Pleading Securities Fraud

Richard G. Himelrick

Follow this and additional works at: http://digitalcommons.law.umaryland.edu/mlr

Part of the Commercial Law Commons

Recommended Citation

Available at: http://digitalcommons.law.umaryland.edu/mlr/vol43/iss2/7

This Article is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Law Review by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.
PLEADING SECURITIES FRAUD

RICHARD G. HIMELRICK*

Through their pleadings the parties to a lawsuit give notice of the claims and defenses to be advanced. Borrowing from Wigmore, Roscoe Pound warned that except to the extent they serve a notice function, the pleadings are only "instruments of stratagem to the bar and logical excercitation to the judiciary." His point was well made. If the pleadings are confined to a notice function, then responsive pleadings can accomplish little by disputing the sufficiency of an adversary's allegations. But if pleadings are assigned more importance, perhaps with the thought of narrowing the triable issues and thwarting improbable claims, their formality inevitably increases, enhancing the possibility of errant draftsmanship. With added importance and formality, the opportunities for pleading stratagems multiply.

The federal rules strive to minimize objections to the form of pleadings and to ensure that deficiencies in draftsmanship are not dispositive. They emphasize simplicity and brevity of statement. Rule 8 states the general principles. It provides for a short and plain statement of a party's claim, including simple, concise, and direct averments. No technical form of pleading is required. Instead, "pleadings shall be so construed as to do substantial justice." It is envisioned that the matters at issue between the parties will develop through discovery and pretrial motion practice. A party need not detail the facts upon which his claim is based. Thus, the pleadings serve merely to provide a general statement of claims that may undergo substantial revision as the lawsuit unfolds.

In many courts all of this gives way when allegations of fraud are made. Rule 9(b) obligates the pleader to present with particularity the circumstances underlying a claim of fraud. Relying on this rule, courts

* Hart & Himelrick, Phoenix Arizona; B.A. Oakland University, 1971; J.D. Wayne State University, 1974.
1. Pound, Some Principles of Procedural Reform, 4 ILL. L. REV. 491, 495 (1910) (quoting J. Wigmore, Evidence § 21, at 79 (1st ed. 1904)).
2. FED. R. CIV. P. 8(a).
3. Id. 8(e)(1).
4. Id.
5. Id. 8(f).
7. FED. R. CIV. P. 9(b) reads:
In all averments of fraud or mistake, the circumstances constituting fraud or mis-
have insisted upon pleading formalities and details entirely foreign to other claims.

Far and away, rule 9(b) has been most vigorously enforced in securities litigation, where it is seen in many quarters as an expeditious device for clearing baseless fraud claims from court calendars. By virtue of the enforcement given rule 9(b), only those plaintiffs who are prepared to detail the manner in which each defendant has committed or participated in an act of fraud are entitled to proceed. In addition, courts have established rigid requirements concerning pleading the defendant's duty, scienter, primary and secondary liability, and other matters. If the defense challenges the pleading's particularity, courts frequently stay discovery until satisfied that the fraud claim is sufficiently specific. The result is a modern form of technical pleading that one would have thought the federal rules consigned to another era.

In securities litigation, insistence upon detailed pleading coincides with substantive efforts, including conspicuous examples in the Supreme Court, to control the expansion of rule 10b-5. The number of transactions subject to the securities laws is, at least to the uninitiated, surprisingly broad. Partnerships, franchises, trust deeds, condominiums, pension plans, and promissory notes have all on occasion been found to constitute securities. A falsehood, half truth, omission, or deceptive act in connection with the purchase or sale of any of these may provide the predicate for a 10b-5 claim. The fraud complained of must be

take shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

8. See infra text accompanying notes 103-17.
9. See infra text accompanying notes 91-95.
10. See infra text accompanying notes 135-53.
11. See infra text accompanying notes 104 & 129-34.
12. See infra text accompanying notes 154-65.
13. See infra text accompanying note 195.
20. The federal securities laws apply only where an instrumentality of interstate commerce is involved. Rule 10b-5, for example, speaks in terms of fraud perpetrated "by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." In practice, satisfying this requirement is a modest bur-
material, but common law requirements of reliance and causation are frequently presumed in the plaintiff's favor. Any misrepresentation can be restated as an omission, and most experienced practitioners elect to structure their case as involving nondisclosure. If the theory is nondisclosure, definite proof of reliance is not required: The "obligation to disclose and [the] withholding of a material fact establish the requisite element of causation in fact." Hence, if the transaction involves a security and the plaintiff can postulate some arguably significant fact that was not succinctly brought to his attention, he has the makings of a 10b-5 claim. Moreover, the class of potential defendants is broad; virtually anyone having a significant connection to the purchase or sale is a potential defendant. Privity—direct dealings between plaintiff and defendant—is not required. In addition, the doctrine of respondeat superior, the "controlling persons" statutes, and theories of aiding and abetting and conspiracy subject many others to liability on the basis of status or conduct that is secondary to the primary wrong.

The burgeoning growth of 10b-5 litigation was acknowledged by the Supreme Court in 1975. Characterizing the 10b-5 action as "a judicial oak which has grown from little more than a legislative acorn," the Court in Blue Chip Stamps v. Manor Drug Stores, concluded that such litigation "presents a danger of vexatiousness different in degree and kind than that which accompanies litigation in general." Concerned with the ease of invoking the securities laws, the Court imposed a standing requirement, limiting 10b-5 actions to plaintiffs who actually purchase or sell a security.

---

21. Little v. First Cal. Co., 532 F.2d 1302, 1304 n.4 (9th Cir. 1976) ("All misrepresentations are also nondisclosures, at least to the extent that there is a failure to disclose which facts in the representation are not true."); Crane, An Analysis of Causation under Rule 10b-5, 9 SEC. REG. L.J. 99, 103 (1981).
24. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 745, reh'g denied, 423 U.S. 884 (1975). ("[P]rivity of dealing or even personal contact between potential defendant and potential plaintiff is the exception and not the rule.").
25. See authorities cited infra note 103.
27. Id. at 739.
28. Id. at 730-31. Before Blue Chip, there were cases concluding that even those who did not purchase or sell, but merely failed to take advantage of an opportunity to buy or sell, or who had indirect involvement in a purchase or sale, could sue under rule 10b-5. See, e.g., Manor Drug Stores v. Blue Chip Stamps, 492 F.2d 136, 141 (9th Cir. 1973), rev'd, 421 U.S.
Blue Chip was followed by other decisions narrowing the reach of rule 10b-5. In Ernst & Ernst v. Hochfelder, by far the most significant decision, the court imposed a scienter requirement. This was followed by decisions restricting the use of rule 10b-5 as a remedy for breaches of fiduciary duty by corporate management and confining omissions cases to those where the defendant has a duty to disclose.

As the reach of rule 10b-5 has been quartered, particularized pleading has insured that plaintiffs take cognizance of the elements of a 10b-5 claim from the start. Loose pleading cannot obscure the absence of scienter, a duty of disclosure, or some other element of the claim if the pleader is required to plead a basis for each element.

This article will analyze the law regarding pleading securities fraud. In the first section it will briefly discuss the history of the requirement of special particularity. With a view towards illuminating practical problems, the second section critically surveys the rules that have developed in those courts advancing a strict approach to pleading fraud. The final portion of the article argues that the particularity requirement inefficiently serves its underlying purposes, impedes the litigation of legitimate claims, and fails to comport with the policy and structure of the federal rules. It concludes that the assessment of sanctions under rule 11, rather than the enforcement of strict pleading, is an appropriate means of deterring vexatious securities litigation.

I. HISTORICAL BACKGROUND OF RULE 9(b)

The common law, despite its formality, allowed considerable generality in stating a party's claim. In fact, one of the criticisms of common law pleading was that the vague, conclusory allegations permitted in many of the forms of action deprived the opposing party of fair notice. But averments of fraud constituted an exception to the rule of generalized pleading. As a consequence of the seriousness of a fraud charge and of its effect on reputations, these claims were said to be disfa-
vored and sustainable only if pled with factually specific allegations.

Common law pleading began to disappear when, in 1848, New York enacted an "[a]ct to simplify and abridge the Practice, Pleadings, and Proceedings of the Courts." Popularly called the Field Code after David Dudley Field, its primary sponsor and draftsman, it provided the impetus for procedural reform and similar code enactments in much of the country. A significant reform under the Field Code and its progeny was the abolition of the common law forms of action. In their place, the codes directed pleaders to provide a plain and concise statement of the facts upon which the cause of action was based. Despite the interest in attaining clear, succinct pleadings, the requirement of particularity in alleging fraud was continued under the codes.

The federal rules discarded the code practice of pleading "facts" and imposed a simplified approach to pleading. The new requirement, adopted in 1938, was that the pleader make only a short and plain state-


An early case, J'Anson v. Stuart, 99 Eng. Rep. 1357 (K.B. 1787), aptly conveys the common law approach to pleading fraud. The plaintiff brought suit for libel on the basis of a newspaper article that accused him of being a swindler. The defendant answered with a plea that plaintiff was one of a "gang of... swindlers and common informers" who were "guilty of deceiving and defrauding divers persons." Id. Plaintiff demurred on the grounds that the defendant's plea was too vague. The court agreed:

The first question then here is, whether the defendant is at liberty to charge the plaintiff with swindling, without shewing any instances of it? That is contrary to every rule of pleading; for wherever one person charges another with fraud, he must know the particular instances on which his charge is founded, and therefore ought to disclose them. . . . Now in the present case, if this plea were to be suffered, it would be to allow any person to libel another more on the records of the Court than he could do in a public newspaper. If the plaintiff has been guilty of any acts of swindling, the defendant must be taken to know them. . . . [K]nowing them he ought to put them on the record that plaintiff might be prepared to answer them. Id.

Three concerns are detectable in this reasoning. The court is concerned that the defendant's reputation not be unfairly tarnished; that he be given fair notice so that he can prepare to meet the charge; and that he not be subjected to the unfounded claims that might be made if the pleader were not required to disclose the "particular instances on which his charge is founded." These concerns are common themes in contemporary decisions favoring a strict approach to pleading fraud. See infra text accompanying notes 174-81.


