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INTRODUCTION

From September 1, 1997 to August 31, 1998, the United States Court of Appeals for the Tenth decided three cases substantially addressing securities law. *Blinder v. Stellatos*[1] focused on timely filing requirements in a liquidation proceeding, and whether notice, given the circumstances, satisfied due process. *Maher v. Durango Metals, Inc.*[2] addressed fraudulent misrepresentation claims, primary liability, and "control person" liability. In *Schwartz v. Celestial Seasonings, Inc.*,[3] the court decided a section 11 claim, the adequacy of a section 10(b) claim under Federal Rule of Civil Procedure 9(b),[4] and the statute of limitations applicable to federal securities claims. Relevant to these issues, this survey will present background information regarding the state of the law, the decisions of the Tenth Circuit, holdings in other circuits, and analyses of the court of appeal's decisions.

I. LIQUIDATION PROCEEDINGS UNDER THE SECURITY INVESTOR PROTECTION ACT: NOTICE & FILING REQUIREMENTS

A. *Background*

In a liquidation proceeding under the Securities Investor Protection Act of 1970[5] (SIPA), many investors will have interests at stake. These investors are entitled to due process, including the important element of notice. The trustee in a bankruptcy or liquidation proceeding is the party obligated to provide sufficient notice to allow these investors to present their claims.[6] Further, investors are required to adhere to filing requirements regarding presentation of a claim in liquidation proceedings under the SIPA.[7]

The central issue when evaluating the sufficiency of notice given by the trustee is due process.[8] Due process requires notice reasonably calculated to apprise all interested parties of the pending action, thereby

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1. 124 F.3d 1238 (10th Cir. 1997).
2. 144 F.3d 1302 (10th Cir. 1998).
3. 124 F.3d 1246 (10th Cir. 1997).
4. FED. R. CIV. P. 9(b).
5. 15 U.S.C. § 78aaa (1994). According to legislative history, SIPA's purpose is to provide protection to customers against losses that might occur when a securities broker-dealer suffers financial failure. *See* S. REP. NO. 95-763, at 1 (1978), *reprinted in* 1978 U.S.C.C.A.N. 764, 764.
6. *See* 15 U.S.C. § 78fff-2(a)(1).
7. *See id.* § 78fff-2(a)(3) ("No claim of a customer or other creditor of the debtor which is received by the trustee after the expiration of the six-month period beginning on the date of publication of notice . . . shall be allowed . . . .").
8. *Cf.* BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 574 (1996) ("Elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice . . . .").

allowing interested parties the opportunity to present their claims.[9] According to the United States Supreme Court in *Mullane v. Central Hanover Bank & Trust Co.*,[10] the reasonableness and constitutional validity of the chosen method of notice can be defended on the ground it is reasonably certain to inform interested parties.[11]

Thus, the next step is determining what form of notice will satisfy the requirements of reasonable notice explained in *Mullane*. One issue in *Mullane* was whether notice by publication alone was sufficient to allow interested parties to present their claims.[12] The Court held that publication by itself, typically, does not constitute sufficient notice.[13] The Court, however, recognized that notice by publication is acceptable when it is "supplemental to other action which in itself may reasonably be expected to convey a warning."[14] Notice by mail is one form of notice that courts agree is reasonable to allow interested parties to present their claims.[15] According to *Mullane*, due process requires notice be sent to interested parties with known addresses.[16] Finally, numerous courts have held notice by mail, supplemented by other forms of notice such as publication

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9. *See* Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950) ("An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.").

10. While *Mullane* arose in the context of a common trust fund, the Supreme Court's holding has not been limited to the facts of that case.

> [*Mullane*] generally is recognized as the keystone of modern philosophy regarding the notice requirement and its importance should not be underestimated. In a series of cases decided since *Mullane*, the Supreme Court has made it clear that notice to defendant must measure up to the standards set forth in that case in all types of actions.

4 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1074, at 465 (2d ed. 1987) (citing Mennonite Bd. of Missions v. Adams, 462 U.S. 791 (1983)).

11. *See Mullane*, 339 U.S. at 315.

12. *See id.*

13. *See id.* ("It would be idle to pretend that publication alone as prescribed here, is a reliable means of acquainting interested parties of the fact that their rights are before the courts."). However, the Court notes an exception to this rule, stating, "[t]his court has not hesitated to approve of resort to publication as a customary substitute in another class of cases where it is not reasonably possible or practicable to give more adequate warning." *See id.* at 317; *cf.* 4 WRIGHT & MILLER, *supra* note 10, § 1074, at 461–62 (explaining that service by publication will only be sufficient "when it is used to serve an absent domicillary who cannot be served in any other way.").

14. *Mullane*, 339 U.S. at 316.

15. *See id.* at 319 (discussing the inadequacy of providing notice by publication alone when it is possible to notify parties by other means, and further stating "the mails today are recognized as an efficient and inexpensive means of communication."); *cf.* 4 WRIGHT & MILLER, *supra* note 10, § 1074 (stating that notice by mail is sufficient under due process, however, also citing *Bonita Packing Co. v. O'Sullivan*, 165 F.R.D. 610 (D.C. Cal. 1995), where notice by mail was deemed insufficient).

16. *See Mullane*, 339 U.S. at 318 ("Where the names and . . . addresses of those affected by a proceeding are at hand, the reasons disappear for resort to means less likely than the mails to apprise them of its pendency."); *cf.* Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 800 (1983) (stating that when name and address are reasonably ascertainable, notice by mail insures actual notice).

in national newspapers, will generally satisfy due process, even when the interested party does not actually receive notice.[17]

The courts have established extensive caselaw regarding what constitutes acceptable notice under the requirements of due process. To comply with these well-established requirements, the SIPA expressly requires that:

> Promptly after the appointment of the trustee, such trustee shall cause notice of the commencement . . . to be published in one or more newspapers of general circulation in the form and manner determined by the court, and at the same time shall cause a copy of such notice to be mailed to each person who, from the books and records of the debtor, appears to have been a customer . . . with an open account within the past twelve months, to the address of such person as it appears from the books and records of the debtor . . . .[18]

Thus, SIPA clearly requires notice by mail, supplemented with notice published in one or more newspapers.

Another important aspect in liquidation proceedings under the SIPA is the section governing the time frame in which investors must file their claims. The Act requires that claims must be filed within six months from the date of notice, and no claims will be allowed after such date.[19] This statutory requirement, however, provides an exception for incompetent persons without guardians.[20] While some courts have attempted to allow extensions based on equitable grounds,[21] such decisions have been reversed in favor of the requirement that requests for extensions must be made within the six-month period.[22] Therefore, the six-month period for

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17. *See, e.g.*, United States v. Real Property, 135 F.3d 1312, 1316 (9th Cir. 1998); United States v. Clark, 84 F.3d 378, 380 (10th Cir. 1996); United States v. 51 Pieces of Real Property, 17 F.3d 1306, 1316 (10th Cir. 1994); Weigner v. City of New York, 852 F.2d 646, 649, 652 (2d Cir. 1988); Nelson v. Diversified Collection Servs., Inc., 961 F. Supp. 863, 868–69 (D. Md. 1997); Scott v. United States, 950 F. Supp. 381, 387 (D.D.C. 1996); Pou v. United States Drug Enforcement Agency, 923 F. Supp. 573, 578 (S.D.N.Y. 1996), *aff'd*, Pou v. Loszynski, 107 F.3d 3 (2d Cir. 1997); United States v. Franklin, 897 F. Supp. 1301, 1303 (D. Or. 1995).

