests, Destabilizing Systems*, 95 IOWA L. REV. 821, 832–33 (2010).

[P]lausibility is not simply a measure of whether the plaintiff has created a permissible inference; rather, it is a freestanding inquiry into whether the pleader’s claims *in toto* are plausible. Thus, even in a case in which plaintiff has averred direct evidence of his entitlement to relief, the court would still consider whether he has made out a plausible claim.

enacted to prevent plaintiffs from bringing frivolous suits that could both harm the reputation of innocent defendants and incentivize some defendants to settle—given the cost of litigating an otherwise frivolous claim²⁵—lower courts have used the heightened pleading standard set forth in *Twombly* and *Iqbal* to summarily dismiss securities claims for inadequacies in pleading prior to the opportunity for discovery.²⁶

It is this note's position that the application of § 10(b) fraud pleading standards and of the *Twombly* and *Iqbal* decisions to § 11 and § 12(a) claims creates an exceedingly strict pleading standard for plaintiffs to overcome. An analysis of recent court decisions, current trends in securities litigation, and limitations imposed by the provisions of these sections will highlight the significance of these changes to the pleading standards for § 11 and § 12(a) claimants. Ultimately, this note will suggest possible solutions to prevent these claims from being summarily dismissed by Rule 12(b)(6) motions.

Part I of this note will address the courts' application of pleading standards for § 10(b)/Rule 10b-5 claims to § 11 and § 12(a) claims when the claims "sound in fraud." The court's use of the heightened pleading standard of plausibility from *Twombly* and *Iqbal* to summarily dismiss cases before plaintiffs have had any opportunity for discovery will be explored in Part II. Part III will analyze the significance of these heightened pleading standards—presented in connection with § 10(b)/Rule 10b-5 claims and by *Twombly* and *Iqbal*—on the ability of private litigants to seek relief under § 11 and § 12(a). Finally, Part IV will propose remedies which may assist § 11 and § 12(a) claimants in their efforts to survive dismissal.

I. APPLYING § 10(B)/RULE 10B-5 PLEADING STANDARDS TO § 11 AND § 12(A) CLAIMS

Section 10(b) of the Exchange Act makes it illegal to manipulate or deceive others in connection with the purchase or sale of securities.²⁷ In order to bring a suit under § 10(b) for manipulative or deceptive conduct, a plaintiff must plead that the defendant acted with fraudulent intent,²⁸ and as necessary for any complaint of fraud, her plea must be stated with particularity, as required by Rule 9(b) of the FRCP.²⁹ Differing from § 10(b), § 11 and § 12(a) of the Securities Act impose strict liability for material misstatements; no intent to deceive is required.³⁰ However, the vast

Allan R. Stein, *Confining Iqbal*, 45 TULSA L. REV. 277, 292 (2009).

25. See H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.).

26. See, e.g., *Detroit Gen. Ret. Sys. v. Medtronic, Inc.*, 621 F.3d 800, 804–05 (8th Cir. 2010); *Panther Partners Inc. v. Ikanos Commc'ns, Inc.*, 347 F. App'x 617, 619 (2d Cir. 2009); *South Cherry St., LLC v. Hennessee Grp. LLC*, 573 F.3d 98, 110–11 (2d Cir. 2009).

27. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006).

28. See *infra* note 35 and accompanying text.

29. FED. R. CIV. P. 9(b).

30. See Securities Act of 1933 §§ 11, 12(a), 15 U.S.C. §§ 77k, 77l(a) (2006).

majority of the circuit courts in the United States have applied the fraud pleading standards to § 11 and § 12(a) claims when a claim under § 10(b) is also alleged in the complaint.³¹

A. SECTION 10(B) OF THE EXCHANGE ACT

Section 10(b) makes it “unlawful . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance.”³² In order to succeed with a § 10(b) claim, a plaintiff must prove materiality, scienter, a purchase or sale of a security, reliance, and causation of an economic loss.³³ In *TSC Industries, Inc. v. Northway, Inc.*, the Supreme Court set the general standard of materiality: “[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.”³⁴ The plaintiff must also prove the defendant’s scienter—i.e. the “mental state embracing intent to deceive, manipulate or defraud.”³⁵ The PSLRA requires the pleading to provide a “strong inference” of the defendant’s necessary intent.³⁶ In addition, § 10(b) requires that the manipulation or deception be used “in connection with the purchase or sale of [a] security” for the section to apply.³⁷ Furthermore, to satisfy reliance, the plaintiff must demonstrate that she justifiably relied on the false information provided by the defendant.³⁸ Finally, the plaintiff then needs to

31. See discussion *infra* Part I.D.

32. 15 U.S.C. § 78j(b). From § 10(b), the SEC promulgated Rule 10b-5, which describes the range of conduct prohibited by § 10(b). See 17 C.F.R. § 240.10b-5 (2010); Colombo, *supra* note 1, at 66.

33. See *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005). See also Michael J. Kaufman & John M. Wunderlich, *Resolving the Continuing Controversy Regarding Confidential Informants in Private Securities Fraud Litigation*, 19 CORNELL J.L. & PUB. POL’Y 637, 642 (2010).

34. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

35. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193–94 n.12 (1976).

36. Private Securities Litigation Reform Act of 1995 § 21D(b)(2), 15 U.S.C. § 78u-4(b)(2) (2006). Section 21D(b)(2) of the PSLRA states the following:

In any private action arising under this chapter in which the plaintiff may recover money damages only on 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.

In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the Supreme Court recently interpreted the meaning of “strong inference” in § 21D(b)(2) of the PSLRA. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007) (“To qualify as ‘strong’ within the intendment of § 21D(b)(2), [the Supreme Court held that] an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.”).

37. 15 U.S.C. § 78j(b).

38. See *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988). In *Basic*, the Supreme Court articulated the “fraud on the market theory” of reliance. *Id.* at 241–42.

prove loss causation—i.e. the plaintiff suffered a loss as a result of the defendant’s false statements.³⁹

B. SECTION 11 OF THE SECURITIES ACT

Section 11 imposes civil liabilities for untrue information contained in a registration statement.⁴⁰ It establishes a cause of action where a registration statement “contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading.”⁴¹ Liability for such false information does not fall only on the issuer of the registration statement.⁴² Rather, in addition to bringing an action against the issuer, the person acquiring securities in connection with the inaccurate information contained in the registration statement can sue: (1) “every person who signed the registration

Succinctly put:

“The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendant’s fraud and the plaintiffs’ purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.”

Id. (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986)). *See also In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006); *Asher v. Baxter Int’l Inc.*, 377 F.3d 727, 731–32 (7th Cir. 2004); Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 CORNELL L. REV. 907, 917–22 (1989). *See generally* Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059 (1990).

39. *See Basic*, 485 U.S. at 243 (discussing how loss causation is the “requisite causal connection between a defendant’s misrepresentation and a plaintiff’s injury”). The Supreme Court has recently further clarified what “loss causation” entails. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 342–47 (2005). Thus, in fraud on the market cases,

an inflated purchase price will not itself constitute or proximately cause the relevant economic loss. . . .

. . .

Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss. It may prove to be a necessary condition of any such loss, and in that sense one might say that the inflated purchase price suggests that the misrepresentation . . . “touches upon” a later economic loss. . . . But, even if that is so, it is insufficient. To “touch upon” a loss is not to *cause* a loss, and it is the latter that the law requires.

Id. at 342–43. Ultimately, in *Dura*, the Supreme Court held that the plaintiff must “provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind”—i.e. § 21D(b)(4) of the PSLRA requires a plaintiff to plead loss causation, rather than prove it throughout the course of the lawsuit. *See id.* at 347; 15 U.S.C. § 78u-4(b)(4) (2006).