38. The most significant other reform was the substitution of the "civil action" for separate actions at Law and in Equity.

39. C. CLARK, supra note 36, § 48, at 311-12. It is familiar learning that the codes did not produce simplified pleadings. The codes' emphasis on pleading the facts engendered elusive distinctions among facts, conclusions, and evidence that all too frequently proved fatal for the pleader who failed to anticipate the distinctions. See Cook, supra note 35, at 423.
ment of his claim. This standard generated considerable discussion\textsuperscript{40} and some dissent.\textsuperscript{41} But the drafters retained the requirement of pleading fraud with specificity without attracting significant comment.\textsuperscript{42} No one seems to have had serious doubt about continuance of this rule or whether it squared with other rules of pleading.

The potential significance of rule 9(b) in modern securities litigation did not arise until 1946, when in \textit{Kardon v. National Gypsum Co.},\textsuperscript{43} an implied right of action under section 10(b) of the Exchange Act\textsuperscript{44} was recognized. Interestingly, \textit{Kardon} also noted that the plaintiff's allega-


\textsuperscript{41} McCaskill, \textit{Easy Pleading}, 35 ILL. L. REV. 28 (1940); see also McCaskill, \textit{The Modern Philosophy of Pleading: A Dialogue Outside the Shades}, 38 A.B.A. J. 123 (1952) [hereinafter cited as McCaskill, \textit{Modern Philosophy of Pleading}].


\textsuperscript{43} 69 F. Supp. 512 (E.D. Pa. 1946).

\textsuperscript{44} Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1982). The elements of common law fraud and a \textit{lOb-5} claim are not coterminous. 5 A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10b-5, at § 11-01 (1981). Because of rule 9(b)'s common law heritage, it has occasionally been suggested that the rule applies to a claim under § 10(b) only if that claim parallels the elements of common law fraud. \textit{E.g.}, Stevens v. Vowell, 343 F.2d 270, 275 n.5 (9th Cir. 1961). Most courts, however, have concluded without qualification that a \textit{lOb-5} claim must be pled with particularity. \textit{E.g.}, Gottreich v. San Francisco Inv. Corp., 552 F.2d 866, 866 (9th Cir. 1977); Tomera v. Galt, 511 F.2d 504, 508 (7th Cir. 1975).

Several other securities statutes have also been deemed subject to rule 9(b). On the theory that the statute is directed at fraudulent conduct, claims under § 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e) (1982), have been held subject to rule 9(b). \textit{E.g.}, Morgan v. Prudential Group, Inc., 81 F.R.D. 418, 426 (S.D.N.Y. 1978); Billet v. Storage Technology Corp., 72 F.R.D. 583, 585–86 (S.D.N.Y. 1976). Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2) (1982), allows recovery for fraudulent negligent conduct; it has been held subject to rule 9(b) when fraud is alleged. \textit{E.g.}, Posner v. Coopers & Lybrand, 92 F.R.D. 765, 770 n.5 (S.D.N.Y. 1981), aff'd mem., 697 F.2d 296 (2d Cir. 1982); Kennedy v. Nicastro, 517 F. Supp. 1157, 1161 (N.D. Ill. 1981); see also Todd v. Oppenheimer & Co., 78 F.R.D. 415, 419 n.4 (S.D.N.Y. 1978) (9(b) applies to § 12(2) claim when claim is based on fraud but not otherwise); \textit{Billet}, 72 F.R.D. at 585 (Rule 9(b) would be inapplicable in an action under § 11, § 12 or a § 14(a) action based on fraud, because "liability under those sections may result from negligent conduct, misstatement or omissions."). By contrast, § 11 of the Securities Act of 1933, 15 U.S.C. § 77k (1982) does not require proof of deception; thus, such claims may be pled generally. Ross v. Warner, 480 F. Supp. 268, 273 (S.D.N.Y. 1979); \textit{Billet}, 72 F.R.D. at 585; Schoenfeld v. Giant Stores Corp., 62 F.R.D. 348, 350 (S.D.N.Y. 1974). Finally, rule 9(b) has been applied to claims under § 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (1982). \textit{E.g.}, Bowman v. Hartig, 334 F. Supp. 1323, 1328 (S.D.N.Y. 1971). The state of mind required under § 17(a) in circuits recognizing a private action is a developing area of the law. See infra note 136. To the extent § 17(a) is actionable on a negligence
tions of fraud were too vague to comport with rule 9(b). Defendants were advised that upon filing a motion for particulars, plaintiffs would be required to replead. Thus the case which expanded plaintiffs' remedies in securities fraud foreshadowed judicial contraction of them by procedural means.

Rule 9(b) appears not to have played an important role in securities litigation in the years following Kardon. There are relatively few reported cases addressing rule 9(b) before 1970, and those cases that decided 9(b) objections against the pleader did not evidence a clear preference for strict pleading. However, in 1972 the Second Circuit decided Segal v. Gordon, a case that signaled a more demanding role for rule 9(b) in securities litigation. Segal was a derivative action, a species of litigation long haunted by suggestions, both real and imagined, of "strike suits." Drawing on the comments of Professors Wright and Miller, Judge Moore opined that the need to deter strike suits had "mo-
tivated the courts to insist on a reasonably high level of specificity." Specificity was needed to protect "defendants from the harm that comes to their reputations or to their goodwill when they are charged with serious wrongdoing." Reasoning from those underpinnings, the court affirmed the district court’s dismissal and denied the plaintiff’s request for discovery, penning on its way what was to become an oft-quoted aphorism: “A complaint alleging fraud should be filed only after a wrong is reasonably believed to have occurred; it should serve to seek redress for a wrong, not to find one.” The impact of Segal was swift and palpable. Decision upon decision in the Second Circuit drew upon its rationale in resolving 9(b) objections, usually against plaintiffs.

The strict Segal approach to pleading fraud has not spread to appellate courts outside the Second Circuit. The Tenth Circuit has held rule 9(b) inapplicable to 10b-5 claims on the theory that while rule 9(b) is directed at common law fraud, rule 10b-5 is not confined to common law fraud. The Fifth, Seventh and Ninth Circuits have produced

49. 467 F.2d at 607.
50. Id.
51. Id. at 607-08.
53. See Stevens v. Vowell, 343 F.2d 374, 379 n.3 (10th Cir. 1965); Rochambeau v. Brent Exploration, Inc., 79 F.R.D. 381, 388-89 (D. Colo. 1978); see also supra note 44, at ¶ 1.
54. McGinty v. Beranger Volkswagen, Inc., 633 F.2d 226, 228 (5th Cir. 1980); Dudley v. Southeastern Factor & Fin. Corp., 446 F.2d 303, 308 n.6 (5th Cir.), cert. denied, 404 U.S. 858 (1971); Brunswick Corp. v. Vineberg, 370 F.2d 605, 610 (5th Cir. 1967); Massey-Ferguson, Inc. v. Bent Equip. Co., 283 F.2d 12, 15 (5th Cir. 1960); Kohler v. Jacobs, 138 F.2d 440, 443 (5th Cir. 1943); see also In re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig., 467 F. Supp. 227, 251 (W.D. Tex. 1979) (noting liberal approach in Fifth Circuit decisions in accepting “less-than-perfect complaints”).

A recent case evidencing a contrary approach is SEC v. Seaboard Corp., 677 F.2d 1315 (9th Cir. 1982). Relying on authority from the Second Circuit, the court affirmed an order dismissing a crossclaim against a defendant bank for failure to make sufficiently specific allegations of wrongdoing. It held it proper to order dismissal even though the plaintiff had not had discovery. Id. at 1317. Moreover, without mentioning a seemingly contrary holding in Walling, 476 F.2d at 397, the court found the complaint deficient for failure to allege a factual basis demonstrating scienter on the bank’s part. 667 F.2d at 1316-17. Although an apparent deviation from prior Ninth Circuit case law, the decision is perhaps explainable on the basis that the defendant bank’s role in the fraud had not been alleged at all: “Is only
substantial authority endorsing a simplified approach to pleading fraud that is similar to the standard of rule 8. There are, of course, cases in these circuits resolving 9(b) objections against the pleader, but these decisions do not depart from the simplified approach of rule 8. They merely mark the line between pleadings that reflect an honest attempt to plead clearly the circumstances of the fraud and those that do not. An unadorned allegation of fraud, for example, that makes no effort to describe the circumstances upon which it is premised will not suffice in these circuits.\(^{57}\)

Other circuits have not clearly indicated a position,\(^{58}\) but no appellate court enforces rule 9(b) with the enthusiasm prevalent in the Second Circuit.\(^{59}\) There are cases that if broadly viewed might imply a strict construction of rule 9(b). On examination, however, these decisions are attributable to some exigency peculiar to the case, such as dilatoriness in pursuing discovery or in amending.\(^{60}\) Thus, on balance Second Circuit decisions evidence a markedly different approach than do those of the other circuits.

The restrictive influence of the Second Circuit decisions is widespread in district courts outside that circuit. Although essentially unacknowledged at the appellate level,\(^{61}\) these district courts are deciding relationship to the litigation was that it held an agency account for . . . one of the principal defendants." \(^{Id.}\) at 1316.

57. E.g., Robison v. Caster, 356 F.2d 924, 925 (7th Cir. 1966) ("bare assertions of a conspiracy to defraud" inadequate); Rubens v. Ellis, 202 F.2d 415, 417 (5th Cir. 1953) (reference to "gross misrepresentation and deceit" too conclusory); cf. Schmidt v. Herman, 614 F.2d 1221, 1223-24 (9th Cir. 1980) (particularity not a license for prolixity).

58. See, e.g., Cramer v. GTE, 582 F.2d 259, 272 (3rd Cir. 1978), cert. denied, 439 U.S. 1129 (1978) (cites Segal for particularity but says averments of scienter may be general).

