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POINTING FINGERS WITHOUT PROOF: ELEMENTS OF A CLAIM UNDER SECTION 11 OF THE SECURITIES ACT OF 1933

I. INTRODUCTION

Plaintiffs making claims under section 11 of the Securities Act of 1933¹ (hereinafter, the “Securities Act” or “Act”) must demonstrate that the defendants communicated statements of belief or opinion on registration statements² that were “both objectively false and disbelieved by the defendant at the time” they were expressed.³ A registration statement is “a legal document filed with the SEC to register securities for public offering that details the purpose of the proposed public offering.”⁴ The Securities Act imposes liability on certain persons who have fiduciary duties to the corporation if the registration statement contains a material misrepresentation when it becomes effective.⁵ Recently, however, the Sixth Circuit drastically lowered the bar for these types of securities claims, holding that section 11 imposes strict liability. Thus, in the Sixth Circuit, a plaintiff is not required to prove that the defendant *intended* to communicate a false opinion or belief in the registration statement.⁶ This holding shied away from prior holdings in the Second and Ninth Circuits, creating a controversial split over the pleading requirements of section 11.⁷ The difference in precedents focuses on precisely what a

¹ 15 USC § 77K.

² The Circuit Split concerns the pleading requirements for liability concerning “soft” information in a registration statement. Such information includes “opinions, ideas, rumors, economic projections, statement of management’s future plans, and market commentary.” Mitchell A. Peterson, *Information: Hard and Soft* (Kellogg School of Management, Northwestern University) (Preliminary and Incomplete) (July 2004).

³ *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011); see *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991).

⁴ <http://www.nasdaq.com/investing/glossary/r/registration-statement>.

⁵ James D. Cox, et al., *Securities Regulation: Cases and Materials* 151 (Wolters Kluwer Law & Business, 7th ed. 2013).

⁶ *Ind. State Dist. Council v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013).

⁷ *Id.*

plaintiff should be required to prove when alleging a section 11 claim based on a statement of opinion or belief⁸ communicated in a registration statement.

In *Rubke v. Capitol Bancorp, Ltd.*,⁹ the Second Circuit upheld a lower court's dismissal of the complaint because the plaintiff failed to allege with particularity that defendant made materially misleading statements and omissions. The information in the registration statement can result in a section 11 claim only if the complaint successfully demonstrates that the statements were both subjectively and objectively false and misleading.¹⁰ While the Second and Ninth Circuits correctly held that a plaintiff must prove that defendant's misstatement was both objectively and subjectively false and/or misleading¹¹, Courts should further add "*loss causation*"¹² and "*scienter*"¹³ as required elements for plaintiff to prove. Therefore, if the plaintiff did not suffer some kind of monetary loss; and if the defendant did not intentionally plan to defraud the shareholder, then the plaintiff (shareholder) should have no claim.¹⁴ Reconciling the circuit split and creating a cohesive list of pleading requirements is the underlying theme of this Comment.

The first section of this Comment explores how and why the Securities Act of 1933 was passed, and explains the legal definition of a "security."¹⁵ Additionally, it will explain what a

⁸ See *supra* note 1.

⁹ 551 F.3d 1156 (9th Cir. 2009).

¹⁰ *Id.* at 1162; see *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991) (holding that "proof of mere disbelief or belief undisclosed should not suffice for liability . . .").

¹¹ *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011); *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009).

¹² *Loss causation* "requires a showing "that the misrepresentations or omissions caused the economic harm." In re *Catanella & E.F. Hutton & Co., Sec. Litigation*, 583 F. Supp. 1388, 1414 (E.D. Pa. 1984) (quoting *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir.1974)

¹³ *Scienter* can be proven by establishing "knowledge or recklessness on the part of defendant[. . ." In re *Catanella*, 583 F. Supp. at 1404.

¹⁴ This controversial split creates several public policy concerns that will need to be examined in great detail to prevent an influx of litigation in the courts and the need for unification in the pleading requirements that plaintiff must establish in order to make a successful claim under § 11.

¹⁵ A security is a fungible, negotiable financial instrument that represents some type of financial value. <http://www.investopedia.com/terms/s/security.asp>.

registration statement is, what information the document should disclose and how and why a plaintiff would bring a section 11 claim. This section also introduces this author's reasons for why a plaintiff, when establishing a section 11 claim, should be required to prove several elements, rather than merely "pointing fingers" – keeping in mind that every story has three sides.

The second section of this Comment discusses in detail the Second¹⁶ and Ninth Circuit¹⁷ cases, as well as the Sixth Circuit case that created the split.¹⁸ The third and final section of my Comment analyzes the need for additional legal components – *loss causation*¹⁹ and *scienter*²⁰ – that a plaintiff should be required to prove in order to establish a claim under section 11 of the Act. Requiring plaintiffs to prove these additional elements will create parity between section 11 of the Securities Act and both section 10b of the Securities Exchange Act of 1934²¹ and SEC Rule 10b-5.²²

¹⁶ *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011).

¹⁷ *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156 (9th Cir. 2009).

¹⁸ *Virginia Bankshares v. Sandberg*, 501 U.S. 1083 (1991).

¹⁹ *See supra* note 6 and accompanying text; *see infra*. Part IV.

²⁰ *Id.*

²¹ "In the aftermath of the 1929 stock market crash, Congress enacted § 10(b) of the Act as part of a wave of federal legislation intended to address the insufficiency of the common law in protecting investors from insider trading. E. Livingston B. Haskell, NOTES: "Disclose-or-Abstain" Without Restraint: The Supreme Court Misses the Mark on Rule 14e-3 in *United States v. O'Hagan*, 55 Wash & Lee L. Rev. 199, 206-7 (1998).

²² Rule 10b-5 states: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit on any person, in connection with the purchase or sale of any security. 17 C.F.R. 240.10b-5 (1997).