18. Securities Investor Protection Act of 1970, § 8, 15 U.S.C. § 78fff-2(a)(1) (1994).

19. *See* 15 U.S.C. § 78fff-2(a)(3) ("No claim of a customer or other creditor of the debtor which is received by the trustee after the expiration of the six-month period beginning on the date of publication of notice . . . shall be allowed . . . .").

20. *See id.* ("[T]he court may, upon application within such period [six month time frame] and for cause shown, grant a reasonable, fixed extension of time for the filing of a claim by the United States, by a State or political subdivision thereof, or by an infant or incompetent person without a guardian.").

21. *Cf., e.g.*, Gov't Secs. Corp. v. Morey, 107 B.R. 1012, 1022 (S.D. Fla. 1989) (involving a situation where the bankruptcy court in error allowed a late claim based on "fairness and equity"); Gov't Secs. Corp. v. Carson, 95 B.R. 829, 832 (S.D. Fla. 1988) (stating that the allowance of a late claim in an attempt to reconcile the SIPA with sections of the bankruptcy code was in error).

22. *See Morey*, 107 B.R. at 1022; *Carson*, 95 B.R. at 833 (explaining that even if the late claimant was an incompetent person under the act, allowing a late claim was not possible because an extension was not requested within the six-month time period).

filing claims is deemed an absolute rule by the courts, and failure to file a claim within this period results in exclusion of the claim.[23]

B. *Tenth Circuit Case*—Blinder Robinson & Co. v. Stellatos[24]

1. Facts

Blinder Robinson & Co. v. Stellatos addressed the sufficiency of notice given by the trustee after three separate investors filed late claims. When assessing the correctness of the district court's decision, which allowed the investor's claims, the Tenth Circuit applied the same standard of review exercised by the district court when it evaluated the bankruptcy court's decision.[25] The applicable standard was whether the lower court's decision was clearly erroneous.[26]

Blinder, Robinson & Company, Inc. (hereinafter "debtor") filed a voluntary petition for bankruptcy under Chapter 11 of the Bankruptcy Code on July 31, 1990.[27] The Securities Investor Protection Corporation then applied to the U.S. District Court for the District of Colorado for protection under SIPA.[28] As a result of the filing, the district court appointed a trustee and removed the case to bankruptcy court.[29] The bankruptcy court subsequently ordered the trustee to mail notice to each investor who maintained an open account with the debtor during the past twelve months and to publish notice in twenty-six newspapers throughout the country.[30] The notice informed individuals of the six-month rule for filing claims under section 78fff-2(a).[31] Under this six-month rule, all claims filed after February 14, 1991, were considered late.[32]

Three investors filed claims after the bar date of February 14, 1991, for various reasons; as a result, the trustee rejected these claims.[33] The bankruptcy court did not agree with the rejection of the claims by the trustee and ordered the claims be treated like claims timely filed.[34] The

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23. *See, e.g., Morey*, 107 B.R. at 1022; Miller v. Austin, 72 B.R. 893, 894, 896–97 (S.D.N.Y. 1987); Secs. Investor Protection Corp. v. J. Shapiro Co., 414 F. Supp. 679, 680, 683 (D. Minn. 1975); Weis Secs. Inc. v. Borghi, 411 F. Supp. 194, 194–95 (S.D.N.Y. 1975), *aff'd*, 538 F.2d 513 (2d Cir. 1976); SEC v. Kenneth Bove & Co., 353 F. Supp. 496, 497 (S.D.N.Y. 1973); *In re* Adler, Coleman Clearing Corp., 204 B.R. 99, 103 (Bankr. S.D.N.Y. 1997); *In re* OTC Net, Inc., 34 B.R. 658, 659–60 (Bankr. D. Colo. 1983).

24. Blinder, Robinson & Co. v. Stellatos, 124 F.3d 1238 (10th Cir. 1997).

25. *See Stellanos*, 124 F.3d at 1241.

26. *See id.*

27. *See id.* at 1239.

28. *See id.*

29. *See id.* (requiring appointment of trustee for the liquidation under 15 U.S.C. § 78eee(b)(3) and removal of the liquidation proceeding to the bankruptcy court under 15 U.S.C. § 78eee(b)(4)).

30. *See id.*

31. *See id.*

32. *See id.*

33. *See id.* at 1239–40.

34. *See id.* at 1240.

bankruptcy court found that the trustee's publication of notice and mailings were reasonable, but that the three investors never received actual or constructive notice of the proceedings concerning the debtor.[35] The bankruptcy court held the investors rebutted the presumption of actual receipt of notice, and each of the claims should be considered along with the timely-filed claims.[36] Further, the bankruptcy court accepted the assertion by each investor that they did not receive constructive notice because they had not read the newspaper during the six-month period.[37] According to the bankruptcy court, based on the absence of actual or constructive notice, application of the SIPA to each of the investors who filed late claims would be unconstitutional.[38]

On appeal, the district court did not analyze the case under due process, but held the mailed notice was inadequate with regard to two of the investors.[39] Further, with respect to one claim, the court found the incompetent person exception was applicable.[40]

2. Decision

The Tenth Circuit first addressed the bankruptcy court's finding that each investor was mailed a customer claim packet, and the trustee successfully published notice in twenty-six newspapers throughout the country.[41] The court of appeals found the bankruptcy court's findings to be reasonable and logical.[42] Thus, the court of appeals reversed the district court's holding of clear error in the bankruptcy court's finding that sufficient notice occurred.[43] Further, the court of appeals found that even though two of the investors' names did not appear on a list of mailings subsequent to the original mailing, such evidence did not invalidate the bankruptcy court's decision that the two investors were mailed notice in the original mailing.[44]

The Tenth Circuit then analyzed the sufficiency of notice under the requirements of due process. Although the district court decided not to analyze the case under due process,[45] the court of appeals held the mailing of notice and the supplemental publication of notice in twenty-six newspapers was sufficient.[46] Based on the court of appeal's holding that

35. *See id.*
36. *See id.* at 1240–41.
37. *See id.* at 1241.
38. *See id.*
39. *See id.*
40. *See id.*
41. *See id.*
42. *See id.*
43. *See id.* at 1242.
44. *See id.*
45. *See id.* (stating that the district court did not address the issue and affirming on other grounds).
46. *See id.* at 1243 (finding that the combination of mailing and publication in 26 newspapers to be a reasonable method of notification).

the trustee's methods of notice were reasonable, the combination of notice by mail and publication was "reasonably calculated to apprise interested parties of the SIPA liquidation and afford them an opportunity to be heard."[47]

Finally, the Tenth Circuit analyzed the six-month time requirement for interested parties to file claims. Citing extensive authority, the court of appeals decided that the six-month time period was an absolute requirement.[48] The only relevant exception under the circumstances of this case was for an "incompetent person without a guardian."[49] Although one investor was in a car accident, the court of appeals held she was still required to file for an extension of time within the six-month period and her failure to file resulted in a late claim.[50] Therefore, the court of appeals found that the district court's holding that the investor's late filed claim fell under the exception to the six-month requirement was "contrary to the plain language of the statute."[51]

C. *Other Circuits*

Regarding the requirement of due process, the Second, Ninth, and District of Columbia Circuits are in accord with the Tenth Circuit's approach,[52] and do not require the party to actually receive notice in order to satisfy due process.[53] For instance, the Second Circuit held that with the existence of supplemental mailings, as in *Blinder*, the risk of non-receipt is constitutionally acceptable.[54]

Decisions among the various circuits regarding the six-month time requirement in the SIPA are also in accord with the Tenth Circuit's recognition of an absolute rule. The Second Circuit denied late claims even though there was a lack of actual receipt of notice.[55] Further, other district courts and bankruptcy courts agree with the Tenth Circuit's interpretation. In Florida, a district court held that the six-month time requirement is absolute, allowing no exceptions to the rule through application of equitable considerations.[56] A New York district court held the six-month

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47. *Id.*

48. *See supra* 23 and accompanying text.