59. Second Circuit decisions evidencing the strict approach include Armstrong v. McAlpin, 899 F.2d 79, 92-94 (2d Cir. 1983); Billard v. Rockwell Int'l Corp., 683 F.2d 51, 57 (2d Cir. 1982) (emphasizing strict approach of past decisions, court dismissed because allegations too general in light of plaintiff's access to discovery); Decker v. Massey-Ferguson, Ltd., 681 F.2d 111, 115-117 (2d Cir. 1982); Rodman v. Grant Found., 608 F.2d 64, 73 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980); Denny v. Barber, 576 F.2d 465, 468-69 (2d Cir. 1978); see also cases cited supra note 52.

60. See, e.g., United States ex rel. Joseph v. Cannon, 642 F.2d 1373, 1385-86 (D.C. Cir.), cert. denied, 454 U.S. 810 (1981) (plaintiff's allegations were "generalized and vague"); plaintiff denied leave to amend because he failed to do so for the 11 months between defendant's motion to dismiss and court's order); Kellman v. ICS, Inc., 447 F.2d 1305, 1310 (6th Cir. 1971) (plaintiff on notice that more details of fraud needed, yet failed to offer details in two amendments).

61. A few appellate decisions have shown a disinclination to follow Second Circuit precedent. See, e.g., Christidis v. First Pa. Mortgage Trust, 717 F.2d 96, 99-100 (3d Cir. 1983) (indicating reluctance to follow Second Circuit cases denying discovery until a complaint satisfies rule 9(b)); McGinty v. Beranger Volkswagen, Inc., 633 F.2d 226, 228 (1st Cir. 1980) (declining to follow Second Circuit authority requiring scienter to be pled with particularity).
cases on the basis of Second Circuit decisions. Occasionally, they go so far as to distinguish decisions by the appellate court within their own circuit in favor of Second Circuit precedents.

Furthermore, appellate decisions have not yet clearly recognized the difference between the Second Circuit approach and the simple, rule 8 approach. Instead, they routinely tend to resolve rule 9(b) issues in the pleader’s favor. Detailed opinions involving the dismissal of patently defective complaints are rarely seen. On the other hand, when the pleading is sufficient, and the court’s decision permissive, its opinion is often insipid reading of slight precedential value. Bobby Jones Garden Apts., Inc. v. Suleski is illustrative. The issue was whether the plaintiff had adequately pled the defendants’ misrepresentations regarding some air units. In three terse sentences the Fifth Circuit decided the matter in the plaintiff’s favor: "Defendants stated: The air units would heat. They did not heat. How much more specific can one get?" A Ninth Circuit decision provides a further example. In Gottreich v. San Francisco Investment Corp., defendants contended that the complaint was deficient for failure to describe why certain alleged misrepresentations were in fact false statements. Essentially, the defendants asked, how could they know the statements "were false if they were not false?" Perceiving a superficial objection, the court rebuked defendants with the admonishment that this was "nit-picking" of the type interred by the federal rules.


63. See McFarland, 493 F. Supp. at 637. In Russo v. Bache Halsey Stuart Shields, Inc., 554 F. Supp. 613, 617-18 (N.D. Ill. 1982), the court applied authority in the Seventh Circuit requiring only a "brief sketch" of fraudulent conduct for part of the claim, but then, citing Second Circuit cases, proceeded to treat allegations of churning, a specialized form of fraudulent conduct, as requiring greater specificity.

64. But see supra note 61. See also Zatkin v. Primuth, 551 F. Supp. 39 (S.D. Cal., 1982), in which the court indicated that in view of the simplified approach to pleading evidenced by Ninth Circuit cases, it was inappropriate to rely on decisions from other circuits advocating a strict approach. Id. at 42.

65. This is of course not a necessary result. A pleading approved with a reasoned explanation of its approval can be of substantial benefit in future cases. See, e.g., Conley v. Gibson, 355 U.S. 41, 47-48 (1957); Denny v. Carey, 72 F.R.D. 574, 577-80 (E.D. Pa. 1976); see also In re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig., 467 F. Supp. 227, 250-56 (W.D. Tex. 1979) (finding complaint sufficient in some respects but not others).

66. 391 F.2d 172 (5th Cir. 1968).

67. Id. at 178 n.18.

68. 552 F.2d 866 (9th Cir. 1977).

69. Id. at 867.

70. Id.
Cases such as *Bobby Jones* and *Gottreich* unmistakably reflect a generous view of pleading. But their precedential value is narrow. They might well reflect and be cited as authority for simplified, notice-type pleading. But just as easily they can be characterized as saying only that on the facts presented the pleading was adequate. Ultimately, therefore, their meaning is left to the trial court’s discretion.

On the other hand, restrictive opinions, such as those of the Second Circuit, that identify rules that have been transgressed are more prone to control the trial judge’s decision. Consider, for example, the Second Circuit’s rule that an allegation that a defendant acted knowingly must be supported by facts that “give rise to a strong inference” of knowledge. This is a rule the pleader must acknowledge in drafting his complaint. The trial court will have discretion to determine what suffices to show a “strong inference” of knowledge, but not to sanction a bare allegation that the defendant acted knowingly.

**II. Pleading An Adequate Securities Fraud Claim**

With a view to analyzing what must be pled to state a legally sufficient claim, this article turns to the restrictive 9(b) cases, most notably those from the Southern District of New York. What suffices will of course vary according to the importance the trial judge attaches to the pleadings, for despite a plethora of case law, resolving a 9(b) objection is still essentially a matter of discretion. This section will first discuss types of securities fraud: misrepresentation, omission, and churning. Then it will cover pleading particular issues, such as scienter, that may be found in any or all of these actions. It is intended to convey a sense of the standard of pleading in courts that favor a strict construction of rule 9(b). What is stated to be a rule in the text may not in a given case be treated as such. The text sets forth working rules supported by precedent and indicative of what is likely to be required when a court is receptive to the argument for greater specificity. Although case law is most prevalent in the Southern District of New York, there is burgeoning support for strict construction of the particularity requirement.

**A. Misrepresentations**

Historically the particularity requirement has been most commonly enforced in cases involving misstatements. False statements lend them-
selves to concrete identification. It is therefore possible to insist upon fairly precise allegations concerning the nature, time, place, manner, and author of a misstatement without unfairly burdening the pleader. This information is typically available to the plaintiff without need for discovery and is usually not subject to the claim that it is peculiarly within the defendant's knowledge. For this reason there has been no substantial resistance to the concept that if the pleader bases his pleading on a misrepresentation he must detail it. Hence the statement alleged to be false should be pled with an explanation of why it is false.\textsuperscript{73}

A time frame is required: If the plaintiff's purchase or sale commitment preceded any omission, misrepresentation, or other deceptive conduct by the defendant, the acts are not in connection with the purchase or sale of a security.\textsuperscript{74} Depending upon the circumstances, adequate notice of the time may be provided by identifying the date of the document containing a misstatement and the date or period of its dissemination\textsuperscript{75} or the date or period during which any oral misrepresentations occurred.\textsuperscript{76}

With written misrepresentations the document containing the misstatement should be identified.\textsuperscript{77} In some instances the plaintiff may be obligated to plead how he received the document. Without this information it may be impossible to ascertain whether the plaintiff received the document in connection with the offer, sale, or purchase of a security, or whether he relied upon it in making his investment decision.\textsuperscript{78}

Each party's role in the misrepresentation should be identified. With oral misrepresentations, the person making the misrepresentations


\textsuperscript{75} See Denny v. Barber, 576 F.2d 465, 468–69 (2d Cir. 1978).


should be identified. With writings, identification of the person preparing the tainted document is required. If the pleading names multiple defendants, it must state the connection between each defendant and the misstatements. Finally, some indication of what advantage a defendant received through the misrepresentation may be necessary.

B. Omissions

Fraud by omission includes cases in which the defendant disclosed only a portion of what he was required to, as well as those in which he made no disclosure whatsoever, but should have. The common law imposes a duty to disclose the whole truth once a defendant speaks; half-truths are forbidden. This principle is codified in a series of securities statutes interdicting nondisclosure of a " . . . material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading . . . ." A complaint averring half-truths should identify the omissions. It should further identify the inclusions that were made misleading and, if not readily apparent, the reasons those statements are misleading. Specific allegations as to the time and place that facts were omitted may not be possible if the nondisclosure was ongoing, but there is no similar impediment regarding misleading statements.

Where there is a complete failure to speak, different issues are presented. In Chiarella v. United States, a criminal case, the Supreme Court concluded that the failure to disclose material information prior to the consummation of a transaction constitutes fraud only if there is a duty to disclose. The court reversed the conviction of Chiarella, a "markup man" employed by a printing company that printed announcements of corporate takeovers. Chiarella had deduced the iden-

80. Prudential Group, Inc., 81 F.R.D. at 426 (failure to identify author of tender offer).
88. Id. at 235.
tity of the target companies and had purchased stock in them prior to release of takeover announcements. Characterizing the case as one involving the legal effect of silence, the court reasoned that silence in connection with the purchase or sale of securities had in the past been found to operate as a fraud only where there existed "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." Chiarella had undertaken no prior dealings with the target companies; he was not their agent, nor was he a fiduciary or person in whom trust and confidence had been reposed. Thus he had no duty.

In the wake of Chiarella, requests for dismissal for failure to adequately allege a duty of disclosure have increased, resulting in considerable dispute over the bases for imposing a duty of disclosure. Chiarella seems to say that a fiduciary relationship or one premised upon trust and confidence must exist. This is the view typically advanced by defendants. Nevertheless, so cramped a reading has not found favor with the courts. A duty to disclose has been found to "inhere in the securities laws" where a licensed securities professional substantially involved in facilitating the public sale of securities knowingly withheld material information. A comparable duty has been posited where the defendant knowingly or recklessly participates in a fraudulent scheme. A duty has also been found to arise from a contractual relationship and from the specific requirements of SEC rules.

