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Securities Regulation

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This Article surveys significant cases decided by the Eleventh Circuit Court of Appeals during 1991 and 1992 in the field of securities regulation. This Article also examines selected Supreme Court decisions during this survey period that affect Eleventh Circuit precedent.

I. The Definition of a Security

In order to state a claim under the Securities Act of 1933, (the "Securities Act")[1] or the Securities Exchange Act of 1934 (the "Exchange Act"),[2] the claim must generally relate to the purchase or sale of a "security." Although this requirement may seem straightforward, there has been considerable litigation over the years as to what constitutes a "security." Section 2(1) of the Securities Act[3] and Section 3(a)(10) of the Exchange Act[4]

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1. 15 U.S.C. §§ 77a-77aa (1988 & Supp. 1990).
2. *Id.* §§ 78a-78kk.
3. Section 2(1) of the Securities Act provides, unless the context requires otherwise, that:

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

define "security" in broad and general terms to achieve the Congressional goal of protecting investors.[5]

The only significant Eleventh Circuit decision[6] during the survey period that addressed the question of what constitutes a security was *Rice v. Branigar Organization, Inc.*[7] In *Rice* the Eleventh Circuit Court of Appeals considered whether the sale of lots in a housing development and equity memberships in a country club constituted "securities" for the

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> participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Id. § 77b(1) (1988).

4. Section 3(a)(10) of the Exchange Act provides, unless the context requires otherwise, that:

> (10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Id. § 78c(a)(10).

5. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975); Holloway v. Peat, Marwick Mitchell & Co., 900 F.2d 1485 (10th Cir.), *cert. denied*, 498 U.S. 958 (1990).

6. There was at least one significant state court decision during this period as well. In Cohen v. William Goldberg & Co., Inc., 262 Ga. 606, 423 S.E.2d 231 (1992), the Georgia Supreme Court rejected the "economic reality" test for determining whether stock in a closely held corporation constitutes a security, adopting, instead, the "stock characterization" test in Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985). *Cohen*, 262 Ga. at 607-08, 423 S.E.2d at 232-33. Under this test, a court looks at the title of the interest (i.e., is it denominated "stock") and whether the interest possesses some of the significant characteristics of stock. *Id.* at 607, 423 S.E.2d at 232. For a discussion of *Landreth*, see John L. Latham, *Securities Regulation*, 38 MERCER L. REV. 1341, 1342-45 (1987).

7. 922 F.2d 788 (11th Cir. 1991). The definition of a security expressly encompasses "investment contracts" under § 2(1) of the Securities Act and § 3(a)(10) of the Exchange Act. *See supra* notes 3 and 4. The Supreme Court has delineated a four part test for determining whether something is an investment contract, and hence a security. *See* Securities Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, *reh'g denied*, 329 U.S. 819 (1946). Under *Howey* an investment contract or security exists when (i) there is an investment of money (ii) in a common enterprise (iii) made with an expectation of profit (iv) coming solely from the efforts of a third party. *Howey*, 328 U.S. at 299.

purposes of the anti-fraud provisions of the Exchange Act.[8] Plaintiffs, non-equity members of the club, filed a complaint alleging that the sale of equity memberships in the club and the sale of undeveloped lots each constituted sales of unregistered securities. Specifically, plaintiffs asserted that these sales involved "investment contracts" and thus fell within the definition of a security. After discovery, the district court granted summary judgment for defendant holding that neither the lots nor the equity memberships were securities.[9]

The Eleventh Circuit agreed with defendant that neither the equity memberships nor the lots constituted a security and affirmed the district court's ruling.[10] The court pointed out that under Supreme Court precedent a security is not involved when a purchase is made with the primary intent to use or consume the object purchased.[11] The court concluded that people buy the types of houses and lots involved in *Rice* primarily to use them, not to derive profits from the entrepreneurial efforts of the developers.[12] In making this determination, the court noted that the promotional material utilized by the developer to entice purchasers can be highly relevant, particularly if the material emphasizes the investment value of the purchase.[13]

In *Rice* the promotional material's greatest emphasis was placed on the beauty of the island and the amenities of the club and the community.[14]

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8. 922 F.2d at 789. *See also supra* note 5. The real issue is whether an investment contract was involved. *See supra* note 7.

Defendant, as part of a residential-unit development, built a large country club with golf courses and tennis courts. The initiation fees and dues required for membership in the country club were not included in the purchase price of a house or lot. Later, defendant created a non-profit corporation and transferred ownership of the club to that corporation. Only members owning an equity interest were allowed to use the club. The court also addressed whether defendant's representations about land-owners' access to the country club violated the anti-fraud provisions of the Interstate Land Sales Full Disclosure Act. The court answered this issue in the negative. 922 F.2d at 789-92.

9. 922 F.2d at 790-91. Plaintiffs also claimed that defendant's failure to disclose that the non-equity club members would eventually be required to buy equity memberships to use the club was a misrepresentation violating Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. *Id.*

10. *Id.*

11. *Id.* at 790. *See supra* note 5. The court stated that it has also looked to the emphasis provided by promotional material to determine whether the sale of something is a sale of "securities" for the purpose of federal securities law. 922 F.2d at 790 (citing SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943)).

12. 922 F.2d at 790-91. The court pointed out that plaintiffs offered no evidence that a majority or even a fair number of buyers bought houses or lots as an investment. Furthermore, the promotional materials did not emphasize the lot's investment values. Only one passage introduced into evidence referred to buying the property as an investment. *Id.*

13. *Id.*

14. *Id.*

The Eleventh Circuit pointed out that the economic reality was that most, if not all, members bought the equity memberships to use and enjoy the club's facilities. Moreover, the court could find little reason for a purchaser to invest in the equity of a non-profit company.[15] Although one marketing item referred to the investment nature of the property, the emphasis was on enjoying the beauty of the property and its amenities. In like fashion, "the promotional material for the equity membership contracts was clearly aimed at selling the memberships to give the purchasers access to the facilities."[16]

Rice appears to have been correctly decided under the facts reported by the court. While the definition of a security should be broadly construed to effectuate the purposes of the securities laws, it should not be construed so broadly as to encompass interests in which the investment aspects are not primary. An overly broad approach to defining a security hampers commerce without providing meaningful benefit to those involved. The court's willingness to uphold the district court's grant of summary judgment, in the face of some reference in the promotional material to the investment nature of the property, reflects the court's implicit conclusion that the contrary evidence was not sufficient to create a "material" question of fact.

II. Offeror or Seller

Section 12 of the Securities Act imposes liability for selling or offering to sell unregistered securities or securities through the use of false communications.[17] In *Ryder International Corp. v. First American National Bank*,[18] the Eleventh Circuit Court of Appeals faced the issue of whether

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15. *Id.* at 791. The court pointed out that "both the Securities and Exchange Commission and the Georgia Commissioner of securities ha[d] issued no-action letters in connection with the sales of the equity memberships." *Id.* Furthermore, plaintiff offered no evidence that the purchasers bought the memberships as investments. *Id.* at 791 n.3.

16. *Id.* at 791. In fact, potential buyers were sent letters that explicity instructed them not to buy the memberships as an investment. *Id.*

17. Section 12 provides that any person who:

> (1) offers or sells a security in violation of Section 5 or, (2) offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading . . . and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him . . . .

15 U.S.C. § 771 (1988).

18. 943 F.2d 1521 (11th Cir. 1991).

a bank should be deemed a "seller" under Section 12(2) when it acts as an intermediary in the purchase of securities for a customer through a registered dealer.[19] Plaintiff, a manufacturing business, regularly made short-term investments to earn interest on its excess cash. On two occasions plaintiff used defendant bank, First American, to buy commercial paper issued by Integrated Resources, Inc. ("Integrated"), a New York Stock Exchange listed company.[20] Integrated was heavily involved in the business of selling real estate tax shelters.[21] Integrated subsequently defaulted on plaintiff's investment. Plaintiff Ryder later learned that defendant had a lending relationship with Integrated.[22]

Prior to 1988, the Eleventh Circuit Court of Appeals held that the definition of "seller" under Section 12 of the Securities Act reached those persons whose participation in the transaction was a "substantial factor" in causing the transaction to occur.[23] A split of authority existed over who could be deemed a "seller" and a number of courts required a showing of privity with the buyer.[24] In *Pinter v. Dahl*, the United States Supreme

19. *Id.* at 1524. In Pinter v. Dahl, 486 U.S. 622 (1988), the Court rejected the "substantial factor" test as well as the "privity test" while determining the definition of "seller" under Section 12(1) of the Securities Act. The decision in *Pinter* did not address the issue under Section 12(2). *Pinter*, 486 U.S. at 642 n.20. The statute does not delineate who should be regarded as a statutory seller and the courts of appeal have been inconsistent in defining the term. The sparse legislative history sheds no light on the issue. 943 F.2d at 1524 (citing *Pinter*, 486 U.S. at 642).

20. 943 F.2d at 1522-23. On both occasions, plaintiff's agent asked defendant for rates of 90-day paper and was given the rates on several investments, including Integrated paper. Defendant bought the paper from Drexel Lambert, the underwriter and exclusive dealer for Integrated. *Id.*

21. According to the court, Ryder had knowledge of this fact. *Id.* at 1523. Furthermore, the court stated that the record did not reveal how much knowledge defendant's loan department had with regard to Integrated's financial difficulties, but, whatever information it had, was not communicated to plaintiff. *Id.*

22. *Id.*

23. *See* Foster v. Jesup & Lamont Sec. Co., 759 F.2d 838 (11th Cir. 1985). This test was used for the "definition" of a § 12 seller. "Secondary participants who did not effectuate the sale could be liable if a plaintiff's injury flowed directly and proximately from their actions." 943 F.2d at 1525 (citing *Foster*, 759 F.2d at 844 (citing Junker v. Crory, 650 F.2d 1349, 1360 (5th Cir. 1981)).

