In the

# Supreme Court of the United States

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| HERMAN & MacLEAN, | ) | |
| | ) | |
| Petitioner | ) | |
| | ) | |
| v. | ) | NO. 81-680 |
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| RALPH E. HUDDLESTON ET AL.; and | ) | |
| | ) | |
| RALPH E. HUDDLESTON ET AL., | ) | |
| | ) | |
| Petitioners | ) | |
| | ) | |
| v. | ) | NO. 81-1076 |
| | ) | |
| HERMAN & MacLEAN ET AL. | ) | |

Washington, D. C.

November 9, 1982

ALDERSON REPORTING

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IN THE SUPREME COURT OF THE UNITED STATES

HERMAN & MacLEAN, Petitioner v. RALPH E. HUDDLESTON ET AL.; and RALPH E. HUDDLESTON ET AL., Petitioners v. HERMAN & MacLEAN ET AL.

No. 81-680

No. 81-1076

Washington, D.C.

Tuesday, November 9, 1982

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 1:44 o'clock p.m.

APPEARANCES:

JAMES L. TRUITT, ESQ., Dallas, Texas,;
on behalf of the Petitioner.

ROBERT H. JAFFE, ESQ., Springfield, New Jersey;
on behalf of Respondent.

PAUL GONSON, ESQ., S.E.C., Washington, D.C.;
as amicus curiae



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P R O C E E D I N G S

CHIEF JUSTICE BURGER: Mr. Truitt, you may proceed whenever you are ready.

ORAL ARGUMENT OF JAMES L. TRUITT, ESQ.,

ON BEHALF OF THE PETITIONER

MR. TRUITT: Mr. Chief Justice, and may it please the Court:

There are two issues presented in this appeal: The first issue is whether or not purchasers of registered securities who may sue under section 11 of the Securities Act of 1933 may also have recourse to the implied remedies permitted under section 17(a) of the Securities Act of 1933 and under Rule 10(b)5 of the Securities Act of 1934.

The second issue is whether in such implied remedies cases the standard of evidence is the clear and convincing standard or is preponderance of the evidence standard.

Herman & MacLean is my client. It is a firm of certified public accountants with offices in Detroit, Michigan. Herman & MacLean were the auditors for Texas International Speedway in connection with a public offering of securities which occurred in November of 1969 in the heyday of the "go-go period." That offering of securities was underwritten on a firm commitment

basis by a group of underwriters headed by Ladenburg, Thalmann & Company.

The offering of securities was successful.

QUESTION: Is that a term of art, "go-go period" or --

MR. TRUITT: I think it has gotten to be, Your Honor. It's a term which has been applied frequently. I think there's a book called "The Go-Go Years," which describes the period, the period of the late '60s and early '70s, in which it seemed that purchasers or investors --

QUESTION: Can we find it in West's Law or someplace like that?

MR. TRUITT: You may, Your Honor. I am not sure. I haven't looked at that. But I think it's a term that has a commonly understood significance in the securities industry.

QUESTION: You haven't told me what it is yet.

MR. TRUITT: I beg your pardon?

QUESTION: You haven't told me what it is yet. I would like to know if you are going to --

MR. TRUITT: The "go-go period" I would just define as the period of the late '60s and early '70s during which the appetite for speculative securities seemed to be very high. We've not had, except

sporadically, a recurrence of that sort of appetite for speculative securities.

QUESTION: All right. Now I know.

MR. TRUITT: The operations of Texas International Speedway were not successful. On November 30, 1970, which was some 13 months after the ofering, Texas International Speedway filed a petition for banrkuptcy under Chapter 10 of the federal bankruptcy laws.

On August 25, 1972, which was approixmately 21 months after the filing of bankruptcy proceedings and just short of 3 years after the effective date of the public offering, the plaintiffs in this lawsuit filed their action in the Federal District Court.