II. BACKGROUND

A. *Welcome to the World of Securities: The Securities Act of 1933 & the Securities Exchange Act of 1934*

Following the Great Depression in the early part of the 20th century, the world was introduced to the very first securities act – the Securities Act of 1933.²³ The Securities Act regulates the public offering and sale of securities in interstate commerce. So, one might ask, what exactly is a security? Is it something that secures your money? The answer, all too common in the law is - kind of. Black’s Law Dictionary defines a security²⁴ as: “Collateral given or pledged to guarantee the fulfillment of an obligation; esp., the assurance that a creditor will be repaid any money or credit extended to a debtor.”²⁵ In simpler terms, a security is an investment. For instance, if you purchase stock in Twitter, you are likely hoping that you can make some money – so you are hoping that the stock price will continue to rise so that when you sell it, you can make a profit. Securities law becomes significantly more complex than this, but the basic premise holds throughout.

²³ 15 U.S.C. § 77a *et seq.*

²⁴ The formal definition of a security under the United States Code provides:

“The term “security” means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. 77(b)(a)(1)

²⁵ BLACK’S LAW DICTIONARY 1158 (9th ed. 2010).

The Exchange Act of 1934 (the “Exchange Act”)²⁶ also regulates the securities market. Although similar to the Securities Act, the Exchange Act is primarily concerned with regulating the secondary trading market and its participants. It created the Securities and Exchange Commission, (“SEC”) giving the SEC the authority to regulate the securities market to protect investors against fraudulent or discriminating practices. While the Securities Act and the Exchange Act regulate different types of behavior, the same type of conduct that would cause a violation of SEC Rule 10b-5 under the Exchange Act will likely cause a section 11 claim under the Securities Act.²⁷ When a plaintiff alleges that defendant has violated section 11 – and the complaint “sounds in fraud,” plaintiff should be required to meet the following requirements²⁸: [1] the “heightened pleading” requirement of Rule 9(b), [2] a subjective element, requiring proof that a defendant knew the statement made in the registration statement was false; [3] proof establishing that an objective, reasonable person would have disbelieved the information given in the registration statement was true; [4] scienter; and [5] loss causation.

B. §11 of the Securities Act, §10b of the Exchange Act & SEC Rule 10b-5

“The central objective of the Securities Act is the preparation of a registration statement for securities offered to the public.”²⁹ The following information is what needs to be included: [1] information regarding the company that is offering the securities to the public. This includes management and compensation information, an overview of the company, information pertaining

²⁶ 15 U.S.C. § 78a *et seq.*

²⁷ *Rombach v. Chang*, 355 F.3d 164, 171 (2d Cir. 2004)

²⁸ Several district and circuit courts have held that in order for a defendant to be held liable, plaintiff must prove that the information in the registration statement was both subjectively and objectively false and misleading. Further, for a complaint that “sounds in fraud” – meaning when the plaintiff alleges that defendant fraudulently provided misleading and false information in the registration statement; plaintiff must establish his allegation[s] with “heightened particularity” pursuant to Federal Rule of Civil Procedure 9(b). *See, e.g., Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991); *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009); *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 111 (2d Cir. 2011); *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1131 (2d Cir. 1994); *In re McKesson HBOC, Inc. Secs. Litig.*, 126 F. Supp. 2d 1248, 1265 (N.D. Cal. 2000).

²⁹ James D. Cox, et al., *Securities Regulation: Cases and Materials* 136 (Wolters Kluwer Law & Business, 7th ed. 2013).

to any outstanding common stock, prices of that stock within the past two fiscal years, the number of shareholders of that stock, and the number of dividends for each class of stock; [2] the company's distribution of its proceeds – including any future plans for those proceeds; [3] an explanation of the securities being offered to the public – including the “rights, privileges and preferences” of such security; and [4] supporting documents and exhibits, including the company's bylaws, articles of incorporation , the attorney's opinion with regard to the “legality of the securities registered,” and other supporting information.³⁰

Section 11 of the Securities Act holds liable a defendant who gives materially false or misleading information in a registration statement.³¹ Similarly, section 10(b) of the Exchange Act and corresponding SEC Rule 10b-5 prohibit deceptive practices in the buying or selling of securities.³² Both section 10(b) and Rule 10b-5 are “grounded on the notion of fraud.”³³

Section 10(b) grants the SEC power to regulate manipulative or deceptive devices connected with securities transactions in an attempt to preserve the public interest and to protect investors. . . [B]ased on this authority, the SEC promulgated Rule 10b-5, a general antifraud provision that the SEC utilizes to enforce the prohibition on insider trading.³⁴

Furthermore, to state a successful claim for a violation of section 10(b), a plaintiff must allege:

(1) the existence of a material misrepresentation (or omission), (2) made with scienter (i.e., "a wrongful state of mind"), (3) in connection with the purchase or sale of any security, (4) on which the plaintiff relied, and (5) which was causally connected to (6) the plaintiff's economic loss.³⁵

³⁰ *Id.*

³¹ 15 USC § 77K

³² 15 USC § 78j; 17 C.F.R. 240.10b-5.

³³ Richard J. Morgan, *Insider Trading and the Infringement of Property Rights*, 48 Ohio St. L.J. 79, 83 (1987).

³⁴ E. Livingston B. Haskell , "Disclose-or-Abstain" Without Restraint: *The Supreme Court Misses the Mark on Rule 14e-3 in United States v. O'Hagan*, 55 Wash & Lee L. Rev. 199, 206-7 (1998).

³⁵ *Thompson v. RelationServe Media, Inc.*, 610 F.3d 628, 633 (11th Cir. 2010).

To state a successful claim for a violation of Rule 10b-5 . . .

