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ANTIFRAUD

Seven on 11: Seven Avenues to Early Dismissal of Claims Under Section 11 of the Securities Act

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Section 11 of the Securities Act of 1933 imposes "a stringent standard of liability" on participants in public securities offerings, permitting recovery by investors for even innocent material misstatements in registration statements. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-82 (1983). Plaintiffs generally need not demonstrate intent to defraud, and ordinarily need not prove that they relied on the alleged misstatements or omissions. 15 U.S.C. § 77k(a); *In re Initial Pub. Offering Sec. Litig.* ("*In re IPO Sec. Litig.*"), 241 F. Supp. 2d 281, 342-44 (S.D.N.Y. 2003) . For corporate issuers, who unlike other potential defendants do not have a statutory "due diligence" defense, Section 11 liability has been described as "virtually absolute." 15 U.S.C. § 77k(b); *Huddleston*, 459 U.S. at 382; *Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, 238 F.3d 363, 369 (5th Cir. 2001). Further, statutory damages initially are presumed to have been caused by the alleged misstatements in the registration statement. *See* 15 U.S.C. § 77k(e); *NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co.*, 693 F.3d 145, 167 (2d Cir. 2012). Given these challenges, defendants and their counsel may discount the prospects for early dismissal of Section 11 claims. However, examination of the following seven questions can provide fertile grounds for early dismissal or, at least, a substantial narrowing of the case.

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1. Do Plaintiffs Have Standing?

A Section 11 plaintiff must satisfy the statute's significant restrictions on standing. *See, e.g., Harden v. Raffensperger, Hughes & Co.*, 933 F. Supp. 763, 766 (S.D. Ind. 1996). Section 11 is "concerned with the initial distribution of securities" and its standing provisions are accordingly limited to the "narrow class of persons" who purchased the specific securities that are the "direct subject" of the challenged registration statement. *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 495 (5th Cir. 2005); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 861 (5th Cir. 2003). Courts have interpreted the language of Section 11 as denying standing to purchasers

who cannot ''trace'' their shares to the specific registration statement at issue. *Krim*, 402 F.3d at 495.

Section 11 defendants and their counsel should consider raising standing early and often. At the pleading stage, courts have rejected complaints that failed to include allegations with respect to a plaintiff's Section 11 standing, particularly where the PSLRA-required stock certification attached to the complaint reflects that the plaintiff purchased its shares in the aftermarket. *See, e.g., In re Alamosa Holdings, Inc.*, 382 F. Supp. 2d 832, 864 (N.D. Tex. 2005). Moreover, some courts have held that a complaint insufficiently alleged that the plaintiffs' shares were ''traceable'' to the offering in question when multiple registration statements have been issued and the plaintiff fails to allege specific facts showing which registration statement was the source of the plaintiff's shares. *In re Ariad Pharms., Inc. Sec. Litig.*, 842 F. 3d 744, 755-56 (1st Cir. 2016). Courts also have rejected claims by putative Section 11 plaintiffs with respect to shares clearly purchased before the challenged offering. *See, e.g., Abbey v. Comp. Memories, Inc.*, 634 F. Supp. 870, 872 (N.D. Cal. 1986).

Even if a complaint's Section 11 standing allegations withstand dismissal, defendants should consider putting the plaintiff to its proof as soon as possible, either through an early summary judgment motion or in opposition to class certification. In particular, aftermarket purchasers face a ''problem of proof'' in a situation where shares have entered the market from multiple offerings. *See, e.g., Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 & n.4 (9th Cir. 1999). In a ''mixed'' market comprised of shares from multiple sources, physical tracing of particular shares is virtually impossible. *See, e.g., Barnes v. Osofsky*, 373 F.2d 269, 271-73 (9th Cir. 1967); *In re IPO Sec. Litig.*, 2004 WL 2297401, at *38 n.402 (S.D.N.Y. Oct. 13, 2004), *vacated and remanded on other grounds*, 471 F.3d 24 (2d Cir. 2006); *In re Crazy Eddie Sec. Litig.*, 792 F. Supp. 197, 202 (E.D.N.Y. 1992); *Abbey*, 634 F. Supp. at 875.