Section 11 of the Securities act of 1933 is a piece of legislation directed specifically at public offerings of securities. It is a statute which was designed specifically for the plaintiffs in this case. Section 11 was intended by Congress to accomplish certain things. It was intended to, as this Court has observed in Hochfelder, to make certain that all material information necessary to permit an investor to make an informed judgment would be available for that investor.

It was also intended to enhance standards of

integrity and fair dealing through the imposition of specified civil liabilities. And I think the operative word for my purposes in that paraphrase of Hochfelder is the term "specified."

In order to protect the capital formation process, Congress deemed it necessary to advise those persons participating in public offerings as to what the scope of their liabilities would be. Congress did that very specifically in section 11. Every participant in a section -- or in a registration statement can read section 11 and tell precisely what the scope of his liability is. Whether he is the issuer, a director, an officer of the company, an underwriter, or an accountant, he can tell what his liabilities are.

Notwithstanding the availability of section 11, the plaintiffs, as I have said, chose to sue under 10(b)5 and 17(a). By doing so, they accomplished three objectives: They avoided limitations claims, which would have been particularly difficult under the facts of this case. They broadened the basis for liability of those persons who they named as defendants.

In particular reference to my client, the public accounting firm, by suing under 10(b)5 rather than section 11, the plaintiffs were permitted to allege that accountants are responsible for non-accounting

materials, for materials that appear in the prospectus, in the use of proceeds table and elsewhere, despite the fact that those materials not only were not expertised by my client, by the accounting firm, but were in fact expertised by other experts.

Probably the clearest example that you can find in section 11 of the type of representation for which one expert is not liable; that is, something expertised by another expert.

QUESTION: What does "expertised" mean? We are getting an education. What does "expertised" mean, Mr. Truitt?

MR. TRUITT: Expertised, a piece of expertised material is material which is included in a registration statement on the basis of the authority of an expert. A prospectus, and the prospectus in this case, has a section entitled "Experts," and it says, it identifies that portion of the prospectus that is included therein on the basis of the authority of an expert. And it identifies which expert it is and what the materials are.

For example, in this case, the expert section stated that the estimated cost of building the speedway was expertised by a firm of accountants -- excuse me -- a firm of engineers. And yet notwithstanding the fact that it was expertised by engineers and not by

accountants, the plaintiffs by suing under 10(b)5 were permitted to allege that the accountants were responsible as a result of the fact that those estimates were incorrect.

QUESTION: What is the theory on which they do that, on which the plaintiffs seek to assess liability against the accountants for something like that which was done --

MR. TRUITT: Well, the plaintiffs allege both that the accountants wer acting as principal and that they were acting as aiders and abettors; that is to say that, even though they were not responsible for those estimates, they are charged with knowledge of the incorrectness of those estimates and that that knowledge serves to satisfy the Scienter requirement of 10(b)5 and section 17.

QUESTION: Where does the concept of aiders and abettors in civil litigation come from?

MR. TRUITT: It seems to me that it has been borrowed from the criminal law without a great deal of analysis. It has been taken in whole from the criminal law. And the courts have applied it holding that the -- that the elements are an awareness, a generalized awareness, that there is some illegal activity going on and the performance of some conduct which materialy

contributes to the accomplishment of the illegal purpose.

QUESTION: Do any of the relevant securities acts passed by Congress use the term "aiders and abettors"?

MR. TRUITT: No, Your Honor, they do not.

QUESTION: How about Committee Reports?

MR. TRUITT: There, not in connection with the '33 or '34 acts. There was a Committee Report, there was a proposal, as I recall, in 1959 or 1960, to use the term "aider and abettor" in application to certain administrative processes.

But the Commission advised the Congress at that time that the aider-and-abettor analysis would apply only as regards administrative processes, SEC regulation, and that it did not at that time regard the aider-and-abettor concept as applicable for civil purposes. In any event, that legislation in which that proposal was made did not come to fruition.