40. *See* Securities Act of 1933 § 11, 15 U.S.C. § 77k (2006).

41. *Id.* § 77k(a).

42. *See id.*

statement” (e.g. officers of the issuer); (2) every director of or partner in the issuer; (3) “every accountant, engineer, or appraiser, or [other professional] . . . who has . . . certified any [information] . . . which is used in connection with the registration statement”; and (4) “every underwriter.”⁴³

Furthermore, under § 11, the plaintiff need not prove any intent on the defendant’s part.⁴⁴ The Supreme Court has held that “[i]f a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his prima facie case.”⁴⁵ When determining materiality, courts consider whether the information would have misled a “reasonable investor” in evaluating the investment.⁴⁶ In addition, the plaintiff must show that the securities were, in fact, purchased pursuant to the allegedly misleading registration statement.⁴⁷ To do so, circuit courts have held “that the plaintiff must directly trace his or her security to the allegedly defective registration statement at issue in the case.”⁴⁸ Moreover, while § 11 imposes civil liability on essentially any person connected to the registration statement⁴⁹ and requires no intent,⁵⁰ the damages that a plaintiff can recover under the statute are limited to the difference between the purchase price of the securities and either the price at which the plaintiff sold the securities or the value of the securities at the time of the suit.⁵¹ Section 11 claims can also only be brought up to one year after the discovery of the untrue statement or one year after the point in time when a reasonably diligent person would have discovered the misstatement.⁵²

C. SECTION 12(A) OF THE SECURITIES ACT

Section 12(a) creates civil liabilities against any person who offers securities “by means of a prospectus or oral communication” which contains an “untrue statement of a material fact or omits to state a material fact necessary in order to make the statements . . . not misleading.”⁵³ Similar to § 11, securities litigants bringing actions under § 12(a) do not

43. *Id.*

44. *See id.* § 77k. *See also* Lee v. Ernst & Young, LLP, 294 F.3d 969, 977 (8th Cir. 2002).

45. Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983).

46. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., 936 F.2d 759, 761 (2d Cir. 1991). *See also* Akerman v. Oryx Commc’ns, Inc., 609 F. Supp. 363, 367 (S.D.N.Y. 1984).

47. *See* 15 U.S.C. § 77k; *Lee*, 294 F.3d at 977.

48. *Lee*, 294 F.3d at 977. *See* DeMaria v. Andersen, 318 F.3d 170, 176 (2d Cir. 2003).

49. *See* 15 U.S.C. § 77k.

50. *See id.*; *Lee*, 294 F.3d at 977.

51. 15 U.S.C. § 77k(e).

52. *Id.* § 77m.

53. *Id.* § 77l(a).

need to prove the defendant's scienter.⁵⁴ The plaintiff simply must demonstrate that the untrue information would be material to a "reasonable investor."⁵⁵ As with § 11, § 12(a) limits the remedies available to the rescission of the purchase of securities, or if the purchase cannot be rescinded (i.e. the purchaser no longer owns the shares), then rescissory damages.⁵⁶ Section 12(a) claims can also only be brought up to one year after the inaccurate information was discovered, or should reasonably have been discovered.⁵⁷

Nonetheless, § 12(a) differs from § 11 in two significant ways. First, under § 12(a), the purchaser can only sue the "seller" of the securities.⁵⁸ Whereas § 11 allows the purchaser to bring an action against any person who may be connected to the registration statement,⁵⁹ § 12(a) limits the litigious scope to those who "either passed title to the securities or solicited the sale of the securities."⁶⁰ Some courts have interpreted this definition broadly, holding that a "purchaser must demonstrate direct and active participation in the solicitation of the immediate sale to hold the issuer liable as a § 12(2) seller."⁶¹ However, most courts take a narrower view, requiring the defendant to have "directly communicate[d]" with the plaintiff-buyer.⁶²

Second, § 12(a) allows only those purchasers in direct privity with the seller to sue.⁶³ As a result, secondary market purchasers have no cause of action against the initial seller.⁶⁴ Likewise, depending on how many of the initial purchasers sell their securities in the market for profit, there may be relatively few plaintiffs who could actually sue under § 12(a).⁶⁵ These differences may be explained by the distinct scope of § 11 and § 12(a).⁶⁶

54. See *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 659 (S.D.N.Y. 2004) ("Section 12 turns on status, not scienter: It imposes liability without requiring 'proof of either fraud or reliance.'" (quoting *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 582 (1995))).

55. See *Rombach v. Chang*, 355 F.3d 164, 178 n.11 (2d Cir. 2004) (citing *I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co.*, 936 F.2d 759, 761 (2d Cir. 1991)) ("The test for whether a statement is materially misleading under Section 12(a)(2) is identical to that under Section 10(b) and Section 11: whether representations, viewed as a whole, would have misled a reasonable investor.").

56. 15 U.S.C. § 77l(a).

57. *Id.* § 77m.

58. *Id.* § 77l(a).

59. *Id.* § 77k.

60. *In re Metro. Sec. Litig.*, 532 F. Supp. 2d 1260, 1295 (E.D. Wash. 2007) (citing *Moore v. Kayport Package Exp., Inc.*, 885 F.2d 531, 537 (9th Cir. 1989); *Pinter v. Dahl*, 486 U.S. 622, 643 (1988)).

61. *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 636 (3d Cir. 1989) (citing *Moore*, 885 F.2d at 536–37).

62. See *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 871 (5th Cir. 2003).

63. See 15 U.S.C. § 77l(a); Michele Odorizzi, *Liability for Securities Law Violations*, 1757 *PLI/CORP.* 163, 176 (2009).

64. See 15 U.S.C. § 77l(a); Odorizzi, *supra* note 63.

65. See Odorizzi, *supra* note 63.

66. See 15 U.S.C. §§ 77k, 77l(a).

While liability under § 11 is limited to material misstatements or omissions in a particular offering document, a registration statement,⁶⁷ § 12(a) focuses on misrepresentations made by a certain party, the seller.⁶⁸ Thus, the requirements of direct and active communication by, and direct privity with, the seller are necessary to prevent the seller from facing liability to individuals with whom the seller had no direct communication or direct privity.⁶⁹

D. CROSS-APPLYING THE § 10(B) PLEADING STANDARDS TO § 11 AND § 12(A) CLAIMS

Since neither § 11 nor § 12(a) involve an element of fraud,⁷⁰ complaints filed under these sections typically need to meet the pleading standards contained in Rule 8 of the FRCP.⁷¹ However, when these claims accompany a § 10(b)/Rule 10b-5 claim, many courts will require these claims to satisfy Rule 9(b) of the FRCP, as well as § 21D(b)(1) of the PSLRA, which are typically applied to § 10(b) cases.⁷² In these instances, the courts contend that the § 11 and § 12(a) claims “sound in fraud,” and thus, should be evaluated using the heightened pleading standards applicable to § 10(b) to survive.⁷³ Only the Eighth Circuit Court of Appeals finds it improper to apply the heightened pleading standards to § 11 and § 12(a) claims because these claims do not require any element of fraud in order to establish liability.⁷⁴ The Eight Circuit contends that a “pleading standard which requires a party to plead particular facts to support a cause of action that does not include fraud or mistake as an element comports neither with

67. *Id.* § 77k.

68. *Id.* § 77l(a).

69. *See id.*; *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 871 (5th Cir. 2003); *Odorizzi*, *supra* note 63.

70. *See supra* note 19 and accompanying text.