Section 11 plaintiffs have attempted unsuccessfully at various times to rely on statistical probabilities to demonstrate Section 11 standing. *See, e.g., In re Quarterdeck Office Sys., Inc. Sec. Litig.*, 1993 WL 623310, at *2-3 (C.D. Cal. Sept. 30, 1993); *In re Elscint, Ltd. Sec. Litig.*, 674 F. Supp. 374, 379-82 (D. Mass. 1987). In *Krim*, the Fifth Circuit became the first Court of Appeals to address the viability of a statistical substitute for the tracing requirement. 402 F.3d 489. The court in *Krim* held that while aftermarket purchasers ''do not inevitably lack standing,'' accepting mere statistical probabilities would impermissibly expand Section 11 liability. *Id*. at 495-96.

The *Krim* decision illustrates that once shares from a public offering become commingled with shares from other sources—such as other public offerings, registration-exempt sales, or option exercises—investors who acquired those commingled shares ordinarily will not be able to establish standing. Accordingly, defendants may achieve early dismissal in those circumstances. *See, e.g., In re Transkaryotic Therapies, Inc. Sec. Litig.*, 319 F. Supp. 2d 152, 158 (D. Mass. 2004) (granting Rule 12(b)(6) motion as to Section 11 claims of plaintiffs who allegedly ''purchased their TKT shares on the open market [when] there were tens of millions of shares'' from prior offerings already trading). Even in putative class actions where the named plaintiff has standing as an original purchaser in the challenged offering, the *Krim* decision's rejection of statistical probabilities strongly suggests that any attempt to obtain certification of a Section 11 class that includes aftermarket purchasers will fail in most cases, as the threshold issue of standing will not be susceptible to common proof, resulting in what another court has termed ''myriad mini-trials.'' *See In re IPO Sec. Litig.*, 2004 WL 2297401, at *38.

2. Are Plaintiffs' Claims Time-Barred?

There are two timeliness defenses to a Section 11 claim that may be raised in a motion to dismiss: the three-year statute of repose and the one-year statute of limitations.

Section 13 of the Securities Act provides that an action under Section 11 must be brought no ''more than three years after the security was bona fide offered to the public.'' 15 U.S.C. § 77m. The Supreme Court has held that the clear and singular purpose of this statute of repose is ''to offer defendants full and final security after three years.'' *Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 2042, 2052 (2017) (''*CalPERS*''). As a result, this repose period is ''absolute,'' ''admits of no exception,'' and ''forecloses the extension of the statutory period based on equitable principles.'' *Id*. at 2049-51.

Accordingly, a shareholder bringing a Section 11 claim more than three years after the challenged offering has little or no ability to salvage his claim from dismissal. The Supreme Court directly held that the *American Pipe* tolling doctrine—which generally tolls statutes of limitations for shareholders between the filing of a putative class action complaint and a decision on class certification—does not apply to the Securities Act's three-year statute of repose. *Id*. Moreover, there are strong arguments that the relation back doctrine does not apply to the statute of repose either. *E.g., In re Lehman Bros. Sec. & Erisa Litig.*, 799 F. Supp. 2d 258, 310 (S.D.N.Y. 2011). Among other reasons, the relation back provision in Federal Rule of Civil Procedure 15, by its plain terms, only applies to statutes of limitations, not statutes of repose. *See* Fed. R. Civ. P. 15(c)(1)(A). Section 13's statute of repose is also a substantive right to be free of liability after three years. *See CalPERS*, 137 S. Ct. at 2049; *Stein v. Regions Morgan Keegan Select High Income Fund, Inc.*, 821 F.3d 780, 794 (6th Cir. 2016). The Federal Rules of Civil Procedure cannot legally ''abridge, enlarge or modify any substantive right.'' 28 U.S.C. § 2072(b) (Rules Enabling Act).