. . . [t]he elements of a civil cause of action and a criminal prosecution are similar. Both require a false statement or an omission of a material fact; however, scienter is required for criminal liability to attach. For civil liability, the plaintiff need only prove reliance that is causally related to the plaintiff's injury.³⁶

The core dispute, however, arises in section 11's pleading requirements – as the Sixth Circuit has recently created a split having determined that the statute provides for strict liability – attaching liability to a defendant for a false statement made in the registration statement, irrespective of defendant's knowledge that the statement[s] was incorrect.³⁷

C. The Requirement of Federal Rule of Civil Procedure 9(b)

“[R]ule 9 requires that ‘in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.’”³⁸ “The textbook definition of fraud is: (1) a false representation of material fact, (2) defendant's knowledge that the representation is false, (3) an intent to induce reliance, (4) justifiable reliance by the plaintiff, and (5) damages.”³⁹ It has been widely held that Rule 9(b) applies to a section 11 claim that “sounds in fraud.”⁴⁰ Despite public policy arguments to the contrary, a plaintiff does not ordinarily need to meet the heightened pleading⁴¹ requirement of Rule 9(b) when bringing a section 11 claim because the “plain language of the statute does not include fraud or mistake as an element of a

³⁶ Joseph Conahan, et al., *Securities Fraud*, 40 Am. Crim. L. Rev. 1041, 1046 (2003).

³⁷ *Ind. State Dist. Council v. Omnicare, Inc.*, 719 F.3d 498, 505 (6th Cir. 2013).

³⁸ Christopher Fairman, *Heightened Pleading*, 81 Tex. L. Rev. 551, 562-63 (Dec. 2002) (quoting Fed. R. Civ. P. 9(b)).

³⁹ *Id.* at 565.

⁴⁰ *See infra* note 53; *see, e.g.*, *Ind. State Dist. Council v. Omnicare, Inc.*, 719 F.3d 498, 503 (6th Cir. 2013); *see, e.g.*, *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009).

⁴¹ In order to plead with “heightened particularity,” a plaintiff must prove: “. . . [w]hat is false or misleading about a statement, and why it is false.” *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d at 1161.

section 11 claim.”⁴² If, however, the plaintiff is alleging that defendant “intended to defraud” the plaintiff by making a false statement, a plaintiff must meet the heightened pleading requirement, but therefore, wouldn’t be alleging a section 11 claim. Rule 9(b) can become quite tricky in this context because there has been widespread debate as to whether or not a plaintiff should be required to adhere to the heightened pleading requirement of Rule 9(b) since a section 11 claim does not require the plaintiff to prove fraud or scienter as an element of such a claim.⁴³ Although the thrust of this Comment is not specifically aimed at the applicability of Rule 9(b), it should be mentioned that when a plaintiff brings a claim under §11, that plaintiff should be required to plead his allegations with particularity. Otherwise, it would seem as though a plaintiff can establish a successful claim against a defendant regardless of whether or not the plaintiff has any proof to support such an allegation. Therefore, when bringing a §11 claim, a plaintiff should be required to meet the heightened pleading requirements of Rule 9(b) regardless of whether or not the plaintiff’s claim sounds in fraud.

D. The Rule of “3”

As we all should have heard, there are three sides to every story – yes, three, not two. The plaintiff has one side of the story – the story that will do nothing but point fingers and reflect the defendant in the most negative and the poorest light possible. Then, we have the defendant’s side of the story – possibly fluffed to allow the listener or reader to feel the smallest ounce of sympathy, leaving us with that bit of doubt as to the guilt or fault of the defendant. Then, there is a third side of the story – the absolute, objective truth regarding the contested matter. The absolute truth is to be determined as closely as possible by the courts. Courts, however, do not always find the truth, because courts inevitably will not always make the proper determination.

⁴² Krista L. Turnquist, Note: Pleading Under Section 11 of the Securities Act of 1933, 98 MICH. L. REV. 2395, 2398 (June 2000).

⁴³ *Id.*

This is precisely what happened in *Ind. State Dist. Council v. Omnicare*.⁴⁴ The Sixth Circuit strayed from the long-held rule that a plaintiff must prove both subjective and objective intent to hold the defendant liable. Courts in the past, particularly the Second and Ninth Circuits, had held that, in a case pleading fraud, the plaintiff must prove “that the statements were both objectively and subjectively false and misleading.”⁴⁵ The Sixth Circuit knowingly created a jurisprudential split.⁴⁶ Because of this, the U.S. Supreme Court may be required to resolve the split in an effort to prevent the many problems that will arise should courts allow a plaintiff to sue a defendant pursuant to section 11 without proving intent. Ultimately, under the Sixth Circuit’s standard, plaintiffs can “point fingers without proof” and come out on top.

III. ANALYSIS

A. The Circuit Split: How low should courts go with liberal pleading standards to establish a §11 claim?

1. The Second Circuit: *Fait v. Regions Fin. Corp.*

In *Fait v. Regions Fin. Corp.*⁴⁷, the plaintiff alleged that defendant, Regions Financial Corporation (hereinafter “Regions”), a regional bank holding company, violated section 11 by negligently delivering “false and material misrepresentations” in its registration statement for the purpose of making a public offering of securities.⁴⁸ In November 2006, Regions acquired AmSouth Bancorporation (hereinafter “AmSouth”) – valued at nearly \$10 billion.⁴⁹ Following the acquisition, Regions filed its annual Form 10-K having reported an \$11.5 billion valuation of

⁴⁴ 719 F.3d 498 (6th Cir. 2013).

⁴⁵ Rubke, 551 F.3d at 1162.

⁴⁶ The Circuit Court neglected to follow the Second and Ninth Circuits – and neglected to follow the U.S. Supreme Court in *Virginia Bankshares*, creating a brand new circuit split that may cause great controversy in the near future.

⁴⁷ 655 F.3d 105 (2d Cir. 2011).

⁴⁸ *Id.* at 108.