89. Id. at 230.
90. Id. at 232.


92. See 445 U.S. at 232.
93. Dirks v. SEC, 681 F.2d 824, 841-42 (D.C. Cir. 1982), rev'd on other grounds, 103 S. Ct. 3255 (1983); see SEC v. Cayman Islands Reinsurance Corp., [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,717, at 93,593 (S.D.N.Y. June 17, 1982) (duty need not be alleged where corporate director was directly involved in the offering and knew of the misstatements, yet failed to disclose them). In Dirks the Supreme Court noted the court of appeals' holding that Dirks acquired a fiduciary duty because of his broker-dealer status. 103 S. Ct. at 3267 n.26. Characterizing this duty theory as "novel," the Court found the issue was not presented in the SEC proceedings and was not therefore preserved for appeal. Id.
94. SEC v. Seaboard Corp., 677 F.2d 1297, 1300 (9th Cir. 1982).
Although misrepresentations and omissions are the most common bases of fraud allegations, other deceptive acts are also within the coverage of the anti-fraud provisions of the securities laws. An area of frequent litigation concerns churning by broker-dealers. Churning is excessive trading by a person in control of another's securities, undertaken for the purpose of generating commissions. What constitutes excessive trading is determined in light of the owner's investment objectives and financial situation.

A general allegation of churning or excessive trading is insufficient. The pleader should identify when the churning occurred and the securities or account involved. A description of the plaintiff's investment objectives may be necessary. In addition, the complaint must present some quantitative information concerning activity in the account from which the court can draw an inference of excessive trading. This requirement may be relaxed if the plaintiff does not have all of the documents necessary to measure the account's activity.

These include tipping and market manipulation, in addition to churning. Tipping — the selective disclosure of material inside information — is a well recognized violation of rule 10b-5. See L. Loss, FUNDAMENTALS OF SECURITIES REGULATION 839-42 (1983). Market manipulation, such as the withholding of dividends to depress a stock's price, is a further example of misleading conduct that may be found fraudulent. See United States v. Charnay, 537 F.2d 341, 347-48 (9th Cir.), cert. denied, 429 U.S. 1000 (1976).


It may be possible to prove churning without statistical evidence concerning the volume of activity in an account. See, e.g., Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369-70 (7th Cir. 1983) (churning established without expert testimony or statistical analysis of account); Quigley v. Dean Witter Reynolds, Inc., 1980–82 Transfer Binder COMM. FUT. L. REP. (CCH) ¶ 21,330, at 25,597 (Jan. 22, 1982) (entry of even one trade that is not for customer's benefit constitutes churning). To the extent that the plaintiff can prevail at trial without statistical evidence of the volume of activity in his account, requiring the pleadings to set forth such information is surely wrong.

If may be possible to prove churning without statistical evidence concerning the volume of activity in an account. See, e.g., Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369-70 (7th Cir. 1983) (churning established without expert testimony or statistical analysis of account); Quigley v. Dean Witter Reynolds, Inc., 1980–82 Transfer Binder COMM. FUT. L. REP. (CCH) ¶ 21,330, at 25,597 (Jan. 22, 1982) (entry of even one trade that is not for customer's benefit constitutes churning). To the extent that the plaintiff can prevail at trial without statistical evidence of the volume of activity in his account, requiring the pleadings to set forth such information is surely wrong.


Bache Halsey Stuart Shields, Inc., 554 F. Supp. at 618 (must allege "facts to allow for a determination of turnover ratio in the account and/or the percentage of the account value paid in commissions"); see Kaufman v. Magid, 539 F. Supp. 1088, 1095 (D. Mass. 1982) (complaint alleging annual turnover rate of six hundred percent held sufficient).

It may be possible to prove churning without statistical evidence concerning the volume of activity in an account. See, e.g., Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369-70 (7th Cir. 1983) (churning established without expert testimony or statistical analysis of account); Quigley v. Dean Witter Reynolds, Inc., 1980–82 Transfer Binder COMM. FUT. L. REP. (CCH) ¶ 21,330, at 25,597 (Jan. 22, 1982) (entry of even one trade that is not for customer's benefit constitutes churning). To the extent that the plaintiff can prevail at trial without statistical evidence of the volume of activity in his account, requiring the pleadings to set forth such information is surely wrong.

Securities actions usually involve multiple defendants. Commonly some defendants will be sued on a theory of primary liability; others will be sued on a theory of secondary liability. The complaint must give some indication of the theory of liability, whether primary, secondary, or both, as to each defendant, and must state the factual basis underlying each defendant's culpability.

Quite often a complaint involving multiple defendants will list a number of misrepresentations and omissions that are imputed to all the defendants. In other cases the complaint will describe a fraudulent scheme and link the defendants to it through allegations of participation, conspiracy, or aiding and abetting. Such vague references to the nature of a defendant's involvement in fraudulent conduct are inadequate. Likewise, blanket group references which obscure a clear reading of the role each defendant is alleged to have played have been condemned. Each defendant is entitled to know the circumstances allegedly constituting fraud on his part. If misrepresentations are


109. *Meridor*, 81 F.R.D. at 111; *Gilbert v. Clark*, 13 F.R.D. 498, 499 (D. Mass. 1952). A contrary view, accepting considerable generality in describing the defendant's role, is reflected in *Denny v. Carey*, 72 F.R.D. 574, 579 (E.D. Pa. 1976). In that case the following allegations were found sufficient to withstand a 9(b) objection:

Each defendants [sic] either drafted, assisted in the drafting or actually promulgated the fraudulent statements or decisions regarding omissions, or with knowledge acquired, aided in the publication of the fraudulent statements, and/or omitted to inform the public of the facts although knowing of the falsity of said statements.
pled, the defendant must be told whether he is alleged to have made those misrepresentations. If omissions are imputed to him, that and the defendant's duty of disclosure must be pled.

Schemes, conspiracies, and other group activities have their own pleading requirements. The facts underlying an alleged scheme must be stated and the nature of each defendant's participation delineated. The same is necessary in alleging a conspiracy. Similarly, an allegation of aiding and abetting must describe the fraud that was aided and set forth circumstances showing the alleged aider and abettor rendered substantial assistance to the fraud. If liability is premised on the controlling persons statutes, identification of the controlled person and the general basis for alleging a control relationship may be necessary.

**E. Alternative Pleading**

The common law prohibited alternative pleading. For example,
an allegation that the defendant authored an article "or" caused it to be authored was improper, as was an allegation that a promissory note "was lost or destroyed." Proscribing disjunctive allegations was thought to facilitate certainty, but it frequently worked injustice. All too often the pleader was forced to frame more specific allegations than his information warranted. In consequence, the proof at trial failed to conform to what was pled. Under the strict common law rules on variance this could be fatal, even though the evidence had, on some basis not pled, shown a right to relief.

The drafters of the federal rules sought to sweep aside this wooden view of the pleadings. Rule 8(e)(2) expressly authorizes alternative and hypothetical pleading. It is supplemented by other rules providing for joinder of multiple parties and claims and directing the court to grant the relief to which the pleader is entitled, regardless of the relief sought in his pleading. These rules acknowledge the complex fact situations out of which lawsuits spring. They provide for framing pleadings that accommodate the pleader's uncertainties and enhance the likelihood that the pleader will receive fair relief.

Although alternative pleading has generally received warm approval, some securities cases, none of which discuss rule 8(e)(2), have used rule 9(b) to circumscribe alternative allegations. For example, one court has concluded that an allegation providing that each defendant's

---

120. Simply put, the doctrine of variance requires a party's proof to conform to the allegations of his complaint. If the evidence showed, for instance, that the plaintiff's vehicle struck the defendant's, but the complaint alleged that the defendant struck plaintiff, the variance in proof might defeat the plaintiff's claim, even though the evidence established that the defendant's negligence caused the collision. See 2A J. Moore & J. Lucas, supra note 34, ¶ 8.03, at 8-22, 23 (2d ed. 1983).
121. Fed. R. Civ. P. 8(e)(2) reads:
   A party may set forth two or more statements of a claim or defense alternately or hypothetically, either in one count or defense or in separate counts or defenses. When two or more statements are made in the alternative and one of them if made independently would be sufficient, the pleading is not made insufficient by the insufficiency of one or more of the alternative statements. A party may also state as many separate claims or defenses as he has regardless of consistency and whether based on legal, equitable, or maritime grounds. All statements shall be made subject to the obligations set forth in Rule 11.
123. Id. 18(a).
124. Id. 54(c).
125. See C. Clark, supra note 36, § 42, at 255. Judge Clark unhesitatingly concluded that the rule permitting alternative allegations was "one of the most simple, desirable, and effective improvements upon the common law..." Id. Alternative pleading has proved eminently workable; many decisions may be cited for the proposition that a pleader has the right to pursue multiple theories of liability through alternative and even inconsistent allegations.
liability "arises from the fact that each has either engaged in or is engaging in all or part of the unlawful acts charged herein" fails to comport with rule 9(b). Although the language is probably more prolix than necessary, these allegations seem precisely what rule 8(e)(2) envisions. The court, however, concluded that "double use of the disjunctive 'or' makes it impossible for each defendant to know the precise misconduct with which he is charged."127

Another intrusion on alternative pleading appears in cases holding that the plaintiff must allege whether a defendant is sued as a primary wrongdoer or an aider and abettor.128 By implication these cases attempt to compel the plaintiff to pursue a single theory—primary or secondary liability. Yet a defendant may be liable for a direct violation of the antifraud provisions and also on the basis of having aided another's violation.129 More fundamentally, where fraud involves multiple participants, the plaintiff may not be sufficiently apprised of the relationship between them to distinguish the primary wrongdoers from those who aided them. This does not mean that the plaintiff lacks an adequate basis for asserting a claim, for despite the inability to delineate the relationships among the defendants, the plaintiff may have substantial information showing their involvement in a fraud.130 Or the plaintiff may know that at least one of the defendants is the source of the injury but because of the circumstances of the case the plaintiff may be uncer-

See, e.g., Hirshfield v. Briskin, 447 F.2d 694, 697 (7th Cir. 1971); Michael v. Clark Equip. Co., 380 F.2d 351, 352 (2d Cir. 1967); Breeding v. Massey, 378 F.2d 171, 178 (8th Cir. 1967).