24. 943 F.2d at 1525. *See* Collins v. Signetics Corp., 605 F.2d 110, 113 (3d Cir. 1979); Sanders v. John Nuveen & Co., 619 F.2d 1222, 1226 (7th Cir. 1980), *cert. denied*, 450 U.S. 1005 (1981). *See generally* Bryan M. Schneider, *Section 12 of the Securities Act of 1933: The Privity Requirement in the Contemporary Securities Law Perspective*, 51 TENN. L. REV. 235 (1984). Prior to the Supreme Court's decision in *Pinter*, the circuits were split over whether privity must exist between the plaintiff-purchaser and the defendant-seller in order for the defendant to be considered a seller under Section 12(2). The Second, Fourth, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits had held no privity was needed. Those circuits either used a "substantial factor" test, a "proximate cause" test, or a variation of those tests to define the class of participants who, although not owners of the securities, could never-

Court rejected the "substantial factor" test utilized by the Eleventh Circuit Court of Appeals as well as the "privity test" for determining who constituted a seller under Section 12(1) of the Securities Act.[25] The Court held that a person soliciting securities purchases may be held liable as a seller under Section 12(1) only when the successful solicitation has been motivated, at least in part, by a desire to serve the solicitor's own financial interests or those of the securities owner.[26]

In *Ryder* plaintiff argued that "sound policy and statutory interpretation required that the definition of 'seller' used in Section 12(2) cases be broader than the *Pinter* definition for Section 12(1) cases."[27] The Elev-

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theless be liable under Section 12(2). 943 F.2d at 1524-25. *See* Pharo v. Smith, 621 F.2d 656, 664-68 (5th Cir. 1980), holding that "the proper test for section 12 generally lies between the antiquated 'strict privity' concepts and the overbroad 'participation' concept which would hold all those liable who participated in the event leading up to the transaction, and thus focuses on whether 'the injury to the plaintiff flow[ed] directly and approximately from the actions of this particular defendant.'" 943 F.2d at 1524 n.9 (citations omitted). *See also* Davis v. Avco Fin. Serv., 739 F.2d 1057, 1063-68 (6th Cir. 1984) (adopting proximate cause test under Section 12), *cert. denied*, 470 U.S. 1005, *and cert. denied*, 472 U.S. 1012 (1985). Lawler v. Gilliam, 569 F.2d 1283, 1287 (4th Cir. 1978) (under Section 12(1), "[l]iability [can] be imposed on any person who actively solicits an order, participates in the negotiations, or arranges the sale, 'but' the definition excludes persons who executed an unsolicited order or minor role in the transaction shows that they have no casual connection with it"); Anderson v. Aurotek, 774 F.2d 927, 930 (9th Cir. 1985) (liability under Section 12 depends on whether the acts of the participants are "both necessary to and a substantial factor in the sales transaction."); Stokes v. Lokken, 644 F.2d 779, 785 (8th Cir. 1981) (employing substantial factor test). 943 F.2d at 1524 n.9. The Court in *Pinter* recognized that "a person may offer or sell property without necessarily being the person who transfers title to, or other interest, in that property." *Pinter*, 486 U.S. at 642-43. The Court concluded that participants who, in the transfer of securities, "solicit" a purchase may also be liable as sellers even though they do not own the securities. *Id.* at 644-45.

25. *See* discussion *supra* note 19.

26. *Pinter*, 486 U.S. at 644-46. The Court relied, in part, on the statutory inclusion of "solicitation of an offer to buy" within the definition of sell. *Id.* at 643. The Supreme Court rejected both the substantial factor and privity tests used by the circuit courts. *Id.* at 643-654. For a discussion of the various tests, see generally, Patricia A. Ohara, *Erosion of the Privity Requirement in Section 12(2) of the Securities Act of 1933: The Expanded Meaning of Seller*, 31 U.C.L.A. L. REV. 921 (1984); Robert N. Rapp, *Expanded Liability Under Section 12 of the Securities Act: When Is a Seller Not a Seller*, 27 CASE W. RES. L. REV. 445 (1977); Leonard Alan Silverstein, Note, *Seller Liability Under Section 12(2) of the Securities Act of 1933: A Proximate Cause-Substantial Factor Approach Limited by a Duty of Inquiry*, 36 VAND. L. REV. 361 (1983).

27. 943 F.2d at 1526. In particular, plaintiff differentiated the two sections on the basis that Section 12(1) imposes strict liability, while Section 12(2) allegedly requires only a showing of negligence. *Id.* Plaintiff asserted that the broader substantial factor test should apply to determine the scope of Section 12(2). Under that test, the issue would become whether First American was a substantial factor in the sale of the commercial paper to plaintiff, an issue of fact inappropriate for summary judgment. *Id.* The Court in *Pinter* had expressly declined to take a position on the meaning of "seller" within Section 12(2); how-

enth Circuit Court of Appeals began its analysis of who should be deemed a seller under Section 12(2) with the statutory language,[28] since the Securities Act uses identical language in Section 12(1) and Section 12(2) to indicate who may be held liable, the person who may sue, and the remedy available.[29]

Based on the language of Section 12 and the Supreme Court's decision in *Pinter*, the Eleventh Circuit modified the "substantial factor" test applicable to Section 12(2) claims to comport with the test enunciated in *Pinter* for a Section 12(1) claim.[30] The court reasoned that "applying *Pinter* to section 12(2) [wa]s consistent with the statute's relationship to the other provisions and underlying policies of the statutory scheme."[31]

After holding that *Pinter* applied to Section 12(2), the court concluded that defendant bank could not be held liable on the facts of the case because it was not a seller or solicitor of the securities.[32] The record showed that defendant bank did not own or hold the Integrated commercial paper prior to or at the time plaintiff requested defendant purchase the paper and thus, defendant was not a "seller" of the securities.[33] Similarly, defendant bank was not a "solicitor" of the sales at issue.[34] Rather, the court held that an agency relationship existed between defendant bank

ever, it did concede that decisions under Section 12(2) were relevant to the scope of "seller" under Section 12(1). *Pinter*, 486 U.S. at 642 n.20.

28. 943 F.2d at 1526 (citing Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197, *reh'g denied*, 425 U.S. 986 (1976)).

29. *See* 15 U.S.C. § 77l(1)-(2) (1988); *see also supra* notes 17 and 19.

30. 943 F.2d at 1527. The court noted other circuits had similarly modified their tests in light of *Pinter*. *See* Moore v. Kayport Package Express, Inc., 885 F.2d 531, 536 (9th Cir. 1989) (substantial factor test reformulated in light of *Pinter*, which applies to Section 12 generally); Crawford v. Glenns, Inc., 876 F.2d 507, 510 (5th Cir. 1989) (substantial factor test reformulated in light of *Pinter*); Craftmatic Sec. Litig. v. Kraftsow, 890 F.2d 628, 635 (3d Cir. 1989) (test for 12(2) status reformulated to abolish privity requirement and conform with *Pinter*'s test for 12(1) status); Wilson v. Saintine Exploration & Drilling Corp., 872 F.2d 1124, 1126 (2d Cir. 1989) (*Pinter*, which this court has held applies to Section 12 generally, in part expands and in part contracts the category of persons potentially liable under Second Circuit case law); Schlifke v. Seafirst Corp., 866 F.2d 935, 940 (7th Cir. 1989) (*Pinter* "seems to undermine the continuing viability of [our Circuit's] strict privity requirement concept under section 12(2)"). 943 F.2d at 1527 n.11.

31. 943 F.2d at 1528. "Section 12(1) creates liability for the sale of unregistered securities, while section 12(2) creates liability for omissions and misrepresentations in a prospectus or oral communication." *Id. See* discussion *supra* note 17. The purpose of both sections is to promote full and fair disclosure of information to potential buyers of securities. This shared purpose strengthens the reasoning for applying *Pinter* to both sections. 943 F.2d at 1528.

32. 943 F.2d at 1530.

33. The Integrated notes were "bearer" paper. Furthermore, the notes contained the same trade dates and settlement dates. This evidence established that defendant never owned the securities.

34. *See* discussion *supra* note 17.

and plaintiff.[35] When an agency relationship exists, the agent is in reality buying on behalf of the purchaser and not selling on behalf of the owner.[36]

The court's approach to Section 12(2) is not surprising and is in keeping with other jurisdictions. The case cannot be read, however, for the proposition that a bank can never be liable as a "seller" or "solicitor." To the contrary, a bank that is actively soliciting securities transactions on behalf of its customers may well be held liable under Section 12.

III. The Application of Rule 10b-5

A. *Statute of Limitations*

Although no private right of action exists in the language of Section 10(b)[37] of the Exchange Act or Rule 10b-5[38] promulgated thereunder, federal courts have implied a private cause of action under that section for over 45 years.[39] The federal courts of appeal have split, however, over whether to apply federal or state law in determining the appropriate statute of limitations for these private claims under Section 10(b) and Rule 10b-5.[40] As a result, the limitation period for bringing a 10b-5 action va-

35. 943 F.2d at 1531.

36. *Id.* (citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng, 697 F. Supp. 1224, 1228-29 (D.D.C. 1988)).

37. Section 10(b) provides:

> [I]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, of any facility of any national securities exchange . . . . (b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device . . . in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j (1988).

38. Rule 10b-5, promulgated pursuant to 15 U.S.C. § 78j provides:

> [I]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national security exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1992).

39. *See* Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

40. *See, e.g.*, Ceres Partners v. GEL Assocs., 918 F.2d 349 (2d Cir. 1990); Bath v. Bushkin, Gaims, Gaines & Jonas, 913 F.2d 817 (10th Cir. 1990); Short v. Belleville Shoe Mfg. Co., 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 2887 (1991); Nesbit v. McNeil, 896 F.2d 380 (9th Cir. 1990); Smith v. Duff & Phelps, Inc., 891 F.2d 1567 (11th Cir.), *reh'g denied*, 904 F.2d 712 (1990); *In re* Data Access Sys. Sec. Litig., 843 F.2d 1537 (3d Cir.),

ried from one to five years, depending on whether federal law or the law of one of the fifty states applied.[41]

On June 20, 1991, in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,[42] the United States Supreme Court created a uniform federal limitation period for all claims brought under Section 10(b) and Rule 10b-5.[43] The Court held that all claims brought under Section 10(b) and 10b-5 must be initiated within one year after the facts constituting the violation are or should have been discovered, and in no event more than three years after the actual violation.[44]

The case arose out of the sale of seven Connecticut limited partnerships that were formed for the purchasing and leasing of computer software and hardware. Defendant law firm helped organize the partnerships and provided additional legal services, including preparation of opinion letters concerning the tax consequences of investment in the limited partnerships. Plaintiffs purchased units in one or more of the partnerships with the expectation of realizing federal income tax benefits from the investment. After the partnerships failed, the United States Internal Revenue Service ("IRS") subsequently disallowed the claimed tax benefits because of overvaluation of partnership assets and the lack of a profit motive.[45] Plaintiffs purchased the units during 1979 through 1981, but asserted that they did not become aware of the alleged misrepresen-

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cert. denied, 488 U.S. 849 (1988); Corwin v. Marney, Orton Invs., 843 F.2d 194 (5th Cir. 1988), *cert. denied*, 488 U.S. 924 (1988); O'Hara v. Kovens, 625 F.2d 15 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124 (1981).

41. *See, e.g.*, Mosesian v. Peat, Marwick, Mitchell & Co., 727 F.2d 873 (9th Cir.), *cert denied*, 469 U.S. 932 (1984) (applying three year limitation based on California law); First Fed. Sav. & Loan Ass'n of Miami v. Mortgage Corp. of South, 650 F.2d 1376 (5th Cir. 1981) (applying two year limitation period based on Alabama law); McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888 (5th Cir. 1979) (applying four year fraud limitation period based on Georgia law); Fox v. Kane-Miller Corp., 542 F.2d 915 (4th Cir. 1976) (applying one year limitation period based on Maryland law).

42. 111 S. Ct. 2773 (1991).

43. *Id.* at 2773.

44. *Id.* at 2782. In an extremely controversial one sentence statement, the Court applied its holding retroactively and dismissed the claims presented in the instant case. *Id.* Congress quickly overruled the Court's decision on this point through a provision enacted as part of the Federal Deposit Insurance Corporation Improvement Act of 1991. Pub. L. No. 102-242, Title IV, § 476, 105 Stat. 2236 (codified at 15 U.S.C.A. § 78aa-1) (West Supp. 1992)). Under this statute, plaintiffs will be able to refile claims within 60 days of enactment, if the claims were originally commenced on or prior to June 19, 1991, and would have been timely filed using applicable borrowing principles.