The other major accomplishment of suing under 17(a) and 10(b)5 rather than section 11 has to do with the issue of damage. The damages provisions of section 11 are well defined and fairly restrictive. The principal restriction which is operative generally is that a participant in the registration process is liable only for an amount equal to the price at which the

securities were offered to the public. Therefore, if you had a situation in which securities offered to the public at $5 a share and trade thereafter at $10 or $15 a share, notwithstanding that increase in price, the participants in the registration process under section 11 are liable only for $5 per share.

Another very important distinction in the area of damages has to do with undewriters. An underwriter is generally liable only for that portion of the securities underwritten by him. There is an exception where an underwriter receives compensation which is not shared prorata with all other underwriters. But aside from that, that exception, an underwriter may be responsible only for that portion of the securities which he underwrites.

In the facts of the present case, that is fairly graphically demonstrated by Russ & Company, which I have chosen just because they're one of the smaller underwriters. They underwrote 30 units out of the 3,300 units which were sold in this offering. Under section 11 the aggregate liability of Russ & Company would have been $44,000. Under 10(b)5 or under 17(a), if those statutes providing client remedies, the liability of Russ & Company would be $4,400,000, plus -- plus -- any additional premium over and above that which might arise

as a result of the fact that those securities trade at a premium.

So the effect of permitting plaintiffs recourse to 10(b)5 and 17(a) is to dramatically increase the exposure of certain defendants.

One other significant effect is that section 11 only imposes liability on certain -- certain persons. Not every participant in the process of preparing a registration statement or bringing an offering to market is even potentially liable. For example, attorneys for underwriters are not liable under section 11. To use the facts of our case, the general contractor who was going to build the speedway, which would have been paid for out of the funds of this offering, was not liable under section 11.

In this case, however, the plaintiffs were permitted to sue under 10(b)5 and 17(a), and they were permitted to sue the attorneys for the underwriters and the general contractor.

Now, this Court has previously remarked on the in terrorem effects of 10(b)5 legislation -- excuse me -- litigation. It is a terrifying prospect because of the large amounts which may be involved, because of the large expenses which are incurred in defending oneself.

The fact of the matter is that 10(b)5 lawsuits

are frequently, if not generally, brought for their settlement value because of the fact that the risks of trial can be enormous. The trial of a 10(b)5 lawsuit is a difficult and tedious proposition for the attorneys and for the judge. As a result of that, federal judges frequently encourage, even demand, that the suit be settled before trial. And a defendant resists this demand at his grave peril.

QUESTION: How can a federal judge demand that a suit be settled before trial?

MR. TRUITT: By calling counsel into his chambers and saying, gentlemen, this is a lawsuit which I think should be settled; I believe very strongly it should be settled. Now, those demands will not always be heeded, but they may be made, and they were made in this case.

QUESTION: Well, what is the implied sanction which the judge has to back up what you describe as a "demand"?

MR. TRUITT: Well, in this case, Your Honor, Herman & MacLean refused to settle, and it suffered five consequences of refusing to settle. First off, it lost virtually every evidentiary ruling which was made --

QUESTION: Well, it might have anyway.

MR. TRUITT: It might have anyway, Your Honor.

MR. TRUITT: However --

QUESTION: Very likely would have.

MR. TRUITT: It might have, Your Honor, but if you will let me go on through the other list of things that happened, I think there is a pattern --

QUESTION: Before you leave that, isn't one partial response to that question that some district judges will drop hints here and there as to what they might do if a party show some activity towards settlement?

MR. TRUITT: Yes, Your Honor, that can be done, and I am sure it has been done. I think the facts of this case are more graphic than one would normally find.

Getting back to the evidentiary rulings which might or might not be correct and which we might or might not have lost, secondly, the jury charge. The jury charge was given in virtually the same language submitted by the plaintiffs. The jury charge was obviously and flagrantly defective. There was no charge given as to reliance. There was no charge given as to causation. The failure to give those charges despite the insistence of the defendants that they be given, required the Court of Appeals to reverse this case and remand it.