49. *Blinder*, 124 F.3d at 1243.

50. *See id.* at 1243–44.

51. *Id.* at 1244.

52. *See id.* at 1243; *see also* United States v. Clark, 84 F.3d 378, 380 (10th Cir. 1996); United States v. 51 Pieces of Real Property, 17 F.3d 1306, 1316 (10th Cir. 1994).

53. *See, e.g.*, United States v. Real Property, 135 F.3d 1312, 1316 (9th Cir. 1998); Nelson v. Diversified Collection Serv., Inc., 961 F. Supp. 863, 869 (D. Md. 1997); Scott v. United States, 950 F. Supp. 381, 387 (D.D.C. 1996); Pou v. United States Drug Enforcement Agency, 923 F. Supp. 573, 578 (S.D.N.Y. 1996).

54. *See* Weigner v. City of New York, 852 F.2d 646, 649, 652 (2d Cir. 1988).

55. *See* Weis Secs., Inc. v. Borghi, 411 F. Supp. 194, 195 (S.D.N.Y. 1975), *aff'd*, 538 F.2d 513 (2d Cir. 1976).

56. *See* Gov't Secs. Corp. v. Morey, 107 B.R. 1012, 1022 (S.D. Fla. 1989).

requirement was an "absolute outer limit,"[57] and a district court in Minnesota also found the six-month rule to be absolute, holding the receipt of actual notice was immaterial.[58] Finally, bankruptcy decisions in New York and Colorado are in accord, holding that the six-month rule of section 78fff-2(a)(3) is an absolute bar.[59]

D. *Analysis*

Based on the holdings of various courts,[60] it is evident the Tenth Circuit Court of Appeal's holding is in accord with current approaches throughout the judicial jurisdictions. With regard to the requirements of reasonable notice, notice by mail, when supplemented with other published notice, is sufficient to satisfy due process.[61] The purpose of notice is to apprise interested parties of the pending proceeding, allowing them the opportunity to present their claims.[62] In *Blinder*, the complaining parties were mailed notice and notice was also published in twenty-six newspapers. Only a certain degree of notice can be given within reason: other factors such as cost, inconvenience, court delays, and the interests of other investors are relevant in cases where many investors are involved.[63] The resulting delays, if each individual were given additional notice, would contradict the basic notice requirement that only notice reasonably certain to apprise interested parties of a proceeding is necessary. There is no requirement that parties are entitled to perfect notice. In fact, the reasonableness and constitutional validity of such notice is judged by whether it is reasonably certain to inform interested parties.[64]

Additionally, the resulting delays of providing further notice would adversely impact the rights of other investors with claims. The purpose of the six-month requirement under the SIPA is to expedite liquidation proceedings and allow investors to get on with their financial endeavors.[65] The longer an investor's money is tied up in a liquidation proceed-

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57. SEC v. Kenneth Bove & Co., 353 F. Supp. 496, 497 (S.D.N.Y. 1973).

58. *See* Securities Investor Protection Corp. v. J. Shapiro Co., 414 F. Supp. 679, 683 (D. Minn. 1975).

59. *See In re* Adler, Coleman Clearing Corp., 204 B.R. 99, 103 (Bankr. S.D.N.Y. 1997); Miller v. Austin, 72 B.R. 893, 896–98 (S.D.N.Y. 1987); *In re* OTC Net, Inc., 34 B.R. 658, 660 (Bankr. D. Colo. 1983).

60. *See supra* text accompanying note 17.

61. *Cf.* Weigner v. City of New York, 852 F.2d 646, 649, 652 (2d Cir. 1988) (after sending notice "reasonably calculated to inform" of forthcoming foreclosure action, the court found no further requirement to send notices for each subsequent step in the proceedings).

62. *See* Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950).

63. *See Mullane*, 339 U.S. at 317 ("This court has not hesitated to approve of resort to publication as a customary substitute in another class of cases where it is not reasonably possible or practicable to give more adequate warning.").

64. *See id.* at 314–15.

65. *See generally* Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 84 Stat. 1636, 1637, 1970 U.S.C.C.A.N 5263, 5264 ("[I]t is in the interests of customers of a debtor that securities held for their account be distributed to them as rapidly as possible in order to minimize the period during which they are unable to trade and consequently are at risk of market fluctuations.").

ing, the greater the chance that investor will be subjected to fluctuations in the market.[66] One cannot expect a court to continue giving additional notice, delaying a case and jeopardizing the interests of the many other investors that fulfilled the filing requirements. As mentioned previously, the key factor is whether the notice given is reasonable to apprise interested parties of a liquidation proceeding. The combination of notice by mail and publication and the six-month requirement for filing a claim is a reasonable method, producing an effective balance between the interests of the investors and the state when resolving liquidation proceedings.

II. CONTROL PERSON AND PRIMARY LIABILITY

A. *Background*

In cases involving alleged violations under section 15 of the Securities Act of 1933 (1933 Act)[67] and section 20(a) of the Securities Exchange Act of 1934 (1934 Act),[68] one of the central issues revolves around the determination of control person liability. When a person controls another individual who violates securities laws, that person can be held jointly and severally liable under section 15 of the 1933 Act[69] and section 20(a) of the 1934 Act.[70] Section 15 of the 1933 Act states, in part, that a person who

> controls any person liable under sections 77k or 771 of this title [sections 11 or 12], shall also be liable jointly and severally with and to the extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.[71]

Under section 20(a) of the 1934 Act:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.[72]

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66. *See id.*

67. Securities Act of 1933, ch. 38, 48 Stat. 74, (codified as amended at 15 U.S.C. § 77(o) (1994)).

68. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78t(a) (1994)).

69. 15 U.S.C. § 77(o).

70. 15 U.S.C. § 78t(a).