Provided the defendant is given fair notice of the pleader's claim, and so long as the pleader has not interposed alternative allegations merely to delay or vex his adversary, there is no ground for objection. The final sentence of Fed. R. Civ. P. 8(e)(2) reminds the pleader that the right to assert alternative allegations is, like all averments, subject to the duty of good faith imposed by Fed. R. Civ. P. 11.


127. Id. at 91,428-29.


130. Where a conspiracy is alleged, several courts have acknowledged that it would be unreasonable to expect the pleader to detail the inner workings of the conspirators. See, e.g., Shamrock Assoc. v. Moraga Corp., 557 F. Supp. 198, 205 (D. Del. 1983) (although complaint dismissed as inadequate, plaintiff not expected to "present a highly explicit record of the intricacies of [a] conspiracy"); In re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig., 467 F. Supp. 227, 252 (W.D. Tex. 1979) (pleader "may not be in a position to delineate the precise role of the defendants" in a conspiracy but "once the core conspiracy is set out in sufficient detail, there remains the obligation to inform each defendant of what he did to join the conspiracy").
tain as to which of the defendants is liable.\textsuperscript{131} Rule 20(a) recognizes that such situations exist and authorizes joinder of defendants against whom the plaintiff asserts relief jointly, severally, or alternatively. Driving home the drafters' recognition that defendants who are not ultimately liable will on occasion be sued, the concluding sentence of rule 20(a) provides that judgment may be entered "against one or more defendants according to their respective liabilities."\textsuperscript{132}

When the plaintiff is uncertain which of several defendants may be liable, it should be sufficient if the plaintiff describes the basic facts giving rise to the fraud and alleges some reasonable basis for believing the defendants may have participated in the fraud.\textsuperscript{133} Specific allegations describing the exact manner in which each defendant furthered the fraud should not be required. In this way the defendant will be given notice, and the plaintiff's uncertainty will be accommodated in a manner consistent with rule 20(a).

\textbf{F. Scienter}

The requirements for proof of a defendant's state of mind vary under the commonly used anti-fraud statutes. Sections 12(2) and 17(a) of the Securities Act\textsuperscript{134} offer the possibility of developing liability through negligence.\textsuperscript{135} Rule 10b-5 of the Exchange Act does not.\textsuperscript{136} In

\begin{itemize}
\item \textsuperscript{132} FED. R. CIV. P. 20(a).
\item \textsuperscript{133} See Documation, Inc., [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,788, at 94,040 (plaintiff required to describe how documents issued by corporation were fraudulent but not obligated to explain how each corporate executive named as a defendant participated in the preparation and dissemination of the documents; it was sufficient that the defendant executives had the responsibility for managing the corporation). In In re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig., 467 F. Supp. 227, 254 (W.D. Tex. 1979), the plaintiff alleged that "some or all of the defendants" made certain misstatements and omissions in connection with a stock manipulation conspiracy. Recognizing the difficulty of pleading the exact workings of the conspiracy, the court sanctioned some generality in describing the defendants' involvement:
\begin{quote}
Although plaintiff may not be in a position to delineate the precise role of the defendants, once the core conspiracy is set out in sufficient detail, there remains the obligation to inform each defendant of what he did to join the conspiracy. \textsuperscript{134} See also cases cited supra note 109.
\end{quote}
\item \textsuperscript{134} Securities Act of 1933 §§ 12(2), 17(a), 15 U.S.C. § 77l(2) (1982).
\item \textsuperscript{135} Section 12(2) has consistently been held actionable on a negligence basis. \textit{E.g.}, Wertheim & Co. v. Codding Embryological Sciences, Inc., 620 F.2d 764, 767 (10th Cir. 1980); Wigand v. Flo-Tek, Inc., 609 F.2d 1028, 1034 (2d Cir. 1980). \textit{See also} Kaminsky, \textit{An Analysis of
Ernst & Ernst v. Hochfelder\textsuperscript{137} the Supreme Court eliminated negligent conduct as a predicate for 10b-5 liability by holding that scienter is an element of a 10b-5 claim. What will satisfy the scienter requirement after Hochfelder has been much debated.\textsuperscript{138} The Court defined scienter as a mental state embracing an "intent to deceive, manipulate or defraud."\textsuperscript{139} Other portions of the opinion suggested, however, that knowledge or recklessness might suffice.\textsuperscript{140} The overwhelming majority of post-Hochfelder decisions in the lower courts accept some formulation of recklessness.\textsuperscript{141} Nevertheless the differences in required mental state present opportunities for pleading stratagems.

A troubling problem concerns supporting detail sometimes required to be pled along with scienter. Rule 9(b) speaks directly to the manner of pleading scienter. It provides that "[m]alice, intent, knowledge, and other condition of mind may be averred generally."\textsuperscript{142} From this most courts have concluded without hesitation that the pleader has no obligation to plead a basis for inferring fraudulent intent.\textsuperscript{143} In the


With respect to § 17(a), the courts are divided on the existence of a private action for damages. For example, compare Landry v. All Am. Assurance Corp., 688 F.2d 381, 389 (5th Cir. 1982) (no private action) with Stephenson v. Calpine Conifers II, Ltd., 652 F.2d 808, 815 (9th Cir. 1981) (private action exists). The courts that recognize a private action are in discord as to the state of mind required. For example, compare Spatz v. Borenstein, 513 F. Supp. 571, 578 (N.D. Ill. 1981) (dictum) (negligence sufficient under clauses (2) and (3) of § 17(a)) with In re Nucorp Energy Sec. Litig., [1982-83 Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,157, at 95,587 (S.D. Cal. Mar. 24, 1983) (§ 17(a) claim dismissed for failure to allege scienter). For a detailed discussion of whether there is an implied private right of action under § 17(a), see Hazen, \textit{A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933}, 64 Va. L. Rev. 641 (1978); Note, Section 17(a) of the Securities Act of 1933: Implication of Private Right of Action, 29 U.C.L.A. L. Rev. 244 (1981).

139. 425 U.S. at 194 n.12.
140. \textit{See}, e.g., \textit{id}. at 197 (the statutory language "strongly suggests that section 10(b) was intended to proscribe knowing or intentional misconduct" (emphasis added)); \textit{id}. at 194 n.12 ("In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act.").
143. \textit{E.g.}, McGinty v. Beranger Volkswagen, Inc., 633 F.2d 226, 228 (5th Cir. 1980).
Second Circuit, however, a line of cases has evolved which requires plaintiffs invoking rule 10b-5 to plead facts giving rise to a "strong inference" of knowledge or reckless conduct by the defendant. This places a dubious gloss on rule 9(b). Not only is it inconsistent with the language of the rule, which contemplates precisely the opposite requirement, it also creates an unrealistic pleading burden. Proving state of mind is complex and is usually accomplished through circumstantial evidence. As a matter of proof, issues of scienter may depend as much on credibility as anything else. Although the skilled trial examiner may graphically convey a feel for the credibility of witnesses, even the most gifted writer will never capture the demeanor of witnesses in his pleadings.

Rule 11 has also been cited as a basis for requiring plaintiffs to plead a factual basis for their scienter allegations. In In re Ramada Inns Security Litigation a district court felt rule 11 "would be stripped of any meaning" if the plaintiffs were not required to articulate a basis for their charges of deliberate misconduct. The court was persuaded of this even though it realized proof of scienter could be dependent on circumstantial evidence. Discovery was denied, and plaintiffs were directed to marshal in their complaint sufficient circumstantial evidence to show that a reasonable basis for pleading scienter existed. That interpretation of the rule is wrong. Rule 11 imposes a duty upon counsel to determine

---


145. Herman & MacLean v. Huddleston, 103 S. Ct. 683, 692 n.30 (1983); Woodward v. Metro Bank, 522 F.2d 84, 96 (5th Cir. 1975); United States v. Dittrich, 3 F.R.D. 475, 477 (E.D. Ky. 1943). The realities of proof at trial were aptly described in Beck v. United States, 305 F.2d 595 (10th Cir.), cert. denied, 371 U.S. 890 (1962):

Fraud or the existence of a fraudulent scheme is seldom susceptible to proof solely by direct evidence and in nearly every such case, direct and circumstantial evidence together with the inferences to be drawn therefrom must be relied upon for proof.

Id. at 598.

146. Oil & Gas Ventures—First 1958 Fund, Ltd. v. Kung, 250 F. Supp. 744, 756 (S.D.N.Y. 1966) (In a fraud case "[t]he demeanor of witnesses before the trier of fact, with an opportunity to appraise credibility, may well mean the difference between acceptance and rejection of crucial testimony.").


148. Id. at 1134.
that there is some legal and factual basis for the pleading. It does not, however, address the manner of drafting the complaint. That is the office of rules 8 and 9. Moreover, rule 9(b) specifically tells the pleader how he may allege scienter. If rule 11 were truly a basis for requiring the pleader to plead a factual basis for scienter, it could just as readily be invoked to require detailed allegations of negligence.

Resolving state of mind issues on the pleadings will close the courthouse to many meritorious claims that could have been proved with adequate discovery. The misstatement or omission of material information forms a sufficient basis to press a claim if the pleader reasonably believes the omission or misstatement was caused by the defendant. The defendant may ultimately not be liable; he may lack the requisite state of mind. That is an issue to be explored through discovery. It is enough at the pleading stage that counsel has a reasonable belief that there is a factual and legal basis for his claim.

Advisory Committee Note to amended Rule 11 (citation omitted).

149. Before its recent amendment (see infra note 223) Rule 11 was treated as establishing a subjective standard under which counsel would be deemed in violation of the rule only upon a finding of bad faith. Nemeroff v. Abelson, 620 F.2d 339, 350 (2d Cir. 1980). For general discussions of Rule 11, see Browne, The Significance of the Signature: A Comment on the Obligations Imposed by Civil Rule 11, 30 CLEV. ST. L. REV. 385 (1981); Risinger, Honesty in Pleading and Its Enforcement: Some "Striking" Problems with Federal Rule of Civil Procedure 11, 61 MINN. L. REV. 1 (1976). In its amended form rule 11 seeks to fix a more exacting, objective standard:

The new language stresses the need for some prefiling inquiry into both the facts and the law to satisfy the affirmative duty imposed by the rule. The standard is one of reasonableness under the circumstances . . . . This standard is more stringent than the original good-faith formula and thus it is expected that a greater range of circumstances will trigger its violation.