45. *Lampf*, 111 S. Ct. at 2776. Plaintiffs named as defendants individuals involved in the preparation of offering memorandum. The complaints alleged that plaintiffs were induced to invest in the partnerships by misrepresentations, namely, the tax benefits to be realized in the offering memorandum, in violation of, among other things, Section 10(b) and Rule 10b-5. *Id.* at 2776-77.

tations, including assurances that the investment would entitle plaintiffs to substantial tax benefits, until 1985, following the disallowance of the tax benefits by the IRS.[46]

The district court granted summary judgment for defendants based on Ninth Circuit precedent.[47] The Court of Appeals for the Ninth Circuit reversed and remanded. In an unpublished opinion, the Ninth Circuit held that unresolved factual issues existed as to when plaintiffs discovered or should have discovered the alleged fraud, thus precluding summary judgment.[48]

The Supreme Court's plurality opinion[49] began with the proposition that when Congress fails to provide a statute of limitations for a federal cause of action, the court "borrows" or "absorbs" the state limitation period most analogous to the case at bar.[50] The Court also noted that, because state legislatures rarely enact limitation periods with federal interests in mind, there is an exception to the rule if the state statute of limitation frustrates the policies embraced by the federal statute. Based on Supreme Court precedent, the Court identified a "hierarchy" that determines the appropriate statute of limitations for federal causes of action as to which Congress failed to delineate a statute of limitations.[51]

Under this hierarchy, the court must first determine whether a uniform statute of limitations is appropriate.[52] If a uniform limitation period is appropriate, the court then decides whether it should be derived from a

46. *Id.* at 2776-77.

47. *See* Robuck v. Dean Witter & Co., 649 F.2d 641 (9th Cir. 1980). Under *Robuck* the Ninth Circuit ruled that Section 10(b) claims were governed by the state statute of limitations for the most analogous forum-state cause of action. The district court determined this to be Oregon's two-year statute of limitation for fraud claims. OR. REV. STAT. § 12.110(1) (1989). The district court further ruled that plaintiffs received reports detailing the declining financial status of each partnerships and thus, had notice of the possible fraud as early as October 1982. *Lampf*, 111 S. Ct. at 2777.

48. *Lampf*, 111 S. Ct. at 2777. The Ninth Circuit also selected the two-year Oregon limitation period for fraud claims as the appropriate statute of limitation. *Id.*

49. The plurality opinion was authored by Blackman, J., joined by Rehnquist, C.J., White, and Marshall, JJ., and joined in pertinent part by Scalia, J. Scalia, in a concurring opinion, joined in the judgment of the Court, but disagreed with the methodology applied. In the absence of an expressed federal limitation period, Scalia would look to state statutes of limitations. If the state period is inconsistent with the policies of the federal statutes, then Scalia would find no limitation period. *Id.* at 2783.

50. *Id.* at 2778.

51. *Id.* at 2778-79.

52. *Id.* The Court pointed out that in cases in which a federal cause of action tends to "encompass numerous and diverse topics and subtopics . . . the federal interests in predictability and judicial economy counsel the adoption of one source, or class of sources, for borrowing purposes." *Id.* at 2779 (citing Wilson v. Garcia, 471 U.S. 261, 273-75 (1985)).

state or federal statute or source.[53] A presumption exists that the court borrows from a state source unless an analogous federal source truly provides a "closer fit" with the cause of action at issue.[54]

The Court pointed out that its task in the present case was complicated by the nontraditional origins of the Section 10(b) cause of action, since the judiciary, not Congress, created the private cause of action.[55] The Court decided that when a claim is implied under a statute that also contains express causes of action with their own time limitation periods, the court should look to the expressed limitation periods contained in the statute for guidance.[56] The Court held that, because the Exchange Act contains a number of express causes of action with express statute of limitations periods, the Court could appropriately look to those periods to determine the appropriate limitation period for Section 10b-5 causes of action.[57] With only one exception,[58] every statute of limitations included within the Exchange Act includes some variation of a one-year period after discovery combined with a three-year period of repose.[59] Thus, the

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53. *Id.* at 2779. Under this inquiry, the court should accord particularly weight to the geographical character of the claim. *Id.*

54. *Id.* Commonality of purpose and similarity of elements will be most relevant to this portion of the inquiry. *Id.*

55. *Id.* In fact, the Court pointed out that it was faced "with the awkward task of discerning the limitations period that Congress intended courts to apply to a cause of action it really never knew existed." *Id.* at 2780.

56. *Id.* The Court uses the expressed limitation periods as a clear indication of how Congress might have balanced the policy considerations for a limitation period under Section 10(b). *Id.* The Court held that if the statute contains comparable express remedial provisions, the time limitation period expressed for those provisions should be used; only when no analogous counterpart exists should a court proceed to apply state borrowing principles. *Id.*

57. *Id.*

58. Section 16(b) sets a more restrictive two-year period of repose. *Id.* at 2780 n.5.

59. Section 9(e) of the 1934 act provides: "No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e) (1988) (as cited in *Lampf*, 111 S. Ct. at 2780 n.6).

Section 18(c) of the 1934 Act provides: "No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued." 15 U.S.C. 78r(c) (1988) (as cited in *Lampf*, 111 S. Ct. at 2780 n.6).

Furthermore, Section 13 of the 1933 Act as amended, provides:

> No action shall be maintained to enforce any liability created under section 77k or 77l(2) of this title unless brought within one year after the discovery of the untrue statement or the admission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77l(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77l(1) of this title more than three years

Court held that "litigation instituted pursuant to [Section] 10(b) and Rule 10b-5 [must] be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation."[60] The Court refused to apply the doctrine of equitable tolling[61] to the limitation period because the three-year period of repose establishes an arbitrary and outside limit for bringing these actions, which is inconsistent with equitable tolling principles.[62]

The Court also applied the one year/three year rule retroactively to bar the claims that were before it.[63] Congress quickly responded to the Court's ruling on the retroactive application of the one year/three year limitation period by enacting Section 27A of the Exchange Act and effectively "overturning" the Supreme Court's retroactivity ruling.[64] The en-

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> after the security was bona fide offered to the public, or under Section 77l(2) of this title more than three years after the sale.

15 U.S.C. § 77m (1988) (as cited in *Lampf*, 111 S. Ct. at 2780 n.7).

60. *Lampf*, 111 S. Ct at 2782. Acknowledging the slight difference in terminology amongst the various statute of limitations periods contained in the Securities and Exchange Acts, the Court selected the language of section 9(e) of the Exchange Act, 15 U.S.C. § 78i(e), as the governing standard for Section 10(b) causes of action. 111 S. Ct. at 2782 n.9. Furthermore, the Court rejected the Securities and Exchange Commission's argument for adopting the five year statute of limitations period contained in Section 20A of the 1934 Act, stating that Congress did not intend that provision to extend to other sections of the Exchange Act. *Id.* at 2781.

61. This doctrine delays the statute of limitations period until the plaintiff discovers or should have discovered the fact comprising the violation.

62. *Lampf*, 111 S. Ct. at 2782. Four members of the Court dissented from the Court's judgment in three separate opinions. Justice Stevens, joined by Justice Souter, questioned the action of the federal judiciary, rather than Congress, in rejecting the long-standing principle of state borrowing that had been applied to Section 10(b) actions. *Id.* at 2783-85. Justice Kennedy joined by Justice O'Connor, agreed with the majority that federal borrowing was appropriate, and argued for the adoption of the one year from discovery rule, but not the three-year period of limitation. *Id.* at 2788. Justice O'Connor, joined by Justice Kennedy, noted her disagreement with the Court's retroactive application of its holding. *Id.* at 2785-88.

63. *Id.* at 2782.

64. Section 27A was adopted as part of the Federal Deposit Insurance Corporation Improvement Act of 1991 and amended the Exchange Act to provide as follows:

> (a) The limitation period for any private civil action implied under section 78j(b) of this title that was commenced on or before June 19, 1991, shall be the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991.
>
> (b) Any private civil action implied under section 78j(b) of this title that was commenced on or before June 19, 1991—
>
> (1) which was dismissed as time barred subsequent to June 19, 1991, and (2) which would have been timely filed under the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991, shall be reinstated on motion by the plaintiff not later than 60 days after Dec. 19, 1991.

actment reinstates the statute of limitations in existence in the applicable jurisdiction on June 19, 1991 for all Section 10(b) and Rule 10b-5 cases filed prior to that date.

Controversy quickly arose over the constitutionality of this enactment.[65] The Eleventh Circuit had an early chance to determine the constitutionality and applicability of Section 27A. In *Henderson v. Scientific-Atlanta, Inc.*,[66] the Eleventh Circuit Court of Appeals held Section 27A constitutional and controlling in the case at bar.[67] The district court had borrowed from the Georgia blue sky statute and applied a two-year statute of limitation that began to run on the date the alleged fraud was discovered.[68] Under this limitation period, plaintiffs' action was timely. While the parties were awaiting trial, however, the Supreme Court announced its decision in *Lampf*, creating the federal one-year/three-year statute of limitations.[69] Based on *Lampf*, the district court granted defendant's motion for summary judgment.[70] While *Henderson* was on appeal, Congress enacted the Federal Deposit Insurance Corporation Improvement Act of 1991, which amended the 1934 Act by adding Section 27A.[71]

The Eleventh Circuit first addressed the effect of Section 27A on the present case. Section 27A requires the Court to apply "the limitation period provided by the laws applicable in the jurisdiction, including principles of retroactivity, as such laws existed on June 19, 1991."[72] As of June 19, 1991, the Eleventh Circuit determined the statute of limitations by borrowing the most analogous state law.[73] The court presumed that Congress was aware of the limitation periods as they existed in all circuits

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15 U.S.C.A. § 78aa-1 (West Supp. 1992).

65. *Compare* Bank of Denver v. Southeastern Capital Group, 789 F. Supp. 1092 (D. Colo. 1992) (declaring section 27A unconstitutional) *with* Brown v. Hutton Group, 795 F. Supp. 1307 (S.D.N.Y. 1992) (finding section 27A constitutional).

66. 971 F.2d 1567 (11th Cir. 1992), *reh'g denied*, No. 91-8938 (11th Cir. 1993).

67. 971 F.2d at 1569. Plaintiff class asserted federal claims under Section 10(b) due to fraudulent admissions, misstatements and misrepresentations that artificially inflated the price of defendant's stock. *Id.*

68. *Id. See* Smith v. Duff & Phelps, Inc., 891 F.2d 1567, 1569-70 (11th Cir.), *reh'g denied*, 904 F.2d 712 (11th Cir. 1990).

69. *See supra* notes 37-64 and accompanying text. On the same day, the Supreme Court held in James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439 (1991), that when the Supreme Court applies a new rule to the litigants in a particular case, that rule must be retroactively applied to all other similarly situated litigants. *Id.* at 2441.

70. 971 F.2d at 1569.

71. *Id.* at 1570.