71. *Id.*

72. *Id.*

Based on the above sections of the statute, the relevant question is whether an individual is liable as a control person. To assert a prima facie case for control person liability, the Tenth Circuit Court of Appeals requires the plaintiff to show, "(1) a primary violation of the securities laws and (2) 'control' over the primary violator by the alleged controlling person."[73] In cases of control person liability, "once the plaintiff establishes the prima facie case, the burden shifts to the defendant to show lack of culpable participation or knowledge."[74]

The Tenth Circuit expressly disagrees with the view that it is necessary for a "plaintiff to show the defendant actually or culpably participated in the primary violation."[75] This test, employed by a minority of the courts, requires a plaintiff to prove actual or culpable participation in addition to control.[76]

The prima facie case required by the Tenth Circuit, including the eventual burden shift to the defendant, conforms with the approach taken by the majority of the circuits.[77] The circuits are split, however, on the issue of what must be proven to allege "control." The two different approaches involve whether it is necessary to prove the controlling person (1) actually exercised control over the primary violator's general affairs, or (2) simply had the power to control the general affairs of the primary violator.[78]

In 1985, the Tenth Circuit addressed control person liability in *San Francisco-Okla. Petroleum Corp. v. Carstan Oil Co.*[79] While control was an issue in the case, the court was satisfied that the defendant was significantly involved in the corporation and was thus a controlling person.[80] Consequently, the court did not specifically address what degree of control is necessary, and instead focused on whether the defendant's lack of knowledge exempted him from liability.[81] The court, however, did state that "[i]t seems apparent that [the defendant] had the authority and the power to control although he may not have sought to exercise the

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73. Maher v. Durango Metals, Inc., 144 F.3d 1302, 1305 (10th Cir. 1998).

74. *Maher*, 144 F.3d at 1305 (citing San Francisco-Okla. Petroleum Corp. v. Carstan Oil Co., 765 F.2d 962, 964 (10th Cir. 1985)).

75. *Id.* (quoting First Interstate Bank v. Pring, 969 F.2d 891, 897 (10th Cir. 1992), *rev'd on other grounds*, Central Bank v. First Interstate Bank, 511 U.S. 164 (1994)).

76. *Cf.* SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996) ("[A] plaintiff must show a primary violation by the controlled person and control of the primary violator by the targeted defendant"). For further discussion of this rule, see Lewis D. Lowenfels & Alan R. Bromberg, *Controlling Person Liability Under 20(a) of the Securities Exchange Act and Section 15 of the Securities Act*, 53 BUS. LAW 1, 9, 20–26 (1997).

77. *See* Lowenfels & Bromberg, *supra* note 76, at 6.

78. *See Maher*, 144 F.3d at 1306 n.8.

79. 765 F.2d 962 (10th Cir. 1985).

80. *See Carstan Oil*, 765 F.2d at 964 (explaining that the defendant was heavily involved in the affairs of the business, was a director, and was the sole shareholder).

81. *See id.* at 964–65.

power."[82] Overall, the court implicitly appeared to acknowledge indirect control, but did not clarify what degree of control is necessary.

The Tenth Circuit also addressed control person liability in *First Interstate Bank of Denver v. Pring*,[83] finding the defendant was at least in a position of indirect control based on various factors. Once again, the court failed to specifically discuss what degree of control was necessary and only found the defendant was possibly a controlling person.[84] Thus, the degree of control necessary in the Tenth Circuit is unclear from these cases addressing control person liability.

Another claim an investor might bring is primary civil liability under section 12(1) of the Securities Act of 1933.[85] An individual is primarily liable if he or she "offers or sells a security in violation of section 77e of this title."[86] Additionally, an individual can also be primarily liable under section 12(1) for improper solicitation of the purchase of securities.[87]

B. *Tenth Circuit Case*—Maher v. Durango Metals, Inc.[88]

1. Facts

The plaintiff, William J. Maher, claimed defendants, Colina Oro Molino, Inc. ("COM") and Gwen Fraser, were liable as control persons under the 1933 and 1934 Acts for securities violations committed by Durango,[89] the company that issued the stock at the center of this dispute.[90] The plaintiff first alleged primary violations of section 10(b) of the 1934 Act, and sections 12(a)(1) and 12(a)(2) of the 1933 Act by the defendants.[91] Further allegations against the defendants were as follows:

> (1) Fraser was the sister of Tatman, who Maher alleged was "an officer or employee of Defendant Durango Metals and/or Defendant COM, Inc." and the general manager of the Gold Hill Mill, owned by COM; (2) Fraser was the sole or principal owner of COM; (3) both

82. *Id.* at 965.

83. 969 F.2d 891 (10th Cir. 1992) *rev'd on other grounds*, Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994).

84. *See Pring*, 969 F.2d at 898 (explaining that the evidence presented was enough to prevent summary judgment against the plaintiffs, but that further determination was necessary and the issue was remanded to the district court).

85. 48 Stat. 84 (codified at 15 U.S.C. § 77*l*(a)(1) (1994)).

86. *Id.* (referring to section 77e which addresses prohibitions relating to interstate commerce and the mail).

87. *See* Pinter v. Dahl, 486 U.S. 622, 647 (1988) (stating liability will continue to an individual "who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner").

88. Maher v. Durango Metals, Inc., 144 F.3d 1302, 1303 (10th Cir. 1998).

89. *See Maher*, 144 F.3d at 1303.

90. *See id.*

91. *See id.* at 1304–05.

> COM and Fraser had access to information relating to Durango that was not available to the public; and (4) pursuant to a Memorandum of Contract. . . , COM purchased from Durango "a sufficient amount of outstanding stock to request a position on their Board of Directors" and "has the option to acquire [a] controlling interest" in Durango.[92]

Plaintiff's claims also alleged violations of various sections of the Colorado Securities Act.[93]

Additionally, the plaintiff claimed that fraudulent misrepresentations induced him to invest in Durango.[94] The misrepresentations alleged by plaintiff were that Tatman and Hartley, allegedly an officer and director of Durango, said they were involved in Durango along with Fraser and COM, and Durango was a "good potential investment."[95] The plaintiff further alleged he was denied access to Durango's financial records, that he had not received a dividend promised to him, and that he demanded and never received the return of his investment.[96]

The district court dismissed plaintiff's section 10(b), section 12(a)(1), and section 12(a)(2) claims as a matter of law, concluding that Fraser and COM were not liable as control persons for Durango's alleged violations.[97] Further, plaintiff's failure to allege Fraser and COM were "sellers of the stock at issue" precluded a finding of primary liability under section 12(a) of the 1933 Act, and failed to show how the "financial interests of [the] defendants related to the sale."[98] The Tenth Circuit Court of Appeals addressed only the purported violations under the 1933 and 1934 Acts.

2. Decision

a. *Control Person Liability*

In its analysis, the Tenth Circuit cited its previous decision in *Richardson v. MacArthur*, which held that the 1934 Act was remedial and should be construed liberally.[99] This decision held a requirement of some indirect influence, but not actual direction, was necessary to find controlling person liability.[100] Analyzing the plaintiff's complaint, the appellate court found the alleged primary violations of the 1933 and 1934 Acts enough to satisfy the first element of a prima facie case.[101]

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92. *Id.* at 1305.

93. *See id.* at 1303 (referring to The Colorado Securities Act, COLO. REV. STAT. § 11-51-125(1), *repealed by* Laws 1990, H.B. 90-1222, § 1, effective July 1, 1990).

94. *See id.* at 1303–04.

95. *Id.* at 1304.

96. *See id.*

97. *See id.*

98. *Id.*

99. *See id.* at 1305 (citing Richardson v. MacArthur, 451 F.2d 35, 41–42 (10th Cir. 1971)).