150. See Billard v. Rockwell Int'l Corp., 683 F.2d 51, 57 (2d Cir. 1982) (intimating that less detail is required where complaint is challenged before discovery); Kimmel v. Peterson, 565 F. Supp. 476, 482 (E.D. Pa.1983) (rejecting 9(b) objection and stating: "Only through discovery will both sides gain the information required to assert their respective claims and defenses."). For an example of the burden that can be placed on plaintiffs by requiring them to plead a factual basis for scienter without discovery, see Posner v. Coopers & Lybrand, 92 F.R.D. 765 (S.D.N.Y. 1981), aff'd mem., 697 F.2d 269 (2d Cir. 1982) (complaint dismissed for failure to allege date defendants became aware of certain facts despite plaintiffs allegations that the precise date could not be pled before discovery).

151. This is obviously a generalization to which exceptions can be postulated. To hypothesize but one example, counsel's presuit investigation might reveal that an accountant's conduct in preparing a false financial statement was an unwitting failure to discover acts of embezzlement that a proper audit would have revealed. Cf. Ernst & Ernst v. Hochfelder, 425 U.S. 185, reh'g denied, 425 U.S. 986 (1976) (securities fraud complaint grounded in negligence). On these facts neither a reasonable nor honest basis for naming the accountant as a defendant on a claim requiring scienter would exist.

pleadings of scienter nurtures circumlocution and prolixity through the need to describe circumstantial evidence from which scienter may be inferred. The drafters of rule 9(b) apparently appreciated these problems and addressed them by approving general allegations of scienter.

G. Information and Belief Allegations

Although the federal rules do not directly address this point, a party may base his allegations on personal knowledge or on information and belief. The integrity of the allegations is protected by rule 11, which places primary responsibility for pleading on the attorney. Counsel is required to vouch for the pleading through his signature, which constitutes a certificate that "to the best of his knowledge, information, and belief formed after reasonable inquiry" the pleading is factually and legally tenable.

The federal rules do not require the pleader to specify which allegations are made on personal knowledge and which on information and belief; nevertheless, the practice of identifying allegations based on information and belief is prevalent. Presumably this is the perpetuation of a practice first developed under the pleading codes. This ritual would seem innocuous enough except that what is essentially a matter of style has, perhaps through nothing more than tired adherence to habit, acquired the rigidity of law. Courts agree that a party may plead on information and belief, but in a fraud claim, the allegations must be


153. Cf. Hilton Hotels Corp., 383 U.S. at 370-71 (verification of complaint by plaintiff on basis of faith in information obtained from adviser, as opposed to personal knowledge, sufficient); see also FED. R. CIV. P. 8(b) (authorizing a party to state lack of "knowledge or information" as a basis for denying an allegation).

154. Risinger, supra note 149, at 7-8.

155. FED. R. CIV. P. 11.

156. C. CLARK, supra note 36, § 36, at 220. At common law, pleading on information and belief was not permitted. Id.

157. It has been suggested that pleading on information and belief is a practical necessity; otherwise the pleader could not avoid the "appearance of perjury" when he lacks personal knowledge. 5 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1224, at 156 (1969). This is doubtful. Since the rules do not require allegations on personal knowledge, there is no reason to believe the pleader is warranting personal knowledge. See Hilton Hotels Corp., 383 U.S. at 370-71 (proper for plaintiff to verify complaint on basis of information obtained from investigators). All that is being said when a complaint is filed is that the pleader's attorney believes there is a good ground, based on knowledge, information and belief, to assert the claim. See FED. R. CIV. P. 11, infra note 223.

158. E.g., Carroll v. Morrison Hotel Corp., 149 F.2d 404, 406 (7th Cir. 1945); General
accompanied by a statement of the information on which the belief is predicated. Failure to identify those sources with precision may occasion a successful 9(b) objection. It is also insisted that the pleader resort to pleading on information and belief only where the matter alleged is peculiarly within the knowledge of the adverse party.

Since the rules do not require plaintiffs to identify the informational basis of their allegations, prudent pleaders will stand their ground and plead without distinction as to what is based upon personal knowledge and what on information. Others, of course, will make the distinction, thereby unnecessarily complicating their task. An example of the burdens to which the pleader is subjected by pleading an informational distinction is Morgan v. Prudential Group, Inc. The issue in Morgan was the manner of pleading scienter. Pleading on information and belief, the plaintiff had generally alleged that the defendant had knowingly or recklessly disregarded certain facts. The court observed that under the second sentence of rule 9(b) a general averment of knowledge is proper. Nevertheless, according to the court, the plaintiff, by pleading on information and belief, was obligated to state facts lending credence to his belief. The court conceded that if the plaintiff had based his allegations on personal knowledge, his allegations "might" have been sufficient.

III. SOME OBSERVATIONS AND SUGGESTIONS FOR IMPROVEMENT

The quest for factually explicit pleadings is neither new nor pecu-
liar to securities litigation. Rules of procedure have always provided a means of ridding the calendar of cases that have been prejudged for one reason or another. At times a court, consciously or unconsciously, will perceive a lack of merit in a case. If the opportunity is presented, some ostensible procedural defect may provide the basis for concluding the litigation. Beyond the idiosyncracies that may shape a particular case, there have historically been categories of cases that for want of a better description have been characterized as disfavored. The reasons for disfavored status vary, but disfavored litigation commonly encompasses lawsuits involving a disproportionate number of unsuccessful claims, unusual complexity, or some special risk of damage to the defendant’s reputation. The resolution of an allegation of fraud involves all three of these difficulties.

In this section the rationale advanced in support of strict pleading in securities litigation is discussed. The conclusion is reached that while strict pleading is intended to further worthy policies, detailed fact pleading of the type catalogued in the preceding section is inconsistent with the role the drafters of the federal rules envisioned rule 9(b) would play in federal pleading. The article then considers two practices—denial of discovery and dismissal—that have been utilized to compel compliance with rule 9(b). After arguing that both practices are improper, the article concludes with the suggestion that rule 11 provides an efficacious means of dealing with abusive securities lawsuits, which does not pose an undesirable risk to meritorious claims.

**A. The Rationale for Strict Enforcement of Rule 9(b)**

There was serious pressure when the federal rules were enacted for the formulation of special pleading rules in complicated cases, especially copyright and patent suits. Nevertheless, no special rules were enacted with the exception of those pertaining to fraud and mistake. Still, resistance to the concept of pleading a general statement of the pleader’s claim has never been eliminated. Although efforts to amend

---

166. Id.; cf. A. DERSHOWITZ, THE BEST DEFENSE 69 (1982) (relating instance of trial judge exploiting the deference afforded findings of fact on appeal as a means of minimizing possibility of reversal); see also id. at xix–xx.
168. Walker Distrib. Co. v. Lucky Lager Brewing Co., 323 F.2d 1, 3 (9th Cir. 1963), cert. denied, 385 U.S. 976 (1966), reh’y denied, 385 U.S. 1032 (1967) (Rule 9(b) indicates particularity is not required in cases other than fraud and mistake).
169. In a notable example, the 1951 judicial conference of the Ninth Circuit cited unfounded lawsuits, overly burdensome discovery, and the need for clarity in defining the issues as reasons for an amendment to Rule 8 that would have required parties to state the “facts
rule 8 have failed, the courts themselves have eroded notice-type pleading. Indeed, the conclusion is unmistakable that resistance to conclusory but facially sufficient claims in disfavored actions has produced a furtive common law of fact-pleading.\textsuperscript{170}

Fortified by the Supreme Court's chary approach to 10b-5 litigation,\textsuperscript{171} many lower courts have been quick to justify strict pleading on policy grounds. Although variously phrased, essentially three reasons have been advanced to justify pleading fraud with particularity. They are not new. They restate the rationale at common law in the context of contemporary litigation.\textsuperscript{172} The first is notice. Fraud is a multifaceted tort of frequently complex dimensions. Requiring specific allegations insures that the defendant will have fair notice of the plaintiff's claims.\textsuperscript{173}

Second, the serious consequences of allegations of fraud warrant strict pleading.\textsuperscript{174} Suggestions of fraud tarnish reputations and denigrate the goodwill of businesses.\textsuperscript{175} Professionals are particularly vulnerable to these charges.\textsuperscript{176} Irreparable loss of standing and prestige may


170. Certain causes of action share fraud's special pleading burdens. Special requirements have historically been most associated with defamation and malicious prosecution, two torts long characterized as disfavored. C. CLARK, supra note 36, § 48, at 314–16. Although these torts enjoy no special status under the federal rules, some courts still require the pleader to set forth more than a general description when pleading them. See, e.g., Brook Water Co. v. Jaffe, 248 F. Supp. 702, 709 (D.N.J. 1968). The explosion of civil rights litigation during the 1960s involved an inordinate volume of meritless claims that placed considerable strain on the federal judiciary. In an effort to minimize the burden of frivolous claims, many of which involved pro se prisoner complaints, a considerable body of courts imposed upon plaintiffs a duty to plead the facts supporting their claims. See, e.g., Martin v. Merola, 532 F.2d 242, 245–46 (2d Cir. 1979). Factualy explicit allegations in habeas corpus petitions have also been required. See, e.g., Blackledge v. Allison, 431 U.S. 63, 75 n.7 (1977). In antitrust litigation special pleading has enjoyed favor in many courts, e.g. Baim & Blank, Inc. v. Warren-Connally Co., 19 F.R.D. 108, 109–10 (S.D.N.Y. 1956), although in recent years the need for detailed fact pleading has been increasingly rejected, e.g., Brett v. First Federal Savings & Loan Ass'n, 461 F.2d 1155, 1157–58 (5th Cir. 1972). Most recently, a requirement of particularity in alleging standing has gained favor. See Roberts, \textit{Fact Pleading, Notice Pleading and Standing}, 65 \textit{CORNELL L. REV.} 390, 415–20 (1980).