Section 11 claims also could be subject to dismissal based on the statute of limitations, which requires that such claims be filed within ''one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence.'' 15 U.S.C. § 77m. Under this standard, the limitations period begins to run when the plaintiff knows—or ''with the exercise of reasonable diligence'' should have known—''the basis of the claims asserted.'' *DeBenedictis v. Merrill Lynch & Co.*, 492 F.3d 209, 218-19 (3rd Cir. 2007). Where the so-called ''truth'' regarding the alleged misstatements in the offering documents was revealed more than one year before a Section 11 claim was first brought, the claim may be subject to dismissal. *See In re Alamosa Holdings, Inc.*, 382 F. Supp. 2d 832, 863-64 (N.D. Tex. 2005) (dismissing Securities Act claims when plaintiffs filed com-

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plaint more than one year after they were on notice of the facts giving rise to the claims); *Rahr v. Grant Thornton LLP*, 142 F. Supp. 2d 793, 796-97 (N.D. Tex. 2000) (dismissal required ''when the pleadings disclose facts sufficient to have placed the plaintiff on inquiry notice of the alleged fraud prior to the one-year cutoff'' (internal quotations omitted)).

Unlike the statute of repose, however, the statute of limitations is subject to potential equitable tolling under the *American Pipe* doctrine as well as the relation back rule. Nonetheless, there are often circumstances where those doctrines are not sufficient to overcome dismissal. For example, in cases where the original lawsuit was filed by a shareholder who lacked standing to assert a Section 11 claim, courts have held that neither the *American Pipe* doctrine nor the relation back doctrine applied. *See In re Magnum Hunter Res. Corp. Sec. Litig.*, 616 F. App'x 442, 447 (2d Cir. 2015) (subsequent Section 11 plaintiffs could not benefit from ''relation back'' or ''equitable tolling'' where ''plaintiffs who originally filed suit did not allege stock purchases traceable to any of [the company's] offerings and, thus, lacked standing''); *see also In re Puda Coal Sec. Inc. Litig.*, 2013 WL 5493007, at *12-15 (S.D.N.Y. Oct. 1, 2013) (*American Pipe* tolling inappropriate where named plaintiff in earlier complaints lacked standing to bring Securities Act claims because ''if standing does not exist at the outset, it cannot be manufactured through belated intervention''). Likewise, if the amended pleading challenges entirely different representations than the earlier complaint did, courts have held that the statute of limitations is not tolled and that the amended pleading will not relate back even if it challenges the same offering documents. *Caldwell v. Berlind*, 543 F. App'x 37, 40 (2d Cir. 2013); *In re Noah Educ. Holdings, Ltd. Sec. Litig.*, 2010 WL 1372709, at *9 (S.D.N.Y. Mar. 31, 2010); *In re Alcatel Sec. Litig.*, 382 F. Supp. 2d 513, 527-29 (S.D.N.Y. 2005).

3. Is There Causation?

An affirmative defense to Section 11 liability, called the ''negative causation'' defense, is that the alleged misrepresentations or omissions in the registration statement did not cause the plaintiff's losses. 15 U.S.C. § 77k(e). Although an affirmative defense, dismissal under Rule 12(b)(6) can be proper where negative causation is apparent on the face of the complaint. *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 894 F. Supp. 2d 144, 151 (D. Mass. 2012); *In re Shoretel Inc., Sec. Litig.*, 2009 WL 248326, at *4-5 (N.D. Cal. Feb. 2, 2009).