71. *See, e.g.*, *Panther Partners Inc. v. Ikanos Commc'ns, Inc.*, 347 F. App'x 617, 619–21 (2d Cir. 2009) (evaluating plaintiff's § 11 and § 12(a) claims “under Rule 8, not Rule 9(b), because [the] plaintiff allege[d] negligent preparation of the registration statement and prospectus, rather than fraudulent preparation.” (citing *Rombach v. Chang*, 355 F.3d 164, 171, 178 (2d Cir. 2004))).

72. *See, e.g.*, *Ind. State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935, 948 (6th Cir. 2009), *cert. denied*, 2010 WL 5638596 (Nov. 5, 2010); *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618, 629 (4th Cir. 2008); *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 68 (1st Cir. 2008); *Wagner v. First Horizon Pharm. Corp.*, 464 F.3d 1273, 1277 (11th Cir. 2006); *In re Daou Sys., Inc.*, 411 F.3d 1006, 1027–28 (9th Cir. 2005); *Rombach v. Chang*, 355 F.3d 164, 171 (2d Cir. 2004); *Cal. Pub. Employees' Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 160–61 (3d Cir. 2004). *Cf. Lone Star Ladies Inv. Club v. Schlotsky's Inc.*, 238 F.3d 363, 368–69 (5th Cir. 2001); *Sears v. Likens*, 912 F.2d 889, 892–93 (7th Cir. 1990). *But see Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1251–52 (10th Cir. 1997).

73. *See cases cited supra* note 72.

74. *See In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 314 (8th Cir. 1997) (“[T]he particularity requirement of Rule 9(b) does not apply to claims under § 11 of the Securities Act, because proof of fraud or mistake is not a prerequisite to establishing liability under § 11.”).

Supreme Court precedent nor with . . . the Federal Rules of Civil Procedure.”⁷⁵

II. SECTION 11 AND SECTION 12(A) PLEADING STANDARDS FOLLOWING *TWOMBLY* AND *IQBAL*

In *Twombly* and *Iqbal*, the Supreme Court heightened the pleading burden in all civil suits, requiring that the pled facts support allegations that are not only conceivable but plausible.⁷⁶ This shift to plausibility has made surviving a Rule 12(b)(6) motion to dismiss increasingly difficult for private securities claims.⁷⁷ While many securities claims already face heightened pleading standards—under Rule 9(b) of the FRCP⁷⁸ and under § 21D(b)(1) of the PSLRA⁷⁹—this change from conceivability to plausibility has both confused the courts⁸⁰ and led them to summarily dismiss securities claims for inadequacies in pleading prior to affording the plaintiff an opportunity for discovery.⁸¹

A. PRE-*TWOMBLY* PLEADING STANDARD

1. *Conley v. Gibson*

Prior to *Twombly*, the standard for pleading was “notice pleading,” set by the Court in *Conley v. Gibson*.⁸² In *Conley*, African-American employees of the Texas and New Orleans Railroad brought an action against their union, the Brotherhood of Railway and Steamship Clerks, alleging that the union had failed to adequately represent them relative to other union members.⁸³ The union filed a motion to dismiss for failure to state a claim for which relief can be granted.⁸⁴ The District Court for the Southern District of Texas granted the motion, and the Fifth Circuit Court of Appeals affirmed the decision.⁸⁵

75. *Id.* at 315.

76. See *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

77. See discussion *infra* Part III.A.

78. FED. R. CIV. P. 9(b).

79. Private Securities Litigation Reform Act of 1995 § 21D(b)(1), 15 U.S.C. § 78u-4(b)(1) (2006).

80. See, e.g., Geoffrey P. Miller, *Preliminary Judgments*, 2010 U. ILL. L. REV. 165, 191 (2010). See generally Stephen B. Burbank, *Pleading and the Dilemmas of “General Rules,”* 2009 WIS. L. REV. 535; Clermont & Yeazell, *supra* note 24; Patricia W. Hatamyar, *The Tao of Pleading: Do Twombly and Iqbal Matter Empirically?*, 59 AM. U. L. REV. 553 (2010); Stein, *supra* note 24; John P. Sullivan, *Twombly and Iqbal: The Latest Retreat from Notice Pleading*, 43 SUFFOLK U. L. REV. 1 (2009).

81. See discussion *infra* Part III.A.

82. See *Conley v. Gibson*, 355 U.S. 41, 47 (1957).

83. See *id.* at 43.

84. See *id.*

85. See *id.* at 43–44.

On appeal, the Supreme Court reversed the ruling.⁸⁶ With respect to the adequacy of the complaint, the Court held that a motion to dismiss should not be granted “unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.”⁸⁷ However, “the Federal Rules of Civil Procedure do not require a claimant to set out in detail the facts upon which he bases his claim.”⁸⁸ Instead, “all the Rules require is ‘a short and plain statement of the claim’ that will give the defendant fair notice of what the plaintiff’s claim is and the grounds upon which it rests.”⁸⁹ The standard of “notice pleading” afforded plaintiffs the opportunity for discovery as long as they could conceivably prove the facts underlying their claims.⁹⁰

2. Rule 9(b) of the FRCP

Until recently in *Iqbal*, *Conley*’s “notice pleading” applied generally to all civil actions.⁹¹ However, for cases involving fraud, the FRCP prescribed a greater burden on plaintiffs’ pleadings.⁹² Rule 9(b) of the FRCP requires that, “[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.”⁹³ This increased level of specificity offers assurance that the plaintiff has at least some factual basis when alleging fraud.⁹⁴

3. Section 21D(b)(1) of the PSLRA

While Rule 9(b) of the FRCP does apply to securities fraud cases, Congress enacted certain provisions of the PSLRA pertaining to the particularity necessary for securities fraud claims.⁹⁵ Concerned about abusive litigation practices, Congress sought to protect investors and safeguard capital markets from the impact of frivolous lawsuits.⁹⁶

86. *See id.* at 48.

87. *Id.* at 45–46.

88. *Id.* at 47.

89. *Id.* (quoting FED. R. CIV. P. 8(a)(2)).

90. *See id.* at 47–48.

91. *See Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007); *Conley*, 355 U.S. 41.

92. *See* FED. R. CIV. P. 9(b).

93. *Id.*

94. *See Miller*, *supra* note 80, at 189–90.

95. *See* Private Securities Litigation Reform Act of 1995 § 21D(b)(1)–(2), 15 U.S.C. § 78u-4(b)(1)–(2) (2006).

96. *See* H.R. REP. NO. 104-369, at 31 (1995) (Conf. Rep.).

The House and Senate Committees heard evidence that abusive practices committed in private securities litigation include: (1) the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer’s stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action; (2) the targeting of deep pocket defendants, including accountants, underwriters, and

Specifically, § 21D(b)(1) requires that a securities fraud complaint “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, the complaint shall state with particularity all facts on which that belief is formed.”⁹⁷ Unlike Rule 9(b), which mandates particularity in a complaint generally,⁹⁸ § 21D(b)(1) of the PSLRA demands particularity with respect to specific elements of a securities fraud allegation.⁹⁹ Even so, the Supreme Court’s interpretation of the PSLRA is even more restrictive and burdensome to the plaintiff when pleading.¹⁰⁰

B. *BELL ATLANTIC CORP. v. TWOMBLY*

Bell Atlantic Corp. v. Twombly overturned fifty years of judicial precedent concerning “notice pleading.”¹⁰¹ In *Twombly*, consumers filed a class action lawsuit against “incumbent local exchange carriers” (ILECs) for allegedly engaging in activities that violated the Sherman Antitrust Act.¹⁰² The complainants argued that the ILECs conspired to restrict trade activities in two ways: (1) the ILECs “engaged in parallel conduct” to limit the growth of “competitive local exchange carriers” (CLECs); and (2) the ILECs agreed to not compete with one another.¹⁰³

The District Court for the Southern District of New York dismissed the action for failure to state a claim for which relief can be granted.¹⁰⁴ Even though there was parallel business behavior among the ILECs, the district court held that “allegations of parallel business conduct, taken alone, do not state a claim under [the Sherman Antitrust Act]; plaintiffs must allege additional facts that ‘ten[d] to exclude independent self-interested conduct as an explanation for defendants’ parallel behavior.”¹⁰⁵ The plaintiffs appealed, and the Second Circuit Court of Appeals reversed the district court’s decision, finding that it had applied the wrong standard when

individuals who may be covered by insurance, without regard to their actual culpability; (3) the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle; and (4) the manipulation by class action lawyers of the clients whom they purportedly represent.