172. See supra note 36.


175. \textit{Id.;} Decker v. Massey-Ferguson, Ltd., 681 F.2d 111, 114 (2d Cir. 1982).

befall the attorney or accountant who is linked with a fraudulent scheme through attenuated allegations that may take years to disprove. Comparable problems are presented for public companies which may be obligated to disclose fraud charges, no matter how ill-founded, in public filings. If a plaintiff is to be allowed to make allegations of such prodigious consequence, he must be prepared to delineate clearly his claim.

Third, particularity in pleading reduces unwarranted discovery by facilitating the early disposition of baseless claims. There is a long history of frivolous securities claims, particularly in class and derivative litigation. Complaints that are unlikely to succeed at trial still hold monetary value. Furthermore, liberal discovery rules enable a plaintiff to consume the time of others in pursuing a largely groundless claim. This adds what the Supreme Court has tagged an "in terrorem increment" to the settlement value of the plaintiff's claim. The accuracy of that observation is supported by empirical evidence documenting the prevalence of discovery problems in securities litigation. A pleading code that mandates specificity enables the court to test the sufficiency of the allegations and, if appropriate, make an early disposition of the case.

The justifications advanced for added specificity reflect legitimate concerns, but whether a system of pleading can provide an efficient means of achieving anything beyond fair notice is open to serious question. As developed below, neither the drafters of the federal rules, nor the courts construing rule 9(b) in its formative years, viewed the rule as a significant intrusion on the general pleading allowed by rule 8.

The drafters considered the Appendix of Forms that accompany the federal rules to be the clearest expression of the form they intended pleadings to take. Form 13 addresses fraud and illustrates what is

---


178. See, e.g., A.H. Robins Co., 607 F.2d at 557; Gordon, 467 F.2d at 607.


Courts must be sensitive to the balancing which Rule 9(b) requires. The rule invites abuse by both plaintiffs and defendants. An unbalanced application on the one hand gives plaintiffs unchecked access to the in [sic] terrorem power of the federal discovery mechanism or on the other hand allows defendants by sophistical claims of ignorance, to plow meritorious claims into stumps.

Id. at 250–51 (footnote omitted).


182. Clark, supra note 166, at 316 (1938); Cook, supra note 34, at 245–46; see also Fed. R. Civ. P. 84 ("forms contained in the Appendix of Forms are sufficient under the rules and are intended to indicate the simplicity and brevity of statement which the rules contemplate.").
necessary to plead a fraudulent conveyance. Its operative allegations appear in paragraph 4:

Defendant C.D. on or about . . . conveyed all his property, real and personal [or specify and describe] to defendant E.F. for the purpose of defrauding plaintiff and hindering and delaying the collection of the indebtedness evidenced by the note above referred to.\(^\text{183}\)

Lawyers accustomed to the tangle of judicially imposed rules currently encumbering securities pleading cannot avoid being struck by the stark simplicity of these allegations. Beyond the date, the parties, and some indication of the property involved, there is scant detail. The documents by which the conveyance was made are not identified; the reason the conveyance was fraudulent is conclusorily stated; and scienter is generally averred. If we are to take the drafters at their word—if form 13 is "intended to indicate the simplicity and brevity of statement which the rules contemplate"\(^\text{184}\)—then rule 9(b) was not a marked departure from the simplistic pleading generally envisioned by the rules.

Early case law confirms the simplicity suggested by form 13. Pleaders were directed to clarify ambiguous pleadings,\(^\text{185}\) or complaints merely alleging "fraud" without supporting detail,\(^\text{186}\) or prolix complaints which circumvented the "short and plain statement" requirement.\(^\text{187}\) While a few decisions were overly technical,\(^\text{188}\) in general the courts accepted averments that merely gave the defendant fair notice.\(^\text{189}\) Rule 9(b) was harmonized with rule 8's standard of simplicity, concise-

---

\(^{183}\) *FORM 13, APPENDIX OF FORMS TO FED. R. CIV. P.*

\(^{184}\) *FED. R. CIV. P. 84.*


\(^{188}\) *See Producers Releasing Corp. v. Pathe Indus.*, Inc., 10 F.R.D. 29, 32 (S.D.N.Y.), rev'd *on other grounds*, 184 F.2d 1021 (2d Cir. 1950) (counterclaim dismissed with leave to amend for failure to identify whether defendant's claim based on common law or statutory fraud); *Mfrs. & Traders Trust Co.*, 1 F.R.D. at 56 (complaint dismissed apparently without leave to amend as to certain defendants because it "failed to show any knowledge of fraudulent acts by any of [those] defendants").


*[it was sufficient to] draft a complaint claiming damages for fraud without indicating any detail. Whether [the plaintiff] was in fact defrauded will come out on the trial. He is entitled to be heard on that. Under the modern philosophy we do our
ness, and substantial justice. Usually this meant striking the balance in favor of the pleader.\textsuperscript{190}

A short per curiam opinion issued in 1941 by a panel consisting of Judges Learned Hand, Harrie Brigham Chase, and Charles Clark nicely illustrates the drift of the early decisions.\textsuperscript{191} The case presented a complaint which the court observed did not plead fraud with the desired particularity. But it was, according to the court, "only a pleading," to be construed to do "substantial justice" as directed by rule 8(f).\textsuperscript{192} Since the pleading adequately informed the defendant of the basis of the claim, the lack of specificity was not fatal: "Its general purport is plain enough, and if the [defendant] had really any doubt about its meaning—which plainly it had not—it had, and still has, relief under Rule 12(e); the day has passed when substantial interests stand or fall for such insubstantial reasons."\textsuperscript{193}

B. Denial Of Discovery

Despite the modest role the drafters envisioned for rule 9(b), a substantial body of contemporary case law treats it as a special pleading rule that must be satisfied before discovery.\textsuperscript{194} If the defendant makes a successful 9(b) objection, all courts allow the plaintiff at least one opportunity to amend.\textsuperscript{195} But in those courts that require satisfaction of a 9(b) objection before discovery, the pleader is obligated to replead solely investigating just before trial, or before motions for summary judgment or pretrial hearing, if they are made.

McCaskill, \textit{Modern Philosophy of Pleading}, supra note 41, at 126.

\textsuperscript{190} See, e.g., Mutual Life Ins. Co. v. Krejci, 123 F.2d 594, 596 (7th Cir. 1941); Levenson v. B. & M. Furniture Co., 120 F.2d 1009, 1009 (2d Cir. 1941); \textit{Mine Safety Appliances Co.}, 54 F. Supp. at 591; United States v. Dittrich, 3 F.R.D. 475, 477 (E.D. Ky. 1943).

\textsuperscript{191} B. & M. Furniture Co., 120 F.2d at 1009.

\textsuperscript{192} Id. at 1009.

\textsuperscript{193} Id. at 1009–10.


on the basis of his own information. The right to amend without discovery is often illusory. With discovery the plaintiff might be able to particularize his allegations, but without it, it is far more probable that he will be unable to satisfy the court's pleading demands.

Different rationales have been offered to justify denying discovery. A few courts have held that rule 9(b) is substantive. So reasoning, they have concluded that if the pleader fails to satisfy the rule he has failed to plead a claim for relief. The more common basis for denying discovery is simply an unarticulated assumption that it is within the court's discretion to police compliance with rule 9 by staying discovery until the rule has been satisfied. In the view of these courts the plaintiff is required to have the details of his claim in hand when he files his complaint. Uncertainty will not be countenanced.

The discretion to curtail discovery in this fashion is open to serious question. As one commentator has said, the "pleader is not required to allege only sure winners for which overwhelming admissible evidence is in hand." It is to be expected that every pleader will have some uncertainty. All that is required is a reasonable belief that the claim can be proved. No penalties flow from the mere fact that the claim may ultimately be proved untrue at trial. The nature of litigation is such that, assuming a decision on the merits, one side's pleadings will always


197. See supra note 150.


201. "A plaintiff in a non-9(b) suit can sue now and discover later what his claim is, but a Rule 9(b) claimant must know what his claim is when he files it." In re Commonwealth Oil/Tesoro Petroleum Corp. Sec. Litig., 467 F. Supp. 227, 250 (W.D. Tex. 1979); accord Seaboard Corp., 677 F.2d at 1317; Segal v. Gordon, 467 F.2d 602, 607-09 (2d Cir. 1972).

202. Risinger, supra note 149, at 56.

203. See supra note 155.

204. This is not entirely accurate. Costs are typically assessed against the losing party. See, e.g., FED. R. CIV. P. 54(d). A prevailing party will not, however, be allowed to foist every expense of litigation on his adversary:

   Items proposed by winning parties as costs should always be given careful scrutiny. Any other practice would be too great a movement in the direction of some systems of jurisprudence that are willing, if not indeed anxious, to allow litigation costs so high as to discourage litigants from bringing lawsuits, no matter how meritorious they might in good faith believe their claims to be.

be disproved. Yet no one experienced in litigation will doubt that in the usual case both sides believe they can prevail and are convinced of the truth of their position. The pleader and his adversary are entitled to plead their cases, to develop them through discovery, and ultimately to have a trial so long as they are proceeding honestly with a reasonable—but not necessarily certain—belief that their claims can be proved.

That rules of discovery exist is proof that the pleader is entitled to file a complaint with less than the information he will ultimately need to prove his case. The rules regarding amendments, alternative pleading, and joiner of multiple claims and parties likewise demonstrate that the pleader, even though uncertain of the parameters of his suit, is entitled to file it. Collectively these rules provide a means of handling the pleader's uncertainties and envision, through the right of discovery, that he will be afforded an opportunity to investigate information under the control of his adversary and uncooperative third parties. Rule 9(b) tells us that something extra is required in pleading fraud, but the terse directive that the "circumstances constituting fraud ... shall be stated with particularity" is too slender a reed to support a litany of pleading rules undercutting both the right to discovery and the flexibility in pleading that the federal rules otherwise envision.