100. *See id.*

101. *See id.*

However, the court found the plaintiff's allegations, even when viewed in a light most favorable to the plaintiff, fell short of establishing COM's control over Durango (the second element of a prima facie case).[102] The court concluded the plaintiff only established a tenuous connection between COM and Durango and failed to prove COM was a control person in any way.[103] Thus, the court dismissed the allegation of control person liability against COM because the plaintiff did not allege COM's power to control Durango, but simply alleged COM's ability to acquire that power.[104] Consequently, the court declined to address "whether a plaintiff must allege actual control of or simply the power to control the primary violator's general affairs in order to establish a prima facie case of control person liability."[105] Further, the court of appeals held that although the determination of control person liability is a question of fact, the court can dismiss the claim when, based on the allegations, it cannot be reasonably inferred the defendant was a control person.[106]

The court also found the plaintiff's allegations of control person liability against Fraser (Fraser's control of Durango) were insufficient.[107] The plaintiff's claims that Fraser had an ownership interest in COM, and that Fraser's brother was an officer or employee of Durango were simply not enough to demonstrate control person liability.[108] Thus, the Tenth Circuit upheld the district court's dismissal of plaintiff's section 10(b), section 12(a)(1), and section 12(a)(2) claims under sections 15 or 20(a) of the 1933 and 1934 Acts against COM and Fraser based on control person liability.[109]

b. *Primary Liability Under Section 12(a) of the 1933 Act*

Under section 12(a)(1) of the 1933 Act, a person is liable if he or she "'offers or sells a security' in violation of the registration requirement of § 5."[110] Further, according to the United States Supreme Court, "§ 12(a)(1) liability is not limited to the person who passes title to the securities, but extends 'to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner.'"[111] The district court dismissed this claim because the plaintiff failed to allege that COM or Fraser were "sellers" of the Durango stock, and failed to establish the financial inter-

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102. *See id.*
103. *See id.* at 1305–06.
104. *See id.* at 1306 n.8.
105. *Id.*
106. *See id.* at 1306.
107. *See id.*
108. *See id.*
109. *See id.*
110. *Id.* at 1307 (citing 15 U.S.C. § 77*l*(a)(1) (1994)).
111. *Id.* (quoting Pinter v. Dahl, 486 U.S. 622, 647 (1988)).

ests of either COM or Fraser regarding the sale.[112] Because the plaintiff did not claim COM and Fraser sold the stock, it was necessary for the plaintiff to establish solicitation by COM and Fraser, and their financial interests, to support the claim.[113] The appellate court, however, held the plaintiff failed to allege the necessary facts in his complaint regarding such solicitation, resulting in failure of the primary liability claim.[114]

C. *Other Circuits*

1. Control Person Liability

a. *Majority Rule/Test*

Under the majority test, after the plaintiff proves control by the controlling person and a primary violation of securities laws by the controlled person, the burden shifts to the defendant (controlling person) to prove his or her defense.[115] However, the various circuits are in disagreement regarding what evidence is necessary to state a prima facie case for control person liability. This split is focused on determining the meaning of the term "control." The question is whether it is necessary for the plaintiff to prove "the alleged control person actually exercised control over the primary violator's general affairs, or whether it is sufficient to show the control person had the power to exercise such control."[116]

The Eighth Circuit held that in order to state a prima facie case of control person liability, the alleged control person must actually exercise control over the primary violator's operations.[117] The Seventh Circuit agreed with the Eighth Circuit, and applied the same test regarding control person liability.[118] Overall, the test established by the Eighth Circuit is the most commonly used test to determine control.[119]

The test established by the Eleventh Circuit requires only that the plaintiff show the alleged control person had the power to control the general affairs of the primary violator to state a prima facie case of control person liability.[120] The Fifth Circuit adopts a test virtually identical to the Eleventh Circuit test.[121]

While there is some disagreement, the majority of the circuits agree a plaintiff only needs to show the control person had the power to control

112. *See id.*
113. *See id.*
114. *See id.*
115. *See* Lowenfels & Bromberg, *supra* note 76, at 6.
116. *Maher*, 144 F.3d at 1306 n.8.
117. *See id.* (citing Metge v. Baehler, 762 F.2d 621, 630–31 (8th Cir. 1985)).
118. *See id.* (citing Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 881 (7th Cir. 1992)).
119. *See* Lowenfels & Bromberg, *supra* note 76, at 14.
120. *See Maher*, 144 F.3d at 1306 n.8 (citing Brown v. Enstar Group, Inc., 84 F.3d 393, 396 & n.6 (11th Cir. 1996)).
121. *See id.* (citing Abbott v. Equity Group, Inc., 2 F.3d 613, 620 (5th Cir. 1993)).

the transaction underlying the alleged securities violation rather than proving actual use of that power to satisfy the requirements of a prima facie case.[122]

b. *Minority Rule/Test*

The minority test is referred to as the culpable participation test. In addition to proving the control element, the plaintiff is also required to prove "culpable participation" by the controlling person regarding the primary violation.[123] While the Third Circuit clearly follows this test, some commentators believe the Second Circuit is steering away from the minority test.[124] There is even stronger evidence the Fourth and Ninth Circuits are moving, or have moved, toward the majority rule that does not require proof of actual or culpable participation.[125]

2. Primary Liability Under Section 12(a)(1) of the 1933 Act

The court of appeals found the allegations in the plaintiff's complaint insufficient to satisfy the requirements for stating a prima facie case of primary liability under section 12(a)(1).[126] The plaintiff did not allege that COM or Fraser sold the stock, thus, the only way to state a prima facie case was to allege and support a claim of solicitation.[127] The court found the plaintiff failed to do so. The court drew support for its position based on a holding in the First Circuit[128] and a decision in a district court in northern California.[129]

D. *Analysis*

The Tenth Circuit did not reach the question of control person liability in this case, dismissing plaintiff's claims based on the insufficiency of the complaint.[130] In the complaint, the plaintiff failed to show that COM or Fraser even possessed the power to control Durango. Thus, the Tenth Circuit Court of Appeals left open the question of "whether a

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122. *See id.* at 1306 n.8.

123. *See, e.g.*, SEC v. First Jersey Secs., Inc., 101 F.3d 1450, 1472 (2d Cir. 1996); Rochez Bros., Inc. v. Rhoades, 527 F.2d 880, 885 (3d Cir. 1975).

124. *See* Lowenfels & Bromberg, *supra* note 76, at 24. *But see Maher*, 144 F.3d at 1306 n.8 (citing *First Jersey*, 101 F.3d at 1472 (stating generally that to establish a prima facie case of control person liability, a plaintiff must show that the alleged control person was in some sense a meaningful participant in the fraud perpetrated by the controlled person)).

125. *See* Lowenfels & Bromberg, *supra* note 76, at 25–26.

126. *See Maher*, 144 F.3d at 1307.

127. *See id.*

128. *See id.* (citing Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1216 (1st Cir. 1996) (concluding dismissal of section 12(2) claim under Rule 12(b)(6) was appropriate)).

129. *See id.* (citing *In re* Words of Wonder Secs. Litig., 694 F. Supp. 1427, 1435 (N.D. Cal. 1988) (dismissing, with leave to amend, section 12(2) claims because plaintiffs failed to allege facts demonstrating that defendants "solicited" the purchase of the relevant securities)).