Thirdly, the district court bifurcated this proceeding for two trials, a trial on liability and then a trial on damages. After the trial on liability and without any evidence being submitted on the issue of damages, a final judgment covering both liability and damages was entered.

Fourthly, attorney's fees in the amount of $1 million were awarded in this case, $500,000 to come from the amount recovered on behalf of the class, $500,000 assessed as additional damages in complete disregard of the holdings of this Court which do not permit under the American rule the assessment of damages -- the assessment of attorney's fees as additional damages without some finding of wrong-doing over and above the establishment of the elements of the cause of action in the case.

The district judge did not pinpoint, did not specify what it was that justified the assessment of these damages, these attorney's fees as damages. But that nevertheless occurred.

Finally, after a judgment was entered, the defendants filed a motion for stay based upon a supersedeous bond which was less than the supersedeous bond called for by the local rule. A hearing was had on that motion, and at that hearing the district judge gave

on the record as his only basis for refusing to grant that motion the fact that the defendants had refused to heed his demand that the lawsuit be settled.

Normally, the causal relationship between a refusal to heed a settlement demand and the animus of the district court is a matter of greater speculation than it is in this case. But I submit that it was on the record in this case.

The significance of this course of events in this appeal and the point that I am trying to make is that the section 11 because of its much greater precision does not lend itself to these kinds of in terrorem tactics as does 10(b)5; and therefore, the integrity of section 11, I submit, should be preserved.

Getting over for a moment to the standard of evidence issue as it relates to the resolution of the overlapping remedies issue, the difficulty in briefing and deciding the standard of evidence applicable in an implied remedies case is the absence of any rule or decision to point to to determine which standard should apply.

After preparing our brief and reading the other briefs, it seems to me that what it comes down to is a subjective determination of the degree of protection which the Court should extend to persons

accused of civil fraud, taking into account the special damages to reputations which can follow from a fraud judgment.

Now, I would point out that this problem is not a problem in section 11 cases. There's no need to attempt to determine which standard of evidence applies, because in a section 11 case the burden is on the plaintiffs to go forward and show that a registration statement is false and misleading. But once that burden is satisfied, then the burden is on the defendant to establish defenses related to lack of culpability, which every defendant other than the issuor has.

This is an example, it seems to me, of the superiority of the section 11 cause of action, and we don't find ourselves in this never-never world of trying to determine by access to federal common law or by, as is the case with respect to the statute of limitations, by reference to what is deemed to be the most comparable state statute of limitations period, the rule applicable to the proceedings.

Now, the question presented in this appeal seems to me to be a very straightforward one, and that is, whether the federal courts are obligated to respect the express statutory remedy for registered offerings provided by Congress. If the courts are obligated to

respect that statutory scheme, then the various elements of that scheme must be respected. The statute of limitations period must be respected. The other attributes of the express remedy must be respected. When that occurs, it seems to me there's no room left for the existence of implied remedies.

Now, the problem of analysis here seems to me to be to some degree a semantic problem. The plaintiffs and the Commission speak in terms of cumulative or supplemental remedies. Now, those terms sound innocuous enough. But the fact is that one cannot permit a cumulative or supplemental remedy to stand alongside an express remedy in those circumstances where the cumulative remedy provides a result which is proscribed by the express remedy.

And a good example is the limitations period. We can -- a plaintiff cannot both sue under section 11 and be forced to comply with the limitations period provided by section 13 of the 1933 Act and also sue under 10(b)5 and have recourse to the longer limitations period provided by that kind of action. The court must select one or the other. And it seems to me that in a situation such as this, where Congress has spoken, the court is obligated to respect what Congress has said.

Now, the Commission and the plaintiffs point

out the fact that there are preservations or remedies clauses in the 1933 and 1934 Acts. And indeed there are. Those provisions, however, do not imply the existence of an implied federal remedy. Section 16 of the 1933 Act was enacted at a time when there was no doctrine of implied federal securities laws remedies. It was enacted before the Securities Act of 1934 was enacted. Therefore, it could not have been enacted in contemplation of a 10(b)5 cause of action.