⁴⁹ *Id.* at 107.

goodwill.⁵⁰ The 10-K additionally stated that Region’s loan loss reserves were significantly increased from \$142.4 million to \$555 million.⁵¹

The following year, in April 2008, Regions Financing Trust III (the “Trust”), a subsidiary of Regions, “issued 13.8 million shares of . . . hybrid securities . . . in a registered public offering” (the “offering”).⁵² Regions registration statement and prospectus pertaining to the offering referenced the prior 10-K that contained both a goodwill amount of \$11.5 billion and an increase of over \$400 million in the loan loss provision.⁵³

In the end of 2008, Regions’ stock plummeted following its 4th quarter filings – filings that disclosed a \$5.6 billion net loss resulting from an impairment of good will, and an increased loan loss provision of \$1.15 billion.⁵⁴ Thereafter, plaintiff filed suit, alleging that Regions, in drafting its registration statement and prospectus, negligently gave false and misleading statements with respect to its goodwill and loan loss reserve figures, thus violating section 11 of the Securities Act.⁵⁵

Regions then moved to dismiss, arguing that the monetary figures regarding goodwill and loan loss reserves were matters of opinion – and not actionable because plaintiff failed to prove

⁵⁰ *Id.* (agreeing that, following its acquisition, Regions “would record AmSouth’s assets and liabilities at fair value, and that any excess of purchase price over net fair value would be recorded as goodwill.”); “*goodwill*” is “an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.” *Fait v. Regions Fin. Corp.*, 655 F.3d at 110 (quoting J.A. 940 (Business Combinations, SFAS No. 141 ¶ 3j (Fin. Accounting Standards Bd. 2007))); a “*loss reserve*” is “[A]n insurance company’s reserve that represents the estimated value of future payments, as for losses, incurred but not yet reported.” BLACKS LAW DICTIONARY 1115 (9th edition 2010).

⁵¹ *Fait v. Regions Fin. Corp.*, 655 F.3d at 107.

⁵² *Id.* at 107; A hybrid security is: “A security that combines two or more different financial instruments. Hybrid securities generally combine both debt and equity characteristics. The most common example is a convertible bond that has features of an ordinary bond, but is heavily influenced by the price movements of the stock into which it is convertible.” <http://www.investopedia.com/terms/h/hybridsecurity.asp>.

⁵³ *Fait v. Regions Fin. Corp.*, 655 F.3d at 107.

⁵⁴ *Id.*; “GAAP also requires that goodwill be tested for impairment annually, or “more frequently if events or changes in circumstances indicate that the asset might be impaired.”” *Fait v. Regions Fin. Corp.*, 655 F.3d at 110 (quoting J.A. 538 (Goodwill and Other Intangible Assets, SFAS No. 142 ¶ 17 (Fin. Accounting Standards Bd. 2001))).

⁵⁵ *Fait v. Regions Fin. Corp.*, 655 F.3d at 108.

that, subjectively, Regions knew they were providing inconsistent figures at the time of disclosure.⁵⁶ District Court Judge Kaplan determined that “the statements in question were not actionable because the complaint failed to allege that defendant[] did not honestly hold those opinions at the time they were expressed.”⁵⁷

On appeal, plaintiff argued that Regions’ incorporation of its 10-K in the offering led to violations of section 11 in its registration statement.⁵⁸ The Second Circuit, however, correctly held that estimates of goodwill do not involve material misrepresentations, “but rather a misstatement regarding Regions’ opinion.”⁵⁹ Estimates of goodwill are solely based upon management’s determination of the fair market value of the acquired assets and expected liabilities, not factually determined figures.⁶⁰

The Second Circuit correctly determined that plaintiff failed to properly allege that Regions intentionally misstated or misrepresented its goodwill and loan loss reserve figures at the time of disclosure.⁶¹ Furthermore, several courts, including prior decisions in the Second Circuit involving identical allegations, have held that, for a plaintiff to successfully establish a section 11 claim, plaintiff must prove that defendant’s statement was [1] false; and [2] not

⁵⁶ *Id.* at 108.

⁵⁷ *Id.* at 109.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.* at 110; *see, e.g.*, Henry v. Champlain Enters., Inc., 445 F.3d 610, 619 (2d Cir. 2006) (“There is no universally infallible index of fair market value. There may be a range of prices with reasonable claims to being fair market value.” (quoting Rhodes v. Amoco Oil Co., 143 F.3d 1369, 1372 (10th Cir. 1998))); In re Time Warner Inc., 9 F.3d 259, 266 (2d Cir. 1993)(holding that “expressions of opinion and . . . projections” in a company’s statements about its future prospects were not actionable because “the complaint contain[ed] no allegations to support the inference that the defendants either did not have the[] favorable opinions on future prospects when they made the statements or that the favorable opinions were without a basis in fact.”); Kowal v. IBM (In re IBM Corporate Securities Litigation), 163 F.3d 102 (2d Cir. N.Y. 1998) (holding that a company’s alleged statements that were merely projections were not actionable under the 1933 or 1934 Acts.)

⁶¹ *Fait v. Regions Fin. Corp.*, 655 F.3d at 113.

believed when it was disclosed.⁶² Therefore, plaintiff in this case failed to state a claim – and the Second Circuit affirmed the lower court’s decision.

2. The Ninth Circuit: *Rubke v. Capitol Bancorp, Ltd.*

In *Rubke v. Capitol Bancorp, Ltd.*⁶³, plaintiffs, minority shareholders, alleged that defendant violated section 11 of the Securities Act for having provided misleading information in its registration statement. Defendant, Capitol Bancorp (hereinafter “Capitol”), a bank holding company, created and controlled smaller community banks, including Napa Community Bank (hereinafter “NCB”), the subject of the suit.⁶⁴ After creating NCB, Capitol solicited investors in the local community, having informed potential investors of its business intentions – for the investors to control 49% of NCB with the remaining 51% of NCB’s stock to be purchased by Capitol, thus causing Capitol to become the controlling shareholder in NCB.⁶⁵

Simultaneously, Capitol established a holding company called First California Northern (hereinafter “FCN”).⁶⁶ Capitol then solicited investors who would own 49% of the company with Capitol owning the majority 51%.⁶⁷ Capitol then offered its FCN investors the opportunity to

⁶² *Id.* at 113; *see* Va. Bankshares v. Sandberg, 501 U.S. 1083, 1098, 1108-09 (1991). There, the Court reasoned that, “. . . [t]he evidence invoked by [shareholders] in the instant case fell short of compelling the jury to find the facial materiality of the misleading statement neutralized.” (Scalia, J., concurring in part) (noting that “the statement “In the opinion of the Directors, this is a high value for the shares” would produce liability if in fact it was not a high value and the directors knew that. It would not produce liability if in fact it was not a high value but the directors honestly believed otherwise.”; *see* MHC Mut. Conversion Fund, L.P. v. United W. Bancorp, Inc., 913 F. Supp. 2d 1026, 1036 (D. Colo. 2012) (holding that under governing law, a plaintiff asserting a claim . . . that is based on an opinion, must allege that the opinion is objectively and subjectively false.”)