72. 15 U.S.C.A. § 78aa-1 (West Supp. 1992).

73. 971 F.2d at 1571. *See* Smith v. Duff & Phelps, Inc., 891 F.2d 1567, 1569-70 (11th Cir.), *reh'g denied*, 904 F.2d 712 (11th Cir. 1990) (rejecting the uniform federal statute of limitations adopted by other circuits).

when it passed Section 27A. The court felt compelled to follow the prior precedent, as codified by Congress. Using the prior limitation period, the court held that the plaintiffs' action was timely.[74]

The court then addressed the constitutionality of Section 27A in light of the separation of powers doctrine[75] and the Fifth Amendment.[76] The court rejected the separation of powers argument.[77] The court considered Section 27A as "a classic example of Congress' practice of 'overruling' a statutory construction by the Supreme Court."[78] The court determined that Congress had not interfered with the judicial process because the Act does not require courts to make any particular finding of facts or applications of law to fact.[79]

The court also rejected the Fifth Amendment due process argument, as it found Section 27A to be a rational means of preserving those lawsuits pending prior to the Supreme Court's decision in *Lampf*.[80] The court found the purpose of Section 27A is clear; to reinstate those causes of action that were timely when filed, but subsequently rendered untimely by the Supreme Court's decision in *Lampf*. Merely because the applicable statute of limitations would thereby vary for a cause of action from one jurisdiction to another did not render the enactment irrational.[81]

A uniform limitation period has been badly needed for claims arising under Rule 10b-5. Prior to *Lampf*, plaintiffs engaged in forum shopping

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74. 971 F.2d at 1571.

75. *See* U.S. CONST. art. III.

76. U.S. CONST. amend. V. The Eleventh Circuit noted that no previous court of appeals had addressed the constitutionality of section 27A. 971 F.2d at 1571. *See* Henley v. Slone, 961 F.2d 23 (2d Cir. 1992) (Second Circuit declined to consider the constitutionality of Section 27A until the district court determined on remand whether the plaintiff's action would be timely under the new statute). The court further pointed out that the district courts are divided on the issue. 971 F.2d at 1571.

77. 971 F.2d at 1573.

78. *Id.* at 1571 n.4. *See also* H.R. REP. No. 102-40(I), 102d Cong., 1st Sess. 14 (1991), *reprinted in* 1991 U.S.C.C.A.N. 549, 552; H.R. REP. No. 102-40(II), 102d Cong. 1st Sess. 1-3 (1991), *reprinted in* 1991 U.S.C.C.A.N. 694-95 (noting primary purpose of the Civil Rights Act of 1991 was to specifically overrule Supreme Court decisions).

79. 971 F.2d at 1573.

80. *Id.* at 1574. Defendant's Fifth Amendment challenge was two-pronged:

> (1)The Act's retroactive application violates [defendant's] right to due process because the Act's purpose is not furthered by rational means, and; (2) The Act deprives [defendant] of equal protection under the law . . . because the Act is not rationally related to the achievement of legitimate government purposes since it treats citizens of different circuits differently and distinguishes between persons who filed suit before June 19, 1991, and those who filed suit after that date.

Id. at 1573. The Eleventh Circuit also rejected an equal protection argument finding the statute rationally related to furthering a legitimate governmental interest. *Id.* at 1574. *See* Vance v. Bradley, 440 U.S. 93 (1979).

81. 971 F.2d at 1574.

to insure that Section 10(b) and Rule 10b-5 claims were brought in jurisdictions that would not deem the claims time barred. A uniform statute of limitation discourages forum shopping and helps insure that claims are brought in a jurisdiction having a meaningful nexus to the dispute. Securities defense counsel should not take too much comfort, however, from the three year "outside" period in *Lampf*. Already, plaintiffs in arbitration proceedings have begun to abandon securities claims in favor of state law fraud claims that typically have a four-year limitation and provide for equitable tolling. In actions in state and federal courts, claims that might be untimely under *Lampf* are being asserted as the predicate acts to a RICO[82] claim, which contains a four year limitation period and also allows for equitable tolling.[83]

B. Proof of Scienter

In *Magna Investment Corp. v. John Does 1 through 200*,[84] the Eleventh Circuit Court of Appeals reaffirmed that "severe recklessness" satisfies the scienter requirement under Section 10(b) and Rule 10b-5.[85] The court in *Magna* vacated and remanded the district court's grant of summary judgment for defendant on Section 10(b) and Rule 10b-5 claims.[86] The court vacated the district court's disposition of the Section 10(b) and Rule 10b-5 claims because the district court granted summary judgment for lack of fraudulent intent, without considering whether defend-

82. A RICO claim is one brought under the Racketeer Influenced and Corrupt Organizations provisions currently codified at 18 U.S.C.A. §§ 1961-1968 (West 1985 & Supp. 1992).

83. *See* Agency Holding Corp. v. Malley-Duff & Assocs., Inc., 483 U.S. 143 (1987) (selecting four year statute of limitations period). *See also* Granite Falls Bank v. Henrickson, 924 F.2d 150 (8th Cir. 1991) and Rodriguez v. Banco Cent., 917 F.2d 664 (1st Cir. 1990) (applying equitable tolling doctrine).

84. 931 F.2d 38 (11th Cir. 1991).

85. *Id.* at 39. *See* Woods v. Barnett Bank of Ft. Lauderdale, 765 F.2d 1004, 1010 (11th Cir.), *reh'g denied*, 772 F.2d 918 (1985); Kennedy v. Tallant, 710 F.2d 711, 720 (11th Cir. 1983). *See supra* notes 37 and 38 for the text of these provisions.

86. 931 F.2d at 39. According to the Eleventh Circuit, the district court based its decision on a misreading of Ernst & Ernst v. Hochfelder, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976). In *Hochfelder*, the Supreme Court held that a private cause of action cannot exist under Section 10(b) and Rule 10b-5 without the element of scienter. *Hochfelder*, 425 U.S. at 193. However, the Supreme Court expressly declined to address the question "whether, in some circumstances, reckless behavior is sufficient for civil liability under section 10(b) and Rule 10b-5." *Id.* at 193 n.12.

ant's alleged recklessness[87] was sufficient to satisfy the scienter requirement under Eleventh Circuit precedent.[88]

In like fashion, the Eleventh Circuit reversed the district court's grant of summary judgment on plaintiff's claims under Section 18 of the Exchange Act.[89] Section 18 imposes liability for material misstatements and omissions in registration and reporting documents filed with the Securities and Exchange Commission. The Eleventh Circuit held that there was no obligation on the part of plaintiff to prove scienter under Section 18 of the Exchange Act; rather, the burden is on defendant to prove he acted in good faith and had no knowledge that the statement was false or misleading.[90]

C. *Derivative Actions Under the Investment Company Act*

In *Kamen v. Kemper Financial Services*,[91] the United States Supreme Court held that there is no uniform federal common law that obligated a

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87. The Eleventh Circuit has defined severe recklessness as:

> highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.

931 F.2d at 39 n.3 (quoting *Woods*, 765 F.2d at 1010).

88. *Id.* at 39.

89. *Id.* at 39-40. Section 18 provides:

> (a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.
> (b) Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.
> (c) No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued.

15 U.S.C. § 78r (1988).

90. 931 F.2d at 39-40.

91. 111 S. Ct. 1711 (1991).

representative shareholder in a derivative action, based on the Investment Company Act of 1940,[92] to make a demand on the board of directors, when such a demand would be excused as futile under state law.[93] The Court, in a unanimous decision written by Justice Marshall, held that state, not federal, law applies when the application of state law does not impede the purposes or regulatory objectives of the federal statute.[94]

The Supreme Court, relying on *Burks v. Lasker*,[95] held that the demand requirement[96] relates to corporate governance, since it "determine[s] who has the power to control the corporate litigation."[97] The Court found the demand requirement and futility exception integral to the balance of power between the individual shareholders and corporate directors relating to initiation and control of corporate litigation; a balance struck best under state law.[98] The Court also observed that the futility exception controlled the scope of the directors' power to terminate derivative litigation once it had been initiated, by establishing the degree of deference to which the director's decision would be entitled.[99] Requir-

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92. The Investment Company Act is designed to regulate investment companies that provide mutual fund services to shareholders. 15 U.S.C. § 80(a)-1 to (b)-21 (1988).

93. 111 S. Ct. at 1723.

94. *Id.* at 1717. The case concerned an action brought by a shareholder of a mutual fund registered under the Investment Company Act. The complaint alleged that the fund's investment advisor and manager violated the proxy solicitation provisions of the 1934 Act by causing the fund's directors to distribute a misleading proxy statement soliciting shareholder's approval to continue the investment management agreement between the advisor and fund. The complaint sought damages to be paid to the fund. The shareholder did not, prior to filing the complaint, make a demand on the fund's board of director to bring the suit, alleging such a demand would have been futile. *Id.* at 1714-15.

95. 441 U.S. 471, 489 (1979) (holding federal court should look to state law in determining whether disinterested directors of registered investment company possess power to terminate a non-frivolous derivative action founded upon the Investment Company Act of 1940 and the Investment Advisors Act of 1940).

96. The Court first rejected any suggestion that the demand requirement was either created or controlled by Federal Rule of Civil Procedure 23.1, which provides in pertinent part, that:

> [t]he complaint [in a shareholder derivative action] shall . . . allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.

FED. R. CIV. P. 23.1 (as cited in 111 S. Ct. at 1716). Although this rule clearly contemplated both the demand requirement and the possibility that the demand may be excused, the Court held it was a rule of procedure, which did not itself create a demand requirement of any dimension. 111 S. Ct. at 1716.

97. 111 S. Ct. at 1719.

98. *Id.* at 1719-20.

99. *Id.* If demand at first had been made by the shareholders, then under the law of many states the directors' decision to terminate litigation would be considered under the

ing shareholder demand even under circumstances in which it would be deemed futile under state law "would enlarge the power of directors to control corporate litigation."[100] The Court stated that it would have displaced state law in this area if the futility exception to the demand requirement were inconsistent with the policies underlying the Investment Company Act; in this case, however, the Court found no such inconsistency.[101]

D. Class Actions—Settlement Bar Orders

One of the most significant decisions affecting securities litigation during the survey period involved the enforceability of settlement bar orders in class actions. Bar orders typically terminate or "bar" the assertion of cross-claims and third party claims for contribution or indemnification between non-settling parties and settling parties. Absent bar orders, many securities defendants are unwilling to settle, since the remaining cross-claim or third party claim prevents termination of their involvement in the litigation. In *In re U.S. Oil & Gas Litigation*,[102] the Eleventh Circuit Court of Appeals affirmed the imposition of a settlement bar order and established the standard of review in similar cases to be an abuse of discretion.[103] In that case, the Federal Trade Commission filed an enforcement action against the various oil and gas companies after they sold their services to 8,000 customers. The district court then appointed a receiver to protect the customers' interests. After filing a complaint on his own behalf, the receiver instituted a class action on behalf of the customers alleging securities fraud and RICO violations.[104] A settlement was reached that dismissed the claims against certain defendants by the re-

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business judgment rule, which affords extremely wide latitude to directors and makes it difficult for a shareholder to challenge their decision successfully. *Id.*

100. *Id.* Moreover, the Court concluded that abolition of the futility exception to the demand requirement would place federal courts in the role of determining the deference to be given to the director's decision to forego or terminate litigation. This would create an entire body of federal court law in contravention of the federal court's general deference to state law on general corporate matters. *Id.* at 1720-21.