Id.

97. 15 U.S.C. § 78u-4(b)(1).

98. FED. R. CIV. P. 9(b).

99. 15 U.S.C. § 78u-4(b)(1).

100. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007) (clarifying § 21D(b)(2) of the PSLRA); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 342–43 (2005) (interpreting § 21D(b)(4) of the PSLRA).

101. See *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

102. See *id.* at 548–50.

103. *Id.* at 550–51.

104. See *id.* at 552.

105. *Id.* (quoting *Twombly v. Bell Atl. Corp.*, 313 F. Supp. 2d 174, 179 (S.D.N.Y. 2003)).

evaluating the complaint.¹⁰⁶ The Second Circuit stated, “to rule that allegations of parallel anticompetitive conduct fail to support a plausible conspiracy claim, a court would have to conclude that there is no set of facts that would permit a plaintiff to demonstrate that the particular parallelism asserted was the product of collusion rather than coincidence.”¹⁰⁷

On appeal, the Supreme Court reversed the Second Circuit’s ruling.¹⁰⁸ In the majority opinion, Justice Souter considered what must be pled under Rule 8(a)(2) of the FRCP.¹⁰⁹ Rejecting “notice pleading” as outdated,¹¹⁰ Souter argued that the Court does “not require heightened fact pleading of specifics, but only enough facts to state a claim to relief that is plausible on its face.”¹¹¹ However, the Court was careful to note that a plausible basis does not equate to a probability standard.¹¹² Justice Stevens dissented, commenting that “[w]hether the Court’s action will benefit only defendants in antitrust treble-damages cases, or whether its test for the sufficiency of a complaint will inure to the benefit of all civil defendants, is a question that the future will answer.”¹¹³

C. PRE-*IQBAL* SECURITIES CASES APPLYING *TWOMBLY*

In *Twombly*, the Supreme Court did not articulate whether the holding applied to all cases, or just antitrust cases.¹¹⁴ Amid this ambiguity, some courts began applying the plausibility standard from *Twombly* to securities cases.¹¹⁵ Fewer than two months after the Court decided *Twombly*, the Second Circuit Court of Appeals, citing the case, required a plaintiff bringing a securities fraud action to “provide the grounds upon which his claim rests through factual allegations sufficient ‘to raise a right to relief above the speculative level.’”¹¹⁶ This language by itself does not necessarily

106. *Id.*

107. *Id.* at 553 (quoting *Twombly v. Bell Atl. Corp.*, 425 F.3d 99, 114 (2d Cir. 2005)).

108. *Id.*

109. *Id.* at 557.

110. *See id.* at 561–63.

111. *Id.* at 570.

112. *See id.* at 556.

113. *Id.* at 596 (Stevens, J., dissenting).

114. *See id.*

115. *See, e.g., Stark Trading v. Falconbridge Ltd.*, 552 F.3d 568 (7th Cir. 2009); *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618 (4th Cir. 2008); *ATSI Commc’ns v. Shaar Fund, Ltd.*, 493 F.3d 87 (2d Cir. 2007); *Coronel v. Quanta Capital Holdings Ltd.*, No. 07 Civ. 1405 (RPP), 2009 WL 174656 (S.D.N.Y. Jan. 26, 2009); *In re Scottish Re Group Sec. Litig.*, 524 F. Supp. 2d 370 (S.D.N.Y. 2007).

116. *ATSI*, 493 F.3d at 98 (quoting *Twombly*, 550 U.S. at 555). Two judges in the Southern District of New York also applied the *Twombly* standard to securities fraud claims. *See Coronel*, 2009 WL 174656, at *10; *Scottish Re Group*, 524 F. Supp. 2d at 382. Interestingly, *Coronel* applies Rule 8 of the FRCP to § 11 and § 12(a) claims whereas *Scottish Re Group* applies Rule 9(b) of the FRCP to § 11 and § 12(a) claims. *Compare Coronel*, 2009 WL 174656, at *12.

suggest that the court was adopting the plausibility standard.¹¹⁷ However, in a footnote which cites the circuit court opinion in *Iqbal*, the Second Circuit commented that it was reading the plausibility standard as applicable beyond antitrust cases.¹¹⁸ In the two years after *Twombly*, the Fourth Circuit and the Seventh Circuit also interpreted *Twombly* as reaching beyond the scope of antitrust.¹¹⁹

D. *ASHCROFT V. IQBAL*

Following the *Twombly* decision, it was unclear whether the “plausible” pleading standard applied outside the antitrust context.¹²⁰ *Ashcroft v. Iqbal*

A plaintiff may establish Section 11 and 12(a)(2) claims by alleging only negligence. . . . Where the underlying allegations sound solely in negligence, the applicable pleading standard is set forth in Rule 8(a), under which, a “complaint is sufficient if it alleges [plausible grounds] that the registration statement contains a material misstatement or omission.”

Id. (quoting *In re Initial Pub. Offering Sec. Litig.*, 358 F. Supp. 2d 189, 206 (S.D.N.Y. 2004)), with *Scottish Re Group*, 524 F. Supp. 2d at 387 (“Although fraud ‘is not an element or a requisite to a claim under Section 11 or Section 12(a)(2),’ those claims ‘may be—and often are—predicated on fraud.’ In such circumstances, Rule 9(b), which applies to ‘all averments of fraud,’ will be applied.”) (quoting *Rombach v. Chang*, 355 F.3d 164, 171 (2d Cir. 2004)).

117. *See, e.g., ATSI*, 493 F.3d at 98 (holding that “[t]o survive dismissal, the plaintiff must provide the grounds upon which his claim rests through factual allegations sufficient ‘to raise a right to relief above the speculative level’”) (quoting *Twombly*, 550 U.S. at 555).

118. Footnote 2 in *ATSI* reads as follows:

We have declined to read *Twombly*’s flexible “plausibility standard” as relating only to antitrust cases. . . . “Some of [*Twombly*’s] language relating generally to Rule 8 pleading standards seems to be so integral to the rationale of the Court’s parallel conduct holding as to constitute a necessary part of that holding.”

ATSI, 493 F.3d at 98 n.2 (citing *Iqbal v. Hasty*, 490 F.3d 143, 158 (2d Cir. 2007)).

119. *See Stark Trading*, 552 F.3d at 574 (“[T]he complaint in a complex case must, to avert dismissal for failure to state a claim, include sufficient allegations to enable a judgment that the claim has enough possible merit to warrant the protracted litigation likely to ensue from denying a motion to dismiss.”) (citing *Twombly*, 550 U.S. 544); *Cozzarelli*, 549 F.3d at 630 (“Because plaintiffs have not provided credible explanations of the falsity of these statements, we have serious doubts that plaintiffs have even ‘nudged the[se] claims across the line from conceivable to plausible,’ as required by the minimal pleading standards of Rule 8.”) (quoting *Twombly*, 550 U.S. at 570).