⁶³ 551 F.3d 1156 (9th Cir. 2009)

⁶⁴ *Id.* at 1159.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

exchange their FCN shares for Capitol shares.⁶⁸ As a result, Capitol gained absolute control (100%) of FCN.⁶⁹

Less than a year later, Capitol offered the minority shareholders of NCB (hereinafter referred to as “plaintiffs”) an exchange offer (the “offer”) – in hopes that this offer, identical to the FCN offer, would produce a similar result.⁷⁰ The offer was for the exchange of Capitol shares at a rate of 150% of the book value of NCB’s common stock.⁷¹ Plaintiffs, having believed that the offer was unfair, formed a “minority shareholders committee.”⁷² The committee obtained its own fairness opinion that set forth the fair market value (“FMV”) of the NCB shares at a rate of \$21 per share (roughly 33% higher than the original offer).⁷³

While some of the minority shareholders exchanged their shares, others did not.⁷⁴ After the offer ended, Capitol had acquired 87% of NCB’s shares, leaving 13% in the hands of the remaining shareholders.⁷⁵ The minority shareholders, including those who agreed to exchange their NCB shares for Capitol shares, filed suit alleging that, *inter alia*, defendant violated section 11 of the Securities Act for providing misleading statements in its registration statement.⁷⁶ The Northern District of California, however, immediately dismissed plaintiffs’ claims because they failed to plead their claim with particularity, as required by Federal Rule Civil Procedure 9(b).⁷⁷ After amending their complaint – by merely adding a separate claim – the district court again dismissed plaintiffs complaint because they failed to allege with particularity the securities

⁶⁸ Rubke, 551 F.3d at 1159.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ Rubke, 551 F.3d at 1159-60.

⁷⁴ *Id.* at 1160.

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.*

violations that defendant had allegedly committed.⁷⁸ Thereafter, plaintiffs appealed to the Ninth Circuit Court of Appeals.⁷⁹

On appeal, plaintiffs argued that the district court erroneously dismissed their First Amended Complaint that alleged that defendant Capitol's registration statement, "contained material misrepresentations in violation of section 11 of the Securities Act."⁸⁰ Specifically, plaintiffs alleged that six different statements in defendant's registration statement were "either affirmatively misleading or were misleading by omission."⁸¹ One of plaintiffs' allegations was that defendant's registration statement misled plaintiffs' by including two fairness opinions that determined that the transaction was "financially fair."⁸² But what plaintiff failed to prove was that the defendant thought otherwise.

Plaintiffs' second allegation was that defendant's registration statement failed to provide that one year prior, defendant implemented an analogous offer for shares of NCB's holding company, First California Northern – paying nearly 167% of book value for those shares.⁸³ This information, however, does not need to be disclosed in the registration statement because this information bears no significance on the present offer.

Plaintiffs' third allegation was that defendant's statement in the registration statement that defendant "believes that NCB's profitability will increase" failed to "adequately disclose" NCB's dramatic growth in profitability.⁸⁴ Essentially what plaintiff alleged here is that defendant didn't disclose how much profitability would increase⁸⁵ – something that defendant is not

⁷⁸ Rubke, 551 F.3d at 1160.

⁷⁹ *Id.*

⁸⁰ *Id.* at 1161.

⁸¹ Rubke, 551 F.3d at 1162.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.* at 1163.

required to disclose in the registration statement because its income projections may be considered forward looking statements.⁸⁶

Plaintiffs' fourth accusation was that defendant misled plaintiffs' into believing that they were required to sell their NCB shares to defendant after three years and that defendant had a duty to disclose that plaintiffs', in no way, had any obligation of selling their shares to defendant.⁸⁷ The Court correctly pointed out that plaintiffs', in making this allegation, failed to prove that defendant "misled" them.⁸⁸ Furthermore, according to the registration statement and supporting documents, "accepting the tender offer was optional."⁸⁹

Plaintiffs' fifth allegation alleged that defendant's registration statement "contained misleading references to a 'premium' that caused NCB minority shareholders [plaintiffs'] to believe that accepting the tender offer would give them a premium on the shares' fair value."⁹⁰ Again, the Court corrected the ridiculous allegation by noting that the registration statement clearly identified that plaintiff minority shareholders would be given a premium on the "book value" of the shares, not the fair value.⁹¹

Lastly, plaintiffs' sixth and final allegation claimed that defendant made misleading statements through telephone communications.⁹² Apparently, a NCB board member telephoned

⁸⁶ See *In re Lyondell Petrochemical Co. Sec. Litig.*, 984 F.2d 1050, 1053 (9th Cir. 1993)

A forward looking statement is defined to include: "any economic projection, statement of management's plans and objectives for future operations, statement of future performance and assumptions underlying the foregoing." 59 FR 52723.

⁸⁷ Rubke, 551 F.3d at 1164.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² Rubke, 551 F.3d at 1164.

several plaintiff minority shareholders in an attempt to persuade them to sell their shares to defendant because otherwise, their shares would be worthless.⁹³

The Ninth Circuit pointed out, however . . .

To prevail in such an action, a plaintiff must prove: [1] that the registration statement contained an omission or misrepresentation, and [2] that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment.⁹⁴

Furthermore, Rule 9(b) requires a plaintiff to plead his allegation(s) with particularity if the case “sounds in fraud,” which plaintiffs have failed to do.⁹⁵ Incidentally, plaintiffs’ also made claims pursuant to section 10(b) and 14(e) of the Exchange Act⁹⁶, but the Court correctly determined that plaintiffs’ failed to allege with particularity that defendant “made materially misleading statements and omission in connection with the Exchange Offer.”⁹⁷

3. The Sixth Circuit: *Indiana State Dist. Council v. Omnicare, Inc.*

Similarly, in *Indiana State Dist. Council v. Omnicare, Inc.*⁹⁸, plaintiff shareholders alleged that defendant Omnicare (“Omnicare”) violated §11 of the Securities Act for providing material misstatements and/or omissions in its registration statement.