That provision seems to me clearly to contemplate the survival state common law remedies. And I think that that fact is borne out by the existence of section 22 of the 1933 Act. Section 22 provides that actions may be brought either in the state court or in the federal court and further provides that if brought in the state court such actions may not be removed to the federal court.

The '34 Act, section 27 of the '34 Act, provides exactly the opposite. It provides that actions brought under the 1934 Act may be brought only in the federal courts. The federal courts have exclusive jurisdiction over such actions. That --

QUESTION: Mr. Truitt, may I ask, under your view, what remedy you think a defrauded purchaser of registered securities would have? Does that person have

a 10(b)5 implied action, do you think, or only if he doesn't have a section 11 remedy, or what?

MR. TRUITT: A purchaser who alleges to have been defrauded in connection with the purchase of registered securities --

QUESTION: Yes.

MR. TRUITT: -- may sue under section 11. Now, section 11 is a fraud statute. Under some circumstances a defendant can avoid liability by showing that he did not act negligently. But the plaintiff must first show fraud at least to the degree that fraud is defined as there being something false or misleading about the registration statement.

Now, as to certain people, negligence is not the standard. For example, as to a director who is trying to avoid, or an underwriter who is trying to avoid, liability with respect to something appearing in the financial statements, he is not required to show negligence or he is not required to disprove negligence. He is required only to disprove that he did not act either recklessly or intentionally. So that the notion that section 13 is a negligence statute and therefore constitutes a different sort of animal from 10(b)5 is, I think, an erroneous notion. They are both fraud statutes. They contemplate different schemes and

under some circumstances a proof that a person has not been either negligent nor behaved intentionally will provide a defense, but it's nevertheless a fraud statute.

Now, if a person finds himself outside the scope of that statute because the limitations period has run or he wants to sue the attorney for the underwriters or for any of a number of other reasons, such a person may still sue in state courts. And that is why the preservation of remedies language is there. And that is why the '33 Act provides that actions alleging liability under section 11 may be brought in the state courts and, if brought in the state courts, must be maintained in the state courts.

The argument has been made that it would be wrong not to permit recovery under section 10(b) because of the fact that the Congress intended the securities laws, and particularly the '34 Act, to be complete and effective. The Commission has cited in support of that proposition section 2 of the 1934 Act.

If it please the Court, I will reserve the remainder of my time, unless there are questions, for rebuttal.

CHIEF JUSTICE BURGER: Very well.

Mr. Jaffe.

ORAL ARGUMENT OF ROBERT H. JAFFE, ESQ.,

ON BEHALF OF THE RESPONDENTS

MR. JAFFE: Mr. Chief Justice, and may it please the Court:

The first issue before the Court today as framed by cross-petitioner Herman & MacLean is suggested in footnote 15 of this Court's decision in Blue Chip Stamps v. Manor Drug Stores for the implied action under section 10(b) of the 1934 Act and in Rule 10(b)5 lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act, the civil remedy provisions being section 11 and section 12(ii). Section 12(i) for unregistered securities is not involved here.

The important fact here in -- and certainly it becomes more important fact in view of some of the comments made by counsel -- is that the fraud committed by Herman & MacLean was for actions that for the most part are not covered by the express provisions of section 11 of the 1933 Act as they pertain to an expert accountant such as Herman & MacLean, named as an expert in a prospectus; the name in a limited way only consented to a certain portion of the prospectus or the registration statement as being expertised.

This distinction is highlighted by the unique circumstances of this case. Unlike most other cases

recently decided by this Court dealing with the scope of section 10(b) and Rule 10(b)5, cases such as Hochfelder, Blue Chip Stamps, and Santa Fe Industries, where the facts or allegations of fraud were based on pleadings made in a complaint, this case that comes before you after a jury, a trial judge, a somewhat maligned trial judge here, and the Fifth Circuit had determined Herman & MacLean had violated Rule 10(b)5 and that the trial record justified the finding in Scienter for a course of conduct intended to deceive purchasers of securities which would meet a clear and convincing standard of proof.