Dismissal may be appropriate, for example, where there is a disconnect between the stock price decline that supposedly resulted in the plaintiff's losses and the alleged misrepresentations or omissions in the registration statement. In nearly all securities cases, the plaintiff points to some public announcement of the so-called ''truth'' and alleges that the company's stock price sharply declined immediately thereafter. But, generally, a '' 'price decline before disclosure [of the truth] may not be charged to defendants.' '' *Alamosa*, 382 F. Supp. 2d at 865. Further, defendants can argue that the supposed announcement of the truth does not in fact reveal that any statement in the registration statement was untrue. For example, in *Alamosa*, a Section 11 plaintiff alleged that the issuer had included false historical financial statements in its registration statement, and that the company's stock later ''plummeted'' upon a downward revision of forward-looking projections. *Id.* at 865-66. The press release allegedly precipitating this stock price decline, however, did not set forth new contradictory historical numbers and, in fact, did not correct any allegedly untrue statement from the challenged registration statement. *Id.* at 838-39, 866. The court therefore dismissed the Section 11 claims because ''any loss experienced by the plaintiffs could not be attributable to an alleged misrepresentation or omission from the Registration Statement.'' *Id.* at 866; *see Brown v. Ambow Educ. Holding Ltd.*, 2014 WL 523166, at *14-16 (C.D. Cal. Feb. 6, 2014) (similar).

Dismissal may also be appropriate where it is apparent from the PSLRA-required certification attached to the complaint that the Section 11 plaintiff completely divested his or her shares prior to the first disclosure of the purported truth. *Amorosa v. Ernst & Young LLP*, 682 F. Supp. 2d 351, 372 (S.D.N.Y. 2010); *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1262 (N.D. Cal. 2000). In that circumstance, the plaintiff's investment loss ''could not have been caused by misstatements which had not yet been revealed.'' *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 272 F. Supp. 2d 243, 253-55 (S.D.N.Y. 2003).

4. Are There Forward-Looking Statements?

When a Section 11 claim is based on forward-looking statements, the statutory safe harbor provided by the PSLRA may limit liability. 15 U.S.C. § 77z-2(c). The safe harbor generally does not apply to an initial public offering, but will apply to claims based on a secondary offering. 15 U.S.C. § 77z-2(b)(2)(D). Where applicable, the safe harbor eliminates liability for written and oral forward-looking statements that are: (1) identified as such and ''accompanied by meaningful cautionary statements'' setting forth factors that could cause actual results to differ; (2) immaterial; or (3) not proven to have been made with ''actual knowledge'' that they were false or misleading. *Id.* § 77z-2(c)(1)(B); *Southland Sec. Corp. v. INSpire Ins. Sols., Inc.*, 365 F.3d 353, 371-72 (5th Cir. 2004). As a result, courts have dismissed plaintiffs' claims that attack these types of protected statements. *See, e.g., TransEnterix Inv'r Grp. v. TransEnterix, Inc.*, 272 F. Supp. 3d 740, 757-58, 762 (E.D.N.C. 2017) (finding forward-looking statements non-actionable where plaintiffs failed to adequately plead ''actual knowledge''); *Plymouth Cty. Ret. Ass'n v. Primo Water Corp.*, 966 F. Supp. 2d 525, 556 (M.D.N.C. 2013) (applying safe harbor to statements about ''future operations and the expectation of additional growth'' and to statements ''accompanied by sufficient cautionary language''); *Elhert v. Singer*, 245 F.3d 1313, 1320 (11th Cir. 2001) (holding that adequate cautionary language accompanied the forward-looking statement and safe harbor protected defendants from liability).

Although Section 11 claims based on alleged misrepresentations of historical fact have been termed essentially ones of strict liability, the requirement that a plaintiff prove actual knowledge with respect to any forward-looking statement significantly increases plaintiffs' pleading burden and burden of proof. Ordinarily, a Section 11 claim based on a historical statement does