Omnicare, a provider of pharmaceutical care services for long-term care facilities, initiated a public offering in 2005 through which several investors, including plaintiffs, purchased Omnicare securities.⁹⁹ One month later, however, plaintiffs sold their securities.¹⁰⁰

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *See supra* note 22 and accompanying text.

⁹⁷ Rubke, 551 F.3d at 1167.

⁹⁸ 719 F.3d 498, 500 (6th Cir. 2013)

⁹⁹ *Id.* at 500.

¹⁰⁰ *Id.* at 501.

Plaintiffs then filed suit – alleging that Omnicare failed to disclose its engagement in illegal activities; and that the statements given in the registration statement pertaining to Omnicare’s compliance with the law, were false and misleading.¹⁰¹ Omnicare moved to dismiss; and the district court granted its request, determining that plaintiffs failed to plead “*loss causation*.”¹⁰²

On appeal, the Sixth Circuit determined that the lower court erroneously held that plaintiff was required to prove loss causation – and thus, remanded the case for additional analysis.¹⁰³ Plaintiffs then amended their section 11 claim – but were again struck down by the district court (for the second time) that held that plaintiffs’ claim “sounds in fraud”¹⁰⁴ and requires that plaintiffs allege their claim with “heightened particularity” pursuant to Federal Rule of Civil Procedure 9(b).¹⁰⁵ Furthermore, the court held that plaintiff was required to plead “knowledge of falsity on the part of” Omnicare, which plaintiffs failed to allege.¹⁰⁶

Plaintiffs again appealed, arguing that Rule 9(b) did not apply because their amended complaint specifically stated, “Plaintiffs expressly exclude and disclaim any allegation that could be construed as alleging fraud or intentional or reckless misconduct, as this claim is based solely on the theories of strict liability and negligence under the Securities Act.”¹⁰⁷ “This one-sentence

¹⁰¹ *Id.*

¹⁰² *Id.*; *see supra* note 6-7.

¹⁰³ Ind. State Dist. Council, 719 F.3d at 502.

¹⁰⁴ “Although section 11 does not contain an element of fraud, a plaintiff may nonetheless be subject to Rule 9(b)’s particularity mandate if his complaint “sounds in fraud”:

The plaintiff may allege a unified course of fraudulent conduct and rely entirely on that course of conduct as the basis of a claim. In that event, the claim is said to be “grounded in fraud” or to “sound in fraud,” and the pleading of that claim as a whole must satisfy the particularity requirement of Rule 9(b).

SEC v. Patel, 2008 DNH 53, 2008 U.S. Dist. LEXIS 23553, *12-13 (D.N.H. 2008) (quoting *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1103-04 (9th Cir. 2003)).

¹⁰⁵ Ind. State Dist. Council, 719 F.3d at 502.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

disclaimer, however, does not achieve Plaintiffs' desired result.”¹⁰⁸ The plaintiffs, therefore, were still subject to the heightened pleading requirement.¹⁰⁹ The court ultimately determined that, “in order to meet the particularity of Rule 9(b), ‘a plaintiff [must] allege the time, place, and content of the alleged misrepresentations on which he or she relied; the fraudulent scheme; the fraudulent intent of the defendant; and the injury resulting from the fraud.’”¹¹⁰

Plaintiffs, however, argued that the district court’s decision requiring plaintiffs to prove defendant’s knowledge (subjective intent) of misrepresentation and falsity in the registration statement was erroneous because section 11 provides for strict liability.¹¹¹ In response, defendant argued that section 10b of the Exchange Act and corresponding SEC Rule 10b-5 sets forth similar pleading requirements that plaintiff must prove in order to hold defendant liable. Defendant insists that the court should mirror the pleading requirements of section 10b (and 10b-5) with that of section 11.¹¹² Plaintiffs alleged that defendant’s statements of legal compliance in the registration statement misled investors to believe that defendant complied with the law – which later turned out to be untrue when it was determined that defendant had “engaged in illegal activities.”¹¹³ The district court, as noted above, determined that plaintiffs’ were required to prove that the defendant “knew that the statements of legal compliance were false at the time they were made.”¹¹⁴ Plaintiffs, however, argued that section 11 was a strict liability statute and

¹⁰⁸ *Id.*; see *Cal. Pub. Emps. Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 160 (3rd Cir. 2004) (“[A]n examination of the factual allegations that support Plaintiffs' section 11 claims establishes that the claims are indisputably immersed in . . . fraud. The one-sentence disavowment of fraud contained [in] . . . the . . . [c]omplaint does not require us to infer” otherwise) (footnote omitted)

¹⁰⁹ *Ind. State Dist. Council*, 719 F.3d at 503.

¹¹⁰ *Id.* at 503 (quoting *Sanderson v. HCA-The Healthcare Co.*, 447 F.3d 873, 877 (6th Cir. 2006)) (internal quotation marks and citation omitted).

¹¹¹ *Id.*

¹¹² This is the central theme of my comment. Courts should be analyzing § 11 violations in the same way that courts analyze § 10b of the Exchange Act and SEC Rule 10b-5 violations. The several elements that plaintiff must prove should also be construed in § 11 claims; See *supra* notes 6-7 and accompanying text; see *infra* Part IV.

¹¹³ *Ind. State Dist. Council*, 719 F.3d at 503.