I call attention to the Court that footnote 13 to the decision of Judge Reuben below -- I don't have to read it precisely; it is the "smoking gun" letter, which is found in the appendix at 257(a), the letter dated May 20, 1969, in which Herman & MacLean states, "We have calculated the expenses from the figures given to us and the contracts and the other information obtained. And it would appear that the total cost for building the speedway and for the initial cost to bring it into operation would be $488,000 above that which would be available from the sale of the issue and apart from mortgage financing."

Then there is immediate Larry's House, Larry

Lopatin, president of TIS. Rare, after that meeting there is another letter that comes out. The letter is also found in the appendix at 267(a), June 9, 1969, for Herman & MacLean indicates that a reduced cost as a consequence of that meeting. Again, as found by the court below, found by Judge Reuben after reviewing the whole trial record, the costs that were parred from the preparer of the use of proceeds section, Herman & MacLean, were costs which in fact had been contracted for prior to the date of his letter, June 9, 1969.

So what we have here is clear evidence according to the jury, according to the trial judge, and according to the Fifth Circuit review of the whole record, that the evidence against Herman & MacLean was not just a possible gross negligence but of the type of evidence that would meet a clear and convincing standard of fraud.

QUESTION: Counsel, do you think that the Court of Appeals held that the clear and convincing standard applied to proof of knowledge or Scienter only or to proof of all the elements of the 10(b) --

MR. JAFFE: Justice O'Connor, that's a good question because I don't know the answer. This was a sua sponte decision by the Fifth Circuit. It was never raised by any party. I in reading the decision cannot

answer that question. I don't know what's going to happen if we get down to -- if the clear and convincing standard is upheld by this Court as being the standard in a civil fraud action.

As to whether that's going to apply to the element of materiality, whether it's going to apply to the element of reliance, whether it's going to apply to the element of causation, how are they going to break it down? It would seem to me that it seems to apply across the board as to each particular element, as it's phrased in the Fifth Circuit's decision. But I really don't know what the answer would be, and I imagine if this Court upheld that standard, it's going to have to be explored on a case-by-case basis.

QUESTION: Well, isn't the common law standard of clear and convincing evidence in an action for civil fraud across the board as to all the elements with respect to which the plaintiff bears the burden of proof?

MR. JAFFE: Well, Your Honor, I think it differs from state to state. I know my state -- I come really from New Jersey, not Texas -- it's -- it's a preponderance standard, for sure.

QUESTION: Oh, but in those states where there is a clear and convincing standard, isn't it all elements, just as I presume in New Jersey it's all

elements --

MR. JAFFE: I think it would be all elements, Your Honor. And to deal with that very quickly, we have -- and I don't want to deal with it quickly; this is really important -- we might have met it in this case, according to the Fifth Circuit, but it's going to put a very big burden under the securities laws if that's applied to all 10(b)5 cases.

What is at risk here is money damages. That was what was at risk here, and we've talked about it being a lot of money damages. But the fact remains it's still money damages. Herman & MacLean was never required to not practice in front of the SEC, not required to limit their activities, were not enjoined in any way, and the approbrium which they attach to this decision that meeting the clear and convincing standard does not seem to comport with the other decisions of this Court which would find only in special circumstances -- deportation hearings, confinement to a mental institution. I don't think it comes to that.

QUESTION: But, Mr. Jaffe, this is a question that might just as well be put to your opponent as to you and perhaps is not proper in light of some of our Court's decisions. But how many juries do you think would reach a different result if they're charged that

you have to find by clear and convincing evidence as opposed to a preponderance?