120. *See* Ryan Mize, Comment, *From Plausibility to Clarity: An Analysis of the Implications of Ashcroft v. Iqbal and Possible Remedies*, 58 U. KAN. L. REV. 1245, 1246 (2010).

Less than one month after *Twombly*, the Supreme Court in *Erickson v. Pardus* applied Federal Rule of Civil Procedure 8(a)(2) in traditional fashion, citing the “fair notice” standard enunciated in *Conley*. Although *Erickson* involved a pro se prisoner alleging civil rights violations, a vastly different situation than *Twombly*, the opinion’s significance was its citation of *Conley* and its ‘no set of facts’ standard after *Twombly*. However, any speculation about the significance of the Court’s reliance on *Conley* was unwarranted because courts have historically scrutinized pro se prisoners under a lower standard.

Id. (footnotes omitted).

clarified this uncertainty.¹²¹ In the case, *Javid Iqbal*, a Pakistani citizen, was arrested and detained by U.S. officials following the September 11, 2001 terrorist attacks.¹²² Iqbal brought an action against several federal officials—the Attorney General (John Ashcroft) and the Director of the Federal Bureau of Investigation, among others—alleging that these individuals had violated his constitutional rights by not affording him certain protections guaranteed by the Constitution.¹²³

The District Court for the Eastern District of New York held that the pleading was sufficient to survive a motion to dismiss.¹²⁴ The defendants filed an interlocutory appeal in the Second Circuit Court of Appeals, which affirmed the district court's judgment.¹²⁵ In a 5-4 decision,¹²⁶ the Supreme Court found the complaint to be insufficient, reversing the court below.¹²⁷

The Court described the two principles from *Twombly*: “First, the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. . . . Second, only a complaint that states a plausible claim for relief survives a motion to dismiss.”¹²⁸ Essentially, a claim possesses “facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.”¹²⁹ Furthermore, the Court also explained that the plausibility standard from *Twombly* would apply generally to all civil actions, not just in the case of antitrust allegations.¹³⁰

Justice Souter, who wrote for the majority in *Twombly*,¹³¹ dissented in *Iqbal*.¹³² In his dissent, Souter contends that the majority misapplied the plausibility standard from *Twombly* to *Iqbal*.¹³³ Under *Twombly*, a plaintiff's complaint, assuming the alleged facts are true, must only state a claim for relief which is plausible—i.e. “a plaintiff must ‘allege facts’ that, taken as true, are ‘suggestive of illegal conduct.’”¹³⁴ In *Twombly*, even though the plaintiff alleged parallel conduct, this allegation alone was not enough to plausibly amount to conspiracy under the Sherman Antitrust Act.¹³⁵ However, in *Iqbal*, if the plaintiff's pled facts were assumed to be

121. See *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009).

122. *Id.* at 1942.

123. *Id.*

124. *Id.*

125. See *id.*

126. *Id.* at 1941.

127. *Id.* at 1943.

128. *Id.* at 1949–50.

129. *Id.* at 1949.

130. See *id.* at 1953.

131. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 548 (2007).

132. *Iqbal*, 129 S. Ct. at 1954 (Souter, J., dissenting).

133. See *id.* at 1960.

134. *Id.* at 1959 (quoting *Twombly*, 550 U.S. at 564 n.8).

135. *Twombly*, 550 U.S. at 556–57.

true, the plaintiff would, in fact, have plausible ground for relief.¹³⁶ The plaintiff's allegations did not "stand alone" as "nonconclusory statements" in the complaint, as was the case in *Twombly*.¹³⁷

Justice Breyer also wrote a dissenting opinion in *Iqbal*.¹³⁸ He agreed with Souter's dissent and joined it,¹³⁹ but he wrote separately to emphasize the need for judicial economy.¹⁴⁰ Breyer believed "it important to prevent unwarranted litigation from interfering with 'the proper execution of the work of the Government.'"¹⁴¹

E. AFTERMATH OF THE *TWOMBLY* AND *IQBAL* DECISIONS

The *Twombly* and *Iqbal* decisions effectively overturned over fifty years of jurisprudence concerning conceivable pleading established in *Conley*.¹⁴² In response, members of Congress attempted to return the standard from plausibility to conceivability.¹⁴³ In the Senate, Arlen Specter introduced the Notice Pleading Restoration Act of 2009 in July 2009.¹⁴⁴ The text states:

Except as otherwise expressly provided by an Act of Congress or by an amendment to the Federal Rules of Civil Procedure which takes effect after the date of enactment of this Act, a Federal court shall not dismiss a complaint under rule 12(b)(6) or (e) of the Federal Rules of Civil

136. See *Iqbal*, 129 S. Ct. at 1960 (Souter, J., dissenting).

137. *Id.*

138. *Id.* at 1961–62 (Breyer, J., dissenting). Justice Breyer posed the following hypothetical during oral arguments:

How does—how does this work in an ordinary case? I should know the answer to this, but I don't. It's a very elementary question. Jones sues the president of Coca-Cola. His claim is the president personally put a mouse in the bottle. Now, he has no reason for thinking that. Then his lawyer says: Okay, I'm now going to take seven depositions of the president of Coca-Cola. The president of Coca-Cola says: You know, I don't have time for this; there is no basis. He's—I agree he's in good faith, but there is no basis. Okay, I don't want to go and spend the time to answer questions.

Where in the rules does it say he can go to the judge and say, judge, his lawyer will say, my client has nothing to do with this, there is no basis for it; don't make him answer the depositions, please? Where does it say that in the rules?

Transcript of Oral Argument at 13, *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009) (No. 07-1015), 2008 WL 5168391 at *5.

139. *Iqbal*, 129 S. Ct. at 1961 (Breyer, J. dissenting).

140. See *id.*

141. *Id.* (quoting *id.* at 1953 (majority opinion)).

142. See Sullivan, *supra* note 80, at 1. In *Twombly*, "the Court abandoned the fifty-year-old 'no set of facts' standard set out in *Conley v. Gibson*," and in *Iqbal*, "the Court extended the *Twombly* standard to all civil cases filed in the federal district courts." *Id.*

143. See Notice Pleading Restoration Act of 2009, S. 1504, 111th Cong. (2009); Open Access to Courts Act of 2009, H.R. 4115, 111th Cong. (2009).

144. See S. 1504.

Procedure, except under the standards set forth by the Supreme Court of the United States in *Conley v. Gibson*, 355 U.S. 41 (1957).¹⁴⁵

The Notice Pleading Restoration Act of 2009 has been referred to the Senate Judiciary Committee.¹⁴⁶ In addition, in the House, Representative Jerrold Nadler presented the Open Access to Courts Act of 2009 in November 2009.¹⁴⁷ It reads:

A court shall not dismiss a complaint under subdivision (b)(6), (c) or (e) of Rule 12 of the Federal Rules of Civil Procedure unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim which would entitle the plaintiff to relief. A court shall not dismiss a complaint under one of those subdivisions on the basis of a determination by the judge that the factual contents of the complaint do not show the plaintiff's claim to be plausible or are insufficient to warrant a reasonable inference that the defendant is liable for the misconduct alleged.¹⁴⁸

The Open Access to Courts Act of 2009 has been referred to the House Judiciary Committee and the House Judiciary, Subcommittee on Courts and Competition Policy.¹⁴⁹ While the possibility of success for these two pieces of legislation is unclear,¹⁵⁰ at the very least they demonstrate Congress' interest in returning to the *Conley* pleading standard of conceivability.¹⁵¹

III. THE SIGNIFICANCE OF HEIGHTENED PLEADING STANDARDS ON § 11 AND § 12(A) LITIGANTS

The application of § 10(b) fraud pleading standards and of the *Twombly* and *Iqbal* decisions to § 11 and § 12(a) claims makes it especially difficult for plaintiffs to survive Rule 12(b)(6) motions to dismiss.¹⁵² An analysis of recent court decisions and of current trends in securities litigation illustrates

145. *Id.*

146. Notice Pleading Restoration Act of 2009: Bill Summary & Status, Committees, THE LIBRARY OF CONGRESS, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SN01504:@@C> (last visited Apr. 11, 2011) [hereinafter Notice Pleading Restoration Act Bill Status Summary].