130. *See id.* at 1306 & n.8.

plaintiff must allege actual control of or simply the power to control the primary violator's general affairs in order to establish a prima facie case of control person liability."[131] While the Tenth Circuit's requirements for stating a prima facie case fall under the majority rule, the court chose not to decide what evidence would suffice when alleging control.

The distinction between the two views regarding control are whether actual control or just the power to control the general affairs of the primary violator is necessary to satisfy the control element of the prima facie case. The majority approach requiring actual control by the alleged control person over the primary violator's general affairs appears to be the better choice. It would be inequitable to hold the alleged control person jointly liable for the acts of the primary violator, based solely on the power to control the general affairs of the primary violator. By requiring actual control for a prima facie case, liability will only extend to those control persons who actually participated in the affairs of the primary violator, rather than holding a potentially innocent party liable based on the power to control.

Although the *Maher* court declined to specifically decide the issue, it appears at least arguable that the court is leaning in the direction of only requiring the power to control the general affairs of the primary violator. In its decision, the Tenth Circuit Court of Appeals cites a prior case where it construed the statute liberally, further stating a requirement of "only some indirect means of discipline or influence short of actual direction to hold a 'controlling person' liable."[132] The *Maher* court then reiterated that summary judgment in favor of the defendant is inappropriate when the defendant is in a position of at least indirect control over two companies that together control the primary violator.[133] Based on language in *Maher*, advocating a liberal approach, one can formulate the argument that the Tenth Circuit would not require proof of actual control by the controlling person over the primary violator's general affairs.

III. RELATION OF SECTIONS 11 AND 10(B) SECURITY EXCHANGE ACTS (1933 AND 1934) CLAIMS TO F.R.C.P. 9(B) AND THE STATUTE OF LIMITATIONS FOR A FEDERAL SECURITIES CLAIM

A. *Background*

When pleading securities fraud, the particularity requirements of Federal Rule of Civil Procedure 9(b)[134] often become an issue. Regarding a section 11 Securities Act claim, "a plaintiff who 'purchased a security

131. *Id.* at 1306.

132. *Id.* at 1302 (quoting Myzel v. Fields, 386 F.2d 718, 738 (8th Cir. 1967)).

133. *See id.* at 1305.

134. FED. R. CIV. P. 9(b) ("In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.").

issued pursuant to a registration statement . . . need only show a material misstatement or omission to establish [a] prima facie case. Liability against the issuer of a security is virtually absolute, even for innocent misstatements.'"[135] However, courts addressing section 11 claims have held that because section 11 claims are not necessarily based on fraud, the particularity requirements of Rule 9(b) are inapplicable.[136] Finally, a plaintiff can sue various parties for misrepresentations, or misleading statements, assuming the plaintiff who purchased the securities did not have knowledge of the false or misleading statement, or omission at the time of the acquisition.[137]

In regard to section 10(b) claims, Rule 9(b) requires the claim to include identification of circumstances constituting fraud.[138] The complaint must also include time, place, and contents of the false representation, identity of the party making the false statements, and consequences of such statements.[139] The complaint must state the identity of each party in relation to each statement made.[140] The purpose of requiring parties to comply with Rule 9(b) in securities cases is to protect the defendant's business reputation from unsupported fraud claims.[141] Additionally, the particularity requirements of Rule 9(b) also provide specific notice regarding which acts of the defendant are related to the fraud claim.[142]

Finally, the statute of limitations for a federal securities claim is one year.[143] This period is measured from the point the plaintiff has notice of the violation, and extends for one year from such notice.[144]

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135. Schwartz v. Celestial Seasonings, Inc., 124 F.3d 1246, 1251 (10th Cir. 1997) (quoting Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983)).

136. *See* 69A AM. JUR. 2D *Securities Regulation-Federal* § 1490 (1993). *Compare* Schoenfeld v. Giant Stores Corp., 62 F.R.D. 348, 350 (S.D.N.Y. 1974) (holding Rule 9(b) inapplicable to a section 11 claim), *with* Stac Elec. Sec. Litig. v. Clow, 89 F.3d 1399, 1404 (9th Cir. 1996) (holding Rule 9(b) requirements applicable when the claims are grounded in fraud).

137. *See* Securities Act of 1933, § 11, 48 Stat. 82 (codified at 15 U.S.C. § 77k (1994)). The statute states the ability to sue applies to

> (1) every person who signed the registration statement; (2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted; (3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner; . . . (5) every underwriter with respect to such security . . . .

Id.

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

139. *See Schwartz*, 124 F.3d at 1252 (quoting Lawrence Nat'l Bank v. Edmonds, 924 F.2d 176, 180 (10th Cir. 1991)).

140. *See id.* at 1253 (citing *Edmonds*, 924 F.2d at 180; Seattle-First Nat'l Bank v. Carlstedt, 800 F.2d 1008, 1011 (10th Cir. 1986)).

141. *See* 69A AM. JUR. 2D *Securities Regulation-Federal* § 1490 (1993).

142. *See id.*

143. *Cf.* Securities Exchange Act of 1934, § 10(b), 48 Stat. 908 (codified as amended at 15 U.S.C. § 77(m) (1994)).

144. *See id.*

B. *Tenth Circuit Case*—Schwartz v. Celestial Seasonings, Inc.[145]

1. Facts

Plaintiff brought suit on behalf of himself, and others similarly situated, against Celestial Seasonings, Inc. (Celestial) and other defendants for violations of securities laws.[146] In July 1993, Celestial "issued approximately two million shares of stock in an initial public offering (hereinafter 'IPO')."[147] At the time, Celestial was the largest manufacturer and marketer of herbal teas in the United States.[148] The IPO Prospectus stated Celestial was preparing to introduce a new ready-to-drink tea to the market.[149] The IPO also stated this venture would include an agreement with Perrier (Perrier Agreement), which gave Perrier the exclusive rights to make and sell the product in the United States and Canada.[150]

In January 1994, Celestial made a secondary public offering (SPO), again referring to the Perrier Agreement.[151] In May 1994, Celestial announced that discussions were under way to amend or terminate the Perrier Agreement.[152] After this announcement, Celestial stock prices began to fall.[153]

In his complaint, the plaintiff alleged that the defendants, Celestial, Celestial insiders, and the underwriters for the IPO and SPO, issued statements leading investors to conclude

> that Celestial would be able to utilize Perrier's manufacturing, marketing, and distributing capabilities to sell its [ready-to-drink or "RTD"] teas in the United States and Canada; that the Perrier Agreement would enhance Celestial's position as a specialty beverage company, increase the availability of its products at convenience stores, wholesale clubs, restaurants and food service operations, and allow it to further capitalize on its high brand awareness and on the growth in the RTD market; that Perrier, having promoted Celestial's RTD teas in test markets, would be selling Celestial's RTD products in fourteen major metropolitan markets in the Summer of 1993; and that a joint venture between Perrier's parent Nestle, and Coca-Cola would not adversely impact the Perrier Agreement.[154]

Further, plaintiff alleged defendants' knowing and reckless disregard of numerous facts. These facts included that Perrier's distribution system was incompatible with the sale of RTD teas, that Perrier would have to