¹¹⁴ *Id.*

thus, they were not required to prove defendant’s knowledge or intent.¹¹⁵ In response, defendant argued that section 10(b) of the Exchange Act and SEC Rule 10b-5 have elements “parallel” to that of section 11 – and that because “soft” information was not required to be disclosed pursuant to these two rules, “a defendant corporation that chooses to keep completely silent regarding soft information cannot be held liable for a material omission under those provisions.”¹¹⁶ The Sixth Circuit ultimately agreed with the plaintiff having reasoned that section 11 “does not require a plaintiff to plead a defendant’s state of mind.”¹¹⁷ Furthermore, the Sixth Circuit noted that while the defendant properly relied on both *Rubke* and *Fait* (that both relied on *Virginia Bankshares*) in arguing that the Sixth Circuit should follow precedent, the Sixth Circuit stated, “While Defendants are correct that we are bound by Supreme Court precedent, we see nothing in *Virginia Bankshares* that alters the outcome in the instant case, and we decline to follow the Second and Ninth Circuits as a result.”¹¹⁸

IV. *Virginia Bankshares v. Sandberg*: The Precedent

In *Va. Bankshares v. Sandberg*,¹¹⁹ defendant First American Bankshares, Inc. (hereinafter “FABI”) began a freeze-out merger¹²⁰, in which the First American Bank of Virginia merged into Virginia Bankshares, Inc. (VBI). VBI owned 85% of the First American Bank’s shares, with the remaining 15% being owned by 2,000 minority shareholders.¹²¹ As in any freeze-out merger, the minority shareholders lost their interests in the Bank as a result of the merger.¹²² Defendant

¹¹⁵ *Id.*

¹¹⁶ *Id.*; *In re Sofamor Danek Grp. Inc.*, 123 F.3d 394, 401-02 (6th Cir. 1997).

¹¹⁷ *Ind. State Dist. Council*, 719 F.3d at 503.

¹¹⁸ *Id.* at 506.

¹¹⁹ 501 U.S. 1083 (1991).

¹²⁰ A freeze-out merger, also known as a cash-out merger, is “a merger in which shareholders of the target company must accept cash for their shares.” BLACKS LAW DICTIONARY 846 (9th edition 2010).

¹²¹ *Id.* at 1088.

¹²² *Id.*

conducted its due diligence by having hired an investment banking firm to give an opinion on the appropriate price for the minority shareholders' shares.¹²³ After conducting a thorough analysis, the firm opined that \$42 a share was a fair price for the stock.¹²⁴ VBI then solicited proxies to the minority shareholders regarding the merger proposal – which thereafter, had been approved.¹²⁵ Plaintiff, however, withheld returning her proxy and sought damages pursuant to section 14(a) having alleged that defendant knew that the offer price was not fair.¹²⁶ The jury returned a verdict for plaintiff – having determined that plaintiff would have received \$60 per share if the stock had been valued adequately.¹²⁷

On appeal, the Fourth Circuit Court of Appeals affirmed the defendant's liability for materially misleading the minority shareholders regarding two distinct statements, one being the following: "The Plan of Merger has been approved by the Board of Directors because it provides an opportunity for the Bank's public shareholders to achieve a high value for their shares." Defendants urged that "[s]tatements of opinion or belief incorporating indefinite . . . expressions cannot be actionable as misstatements of material fact . . . and that such a declaration or opinion . . . should never be actionable . . . to enable readers to draw their own, independent conclusions." At issue is not whether the so-called misstatement was material, but whether or not a defendant can and should be held liable for statements of opinion or belief that may turn out to be false.

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Va. Bankshares v. Sandberg*, 510 U.S. at 1088-9

Section 14(a) of the '34 Exchange Act states in pertinent part:

"It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce . . . to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered . . ."

15 USC § 78(n).

¹²⁷ *Va. Bankshares v. Sandberg*, 510 U.S. at 1089.

This, I believe, is why the U.S. Supreme Court agreed to hear the case. Before getting into its discussion, the U.S. Supreme Court stated,

[T]he Court of Appeals affirmed petitioners' liability for two statements found to have been materially misleading in violation of § 14(a) of the Act Petitioners argue that statements of opinion or belief incorporating indefinite and unverifiable expressions cannot be actionable as misstatements of material fact within the meaning of Rule 14a-9, and that such a declaration of opinion or belief should never be actionable when placed in a proxy solicitation incorporating statements of fact sufficient to enable readers to draw their own, independent conclusions.¹²⁸

The Court reasoned that while a plaintiff can prove that a defendant's statement is knowingly false or misleading – “even when stated in conclusory terms” – “disbelief or undisclosed motivation, standing alone, [is] insufficient to satisfy the element of fact that must be established under section 14(a).”¹²⁹

Defendant's argument primarily relied on *Blue Chip Stamps v. Manor Drug Stores* urging the Court to recognize the policy reasons why they should not be held liable.¹³⁰ In essence, the defendant, along with Blue Chip Stamps, “deflected the threat of vexatious litigation over “many rather hazy issues of historical fact the proof of which depended almost entirely on oral

¹²⁸ *Id.* at 1095.

¹²⁹ *Id.* at 1096.

¹³⁰ 421 U.S. 723 (1975).

The issue in *Blue Chip Stamps* was the scope of the class of plaintiffs entitled to seek relief under an implied private cause of action for violating § 10(b) of the Act, prohibiting manipulation and deception in the purchase or sale of certain securities, contrary to Commission rules. This Court held against expanding the class from actual buyers and sellers to include those who rely on deceptive sales practices by taking no action, either to sell what they own or to buy what they do not.

Virginia Bankshares v. Sandberg, 501 U.S. 1083, 1092 (1991).

testimony."¹³¹ Concerning this policy concern, however, the Court held that no such threat to litigation exists because they are:

. . . [c]haracteristically matters of corporate record subject to documentation, to be supported or attacked by evidence of historical fact outside a plaintiff's control. Such evidence would include not only corporate minutes and other statements of the directors themselves, but circumstantial evidence bearing on the facts that would reasonably underlie the reasons claimed and the honesty of any statement that those reasons are the basis for a recommendation or other action, a point that becomes especially clear when the reasons or beliefs go to valuations in dollars and cents.¹³²

Furthermore, the statement by defendant did not focus on the “dollars and cents,” but rather the opinion of what a “high” value would be.¹³³ According to the complaint, the shares were worth more than \$60 per share and plaintiffs’ believed that the defendants being the experts they are, would understand that \$40 per share is not a “high” value, but rather a “fair” value.¹³⁴ After much discussion of what constitutes a “fair value” or “high value” per share, the Court added that, because liability under section 14(a) can only be established by proving both deceptiveness and materiality, defendant’s argument that “publishing accurate facts in a proxy statement can render a misleading proposition too unimportant to ground liability” was sound.¹³⁵ Moreover, the Court stated that, “. . . [t]he temptation to rest an otherwise nonexistent section 14(a) action on psychological enquiry alone would threaten just the sort of strike suits and attrition by discovery

¹³¹ Blue Chip Stamps v. Manor Drug Stores, 421 U.S. at 743; Virginia Bankshares v. Sandberg, 501 U.S. at 1092.