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not require a showing of fraudulent intent, and thus plaintiffs need not plead with particularity unless the claim ''sounds in fraud.'' *In re Plains All Am. Pipeline, L.P. Sec. Litig.*, 245 F. Supp. 3d 870, 894 (S.D. Tex. 2017) (citing *Lone Star*, 238 F.3d at 368). Requiring ''actual knowledge'' with respect to forward-looking statements, however, means that such claims necessarily ''sound in fraud'' and plaintiffs must plead them with particularity under Rule 9(b). *Firefighters Pension & Relief Fund v. Bulmahn*, 53 F. Supp. 3d 882, 910-12 (E.D. La. 2014); *Kurtzman v. Compaq Comp. Corp.*, 2000 WL 34292632, at *60 (S.D. Tex. Dec. 12, 2000). Failure to so plead may provide a basis for dismissal of a plaintiff's Section 11 claims. *Bulmahn*, 53 F. Supp. 3d at 912; *Cal. Pub. Emps.' Ret. Sys. v. Chubb Corp.*, 2002 WL 33934282, at *17 (C.D. Cal. June 26, 2002) (applying safe harbor where plaintiffs failed to ''ple[a]d with particularity defendants' actual knowledge that the statements were false''); *Ehlert v. Singer*, 85 F. Supp. 2d 1269 (M.D. Fla. 1999) (dismissing Section 11 claim because plaintiffs failed to adequately plead actual knowledge of falsity), *aff'd*, 245 F.3d 1313 (11th Cir. 2001).

5. Are The Claims Based on Expressions of Opinion or Belief?

The Supreme Court recently opened the door for persuasive dismissal arguments for Section 11 claims based on an expression of opinion or belief. To state a Section 11 claim based on a statement of opinion or belief, plaintiffs must plausibly allege that the speaker either: (i) did not honestly hold the stated belief; (ii) supplied facts in support of the belief that were untrue; or (iii) omitted a material fact that made the statement of belief misleading. *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1326 (2015).

An opinion that the speaker does not honestly believe can be actionable because ''every such statement explicitly affirms one fact: that the speaker actually holds the stated belief.'' *Id*. Importantly, however, it is not sufficient to allege that ''external facts show the opinion to be incorrect,'' or that a belief ''turned out to be wrong.'' *Id*. at 1327-28; *Tongue v. Sanofi*, 816 F.3d 199, 212, 214 (2d Cir. 2016) (dismissing claims because ''a statement of opinion is not misleading just because external facts show the opinion to be incorrect''); *In re Fairway Grp. Holdings Corp. Sec. Litig.*, 2015 WL 4931357, at *20 (S.D.N.Y. Aug. 19, 2015) (same). The plaintiff must plausibly allege that the speaker did not believe the opinion at the time it was stated. Moreover, when a plaintiff challenges an opinion on grounds that it was disbelieved by the speaker, the defendant has a strong argument that plaintiff must satisfy Rule 9(b)'s heightened pleading requirements because the claim sounds in fraud. *See Plains*, 245 F. Supp. 3d at 894 (citing *Lone Star*, 238 F.3d at 368).

An opinion might also be actionable if it ''contain[s] embedded statements of fact'' expressed in support of the opinion or belief. *Omnicare*, 135 S. Ct. at 1327. For example, if a company states that it believes its computers are the fastest because of a patented processor, but the company does not have a patent on its processor, the opinion might be actionable if the embedded factual statement was material. In such a circumstance, defendants would need to argue that the alleged ''embedded facts'' are either true, not ''determinate or verifiable,'' or too vague or immaterial to be actionable. *See Johnson v. CBD Energy Ltd.*, 2016 WL 3654657, at *12 (S.D. Tex. July 6, 2016) (dismissing claim where ''opinions do not contain any embedded statements of fact that are untrue''); *Fairway Grp.*, 2015 WL 4931357, at *21 (dismissing claim where alleged embedded facts were vague puffery) (citing *Se. Pa. Transp. Auth. v. Orrstown Fin. Servs., Inc.*, 2015 WL 3833849 (M.D. Pa. June 22, 2015)).