147. H.R. 1415.

148. *Id.*

149. Open Access to Courts Act of 2009: Bill Summary & Status, Committees, THE LIBRARY OF CONGRESS, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR04115:@@C> (last visited Apr. 11, 2011) [hereinafter Open Access to Courts Act of 2009 Bill Status Summary].

150. Since its introduction in the Senate on July 22, 2009, the Notice Pleading Restoration Act of 2009 has only been read twice and referred to the Senate Judiciary Committee. Notice Pleading Restoration Act of 2009 Bill Status Summary, *supra* note 146. Likewise, following its introduction in the House on November 19, 2009, the Open Access to Courts Act of 2009 was referred to the House Judiciary Committee, then to the Subcommittee on Courts and Competition Policy. Open Access to Courts Act of 2009 Bill Status Summary, *supra* note 149. However, there has been no congressional action concerning either of these acts in 2010 and 2011. *See* Open Access to Courts Act of 2009 Bill Status Summary, *supra* note 149; Notice Pleading Restoration Act Bill Status Summary, *supra* note 146.

151. *See* Congressional bills cited *supra* note 143.

152. *See, e.g., In re Bare Escentuals, Inc. Sec. Litig.*, No. C 09-3268 PJH, 2010 WL 3893622 (N.D. Cal. Sept. 30, 2010); *In re Fuwei Films Sec. Litig.*, 634 F. Supp. 2d 419 (S.D.N.Y. 2009).

the difficulties that plaintiffs are facing in court. These difficulties are unwarranted given the statutory limitations on § 11 and § 12(a) claims.¹⁵³

A. IMPACT OF THE HEIGHTENED PLEADING STANDARDS ON RECENT SECURITIES CASES

The effect of the heightened pleading standards on § 11 and § 12(a) cases is exemplified in two recent cases: *In re Bare Escentuals, Inc. Securities Litigation*¹⁵⁴ and *In re Fuwei Films Securities Litigation*.¹⁵⁵ In *Bare Escentuals*, plaintiffs brought a securities class action against Bare Escentuals, Inc. (Bare), certain current and former directors and officers of Bare, and Bare's investment bankers.¹⁵⁶ The plaintiff class alleged that Bare violated § 11 and § 12(a) of the Securities Act as well as § 10(b) of the Exchange Act.¹⁵⁷ Specifically, the plaintiffs charged that Bare was not abiding by its "premium" sales restrictions, overstating the profits from its "club" program, harming its sales by "cross-selling" non-foundation products, and, ultimately, engaging in an alleged "cannibalization" of the corporation.¹⁵⁸

The defendants filed a motion to dismiss under Rule 12(b)(6).¹⁵⁹ To examine the legal sufficiency of the claims in this case, the District Court for the Northern District of California used the standard of review set forth in *Twombly* and clarified in *Iqbal*.¹⁶⁰ Relying on these precedents, the court contended that "a plaintiff's obligation to provide the grounds of his entitlement to relief 'requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do.'"¹⁶¹ Furthermore, because the complaint based its § 11, § 12(a), and § 10(b) claims on the same facts, the court held that the § 11 and § 12(a) claims "sound[ed] in fraud."¹⁶² Thus, the court required pleading with particularity, per Rule 9(b) of the FRCP, for all three claims.¹⁶³

The court evaluated the plaintiff class's § 11, § 12(a), and § 10(b) claims individually and found that each failed to meet the pleading

153. See discussion *infra* Part III.C.

154. *In re Bare Escentuals*, 2010 WL 3893622.

155. *In re Fuwei Films*, 634 F. Supp. 2d 419. *But see In re NovaGold Res. Inc. Sec. Litig.*, 629 F. Supp. 2d 272, 290 (S.D.N.Y. 2009) (holding that the heightened pleading standard imposed by Rule 9(b) of the FRCP does not apply to § 11 and § 12(a)(2) claims where the "[p]laintiff sets off its Securities Act claims in a separate section of the complaint, prefaced with the statement that they sound in 'strict liability and negligence'").

156. *In re Bare Escentuals*, 2010 WL 3893622, at *1.

157. *Id.* at *9.

158. *Id.* at *5-8.

159. *Id.* at *9.

160. See *id.* at *9. See also *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

161. *In re Bare Escentuals*, 2010 WL 3893622, at *9 (quoting *Twombly*, 550 U.S. at 555).

162. *Id.* at *13.

163. *Id.*

standards set forth in *Twombly* and *Iqbal* and required by Rule 9(b).¹⁶⁴ Ironically, the court distinguished each of these claims by discussing them separately, but applied the § 10(b)/Rule 10b-5 pleading standards to all three claims.¹⁶⁵ While it is possible that the plaintiff class failed to sufficiently plead the § 10(b)/Rule 10b-5 claim, the complaint alleged numerous misstatements based on thirty-one documents distributed by Bare.¹⁶⁶ These allegations, if presumed true, should have warranted providing the plaintiff with at least the opportunity for discovery to determine materiality of the misstatements.¹⁶⁷

Furthermore, the court in *In re Fuwei Films Securities Litigation* applied Rule 9(b)'s heightened pleading standard—applicable to § 10(b)/Rule 10b-5—to § 11 and § 12(a) claims in the absence of a § 10(b)/Rule 10b-5 allegation.¹⁶⁸ In *Fuwei*, plaintiffs brought a securities class action against Fuwei Films (Holdings) Co., Ltd. (Fuwei), several of Fuwei's directors and officers, and the underwriters for Fuwei's initial public offering.¹⁶⁹ The plaintiff class alleged that Fuwei's registration statement presented false information regarding the following two issues: (1) "the Registration Statement contained misrepresentations and omissions pertaining to Fuwei's allegedly unlawful acquisition of [a subsidiary company]"; and (2) "the Registration Statement contained misrepresentations and omissions pertaining to certain arbitration proceedings that were pending against Fuwei at the time of Fuwei's [initial public offering]."¹⁷⁰

The defendants filed a motion to dismiss under Rule 12(b)(6).¹⁷¹ Considering the motion, the court employed the standard of review established in *Twombly* and clarified in *Iqbal* to evaluate the adequacy of the claims in this case.¹⁷² While the plaintiff class included no allegation of fraud in the complaint, the court applied Rule 9(b) to the § 11 and § 12(a) claims.¹⁷³ Here, the court decided to impute a basis of fraud where the plaintiff had included no fraud claim in its complaint because the "allegations . . . sound[ed] in fraud, and [were] thus subject to the heightened pleading requirements of Rule 9(b)."¹⁷⁴ This case plainly

164. *Id.* at *10–25.

165. *Id.*

166. *Id.* at *8.

167. See *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1959 (2009) (Souter, J., dissenting) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 564 n.8 (2007) ("[A] plaintiff must 'allege facts' that, taken as true, are 'suggestive of illegal conduct.'").

168. See *In re Fuwei Films Sec. Litig.*, 634 F. Supp. 2d 419, 436–37 (S.D.N.Y. 2009).

169. *Id.* at 425.

170. *Id.* at 429.

171. *Id.* at 425.

172. *Id.* at 433.