¹³² Virginia Bankshares v. Sandberg, 501 U.S. at 1092-93.

¹³³ *Id.*

¹³⁴ *Id.* As this comment explains, a defendant should not be held liable merely for making an inaccurate opinionated statement of belief that may turn out to be false or that plaintiff simply does not agree with.

¹³⁵ *Id.* at 1097.

that *Blue Chip Stamps* sought to discourage.”¹³⁶ Ultimately, the U.S. Supreme Court held that defendant’s statement did not mislead plaintiffs’ – and reversed the Court of Appeals decision.¹³⁷

V. The Proposed Solution: Increasing the Bar to Mirror the Pleading Requirements in Section 10b/Rule 10b-5 Claims

As thoroughly explained in the above discussion, the Sixth Circuit neglected to follow the previously held determinations as analyzed in both the Second and Ninth Circuits.¹³⁸ The Sixth Circuit significantly lowered the bar for plaintiffs who seek to pursue a section 11 claim against a company for providing materially “misleading” or omitting material “soft” information in a registration statement.¹³⁹ My proposed solution is to increase the bar for a plaintiff alleging a section 11 violation. As the Second and Ninth Circuits correctly determined, a plaintiff is required to prove the following: [1] plead with particularity pursuant to Federal Rule of Civil Procedure 9(b)¹⁴⁰; [2] subjective intent¹⁴¹; and [3] objective intent.¹⁴² However, courts should take it a step further and require that plaintiff prove both scienter and loss causation. If the defendant did not intend to give false information in the registration statement, then there should be no liability. Moreover, the plaintiff should be required to prove “loss causation,” meaning that the plaintiff suffered from some degree of monetary loss. How a court can remedy a plaintiff financially if the plaintiff did not suffer monetarily is what is quite concerning. From a policy perspective, there will be an influx of litigation should courts begin to follow the newly held Sixth Circuit decision. Plaintiffs’ will have little to nothing to prove and defendants’ will be held

¹³⁶ *Id.*

¹³⁷ *Id.* at 1108.

¹³⁸ *Id.*

¹³⁹ *Ind. State Dist. Council v. Omnicare*, 719 F.3d 498 (6th Cir. 2013).

¹⁴⁰ *See, supra* notes 37 & 40.

¹⁴¹ The actual intent of the defendant when writing the registration statement.

¹⁴² What a reasonable investor would have thought after reading the registration statement – would they have thought that the defendant knowingly provided a false opinion or belief.

liable for mere “mistakes” made in a registration statement – even when no one was financially hurt by the mistake.

While my recommendations may be a step in the right direction, it is clear that a countervailing argument will address the necessity to contrast the statutory language of section 10b with that of section 11. Section 10b requires the heightened pleading requirement of Rule 9b because “Any purchaser of a security may bring a section 10(b) action against any person who has used any manipulative or deceptive device in connection with the sale of a security.”¹⁴³ That being said, in a section 10b complaint, it is likely that a plaintiff will be alleging fraud and thus will be required to abide by Rule 9(b).¹⁴⁴ In contrast, a section 11 claim does not sound in fraud. Therefore, although section 10b and section 11 overlap in some respect, they represent “separate causes of action; and therefore, it is reasonable to apply a different pleading standard to each section.”¹⁴⁵ But, why is it necessary for section 11 to have such a distinct and liberal pleading standard from a section 10b claim? Section 11 should not place such minimal burdens on a plaintiff. It will lead to nothing more than an influx of litigation. As previously mentioned, a plaintiff should be required to prove additional elements before a court can hold a defendant liable for something that the defendant shouldn’t be held liable for. Regardless of the “differences in statutory language and legislative history of section 11 and section 10(b) . . . ,”¹⁴⁶ it would be outlandish to lower the standard for a plaintiff when establishing a section 11 claim.

Although some believe that Congress intended to lower the bar for plaintiffs in a section 11 claim to facilitate full and fair disclosure of securities, to say that “Without civil liability, issuers will not comply with the Securities Act and the United States financial markets will

¹⁴³ See *supra* note 41 (internal quotations omitted).

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

suffer . . .”¹⁴⁷ is nothing more than an ill-informed statement that assumes every issuer will try to take advantage of shareholders when disclosing information in a registration statement. While I understand that there is a need to “protect investors and the integrity of the regulatory scheme,”¹⁴⁸ there should also be a need to protect issues selling their shares to the public. To think that only issuers engage in fraud is a false belief. Lowering the bar to this extent may cause shareholders to bring frivolous lawsuits against issuers and engage in fraud themselves.

VI. Conclusion

In sum, this comment proposes a new analytical framework to apply to plaintiff’s pleading requirements when alleging a material misrepresentation or omission (pertaining to “soft” information) under section 11 of the ’33 Act. While the Second and Ninth Circuits have correctly determined that a plaintiff should be required to prove both subjective and objective intent when pursuing a section 11 claim, this comment discusses the importance and need for additional pleading requirements – scienter and loss causation. The Sixth Circuit erroneously lowered the bar by essentially holding that a plaintiff, if unhappy with the defendant’s registration statement, can pursue a section 11 claim without having to prove subjective intent, objective intent, scienter, or even loss causation. If courts can find neutral ground by giving a plaintiff specific pleading requirements for challenging soft information pursuant to section 11, we can prevent this problem entirely.

¹⁴⁷ *Id.* at 2416.

¹⁴⁸ *Id.* at 2417.