145. Schwartz v. Celestial Seasonings, Inc., 124 F.3d 1246, (10th Cir. 1997).
146. *See Schwartz*, 124 F.3d at 1249.
147. *Id.*
148. *See id.*
149. *See id.*
150. *See id.*
151. *See id.*
152. *See id.*
153. *See id.*
154. *Id.*

spend large amounts of money to adapt this system to market RTD teas, that Perrier was not in a position to focus its time and efforts on marketing Celestial's product, that Nestle's arrangement with Coca-Cola was interfering with Perrier's agreement with Celestial, and that Celestial would not be able to afford the shelf space necessary for expansion based on the limited distribution of teas under the Perrier Agreement.[155] Based on these allegations, plaintiff claimed

> (1) primary liability for direct violations of § 11 of the Securities Act of 1933 and § 10(b) of the Securities and Exchange Act of 1934 (including Securities and Exchange Commission Rule 10(b)(5) promulgated thereunder); and (2) secondary liability of 'control persons' for violations of § 15 of the 1933 Act and § 20 of the 1934 Act.[156]

The district court eventually dismissed plaintiff's claims. The court found the sections 11 and 10(b) claims were based on fraud, and the complaint failed to satisfy the particularized pleading requirement of Rule 9(b).[157] The court held the complaint insufficiently identified "the circumstances constituting fraud upon which his various securities claims rely."[158] Further, the district court found cross-referencing in the complaint inadequate, that the sections 11 and 10(b) claims failed because there was no indication of which documents contained the alleged fraudulent statements.[159] Finally, the district court stated "that the § 10(b) claim failed to 'identify the specific misrepresentations made and which defendants [were] alleged to have made them.'"[160]

2. Decision

The Tenth Circuit held the section 11 claim was not subject to Federal Rule of Civil Procedure 9(b).[161] The plaintiff was not required to allege fraud to establish a section 11 claim.[162] However, defendants argued that plaintiff's claim was based on fraud, and Rule 9(b) was therefore applicable.[163] The court of appeals concluded, based on the plaintiff's complaint, that there was absolutely no allegation of fraud.[164] Thus, Rule 9(b) was inapplicable to the section 11 claim pleaded by plaintiff.

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155. *See id.* at 1249–50.

156. *Id.* at 1250.

157. *See id.* at 1250 & n.1.

158. *Id.* at 1250 (explaining further that the complaint failed "to meet the particularity requirements of Rule 9(b) because it does not adequately identify (1) the time, place and contents of the fraudulent misrepresentations or omissions; (2) the identity of the party alleged to have made the misrepresentations or omissions; and (3) the consequences of those misrepresentations or omissions.").

159. *See id.*

160. *Id.*

161. *See id.* at 1252.

162. *See id.* at 1251.

163. *Cf. id.* at 1250.

164. *Id.* at 1252. The case lists the allegations under Count I of the complaint:

The court of appeals found the section 10(b) claim was sufficient under Rule 9(b) because the plaintiff satisfied the factual allegation requirements of Rule 9(b). First, the court assessed whether plaintiff satisfied the time, place, and content requirements of Rule 9(b).[165] The complaint satisfied these requirements by stating and quoting the alleged fraudulent statements, identifying the sources of such statements, and even alleging facts that the alleged fraudulent statements misrepresented or failed to disclose.[166] The court of appeals found error in the district court's finding that plaintiff failed to satisfy these requirements, stating "[a] fair reading of the Complaint indicates that by cross-referencing as allowed by Rule 10(c), it sufficiently particularizes the circumstances constituting fraud to comply with Rule 9(b)."[167]

Next, the court of appeals addressed whether the complaint satisfied the requirement of identifying the parties who made the alleged fraudulent statements. With regard to the corporate defendant, the court found the complaint "plainly attributes the statements of the individual defendants to Celestial Seasonings, Inc. itself."[168] The court also looked at the identification requirement in regard to the individual defendants at Celestial.[169] The court of appeals did not accept defendant's argument the complaint violated Rule 9(b) because it failed to pair the individual statements with particular individual defendants.[170] Finally, the court assessed the identity requirement with regard to the securities underwriter defendants. The court of appeals found the complaint sufficiently alleged the roles of the underwriters with regard to the alleged fraudulent statements.[171]

> [D]efendants failed to make a "reasonable investigation of the statements contained in the Registration Statements and Prospectuses" . . . ; that the misrepresentations "would have been known [by the defendants] had they carried out their responsibilities with reasonable care" . . . ; and that [the] defendants "failed to make a reasonable investigation, . . . [did not] possess[] reasonable grounds for belief, . . . and knew, or in the exercise of reasonable care should have known, that the statements . . . were materially untrue and incomplete."

Id.

165. *See id.*

166. *See id.*

167. *Id.* at 1253 (citing Seattle-First Nat'l Bank v. Edmonds, 800 F.2d 1008, 1011 (10th Cir. 1986)).

168. *Id.*

169. *See id.* The case states that the complaint alleged the individual defendants at Celestial were responsible for all of Celestial's alleged fraudulent statements:

> The Individual Defendants had the power and the influence . . . to cause Celestial to engage in the unlawful acts and conduct alleged herein. The Individual Defendants caused the publication of the materially false and misleading Prospectuses, Registration Statements and Celestial's public filings and statements issued during the Class Period . . . .

Id.

170. *See id.* at 1254 ("Identifying the individual sources of statements is unnecessary when the fraud allegations arise from misstatements or omissions in group-published documents such as annual reports, which presumably involve collective actions of corporate directors or officers.").

171. *See id.* ("In order to adequately allege underwriter responsibility for Celestial's statements, the complaint must identify the specific role of the underwriters in propounding the fraudulent statements.").

Finally, the Tenth Circuit assessed whether plaintiff identified the consequences of the misrepresentations or omissions.[172] The court of appeals found the complaint sufficiently described the alleged fraudulent scheme and its consequences.[173] Further, the complaint detailed the history of Celestial's stock price, the inflationary impact of the fraud, and the future decline of the stock price and rating upon Celestial's statements regarding the possible termination of the Perrier agreement.[174]

The court finally held plaintiff's action was not barred by the statute of limitations.[175] The court of appeals found the plaintiff could not have known about the violations until the release of Celestial's Form 10-Q that announced Celestial and Perrier were considering termination of the Perrier agreement.[176] Thus, plaintiff's claims were filed within one year following publication of Celestial's 10-Q.[177]

Based on the above holdings, the Tenth Circuit Court of Appeals also allowed plaintiff to bring secondary liability claims under sections 15 and 20 of the 1933 and 1934 Acts.[178] These claims were disallowed under the district court's analysis.

C. *Other Circuits*

1. Section 11 (1933 Act) Claims & 9(b) Requirements

The Tenth Circuit's holding that Rule 9(b) does not apply to a section 11 claim is in accord with decisions in other districts. For instance, a district court in New York held that Rule 9(b) does not apply to a section 11 claim because fraud is not required under a 1933 Act section 11 claim.[179] However, a Ninth Circuit decision holds that when a section 11

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172. *See id.* at 1254–55.