173. *Id.* at 436–37.

174. See *id.*

illustrates the difficulty that plaintiffs face when pleading § 11 and § 12(a), even in the *absence* of a § 10(b)/Rule 10b-5 claim.

B. ANALYSIS OF CURRENT TRENDS IN SECURITIES LITIGATION

Current trends in securities litigation highlight some interesting results with respect to dismissals and the types of claims being brought. Cornerstone Research, in conjunction with The Stanford Law School Securities Class Action Clearinghouse, evaluated 3,052 federal securities class action suits filed between January 1, 1996 and December 31, 2009.¹⁷⁵ In each year between 1997 and 2008, an average of 197 securities class action suits were filed.¹⁷⁶ In 2008, 223 of these lawsuits were filed, and in 2009, 169.¹⁷⁷

Of the resolved (non-continuing) lawsuits in the securities class action sample, 54% were settled in 2006, 49% were settled in 2007, and 16% were settled in 2008.¹⁷⁸ In 2009, none of the resolved/non-continuing lawsuits were settled; 100% were dismissed.¹⁷⁹ Furthermore, among the sample, § 10(b) claims have declined over the past five years while § 11 and § 12(a) claims have increased.¹⁸⁰ The percentage of complaints which included a § 10(b) claim was 91%, 87%, 80%, 75%, and 66% for 2005, 2006, 2007,

The Second Circuit has found that, although fraud is not an element of a section 11 or section 12(a)(2) claim, “the heightened pleading standard of Rule 9(b)” applies to such claims where a complaint is “premised on allegations of fraud.” Rule 9(b) “is cast in terms of the conduct alleged, and is not limited to allegations styled or denominated as fraud or expressed in terms of the constituent elements of a fraud cause of action.” Accordingly, “a complaint may sound in fraud even where, as here, no fraud claims under [section 10(b) of] the Exchange Act are asserted.”

Id. at 436 (citations omitted).

175. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2009: A YEAR IN REVIEW 1 (2010), http://securities.stanford.edu/clearinghouse_research/2009_YIR/Cornerstone_Research_Filings_2009_YIR.pdf. The research sample consisted of the following:

[1] These filings include 313 “IPO Allocation” filings, 67 “Analyst” filings, 25 “Mutual Fund” filings, 40 “Options Backdating” filings, 23 “Ponzi” filings, and 192 “Credit Crisis” filings; the Credit Crisis category includes 21 filings related to auction rate securities.

[2] The sample used in this report excludes IPO Allocation, Analyst, and Mutual Fund filings.

[3] Multiple filings related to the same allegation against the same defendant(s) are consolidated in the database through a unique record indexed to the first identified complaint.

Id. at 1.

176. *Id.* at 2.

177. *Id.*

178. *Id.* at 22.

179. *Id.*

180. *Id.* at 27.

2008, and 2009, respectively.¹⁸¹ For § 11 claims, the percentage of complaints was 9%, 12%, 19%, 24%, and 26% for 2005, 2006, 2007, 2008, and 2009, respectively.¹⁸² Likewise, the percentage of complaints with § 12(a) claims was 5%, 9%, 11%, 18%, and 24% for 2005, 2006, 2007, 2008, and 2009, respectively.¹⁸³

With this data, one could argue that a connection exists between the decline in settled cases and the rise in the proportion of § 11 and § 12(a) claims. These trends may also correspond with the *Twombly* and *Iqbal* decisions and the heightened pleading standards placed on § 11 and § 12(a) claimants. However, there exists no actual correlation among this data. Although, two premises can be derived from this information. First, an increase in the proportion of § 11 and § 12(a) claims translates into an increase in the percentage of securities litigation cases that will face strict pleading standards. Second, a decrease in the amount of settlements suggests that the defendants are not afraid to take these securities cases to court, and when faced with the possibility of settling against the chance of successfully moving to dismiss, defendants have done well with motions to dismiss. Ultimately, while this data provides no dispositive conclusion, it should be taken into consideration when examining the significance of the heightened pleading standards placed on § 11 and § 12(a) claimants.

C. LIMITATIONS IMPOSED BY § 11 AND § 12(A)

While § 11 and § 12(a) require no showing of intent and can impose civil liability on any innocent misstatement (provided that the false information was material), a number of limitations on liability can be found in these provisions.¹⁸⁴ These restrictions cover the scope, damages, and timeliness of lawsuits that can arise under these sections.¹⁸⁵ Consequently, heightened pleading standards for § 11 and § 12(a) claims are unnecessary since the claimants already face boundaries on the range of claims that can be brought.¹⁸⁶

One of the key factors of § 11 and § 12(a) is that, as provisions in the Securities Act, these sections do not apply to the exchange of securities in secondary markets.¹⁸⁷ As a result, there is a finite number of claimants, and this decreases over time as securities offered pursuant to the Securities Act enter secondary markets and may, by some point, have little, if any,

181. *Id.*

182. *Id.*

183. *Id.*

184. See Securities Act of 1933 §§ 11, 12(a), 15 U.S.C. §§ 77k, 77l(a) (2006).

185. See 15 U.S.C. §§ 77k, 77l(a).

186. See 15 U.S.C. §§ 77k, 77l(a).

187. See JAMES D. COX, ROBERT W. HILLMAN, & DONALD C. LANGEVOORT, SECURITIES REGULATION: CASES AND MATERIALS 7 (6th ed. 2009) (“Whereas the Securities Act grapples with the protection of investors in primary distributions of securities, the Exchange Act’s concern is trading markets and their participants.”). See also 15 U.S.C. §§ 77k; 77l(a).

connection with the initial purchaser and issuer of the securities.¹⁸⁸ While one could argue that § 12(a) imposes strict liability on a “seller” and that “seller” can be broadly construed, the claimant must be in privity with the seller.¹⁸⁹ That is, the plaintiff must be one of the initial purchasers of the securities in order to sue under § 12(a).¹⁹⁰ Moreover, even though § 11 allows a plaintiff to essentially sue anyone who had a connection with the production of the registration statement, the plaintiff has to demonstrate that the misstatements contained in the registration statement were actually material to the plaintiff herself.¹⁹¹

With respect to damages, a plaintiff under § 11 can recover the difference between the purchase price of the securities and either the price at which the plaintiff sold the securities or the value of the securities at the time of the suit.¹⁹² Section 12(a) limits the remedies available to the rescission of the purchase of securities, or if the purchase cannot be rescinded (i.e. the purchaser no longer owns the shares), then rescissory damages.¹⁹³ In addition, concerning the timeliness of the suits, under § 13 of the Securities Act, § 11 and § 12(a) claimants must file suit within one year of when the false information was discovered or should have reasonably been discovered.¹⁹⁴ Unlike other securities statutes (namely, § 10(b)), these limitations on the lawsuits that can be filed under § 11 and § 12(a) make heightened pleading burdens not only unnecessary but excessive.

IV. RECOMMENDED SOLUTIONS TO PREVENT § 11 AND § 12(A) CLAIMS FROM FALLING VICTIM TO RULE 12(B)(6) MOTIONS

There are several possible ways to ease the pleading burdens placed on § 11 and § 12(a) claimants. Legislative remedies include amending § 21D(b)(1) of the PSLRA, amending Rule 9(b) of the FRCP, and changing the plausibility pleading standard through legislation. Recommendations for the Court involve adopting the Eight Circuit’s approach to § 11 and § 12(a) claims with respect to pleading and returning to *Conley*’s conceivability pleading standard.

188. See Odorizzi, *supra* note 63, at 176.

189. *Id.*; 15 U.S.C. § 77l(a).