C. Dismissal

The burden placed upon pleaders who are denied discovery is a serious problem. More alarming, however, is the increasing willingness of courts to remedy a 9(b) objection through a dismissal with prejudice. There is a very real impediment to advancing fraud claims in those courts that insist upon detailed allegations, deny discovery until the detail is provided, and while granting the pleader leave to amend, dismiss his complaint if his amended pleading does not provide the specificity the court demands. Dismissal under these circumstances is an abuse of discretion.

Assuming a claim for relief has been pled so far as rule 8 is concerned, and assuming that the court's orders are not being deliberately

v. Wilderness Soc'y, 421 U.S. 240, 247 (1975) (under the "American Rule" prevailing party is not ordinarily entitled to recover legal fees from the loser).

206. Id. 8(e)(2).
207. Id. 18(a).
208. Id. 20(a).
flouted,\textsuperscript{210} dismissal for a reason unrelated to the merits is too severe: it does not comport with the requirement in rule 8(f) that pleadings be construed to do substantial justice.\textsuperscript{211} The Supreme Court’s decisions in \textit{Glus v. Brooklyn Eastern District Terminal}\textsuperscript{212} and \textit{Conley v. Gibson}\textsuperscript{213} lend support to this theme.

\textit{Conley v. Gibson}\textsuperscript{214} is the Supreme Court’s leading pronouncement on the standard for dismissal for failure to state a claim for relief. There the Court deemed it “an accepted rule” that dismissal should not be entered “unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.”\textsuperscript{215} Tested by this standard, an incomplete or obscure explication of the pleader’s claim would rarely, if ever, warrant dismissal. If, for example, a complaint alleges that the plaintiff was defrauded through the sale to him of worthless bonds, he has set forth a claim entitling him to relief. A fraudulent sale of securities is plainly actionable, and if the plaintiff can prove the elements of fraud, he is entitled to damages. But the objection to the plaintiff’s complaint is not that a claim of fraud, even if proved, would not suffice for relief. Instead, the argument is that the fraud has not been adequately described.\textsuperscript{216} There are thus two separate inquiries: first, is the plaintiff’s claim one that if proved would, on some set of facts, entitle him to relief, and second, has the claim been adequately described?

The \textit{Conley} standard for dismissal does not address the disposition of the second issue. Indeed, the \textit{Conley} opinion acknowledged that the sufficiency of the complaint is a separate problem. After stating that the

\begin{itemize}
\item \textsuperscript{210} If the court directs the plaintiff to replead and he disregards the order, dismissal is appropriate. \textit{See}, e.g., \textit{Agnew v. Moody}, 330 F.2d 868, 870–71 (9th Cir. 1964) (complaint under 42 U.S.C. \S\S 1983, 1985, & 1986 dismissed where plaintiff was ordered to replead and failed to do so after 3 months).
\item \textsuperscript{212} 359 U.S. 231 (1959), \textit{rev’d}, 253 F.2d 957 (2d Cir. 1958).
\item \textsuperscript{213} 355 U.S. 41 (1957).
\item \textsuperscript{214} \textit{Id.}
\item \textsuperscript{215} \textit{Id.} at 45–46.
\item \textsuperscript{216} \textit{Cf.} the remarks of Judge Clark in chiding the judges of the Southern District of New York for dismissing antitrust claims for lack of specificity:

\begin{quote}
\textit{From all this it is quite apparent that the real objection is not failure to state a claim, for that is abundantly stated; it is rather the lack of detail which the defendant seeks and the court thinks he should have. But this, where really needed, is to be secured directly and simply by pretrial conference or discovery.}
\end{quote}

Clark, \textit{supra} note 167, at 52.
\end{itemize}
complaint did set forth a claim under the Railway Labor Act for relief for racial discrimination, the Court noted:

The respondents also argue that the complaint failed to set forth specific facts to support its general allegations of discrimination and that its dismissal is therefore proper. The decisive answer to this is that the Federal Rules of Civil Procedure do not require a claimant to set out in detail the facts upon which he bases his claim. To the contrary, all the Rules require is "a short and plain statement of the claim" that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests.217

The Conley opinion does not completely resolve the problem of failure to comply with rule 9(b), but when read together with Glus, it strongly suggests that dismissal is not a proper remedy for curing a 9(b) objection.218 In Glus the plaintiff sought to avoid the statute of limitations by alleging that the defendant had misled him as to the time for asserting his claim. The plaintiff claimed that as a result of the misrepresentations, the defendant was estopped to assert the limitations defense. The defendant disputed the sufficiency of plaintiff's allegations of fraud.219 Citing Conley v. Gibson, the Supreme Court rejected the remedy of dismissal even if the allegations were deficient:

It may well be that petitioner's complaint as now drawn is too vague, but that is no ground for dismissing his action. [Citing Conley]. His allegations are sufficient for the present. Whether petitioner can in fact make out a case calling for application of the doctrine of estoppel must await trial.220

D. Rule 11 As An Alternative Remedy

The obvious objection to denying the court authority to dismiss a complaint that fails to particularize the fraud is that rule 9(b) will be rendered unenforceable and thus eviscerated. This need not follow. The pleader may, as indicated, be ordered to replead.221 Regardless of whether a litigant has the solace of knowing his pleading will not be

217. 355 U.S. at 47.
218. Recent decisions of the Supreme Court indicate the Court is more willing to consider dismissal in some types of cases. Cf., e.g., Havens Realty Corp. v. Coleman, 455 U.S. 363, 377-78 (1982) (remanding with directions to allow plaintiff to replead a factual basis for standing but upon failure to do so, to dismiss); Blackledge v. Allison, 431 U.S. 63, 75 (1977) (indicating a vague or conclusory habeas corpus petition might be dismissed).
220. 359 U.S. at 235.
221. See supra note 210.
dismissed, such orders are coercive. Only the most intransigent litigant will be undaunted by the prospect of explaining his noncompliance to the court. In the exceptional case, when repleading fails to cure the problem, rule 11\textsuperscript{222} offers further remedies. Rule 11 obligates counsel to make a prefiling inquiry into the facts and law to ensure there is a reasonable basis for the claims asserted. The court will not be able to assess counsel’s compliance with rule 11 at the pleading stage, for the same reasons the undeveloped record cautions it not to judge the efficacy of the plaintiff’s claims from the pleadings. But as the record develops, the absence of a reasonable basis for the claim may be indicated. If so, a hearing inquiring into counsel’s basis for asserting the claim would be proper.\textsuperscript{223} Sanctions are authorized if appropriate.\textsuperscript{224}

\textsuperscript{222} Effective August 1, 1983, Fed. R. Civ. P. 11 was amended. The text of the rule is set forth below (new material is italicized; deleted language is bracketed):

Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading, motion, or other paper and state his address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath must be overcome by the testimony of two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief [there is good ground to support it; and that it is not interposed for delay] formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. If a pleading, motion, or other paper is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the pleader or movant. [or is signed with intent to defeat the purpose of this rule, it may be stricken as sham and false and the action may proceed as though the pleading had not been served. For a willful violation of this rule an attorney may be subjected to appropriate disciplinary action. Similar action may be taken if scandalous or indecent matter is inserted.] If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney’s fee.

\textsuperscript{223} For an example of this procedure, see Morgan v. Prudential Group, Inc., 81 F.R.D. 418, 429-31 (S.D.N.Y. 1978).

In determining whether a reasonable basis exists, the focus should be on the entire claim for relief as opposed to its individual elements. Counsel may be uncertain about one or more elements of the claim (e.g., the defendant’s state of mind) and yet may have very substantial evidence of other elements — for instance, that the defendant misrepresented a fact, that the plaintiff relied on it, that the fact was material and that the plaintiff was damaged as a result of it. Viewing the claim and the information supporting it as a whole may provide a credible, albeit circumstantial and somewhat uncertain, basis for believing the claim can be proved with discovery. In such situations counsel should be deemed to have a reasonable
There will undoubtedly be some plaintiffs who escape sanctions and succeed in leveraging the threat of protracted litigation and burdensome discovery into the settlement of untenable claims. On the other hand, if rule 11 sanctions are evenly and consistently applied, most such claims will be deterred by the threat of the assessment of counsel fees against the plaintiff. As the probability of penalties for filing vexatious litigation becomes more certain, the incentive to proceed with such suits should diminish.  

IV. CONCLUSION

A rule of added specificity in pleading fraud has been with us since the common law. It deters glib fraud charges and facilitates the early disposition of claims lacking merit. To this extent it is to be commended. But enforcing a rule of specificity has its price. As the line is drawn between legally sufficient and insufficient complaints, the requirements for pleading become increasingly complex. Requirements codified in the reported decisions engender a multiplicity of further requirements in the minds of counsel. As the process develops the pleadings become increasingly important and the number of motions directed at supposed defects in them ever increases. In the end whatever is gained in eliminating baseless claims is offset by the unfortunate dismis-
sal of meritorious claims and the escalating expense of handling pleading objections.

The drafters of the federal rules were aware of the arguments for and against special pleading. On the whole they resolved the matter in favor of general pleading. Although a requirement of added particularity was retained for fraud, the simplicity of the allegations in Form 13 and the format of the federal rules as a whole indicate that this was not a substantial departure from the other pleading rules. Rule 9(b) must be harmonized with rule 8(f)’s admonishment that the pleadings are to be construed to do substantial justice. It must also be construed in the spirit of flexibility suggested by the right to plead alternatively, to join multiple parties and claims, and most importantly, to have discovery and to amend following that discovery.

While there have undoubtedly been many frivolous securities claims, attempting to deter such claims through specialized pleading that is enforced through dismissal and denial of discovery is in conflict with the intent and format of the federal scheme of pleading. Rule 11 now offers sufficient sanctions to deal with abusive claims; there is no longer adequate justification for enforcing rule 9(b) sanctions. Whatever merit that approach had is confined to the rigor of its own precedent.