173. *See id.* The court stated:

> [The Complaint] identifies the fraudulent statements and alleges the facts which the statements misrepresented or failed to disclose . . . The Complaint specifically pleads: [T]he materially false and misleading . . . statements . . . led investors to believe that, as a result of the Perrier Agreement, Celestial would obtain a substantial market for its ready-to-drink tea in the very near future, with a resulting increase in earning and profits. The . . . unlawful acts and conduct alleged herein . . . maintain[ed] an artificially high price for Celestial's shares. . . . By stressing the Perrier Agreement and its imminent prospects, defendants knew that and intended that investors would look at Celestial as an immediately viable competitor to Snapple, in the then exploding market for ready-to-drink teas. To accomplish this illusion, the Prospectus repeatedly touted the existence of the Perrier Agreement . . . .

Id.

174. *See id.* at 1255.

175. *See id.*

176. *See id.*

177. *See id.*

178. *See id.*

179. *See* Schoenfeld v. Giant Stores Corp., 62 F.R.D. 348, 350–51 (S.D.N.Y. 1974).

claim has its basis in fraud, the particularity requirements of Rule 9(b) are applicable.[180]

2. Section 10b Claims and the Requirements of Rule 9(b)

The Tenth Circuit's application of the particularity requirements of Rule 9(b) is also in accord with decisions in other courts.[181] A decision in the Ninth Circuit required parties to meet the particularity requirements when alleging 10(b)(5) claims.[182] Additionally, the Second Circuit upheld dismissal of a complaint based on Rule 9(b) particularity requirements because it only contained conclusory allegations of fraud.[183]

Further, a district court in Utah held a "securities purchaser's allegations of fraud against securities issuing company and company directors to be sufficient under Rule 9(b) because they set forth specific time period and content of misrepresentations."[184]

3. Statute of Limitations for Federal Securities Claims

Though the decision only briefly addressed the issue, the one year statute of limitations starts from the date when the party knows of, or should have discovered the violations.[185] However, it is important to note there are varying definitions of notice that differ from that of the Tenth Circuit.[186]

D. *Analysis*

The Tenth Circuit's determination that section 11 claims under the 1933 Act, not based on fraud, do not trigger the particularity requirements of Rule 9(b) correctly recognizes that a section 11 claim does not require allegations of fraud. An allegation of negligent misrepresentation is enough to satisfy the requirements of claiming a violation under section 11.[187] Further, requiring particularity under Rule 9(b) would be inconsistent with the policy that "liability against the issuer of a security is

180. *See* Stac Elec. Sec. Litig. v. Clow, 89 F.3d 1399, 1404–05 (9th Cir. 1996).

181. For further discussion, and an extensive list of decisions requiring pleadings with particularity in cases based on fraud, see Barney J. Finberg, Annotation, *Construction and Application of Provision of Rule 9(b), Federal Rules of Civil Procedure, that Circumstances Constituting Fraud or Mistake Be Stated with Particularity*, 27 A.L.R. FED. 407 (1976).

182. *See Clow*, 89 F.3d at 1404.

183. *See Schwartz*, 124 F.3d at 1252 (citing Segal v. Gordon, 467 F.2d 602, 607 (2d Cir. 1972)).

184. *See id.* (citing Bradford v. Moench, 670 F. Supp. 920, 923 (D. Utah 1987)).

185. *Id.* at 1255 (citing Securities Exchange Act of 1934, § 10(b), 48 Stat. 908 (codified as amended at 15 U.S.C. § 77m (1994)).

186. For further discussion of inquiry notice, see Lawrence Kaplan, Annotation, *What Constitutes "Inquiry Notice" Sufficient to Commence Running of Statute of Limitations in Securities Fraud Action- Post-Lampf Cases*, 148 A.L.R. FED. 629, 648–51 (1998).

187. *See* Schoenfeld v. Giant Stores Corp., 62 F.R.D. 348, 350 (S.D.N.Y. 1974).

virtually absolute, even for innocent misstatements."[188] This policy is obviously intended to protect investors and hold those who issue registered securities accountable for their misstatements and omissions. Requiring plaintiffs or investors to allege section 11 claims with particularity would contradict the policy of virtual absolute liability.

In regard to the particularity requirements of Rule 9(b), as applied to 10(b) claims, the Tenth Circuit's decision again appears to be correct. Allegations of 10(b)(5) violations require the plaintiff to allege fraud, and to plead such fraud with particularity.[189] Further, the purpose of the particularity requirements of Rule 9(b) are to give the defendant notice of the claim against them, and the factual allegations in support of that claim.[190] Thus, requiring pleadings with particularity in cases alleging fraud supports the purpose behind Rule 9(b). Further, requiring a plaintiff to support claims of fraud results in many benefits. First, this requirement expedites resolution of the case by notifying the defendant of the alleged false statements, thereby giving the defendant an opportunity to defend him or herself. Further, expedition of claims will prevent backlog in the courts. It seems sensible to require a plaintiff to support claims of fraud when making allegations in the complaint, as opposed to using the judicial process to adjudicate claims which could be baseless. The severity of fraud allegations should require the presence of facts that indicate and support the fraud claim. Overall, the requirement of pleading 10(b) claims with particularity is supported by the purpose of Rule 9(b) and by decisions of various courts.

CONCLUSION

In *Blinder*, the Tenth Circuit Court of Appeals took the opportunity to correct the decision made by the district court.[191] The court found the combination of mailing and publishing notice satisfied due process requirements and that the six-month requirement for filing claims was absolute.[192] Further, the court established that an incompetent person is required to file for an extension within the six-month period to take advantage of the exception enumerated in the statute.[193]

In *Maher*, the court explained the split among the circuits regarding interpretation of the term "control."[194] Although the court does not spe-

188. *Schwartz*, 124 F.3d at 1251 (quoting Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983)); *see also* Kaplan v. Rose, 49 F.3d 1363, 1371 (9th Cir. 1994) ("No scienter is required for liability under § 11; defendants will be liable for innocent or negligent material misstatements or omissions.").

189. *Cf., e.g.*, Stac Elec. Sec. Litig. v. Clow, 89 F.3d 1399, 1404 (9th Cir. 1996).

190. *See Schwartz*, 124 F.3d at 1252.

191. Blinder, Robinson & Co. v. Stellatos, 124 F.3d 1238, 1244 (10th Cir. 1997).

192. *See Blinder*, 124 F.3d at 1244.

193. *See id.* at 1243.

194. Maher v. Durango Metals, Inc., 144 F.3d 1302, 1306 n.8 (10th Cir. 1998).

cifically answer the issue, it is arguable the language in the opinion advocating a liberal approach is an indication the Tenth Circuit would recognize the controlling person's power to exercise control over the general affairs of the primary violator as a sufficient amount of control.[195]

Finally, in *Schwartz* the court assessed the applicability of the Rule 9(b) particularity requirements when pleading section 11 (of the 1933 Act) and section 10(b) claims (of the 1934 Act).[196] The court determined the plaintiff's complaint clearly did not allege fraud in connection with the section 11 claim and thus, Rule 9(b) was inapplicable.[197] In regard to the section 10(b) claim, the court held the plaintiff's detailed complaint satisfied the requirements of Rule 9(b) and found the cross-referencing in the complaint to be acceptable.[198]

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195. *See Maher*, 144 F.3d at 1306 n.8.
196. *See* Schwartz v. Celestial Seasonings, Inc., 124 F.3d 1246 (10th Cir. 1997).
197. *See Schwartz*, 124 F.3d at 1252.
198. *See id.* at 1253.

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