190. See Odorizzi, *supra* note 63, at 176; 15 U.S.C. § 77l(a).

191. See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) (“If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case.”). See also 15 U.S.C. § 77k.

192. Securities Act of 1933 § 11(e), 15 U.S.C. § 77k(e) (2006).

193. 15 U.S.C. § 77l(a).

194. Securities Act of 1933 § 13, 15 U.S.C. § 77m (2006).

A. LEGISLATIVE REMEDIES

1. Amending the PSLRA

One possible solution is to amend the PSLRA to explicitly limit its applicability causes of action alleging fraud. This legislation only affects private securities litigation.¹⁹⁵ An amendment to § 21D(b)(1) of the PSLRA explicitly barring courts from applying this section to non-fraud suits could prevent courts from employing the standard of pleading with particularity, as required by § 21D(b)(1), to § 11 and § 12(a) claims. However, this alone will not prevent courts from applying Rule 9(b) to § 11 and § 12(a) claims when such claims “sound in fraud.”¹⁹⁶

2. Amending the FRCP

Another option is to revise Rule 9(b), making it only applicable to pleadings where the claim in question alleges fraud, and perhaps expressly stating that all claims not subject to Rule 9(b) are governed by Rule 8. Conversely, Rule 8 could also be amended to explicitly include all non-fraud claims. Nevertheless, neither an amendment to the PSLRA nor to Rule 9(b) or Rule 8 would stop courts from evaluating cases using a standard of plausibility.

3. Changing Plausibility Pleading through Legislation

A third legislative solution would be to change the plausibility pleading standard through legislation. Senator Specter’s Notice Pleading Restoration Act of 2009 and Representative Nadler’s Open Access to Courts Act of 2009 would each lessen the current pleading burden on plaintiffs.¹⁹⁷ The Notice Pleading Restoration Act of 2009 would expressly return the pleading standard to conceivability, prohibiting courts from dismissing a complaint under Rule 12(b)(6) or Rule 12(e) of the FRCP unless the complaint failed to satisfy the standard set forth in *Conley*.¹⁹⁸ The Open Access to Courts Act of 2009 does not explicitly mention *Conley*.¹⁹⁹ It requires, rather, that a complaint not be dismissed “unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claim.”²⁰⁰ The Open Access to Courts Act of 2009 also restricts courts from dismissing claims for failing to demonstrate plausibility.²⁰¹

195. See Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 (2006).

196. Even prior to the enactment of the PSLRA in 1995, courts were applying Rule 9(b) to non-fraud securities claims. See, e.g., *Sears v. Likens*, 912 F.2d 889, 892–93 (7th Cir. 1990) (applying Rule 9(b) to § 12 claims).

197. See Congressional bills cited *supra* note 143.

198. See Notice Pleading Restoration Act of 2009, S. 1504, 111th Cong. (2009).

199. See Open Access to Courts Act of 2009, H.R. 4115, 111th Cong. (2009).

200. *Id.*

201. *Id.*

Nonetheless, this legislation is problematic for two reasons. First, it would present new legislation open to the Court's interpretation. While the possibility exists for this legislation to be construed favorably for plaintiffs—i.e. consistently with *Conley*—it also presents an opportunity for the Court to interpret these provisions more narrowly than Congress intended. The Supreme Court in *Twombly* rejected “notice pleading” as being outdated; the Court could continue with the same opinion in the future.²⁰² Second, if the Court found these provisions to be profoundly inconsistent with its jurisprudence, it may take the opportunity to strike down the legislation as fundamentally unfair to defendants—who arguably stand to suffer greater reputational harm from “notice pleading” than from plausibility pleading—or possibly contrary to public policy (e.g. in the interest of judicial economy).

B. JUDICIAL REMEDIES

1. Adopting the Eighth Circuit's Approach to § 11 and § 12(a) Claims

The most feasible remedy available to § 11 and § 12(a) plaintiffs would be for the Court to adopt the Eighth Circuit's approach. The Eighth Circuit is the only circuit court to consistently apply Rule 8 of the FRCP to § 11 and § 12(a) claims, regardless of whether they are pled along with § 10(b) claims.²⁰³ While plaintiffs have petitioned the Supreme Court to resolve this circuit split, it has yet to accept a case to consider it.²⁰⁴

2. Returning to *Conley's* Conceivability Pleading

A second judicial remedy would be to overturn the precedent established in *Twombly* and *Iqbal* and return to the conceivability standard

202. See *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 561–63 (2007).

203. See *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 314 (8th Cir. 1997) (“[T]he particularity requirement of Rule 9(b) does not apply to claims under § 11 of the Securities Act, because proof of fraud or mistake is not a prerequisite to establishing liability under § 11.”). *Cf.* *Ind. State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935 (6th Cir. 2009), *cert. denied*, 2010 WL 5638596 (Nov. 5, 2010); *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618 (4th Cir. 2008); *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46 (1st Cir. 2008); *Wagner v. First Horizon Pharm. Corp.*, 464 F.3d 1273 (11th Cir. 2006); *In re Daou Sys., Inc.*, 411 F.3d 1006 (9th Cir. 2005); *Rombach v. Chang*, 355 F.3d 164 (2d Cir. 2004); *Cal. Pub. Employees' Ret. Sys. v. Chubb Corp.*, 394 F.3d 126 (3d Cir. 2004); *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246 (10th Cir. 1997). *But see Lone Star Ladies Inv. Club v. Schlotsky's Inc.*, 238 F.3d 363 (5th Cir. 2001); *Sears v. Likens*, 912 F.2d 889 (7th Cir. 1990).

204. Recently, plaintiffs in a securities class action suit in the Sixth Circuit Court of Appeals petitioned for certiorari, seeking for the Supreme Court to address the question of whether Rule 9(b) of the FRCP applies to § 11 claims. See *Ind. State Dist. Council of Laborers*, 583 F.3d 935. While the Court requested that the U.S. Solicitor General express its views about the application of Rule 9(b) to § 11 pleadings, the Court ultimately denied the petition for certiorari. See *Laborers Dist. Council Const. Indus. Pension Fund v. Omnicare, Inc.*, 131 S. Ct. 380 (2010); *Ind. State Dist. Council of Laborers*, 583 F.3d 935.

in *Conley*. Given the differences between the justices who joined the majority in *Twombly* and those who joined it in *Iqbal*, it appears that the Court has not reached a solid consensus concerning the plausibility standard.²⁰⁵ Justice Ginsburg even publicly disagreed with this precedent, stating that “[i]n [her] view, the [*Iqbal*] Court’s majority messed up the Federal Rules.”²⁰⁶ Although, since there seems to be no single voice on this matter from a majority of the justices, this is not necessarily a viable, let alone timely, remedy for improving the obstacles that § 11 and § 12(a) plaintiffs face in court.

CONCLUSION

This note has attempted to establish that the application of § 10(b) fraud pleading standards under Rule 9(b) and of the *Twombly* and *Iqbal* decisions to § 11 and § 12(a) claims creates an unreasonably strict pleading standard for plaintiffs to overcome. Recent court decisions, current trends in securities litigation, and limitations imposed by the provisions of § 11 and § 12(a), illustrate the importance of these changes in pleading standards. Ultimately, the most viable solution to this issue would be the Supreme Court resolving the split among circuit courts by determining whether courts ought to apply fraud pleading standards to non-fraud securities claims.

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205. See *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009); *Twombly*, 550 U.S. 544.

206. *Clermont & Yeazell*, *supra* note 80, at 831. See *Miller*, *supra* note 80. See generally *Burbank*, *supra* note 80; *Hatamyar*, *supra* note 80; *Stein*, *supra* note 80; *Sullivan*, *supra* note 80.

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