Lastly, a statement of belief may be actionable ''if a registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself.'' *Omnicare*, 135 S. Ct. at 1329. For example, it may be misleading for a company to state it believes its conduct is lawful if: (i) it has not consulted with an attorney; (ii) the company's lawyers provided contrary advice; or (iii) the company knew the government was investigating it. *Id*. at 1328-39. Nevertheless, plaintiffs must ''identify particular (and material) facts going to the basis for the [declarant's] opinion,'' the omission of which makes the opinion misleading when read ''fairly,'' ''in context,'' and with ''other hedges, disclaimers, or qualifications.'' *Id*. at 1332-33. ''That is no small task'' for plaintiffs, and in dismissal motions defendants should highlight risk disclosures in public offering documents to rebut plaintiffs' allegations that a statement of belief was misleading by omission. *See id*.; *Tongue*, 816 F.3d at 211 (no misstatements where offering materials ''made numerous caveats''); *Fairway Grp.*, 2015 WL 4931357, at *20 (similar). Defendants can also argue that they need not disclose every ''fact cutting the other way,'' as a ''reasonable investor does not expect that every fact known to [a speaker] supports its opinion statement,'' and ''the presence of such facts'' may be why the speaker ''frame[d] a statement as an opinion.'' *Omnicare*, 135 S. Ct. at 1329; *In re Deutsche Bank AG Sec. Litig.*, 2016 WL 4083429, at *23, 25 (S.D.N.Y. July 25, 2016) (dismissing claim because an investor ''does not expect that every fact known to an issuer supports its opinion statement'').

6. Are the Alleged Falsehoods Immaterial?

Section 11 requires that a plaintiff demonstrate ''that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment.'' *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009); *see also* 15 U.S.C. § § 77k(a), 77l(a)(2). There is no materiality unless the alleged misrepresentation or omission in the registration statement ''would have altered the way a reasonable investor would have perceived the total mix of information available in the prospectus as a whole.'' *Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 213-14 (5th Cir. 2004). Viewing materiality as a mixed question of law and fact, ''courts often will not dismiss a securities fraud complaint at the pleading stage of proceedings, unless reasonable minds could not differ.'' *In re Bank of Am. Corp. Sec., Derivative, & ERISA Litig.*, 757 F. Supp. 2d 260, 301 (S.D.N.Y. 2010) (quoting *Halperin v. eBanker USA.COM, Inc.*, 295 F.3d 352, 357 (2d Cir. 2002)). ''No shortage of cases, however, make clear that materiality may be resolved by a court as a matter of

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law.'' *Greenhouse v. MCG Capital Corp.*, 392 F.3d 650, 657 (4th Cir. 2004). While an attack on materiality at the dismissal stage may not always be appropriate, it should be considered, particularly where: (i) the allegedly omitted fact was otherwise available through ''language [in the prospectus that] fully disclosed the risk of investment and was specific enough to warrant a reasonable investor's attention''; (ii) the alleged undisclosed truth or fact was publicly available; or (iii) it is the ''Complaint's portrayal'' of the offering disclosures ''which distorts reality.'' *Olkey v. Hyperion 1999 Term Tr.*, 98 F.3d 2, 9 (2d Cir. 1996); *see also Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 549 (8th Cir. 1997) (''Only by discarding common sense and ignoring the multitude of explicit and on-point warnings . . . could investors have been misled by the misrepresentations allegedly made by the Defendants in [the] Prospectus.''); *Braun v. Eagle Rock Energy Partners*, 223 F. Supp. 3d 644, 650-51 (S.D. Tex. 2016); *In re Computervision Corp. Sec. Litig.*, 869 F. Supp. 56, 60 (D. Mass. 1994). For example, courts have dismissed Section 11 claims on ''immateriality'' grounds in the following contexts:

- alleged failure to disclose unpredictability of natural gas prices (*Kapps*, 379 F.3d at 216);
- alleged failure to adequately disclose potential customer resistance to product changes (*Primo v. Pac. Bioscience of Cal., Inc.*, 940 F. Supp. 2d 1105, 1117 (N.D. Cal. 2013));
- alleged failure to disclose a fee dispute with a ''significant customer'' (*Rudman v. CHCH Grp. LTD.*, 217 F. Supp. 3d 718, 729 (S.D.N.Y. 2016));
- alleged misrepresentations with respect to an executive's educational or professional credentials (*In re Jiango Pharms., Inc., Sec. Litig.*, 884 F. Supp 2d 1243, 1264 (S.D. Fla. 2012); *Greenhouse*, 392 F.3d at 657-58);
- alleged misrepresentations about management ''integrity'' (*Greenhouse*, 392 F.3d at 659-60);
- alleged misstatement relating to the significance of a single brand license to the company's aggregate business (*Jones v. Party City Holdco, Inc.*, 230 F. Supp. 3d 185, 191-92 (S.D.N.Y. 2017));
- alleged failure to disclose specifically the risk of bankruptcy, where ''a reasonable investor would comprehend that under [the disclosed] circumstances a company may be forced to seek protection from its creditors'' (*Recupito v. Prudential Sec., Inc.*, 112 F. Supp. 2d 449, 457 (D. Md. 2000)).