101. *Id.* at 1722. The Court noted that the Investment Company Act imposes controls and restrictions on the internal management of investment companies and it is not designed to give corporate directors greater power to preclude shareholders' derivative litigation than they possess under the law of the state of incorporation. *Id.*

102. 967 F.2d 489 (11th Cir. 1992).

103. *Id.* at 491. In this case, the gas and oil companies sold an advisory service to investors seeking to bid on federal oil and gas leases. The customers were obtained through telephone solicitations. The investments were extremely risky because no return on the investment was had unless the customers were successful in the lease auctions. *Id.*

104. *Id.* This case illustrates how cumbersome and complex this type of litigation can become. The complaint named 95 defendants and in a six-year period the court held 50 hearings, plaintiffs attended 260 depositions, and discovery produced hundreds of thousands

ceiver and plaintiff class, and barred "all claims" by non-settling defendants against settling defendants, as well as any claims that the settling defendants might have had against non-settling defendants, related to the subject matter of the litigation.[105] The district court later entered a second settlement bar order that extinguished all claims related to the litigation against other settling defendants.[106]

The first issue presented to the Eleventh Circuit was whether the district court erred in entering the settlement bar order itself.[107] The court began its analysis by recognizing the strong public policy favoring pretrial settlement of class action lawsuits.[108] The complaining defendant argued that independent claims and indemnity claims cannot be precluded

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of relevant documents. As the trial date approached, plaintiffs stipulated that over 700 issues of fact were still unresolved. *Id.*

105. *Id.* at 492.

106. *Id.* at 493. One defendant objected to this second settlement bar order based on its cross-claim against one of the settling defendants. The district court concluded that:

> if litigation of cross-claims were allowed, the resources of the court, class members, class members' counsel, and defendants' counsel would continue to be expended, because it would be impossible to try cross-claims without addressing the complex facts underlying this litigation . . . . Settlements in complex cases cannot satisfy their ultimate purposes unless they conclude the litigation in its entirety.

Id.

107. *Id.* The order provided, in relevant part:

> All claims, however denominated, regardless of the allegations, fact, law, theories, or principles on which they are based, including but not limited to claims for contribution or indemnity against the settling defendants by any individual corporation, partnership, unincorporated association, or other type of entity, including but not limited to any party to this litigation, which claims now exist or have accrued or in the future may exist or accrue, and which arise out of or are in any way related to the class action or the receiver's action or the subject matter of those actions, or arise out of or are in any way related to the Companies, are extinguished, discharged, satisfied, and/or otherwise unenforceable.

Id. at 493 n.2.

108. 967 F.2d at 493 (citing Cotton v. Hinton, 559 F.2d 1326, 1331 (5th Cir. 1977)). Class action settlements require court approval and such approval is within the sound discretion of the district court. Bennett v. Behring Corp., 737 F.2d 982, 987 (11th Cir. 1984). The court noted that class action settlements increasingly incorporate settlement bar orders. "Defendants buy little peace through settlement unless they are assured they will be protected against co-defendants' efforts to shift their losses through cross-claims for indemnity, contribution, and other causes relating to the underlying litigation." 967 F.2d at 494. *See* FED. R. CIV. P. 23(e).

This case presented a slightly unusual situation where a settling defendant challenged a settlement bar order. In most cases, non-settling defendants challenge the bar order as prejudicial to their rights. Another distinctive feature of the case related to the severability of the settlement bar order. Generally, when the parties stipulate that the bar order is integral to the settlement, a reviewing court may not consider the order in isolation. Instead, it usually can review only the entire settlement. In the present case, however, the specific defendant preserved its right to challenge and appeal the bar order and the settlement itself exthrough settlement bar orders, but rather, that such orders are only properly entered in cases when a non-settling defendant seeks to preserve contribution claims against settling defendants. The court found this argument without merit.[109]

The court noted that several federal courts have approved of settlement bar orders against indemnity claims.[110] The court also found the settlement bar effective against the allegedly independent causes of action for fraud and negligence. The court found that these claims were not, in fact, independent and were "nothing more than claims for contribution or indemnification with a slight change in wording."[111] Thus, the court held that "the propriety of the settlement bar order turn[s] upon the inter-relatedness of the claims that it precludes, not upon the labels which parties attach to those claims."[112] The decision removes much of the uncertainty that has historically plagued settling defendants in complex litigation regarding the applicability and enforceability of bar orders. The decision in *U.S. Oil & Gas* will facilitate and encourage many parties to reach an early settlement.

E. Criminal Violation of the Securities Laws

In *United States v. Langford*,[113] the Eleventh Circuit Court of Appeals faced an issue of first impression. At issue was whether the use of multiple mailings or instrumentalities of interstate commerce in furtherance of

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pressly contains language showing that the particular defendant did not waive its right to appeal. 967 F.2d at 494-95.

109. 967 F.2d at 495-96.

110. *Id.* at 495 (citing *In re* Jiffy Lube Sec. Litig., 927 F.2d 155 (4th Cir. 1991); Franklin v. Kaypro Corp., 884 F.2d 1222 (9th Cir. 1989), *cert. denied*, 111 S. Ct. 232 (1992); United States Fidelity & Guar. Co. v. Patriot's Point Dev. Auth., 788 F. Supp. 880 (D.S.C. 1992)). Additionally, the substantive weakness of the indemnity claim itself supported entry of the settlement bar. The weakness resulted because indemnity claims are not cognizable under federal securities laws. *Id.*

111. 967 F.2d at 496 (quoting South Carolina Nat'l Bank v. Stone, 749 F. Supp. 1419, 1433 (D.S.C. 1990)).

112. *Id.* For example, in a cross-claim one defendant sought damages to the extent it was liable to any plaintiff. *Id.* Furthermore, the court stated that the present case did not encompass the situation in which a cross-claim unrelated to defendants' liability to plaintiffs remained in the case. In fact, the court questioned if truly independent claims, which a settlement bar order cannot extinguish, can ever remain in a class action lawsuit. *Id.* at 496 n.5. The court further held that the district court did not deny the complaining defendant due process. *Id.* at 496. The court pointed out that a settlement bar order can be issued against a non-settling defendant by the district court after it makes a reasoned determination that to do so is fair and equitable. *Id.* In this case the district court properly entered a settlement bar order when defendant participated fully in settlement negotiations and utilized every opportunity to preserve its rights within those negotiations. *Id.*

113. 946 F.2d 798 (11th Cir. 1991), *cert. denied*, 112 S. Ct. 1562 (1992).

a conspiracy to defraud a purchaser of securities can form the basis of multiple counts of an indictment under the provisions of Sections 10(b)[114] and 32[115] of the Exchange Act and Rule 10b-5. The court held that it could not.[116]

The appellant, president and chief executive officer of a federal stock association, devised and carried out a fraudulent scheme that artificially inflated the price of the association's stock. The federal grand jury indicted appellant on ten counts related to this scheme.[117]

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114. Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1988).

115. Section 32(a) provides certain criminal penalties for a violation of the Exchange Act (other than violation under section 30A) and states that:

> (a) Any person who willfully violates any provision of this chapter (other than section 78dd-1 of this title), or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $1,000,000 or imprisoned not more than 10 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $2,500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

15 U.S.C. § 78ff (1988).

116. 946 F.2d at 799.

117. *Id.* at 799-800. Count one charged defendant with conspiring to commit an offense against the United States in violation of 18 U.S.C. § 371 (1988). Counts two, three and four charged the defendant with securities fraud, relating to false statements made in a proxy statement, a telephone call and a letter, in violation of 15 U.S.C. §§ 78j(b) and 78ff (1988). Counts five and six alleged false entry offenses in violation of 18 U.S.C. § 1006 (1988). Count seven charged a false statement offense in violation of 18 U.S.C. § 1001 (1988). And counts eight, nine and ten alleged the misapplication of the funds of an insured institution in violation of 18 U.S.C. § 657 (1988). 946 F.2d at 800-01. The court granted acquittal on

The court concluded that the allowable unit of prosecution under Rule 10b-5 is the use of a manipulative device or contrivance[118] and held that the indictment was multiplicitous.[119] Because the sentences were concurrent, however, and all the evidence would still be available and would lead to a conviction on any single count, the court held that the multiplicity of counts was harmless error. The court treated the convictions and sentences on counts two, three and four of the indictment as merged into one count.[120]

IV. Proxy Solicitation

Section 14(a) of the Exchange Act authorizes the Securities and Exchange Commission to adopt rules for the solicitation of proxies, and prohibits violations of the promulgated rules.[121] Pursuant to Section 14(a), the Securities and Exchange Commission promulgated Rule 14a-9, which prohibits the solicitation of proxies by means of materially false or misleading statements or omission.[122]

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counts eight, nine and ten. The jury found appellant guilty on counts one through seven. *Id.* at 801.

In a footnote, the Court dismissed all issues on appeal except whether the securities fraud counts were multiplicitous. Multiplicity is the charging of a single offense in multiple counts. *Id.* at 802 (citing United States v. Anderson, 872 F.2d 1508 (11th Cir.), *cert. denied*, 493 U.S. 1004 (1989)). To determine whether an indictment is multiplicitous, the court must first determine the allowable unit of prosecution; in the present case, the court must examine the allowable unit of prosecution within the securities provisions. *Id.*

118. 946 F.2d at 803. In United States v. Ashdown, 509 F.2d 793 (5th Cir.), *cert. denied*, 423 U.S. 829 (1975), the old Fifth Circuit held that a defendant could be charged with the same scheme incorporated into each count of an indictment. Furthermore, the court found it clear that the use of the mails in conjunction with *separate* purchases or sale transactions can provide for multiple counts. 946 F.2d at 804 (citing Sanders v. United States, 415 F.2d 621, 626 (5th Cir. 1969), *cert. denied*, 397 U.S. 976 (1970)).

119. 946 F.2d at 804. The indictment did not allege that *each* mailing contained specific material misstatements; it did not allege that use of the mails was in conjunction with *separate* purchases or sales transactions. *Id.*

120. *Id.* at 805.

121. Section 14(a) provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to Section 78l of this title.

15 U.S.C. § 78n(a) (1988).

122. Rule 14a-9 provides, in relevant part:

> No solicitation subject to this regulation shall made by means of any proxy statement . . . containing any statement, which, at the time and in the light of circum-

In *Virginia Bankshares, Inc. v. Sandberg*,[123] the United States Supreme Court addressed two questions arising from a "freeze-out" merger:[124] (1) whether a statement in a proxy solicitation that is couched in conclusory or qualitative terms purporting to explain the directors' reasons for recommending certain corporate action can be materially misleading and (2) whether a minority shareholder, whose vote is not required by law or corporate by-law to authorize the corporate action subject to the proxy solicitation, also can establish damages attributable to the misleading or inaccurate solicitation. The court held that knowingly false statements of reasons for director or board approval may be actionable, even though conclusory in form, but that a Section 14(a) private right of action does not extend to minority shareholders whose votes are not required by law or corporate by-law to authorize the corporate action subject to the proxy solicitation.[125]

In *Virginia Bankshares*, shareholders of First American Bank of Virginia ("FABV") brought an action against the holding company, the wholly owned subsidiary, and the directors of FABV after their proxies were solicited in connection with a freeze-out merger into the bank's parent company, Virginia Bankshares, Inc. ("VBI"). Prior to the challenged action, VBI owned 85% of FABV, with the remanding stock held by approximately 2,000 minority shareholders. In the solicitation, the directors urged approval of the merger plan and stated that the board approved the plan because of its opportunity for the minority shareholder to achieve a "high" value for their shares.[126] Plaintiff claimed that the minority shareholders were defrauded by the proxy, which contained material misrepresentations.[127] The complaint was couched in two counts,

> stances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading . . . .

17 C.F.R. § 240.14a-9 (1992).

123. 111 S. Ct. 2749 (1991).

124. The "freeze-out" merger involved a merger of a target bank into a wholly owned subsidiary of the holding company. The subsidiary owned eighty-five (85%) percent of the stock of the target company; the remaining fifteen (15%) percent was held by minority shareholders who were to lose their interest (i.e., be frozen out) as a result of the merger. The minority shareholders would be compensated for their loss at a price determined to be fair. *Id.* at 2755.

125. *Id.*

126. *Id.* at 2756. The Fourth Circuit found that such statements were materially misleading for purposes of Rule 14a-9 under the Exchange Act and that plaintiffs could pursue their claims even though their votes were not legally required to approve the merger. *See* Sandberg v. Virginia Bankshares, 891 F.2d 1112 (4th Cir. 1989). Although most minority shareholders gave the proxies requested, plaintiff Sandberg did not. After the merger she sought damages from VBI, FABV and the Directors of the Bank. 111 S. Ct. at 2756.

127. 111 S. Ct. at 2756.

Count one for the solicitation of proxies in violation of Section 14(a) and Rule 14a-9[128] and Count two for breach of the fiduciary duty owed to the minority shareholders under state law. The jury found for plaintiff on both counts and awarded plaintiff eighteen dollars a share.[129] On appeal, the Fourth Circuit Court of Appeals affirmed the verdict in part, finding the statements to be both misleading and actionable by the minority shareholders.[130]

On certiorari, the Supreme Court first addressed the actionability of statements of reasons, opinion, or belief, applying the materiality standard previously announced by the Court in *TSC Industries, Inc. v. Northway, Inc.*[131] The Court concluded that it was substantially likely that a reasonable shareholder, in deciding how to vote on a recommended corporate action, would consider the directors' belief about the recommended action and their specific reasons for urging the stockholders to embrace the recommendations to be very important.[132] The Court held that statements of reasons, opinions, or beliefs are statements "with respect to material facts" and can form the basis of Section 14 liability because such statements are factual in two senses: (1) as statements that directors do act for the reasons stated or hold the belief expressed, and (2) as statements about the subject matter of the reason or belief expressed.[133]

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128. *See supra* notes 121-22. The complaint alleged, among other things, that "the directors had not believed that the price offered was high or that the terms of the merger was fair, but had recommended the merger only because they had no alternative if they wished to remain on the Board of Directors." 111 S. Ct. at 2756.

129. This amount represented the difference between the price per share plaintiff would have received under the plan and the amount plaintiff would have received if her stock had been valued adequately. 111 S. Ct. at 2756.

130. *Id. See* Sandberg v. Virginia Bankshares, Inc., 891 F.2d 1112 (4th Cir. 1989), *rev'd*, 111 S. Ct. 2749 (1991).

131. 426 U.S. 438, 449 (1976) (the Court held a fact to be material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote").

132. 111 S. Ct. at 2757. The Court pointed out that "shareholders know that directors usually have knowledge or experience far exceeding the normal investor's resources, and the directors' perceived superiority is magnified even further by the common knowledge that state law customarily obliges them to exercise their judgment in a shareholder's interest." *Id.*

133. *Id.* at 2758. The Court qualified its holdings in two respects. First, the Court warned that a defendant's alleged belief or disbelief in a statement "standing alone" would not support a Section 14(a) claim absent objective evidence that the statement expressly or implicitly asserted something false or misleading about a subject matter. *Id.* at 2760. Second, the Court stated that conclusory statements of reasons may in some instances be counter balanced by complete disclosure of the offending statement's factual basis. *Id.* The Court held that unless the presence of accurate information elsewhere in the proxy state-

After holding that the statements were actionable in the abstract, the Court held that the minority shareholders had not demonstrated that the proxy solicitations were an essential link to the adoption of the freeze out merger.[134] A solicitation is an essential link only when applicable state law or corporate by-laws require the proxy solicitation to effectuate the merger.[135] The Court, examining the legislative history, found no evidence of congressional intent to expand the implied right of action under Section 14(a) to protect shareholders whose votes were not legally required.[136] The Court explicitly stated that its holding does not dispose of the issue of whether Section 14(a) provides a cause of action for shareholders' loss of state remedies such as relinquishing appraisal rights by voting for a merger, or failing to seek to prevent it, based on a false proxy statement. The Court was unpersuaded by the argument that, in the interest of public relations, VBI and FABV would not have gone through the merger without the approval of the minority shareholders.[137]

V. Short-Swing Insider Liability

In *Gollust v. Mendell*,[138] the United States Supreme Court unanimously held that a plaintiff who instituted a suit to recover short-swing profits against statutory insiders under Section 16(b)[139] may continue to

ment "discredit[s] the [misleading statement] so obviously that the risk of real deception drops to nil," liability will exist. *Id.*

134. *Id.* at 2760.

135. *Id.* at 2762 (discussing Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970)).

136. *Id.* at 2763-64. Two dissenting opinions argued that causation had been demonstrated. Justice Stevens, joined by Justice Marshall, expressed the expansive view that "shareholders may bring an action for damages under section 14(a) of the Securities Exchange Act of 1934 . . . whenever materially false or misleading statements are made in proxy statements." *Id.* at 2768. Justice Kennedy, in a lengthy dissent, joined by Justices Stevens, Marshall, and Blackmun, argued that the nonvoting theories of causation urged by the SEC's brief were cognizable, and that the evidence in this case demonstrated that, had the truth been disclosed, informal measures could have been brought to bear that would have caused abandonment of the merger or changes in its terms. *Id.* at 2768-73.

137. *Id.* at 2765-66.

138. 111 S. Ct. 2173 (1991).

139. Section 16(b) of the Exchange Act, provides:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding

prosecute the action after his stock in the issuer is exchanged, through a merger, for stock in the issuer's new corporate parent.[140]

The Court, in a unanimous opinion written by Justice Souter, based its decision on the plain meaning of the statutory language and the Court's interpretation of congressional intent.[141] The Court noted that, unlike most of the federal securities statutes that confer enforcement authority on the Securities and Exchange Commission, Section 16(b) depends on the issuer's security holders to bring suit.[142] The statute's only standing restriction is that the plaintiff must be the owner of a security of the issuer at the time the suit is instituted.[143] The Court concluded that Congress intended "instituted" to mean the commencement of the action.[144]

The Court next addressed the issue of whether plaintiff, in the present case, maintained a financial stake in the outcome. The Court held that the statute requires only a modest financial stake to support a plaintiff's standing.[145] In the present case, the equity interest in the issuer's parent was sufficient.[146]

> six months. Suit to recover such profit may be instituted at law or in equity and in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized.

15 U.S.C. §§ 78p(b) (1988).

140. 111 S. Ct. at 2176. Plaintiff owned stock in Viacom International, Inc. ("International") and brought suit against a certain statutory insider on behalf of the corporation, alleging that the insider was liable to International for approximately $11 million in short-swing profits. Less than six months after plaintiff filed his complaint, Arsonal Holdings, Inc. ("Arsonal") acquired International in a reverse triangular merger. As part of the merger, Arsonal changed its name to Viacom, Inc. and became the sole stockholder of International, exchanging all of International's stock for a combination of cash and stock in Viacom. *Id.*

141. *Id.* at 2178-81.

142. *Id.* at 2178.

143. *Id.* at 2179.

144. *Id.* The Court rejected the defendant's claim that a plaintiff must maintain ownership of the issuer's security throughout involvement in the lawsuit. The Court found this position unsupported by either the text of the statute or its legislative history. The Court did, however, hold that section 16(b) requires a plaintiff's security holder to maintain some "financial stake" in the outcome of the litigation. *Id.* at 2179-80.

145. *Id.* at 2181. Section 16(b) places no significant restrictions on the type or amount of security necessary to confer standing. It does not even require that the plaintiff own the security of the issuer at the time of the short-swing trading.

146. *Id.*

VI. Arbitration

A. *Types of Claims for Which Arbitration May Be Compelled*

A significant number of appellate decisions during the survey period concerned securities arbitration, and the types of claims for which arbitration may be compelled continues to expand.[147] In *Gilmer v. Interstate/Johnson Lane Corp.*,[148] the United States Supreme Court held that claims under the Age Discrimination in Employment Act ("ADEA")[149] are subject, under the Federal Arbitration Act ("FAA"),[150] to compulsory arbitration pursuant to an agreement and securities registration application.[151]

The Court rejected plaintiff's argument that arbitration was inconsistent with the statutory framework and purposes of the ADEA.[152] The Court stated the congressional intent in enacting the ADEA was "to promote employment of older persons based on their ability rather than age; to prohibit arbitrary age discrimination in employment; [and] to help employers and workers to find ways of meeting problems arising from the impact of age on employment."[153] The Court found no inherent inconsistency between the policies advanced by ADEA and enforcing agreements to arbitrate age discrimination claims.[154] The Court pointed out that claims under the Sherman Act,[155] the Securities Exchange Act,[156] and RICO[157] are appropriate for arbitration even if they also advance important public policies.[158]

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147. However, the National Association of Securities Dealers (the "NASD"), a primary self-regulatory organization for broker/dealers, recently approved new rules barring class actions in arbitration. *See* NASD Notice to Members 91-65 (1992).

148. 111 S. Ct. 1647 (1991).

149. Age Discrimination in Employment Act of 1967 Pub. L. No. 909-202, 67 Stat. 658 (1967) (codified as amended at 29 U.S.C. §§ 621-634 (1988)).

150. 9 U.S.C. §§ 1 to 14 (1970 & Supp. 1992).

151. 111 S. Ct. at 1650. Plaintiff was a former registered representative who served as the manager of financial services for the brokerage firm. The arbitration agreement was not contained in an employment contract with the firm, but instead, was contained in his registration applications with the various securities exchanges. Therefore, the Court found it unnecessary to discuss the issue of whether the FAA excluded employment contracts from the scope of the Act. Section 1 of the FAA provides that "nothing herein contained shall apply to contracts of employment of seaman, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C.A. § 1 (West 1970).

152. 111 S. Ct. at 1652.

153. *Id.* (quoting 29 U.S.C. § 621(b) (1988)).