Some courts have also been willing to find certain alleged financial overstatements or understatements ''immaterial'' within the context of other financial information in the issuer's offering documents. *See, e.g., Romine v. Acxiom Corp.*, 296 F.3d 701, 706-07 (8th Cir. 2002) ($2.3 million adjustment to employee benefit reserves and $400,000 change in allowance for doubtful accounts not material); *Parnes*, 122 F.3d at 546 (2% overstatement of assets by a high-yield/high-risk opportunity not material).

7. Are There Damages?

Section 11(e) sets forth a specific formula by which damages must be calculated ''in every action'' brought under the statute. 15 U.S.C. § 77k(e); *Alpern v. UtiliCorp United, Inc.*, 84 F.3d 1525, 1542 (8th Cir. 1996). The formula provides three possible damage calculations depending on whether and when the plaintiff sold the securities that are traceable to the challenged registration statement. 15 U.S.C. § 77k(e). For plaintiffs who sold their securities prior to suit, their maximum damages are equal to ''the difference between the amount paid for the security (*not exceeding the price at which the security was offered to the public*) and . . . the price at which such security shall have been disposed of in the market before suit.'' *Id.* § 77k(e) (emphasis added); *Krim v. PcOrder.com, Inc.*, 2003 WL 21076787, at *3 (W.D. Tex. May 5, 2003). Under this prong of the formula, if the plaintiff has sold her shares pre-suit for more than the offering price, she has no conceivable statutory damages—even though she may have lost money on the investment. *In re IPO Sec. Litig.*, 241 F. Supp. 2d at 281, 351 (S.D.N.Y. 2003). Courts have dismissed Section 11 claims at the pleading stage under such circumstances. *See, e.g., id.* at 347-51.

For plaintiffs who have not sold their securities prior to suit, the maximum statutory recovery is the difference between the purchase price (if not greater than the offering price) and whichever of the following yields the *lesser* amount of damages: (1) the ''value'' of the security at the time of suit; or (2) the amount received by the plaintiff in any sale of the securities during the pendency of the suit. 15 U.S.C. § 77k(e)(1), (3); *In re Cendant Corp. Litig.*, 264 F.3d 201, 228 & n.8 (3d Cir. 2001). The application of these provisions means that maximum Section 11 recovery becomes ''frozen'' at the time of suit at the offering price less the value of the security on that day. *Beecher v. Able*, 435 F. Supp. 397, 410 (S.D.N.Y. 1975). Post-suit market declines are not recoverable under the statute. While courts have held that the ''value'' of the security on the day of suit is not necessarily synonymous with its ''market price,'' courts have also opined that the market price is the presumptive value. *See, e.g., McMahan & Co. v. Wherehouse Entm't, Inc.*, 65 F.3d 1044, 1048-49 (2d Cir. 1995). Accordingly, where the market price on the day of suit was equal or greater to the offering price, defendants should seek early dismissal of the suit because of the absence of conceivable statutory damages.

Conclusion

While Section 11 generally imposes a low threshold on plaintiffs for pleading, defendants should not accept as a foregone conclusion that such claims will proceed beyond the pleadings stage or summary judgment. Consideration of these basic ''Seven on 11'' questions will not only assist defendants in crafting a long-term defense strategy, but may well lead to an early avoidance of Section 11 liability.

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