154. *Id.* at 1653.

155. 15 U.S.C. §§ 1-7 (1985 & Supp. 1992).

156. 15 U.S.C. §§ 78a-78kk (1988 & Supp. 1990).

157. 18 U.S.C. § 1961 (1991 & Supp. 1992).

158. 111 S. Ct. at 1653.

The Court was unpersuaded that arbitration would undermine the role of the Equal Employment Opportunity Commission ("EEOC") in enforcing the ADEA, because an individual worker would remain free to file a charge with the EEOC, notwithstanding the arbitration proceeding.[159] Furthermore, the EEOC could still file charges of its own against the firm, notwithstanding the existence of the arbitration agreement.[160] The Court could not discern any congressional intent to preclude resolution of ADEA claims in any forum other than the federal courts.[161]

In a subsequent decision in *Bender v. A.G. Edwards & Sons, Inc.*,[162] the Eleventh Circuit Court of Appeals held that an employee's Title VII claims, based upon sexual harassment, were subject to compulsory arbitration under the FAA.[163] The court, citing the 1991 Fifth Circuit decision in *Alford v. Dean Witter Reynolds, Inc.*[164] and cases from the Sixth and Ninth Circuits,[165] concluded, without much discussion, that Title VII claims were subject to compulsory arbitration.[166] The Eleventh Circuit found the reasoning in *Gilmer* dispositive of the agreement to arbitrate

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159. *Id.*

160. *Id.*

161. *Id.* at 1653-54. In fact, the congressional grant of current jurisdiction over ADEA claims to state courts further shows the lack of congressional intent to resolve all ADEA claims in federal court.

Gilmer also raised a host of challenges to adequacy of arbitration procedures in general. The Court noted that it recently rejected most of these arguments because they " 'rest[] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants', and as such, they are 'far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.' " *Id.* at 1654 (quoting Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 481 (1989)).

The Court distinguished earlier cases on the grounds that they arose in the collective bargaining context and did not involve motions to compel arbitration under the FAA. *Id.* at 1656. *See, e.g.*, McDonald v. City of West Branch, 466 U.S. 284 (1984) (declining to compel arbitration of civil rights claims); Barrentine v. Arkansas-Best Freight Sys., Inc., 450 U.S. 728 (1981) (declining to compel arbitration of claims under the Fair Labor Standards Act); Alexander v. Gardener-Denver Co., 415 U.S. 36 (1974) (declining to compel arbitration for Title VII claims). The holding in *Alexander* seems jeopardized by the reasoning of *Gilmer*, which appears to apply with equal force to claims arising under Title VII and other civil right statutes. In fact, the Supreme Court vacated an order by the Fifth Circuit refusing to compel arbitration of Title VII claims and remanded it for consideration in light of *Gilmer*. Upon remand, the Fifth Circuit reversed its earlier position and held that Title VII claims were arbitrable. Alford v. Dean Witter Reynolds, Inc., 939 F.2d 229 (5th Cir. 1991).

162. 971 F.2d 698 (11th Cir. 1992).

163. *Id.* at 700. The employee, a stockbroker, agreed to arbitrate disputes with her employer in her applications to register with the NASD and NYSEX. *Id.*

164. 939 F.2d 229 (5th Cir. 1991).

165. *See* Mago v. Shearson-Lehman Hutton, Inc., 956 F.2d 932 (9th Cir. 1992); Willis v. Dean-Witter Reynolds, Inc., 948 F.2d 305 (6th Cir. 1991).

166. 971 F.2d at 968.

Title VII claims, even though *Gilmer* involved claims under the ADEA. The court saw no reason to distinguish between ADEA claims and Title VII claims.[167]

Although there is technically a split of authority on the arbitrability of Title VII claims,[168] the jurisdictions that have held these claims non-arbitrable have not addressed the issue since the Supreme Court's decision in *Gilmer*. The jurisdictions that have examined the issue post-*Gilmer* have held Title VII claims to be arbitrable.[169]

B. Standard of Review for Arbitration Awards

The Eleventh Circuit Court of Appeals refused to adopt the "manifest disregard of the law" as the standard used to vacate an arbitration award in *Ainsworth v. Skurnick*.[170] The Eleventh Circuit pointed out "that courts are generally prohibited from vacating an arbitration award on the basis of errors of law".[171] The grounds enumerated in the Federal Arbitration Act[172] ("FAA") have been held as the exclusive grounds for vacating or modifying an award.[173] The court pointed out that although many

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167. 939 F.2d at 230 (both ADEA and Title VII are similar civil rights statutes and both are enforced by the EEOC).

168. *See* Utley v. Goldman Sachs & Co., 883 F.2d 184 (1st Cir. 1989), *cert. denied*, 493 U.S. 1045 (1990) and Swenson v. Management Recruiters Int'l, Inc., 858 F.2d 1304 (8th Cir. 1988), *cert. denied*, 872 F.2d 264 (1989) (both holding Title VII claims cannot be forced into arbitration).

169. *See Mago*, 956 F.2d at 932 and *Willis*, 948 F.2d at 305 (subjecting Title VII claims to compulsory arbitration).

170. 960 F.2d 939 (11th Cir. 1992), *cert. denied*, 61 U.S.L.W. 3455 (1993). In this case, a customer sued the securities broker for negligence in handling his securities account. The arbitration panel found negligence on the part of the broker but failed to award mandatory monetary damages provided for under Florida law. 960 F.2d at 939. *See* FLA. STAT. ANN. § 517.211 (West 1988 & Supp. 1993). The district court vacated the arbitration judgment as being in manifest disregard of the law. 960 F.2d at 940. Although an incorrect statement of the law, the decision was upheld on the grounds that the ultimate decision of the arbitration panel denying damages was arbitrary or capricious. *Id.*

The Eleventh Circuit previously discussed this issue and failed to adopt the manifest disregard of the law. *See* Robbins v. Day, 954 F.2d 679 (11th Cir. 1992), *cert. denied*, 113 S. Ct. 201 (1992).

171. 960 F.2d at 940.

172. 9 U.S.C. §§ 1-14 (1987).

173. *See* O.R. Securities v. Professional Planning Assoc., 857 F.2d 742, 746 (11th Cir. 1988). The FAA provides:

> In any of the following cases the United States Court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration
>
> (1) Where the award was procured by corruption, fraud, or undue means, (2) Where there was evident partiality or corruption in the arbitrators, or either of them, (3) Where the arbitrators were guilty of misconduct in refusing to postpone

courts and the Eleventh Circuit have discussed the use of a "manifest disregard of the law standard,"[174] the Eleventh Circuit has never adopted that standard as a ground for vacating an arbitration award.[175] Nonetheless, although great deference is normally accorded to an arbitration award, courts generally refuse to enforce an award that is arbitrary or capricious.[176] An award is arbitrary and capricious only if "a ground for the arbitrator's decision cannot be inferred from the facts of the case."[177]

The court found that in this case there was absolutely no explanation in the award itself explaining why damages were not awarded.[178] Because the arbitration panel knew or should have known that Florida law required the imposition of monetary damages, the panel's refusal to award damages was clearly arbitrary.[179]

It is difficult to understand how the approach taken by the Eleventh Circuit to arbitration awards that are contrary to law is meaningfully different than the manifest disregard for the law standard utilized in several other jurisdictions. Future decisions will be needed to ascertain how the Eleventh Circuit will apply the arbitrary and capricious standard and how it differs, if at all, from the manifest disregard standard favored by other courts. Until the rule is refined in this circuit, the court's willing-

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> the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced, (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. (5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

9 U.S.C.A. § 10(a) (1987). Unless one of these situations exist, the statute directs the court, if requested by one of the parties, to enter an order confirming the award. *See* 9 U.S.C. § 9 (1988).

174. *See* Robbins v. Day, 954 F.2d 679 (11th Cir. 1992), *cert. denied*, 113 S. Ct. 201 (1992); Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); Marshall v. Green Giant Co., 942 F.2d 539 (8th Cir. 1991); Upshur Coals Corp. v. United Mine Workers of America, 933 F.2d 225 (4th Cir. 1991); Advest, Inc. v. McCarthy, 914 F.2d 6 (1st Cir. 1990); Jenkins v. Prudential-Bache Securities, Inc., 847 F.2d 631 (10th Cir. 1988); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, Inc., 808 F.2d 930 (2d Cir. 1986).

175. *See Robbins*, 954 F.2d at 684; Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412 (11th Cir. 1990). However, the court pointed out that its own cases were unclear as to whether the Eleventh Circuit had ever held it would be error to vacate an arbitration award as being in manifest disregard of the law. *See* 960 F.2d at 941.

176. 960 F.2d at 941.

177. *Id.* (quoting *Raiford*, 903 F.2d at 1413).

178. *Id.* The panel had concluded that the claimants sustained no damages and therefore were not entitled to recover any monetary reward. This conflicted with the mandatory damage provision under Florida law. *See* FLA. STAT. ANN. § 517.21 (West 1988 & Supp. 1993).

179. 960 F.2d at 941.

ness to vacate awards that are contrary to law will increase the likelihood that customers and brokerage firms will appeal from unfavorable decisions.

In *Robbins v. Day*,[180] the Eleventh Circuit Court of Appeals confirmed the arbitration and rejected the Trustee/claimants' contention that the arbitrators' refusal to compel the respondent brokers to testify, after asserting their Fifth Amendment privileges against self-incrimination, was a refusal to hear evidence so as to warrant vacation of an award due to misconduct.[181] The court acknowledged that judicial review of arbitration awards is expressly limited and great deference is to be given to the arbitrator's resolution of the dispute.[182] Furthermore, the basis for review of a commercial arbitration award is specifically delineated in the Federal Arbitration Act ("FAA").[183]

The court examined the arbitrators' actions under the FAA.[184] The court held "[t]hat the award should not be vacated under [9 U.S.C.] section 10(a)(3) because prior to the arbitration hearings both Paine Webber and the brokers moved to postpone the hearings until after the pending criminal proceedings, which then would have made it possible for the brokers to testify."[185] The Trustee/claimants opposed the continuance on the grounds that the brokers' testimony was "unimportant" to the Trustee's case. The court held that it was within the arbitrators' broad discretion to accept the Trustee's representations that the brokers' testimony was unimportant and, if given, would only provide cumulative evidence.[186] Furthermore, the arbitrators enjoy wide latitude in conducting the hearing and are not constrained by formal rules of procedure or evidence.[187] Thus, the court held that the arbitrators stayed well within their broad discretion in facilitating a fair hearing and in fashioning the award.[188]

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180. 954 F.2d 679 (11th Cir. 1992), *cert. denied*, 113 S. Ct. 201 (1992).

181. 954 F.2d at 679.

182. *Id.* at 682.

183. *Id.* at 682-83.

184. *Id.* The brokers in question pled the Fifth Amendment's provision against self-incrimination during the hearings and refused to testify because they were under indictment for securities fraud arising from the same set of facts that gave rise to the securities litigation. *Id.* at 684.

185. *Id.* at 684.

186. *Id.* at 685.

187. *See* Hoteles Condado Beach, La Concha & Convention Ctr. v. Union De Tronquistas Local 901, 763 F.2d 34, 38 (1st Cir. 1985). The court also pointed out that the basic policy of conducting arbitration is to offer a means of deciding disputes expeditiously and at lower cost and, thus, a summary hearing, even that restricts inquiry into factual issues, is permissible. 954 F.2d at 682 (citing Booth v. Hume Publishing, Inc., 902 F.2d 925, 931 (11th Cir. 1990)).

188. 954 F.2d at 685. The arbitration lasted 12 days and the NASD panel awarded the plaintiffs $325,000 and dismissed the claims against two of the brokers. The Trustee origi-

Similarly, the Eleventh Circuit in *Schmidt v. Finberg*[189] affirmed an arbitration award in favor of the customer and against the broker.[190] In this case, the parties had extreme difficulty in agreeing to arbitration dates.[191] Once the hearing was finally conducted, the arbitration panel awarded substantial damages to the customer.[192] The broker filed a motion in district court to vacate the award, challenging the arbitration panel's refusal to postpone the hearing or to extend it in order to receive a party's testimony.[193]

The court held that a trial court's denial of a motion to vacate an arbitration award under the FAA is reviewed under an abuse of discretion standard.[194] Thus, defendants had the burden to convince the court that it was an abuse of discretion by the district court in not finding "misconduct" by the panel when it denied defendants' request for a postponement of the hearing.[195]

The Eleventh Circuit concluded that the issue was whether there was any reasonable basis for the arbitrators to refuse to postpone the hearing or to continue it in order to receive defendant's testimony.[196] The court

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nally sought $4,200,000 in actual damages, $12,000,000 in punitive damages, $12,600,000 in RICO damages, attorney fees, costs, and expenses totaling over $26,800,000 in damages. *Id.* at 681.

189. 942 F.2d 1571 (11th Cir. 1991).

190. *Id.* at 1576. Plaintiff filed suit against Paine Webber and two brokers to recover losses sustained in his Commodities Account. Defendants caused the case to be removed to federal court and then had the federal actions stayed pending arbitration. *Id.*

191. The dispute was originally set for final arbitration on February 9, 1989. Approximately one month prior to this date, the parties mutually agreed to an adjournment. The hearing was rescheduled for June 1, 1989. The panel then granted a requested adjournment after both sides stipulated to adjournment because both attorneys were scheduled to participate in another arbitration proceeding previously set for the same day. The panel rescheduled the hearing for January 16, 1990 through January 18, 1990. Plaintiff requested a continuance on December 16, 1989 citing discovery disputes between the parties as appropriate grounds. The parties met on January 16. 1990 for a pre-hearing conference. The panel asked the parties to inform it when they would be available for a final hearing in May. Defendants wrote to the panel and stated they would not be available during the second and third weeks of May, 1990. The panel set the hearing for the second week in May. The panel refused to change the date of the hearing and it proceeded to a conclusion. *Id.* at 1572-73.

192. *Id.* at 1573. One of the grounds cited by defendants for being unavailable the second week of May was a principal witness and a party to the litigation would be absent and unable to testify. *Id.*

193. *Id.*

194. *Id.* (citing Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412 (11th Cir. 1990)).

195. *Id.*

196. *Id.* at 1574.

found good and sufficient reasons to support the panel's action and affirmed the award.[197]

In *Szuts v. Dean Witter Reynolds, Inc.*,[198] the Eleventh Circuit Court of Appeals vacated an arbitration award made by two arbitrators following disqualification and removal of a third arbitrator.[199] The court began with the proposition that "the power and authority of the arbitrators in an arbitration proceeding is dependent on the provisions of the arbitration agreement under which the arbitrators were appointed".[200] In the present case, the arbitration agreement incorporated by reference the Securities Arbitration Rules of the American Arbitration Association ("AAA").[201] The arbitration agreement provided that "[a]ny arbitration hereunder shall be before at least three arbitrators."[202] Thus, two arbitrators alone deciding an award violated the arbitration agreement.[203]

The court held that Rule 20 of the AAA Securities Arbitration Agreement did not change the analysis.[204] Rule 20 provides, in pertinent part, that "[i]n event of a vacancy in a panel of neutral arbitrators after the hearings have commenced, the remaining arbitrator or arbitrators may continue with the hearing and determination of the controversy, unless the parties agree otherwise."[205] The court held that because the actual

197. *Id.* at 1574-75. The court actually had to surmise the possible explanations for Panel's action because the arbitrators gave no reason for denying the postponement. The court pointed out that arbitrators have never been required to explain their awards because the proceedings are summary in nature. *See, e.g.*, O.R. Securities, Inc. v. Professional Planning Assoc., Inc., 857 F.2d 742, 747 (11th Cir. 1988).

The court pointed out the following potential reasons: First, the panel may have been confused as to what was meant by defendants' statement that they would be available the "first week in May." 942 F.2d at 1574. The panel set the hearing for May 8 through 10, which was the first *full* week in May. Thus, the panel may have thought it was in conformity with defendants' timing request. Second, in its request for postponement, defendants did not express or give any indication as to what testimony the missing defendant would give that would be material to the issues raised in the claim. The panel could have reasonably believed that whatever testimony needed to be given on behalf of defendants would be given by the missing defendants' partner. Third, defendants had ample opportunity to have preserved his testimony through deposition. Finally, the panel may have decided that the proceeding had already been protracted so long as to violate the policy of expeditiously handling such disputes. *Id.*

198. 931 F.2d 830 (11th Cir. 1991).

199. *Id.* at 832.

200. *Id.* at 831. *See* Coast Trading Co. v. Pacific Molasses Co., 681 F.2d 1195, 1198 (9th Cir. 1982) (authority of arbitration panel comes from purchase agreement contract for arbitration).

201. American Arbitration Assoc., SECURITIES ARBITRATION RULES §§ 1-57 (1989).

202. 931 F.2d at 831.

203. *Id.*

204. *Id.*

205. *Id.*

arbitration agreement required three arbitrators, the parties "agreed otherwise," thus prohibiting the application of the going-forward provision of Rule 20.[206] The court held that the arbitrators violated the provision of the arbitration agreement requiring three arbitrators and thus, exceeded their authority.[207]

In *Blue Gray Corp.'s I & II v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[208] the Eleventh Circuit Court of Appeals faced the issues of (1) whether an "exception clause"[209] in the arbitration agreement permits plaintiffs the option of choosing whether to submit controversies involving claims arising under federal securities laws to arbitration, and (2) whether the state law claims fall within the language "controversies involving claims arising under federal securities laws" and thus could be resolved through litigation rather than arbitration.[210]

The Eleventh Circuit agreed with the district court that the plain meaning of the arbitration agreement provided an exception to arbitration for claims arising under federal securities laws.[211] As to state law claims, the Eleventh Circuit held that the contract claim provided for them to be arbitrated, even those that arise out of the same transaction or occurrence as the federal securities law claims.[212]

The decision in *Blue Gray* is unlikely to have a significant impact on future arbitration disputes, since the parties were dealing with contract language that had been adopted by the brokerage firms pursuant to SEC Rule 15c2-2(a)[213] after the decision in *Shearson/American Express, Inc.*

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206. *Id.* at 832.

207. *Id.*

208. 921 F.2d 267 (11th Cir. 1991).

209. *Id.* at 267. The clause stated, "[e]xcept to the extent that controversies involving claims arising under the Federal securities laws may be litigated, it is agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration . . . ." *Id.* at 269.

210. *Id.* at 269.

211. *Id.* at 270. The court refused to find the language ambiguous. *See* Nemes v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 741 F. Supp. 657 (E.D. Mich. 1990); Axtell v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 744 F. Supp. 194 (E.D. Ark. 1989). Arbitration clauses are creations of contract; parties are required to arbitrate only those claims they have agreed to arbitrate. Goldberg v. Bear, Stearns & Co., 912 F.2d 1418, 1419 (11th Cir. 1990) (courts should not twist the language to achieve a result that is favored by federal policy but contrary to the interest of the parties).

212. 921 F.2d at 271.

213. Rule 15c2-2(a) stated that:

> It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

v. McMahon[214] but prior to the decision by the United States Supreme Court in *Rodriguez de Quijas v. Shearson-American Express.*[215] The provision at issue in *Blue Gray* is not utilized in arbitration agreements prepared by brokerage firms post-*Rodriguez.*

C. *Should Arbitration be Compelled*

In *Chastain v. Robinson-Humphrey Co.,*[216] defendant brokerage firm removed the case to federal court and then moved to compel arbitration of one of the customers' securities claims against the company.[217] The issue raised was whether the district court or the panel of arbitrators should determine whether the customer agreement that contained the arbitration clause was enforceable when the customer alleged that her signature to the agreement had been forged.[218] Under the Federal Arbitration Act ("FAA"),[219] a district court must compel arbitration if the parties have agreed to arbitrate their dispute.[220] However, the Eleventh Circuit held that if the existence of an agreement to arbitrate itself is at issue, the district court, not a panel of arbitrators, must decide if the arbitration clause is enforceable against the parties.[221]

VII. CONCLUSION

The most significant decision during the survey period was the Supreme Court's decision in *Lampf*, which established a uniform limitation period for claims arising under Rule 10b-5. Although there was some

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17 C.F.R. § 240.15c2-2(a) (1987). Rule 15c2-2 was rescinded effective October 21, 1987. *See* 52 Fed. Reg. 39, 216 (1987).

214. 482 U.S. 220 (1987). *McMahon* held that claims arising under the Exchange Act were arbitrable.

215. 490 U.S. 477 (1989). *Rodriguez* overturned Wilko v. Swann, 364 U.S. 427 (1953), and held that claims arising under the Securities Act were arbitrable. 490 U.S. at 485.

216. 957 F.2d 851 (11th Cir. 1992)

217. *Id.* at 853. The complaint alleged that the company illegally opened and maintained a security trading account in her name, engaged in illegal churning and fraudulently induced her to pay her other indebtedness under the account. The company first removed the case to federal court then sought to compel arbitration, citing the broad arbitration clauses contained in the customer agreement. The customer claimed never to have agreed to either the customer agreements or the arbitration clauses. The district court denied the motion to comply arbitration. The district court expressed doubt about the existence of a valid and enforceable contract, especially in light of plaintiff's affidavit stating that she did not sign the agreement and did not authorize anyone to affix her signature. In fact, the defendant admitted the signature on the original customer agreement was not that of the plaintiff.

218. *Id.* at 853-54.

219. 9 U.S.C. §§ 1-306 (1988 & Supp. III 1991).

220. *See id.* §§ 2,3 (1988).

221. *Id.* § 4. *See also* Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395 (1967).

speculation that Congress might extend the limitation period, that now appears unlikely given the limited approach to the limitation period taken by Congress in amending the Exchange Act as part of the FDIC Improvements Act.

The Supreme Court's decisions in *McMahon* and *Rodriguez*, which made all claims under the Securities Act and the Exchange Act subject to arbitration, appears to have reduced the number of substantive decisions in the securities area, as much of the prior case law was developed in the context of broker/dealer litigation. The primary focus of the appellate decisions involving arbitration awards has been on procedural issues. It is expected that this trend will continue.