MR. JAFFE: Well, I think they would. I think juries pay attention to the charges of the court. And one of the things at every trial is the judge makes very clear even when they pick out the jurors, are you going to pick out -- are you going to follow the directions of this court? I remember in this case there was one juror that says, any director that's involved in fraud I would find liable, and then the judge said, well, it might be a difference of culpability under the controlling person standard, and you are dismissed. He dismissed that person from the jury.

I think the jury has to follow the law. The jury is explained properly the differences between clear and convincing and preponderance of the evidence, they're going to follow it. This jury, I felt, was a very good jury, a discerning jury which made decisions between culpability as to the various defendants here.

QUESTION: Do you think your feeling is certainly understandable in view of their verdict?

(Laughter.)

MR. JAFFE: Some of them, Your Honor, they found were not culpable under the Scienter standard, although we had an action -- we had an action; we don't

anymore -- under the Texas Securities Act, which follows the section 11 as the negligence standard. We chose to go for the Scienter standard as to both on the basis that if there was such a finding, we would then get damages for attorney's fees, which we felt would come under the Texas Securities Act. So I do think there's a big difference.

The findings of fraud with Scienter which Herman & MacLean admits, indeed advocates, in its reply brief, are not covered by the express liability provisions of section 11 of the 1933 Act. Conscious of these findings made by the lower courts as the Scienter, Herman & MacLean has resorted to the defense of no writ, no right.

There was one part of the reply brief which -- in which Herman & MacLean mention in the reply brief that -- that no purchaser -- this is found at page 7 of the reply brief -- no purchaser of the securities, certainly Mr. Huddleston, Mr. Bradley, had any basis from a reading of the prospectus for relying on Herman & MacLean for the accuracy of estimated costs of construction.

I agree that when you look at the prospectus you would not know as a purchaser that it was Herman & MacLean, as we proved during trial, who was the party

essentially responsible for the use of proceeds section for putting together the construction figures, because as part of the fraud, an essential part of the fraud found by the jury in the answers to special interrogatories to be in essence of the fraud, was that they got the engineers to give a comfort letter, which everybody connected with the prospectus knew was untrue, that they had calculated the estimated costs remaining and had found it to be accurate.

They never did, and they knew this to be fact. And this was again what was picked up by Judge Reuben. They refused to give comfort concerning the construction costs, Herman & MacLean in its comfort letter, October 30, 1969, because they knew. This was one of the reasons why the court below found clear and convincing evidence of their participation in the fraud.

And also, may I say, it is Herman & MacLean, there is an administrative process, Herman & MacLean is the one that responds to the letters of comment, which the Securities and Exchange Commission send in respect to these registration statements. And that would be found, for example, there was a letter of the Securities and Exchange Commission found at 284 of the appendix, asking for updated financial statements.

The person that responds to this information

is Herman & MacLean, and they convinced -- well, they certainly do not put the information requested by the Securities Commission, because if they had done so, the fraud would have been revealed. The material adverse financial information regarding the construction of the speedway would have been revealed. It would have been disclosed.

So Herman & MacLean was definitely a direct participant as found by the jury, as found by the trial court. And yet these are areas outside of section 11 because the use of proceeds section does not come under the liability area of the section 11.

I know that -- I believe, I hope -- that a chart was handed up to the Court as to the differences between the two causes of action. And regarding persons subject to liability under section 11, it's a narrow class of persons who have a direct role, the registered offering including experts only -- we use the word "expertised" -- portion of the registration statement.

To that portion of the registration statement to which they gave their consent to affix the name. In this case, it was the certified statement for the year ending May 30, 1969. They did not give their consent, they claimed during trial. And indeed, I had an expert accountant testify who would not ordinarly view the

case, to the pro forma balance sheet which purported to show the effect of the issue, purported to show when the issue was sold and the moneys collected, there would be $93,000 of working capital and there would also be $278,000 of moneys reserved, cash reserved to meet the expenses to the opening day.

In fact, there was half a million dollars' deficit in the working capital position of TIS the day they received the proceeds of the issue.

QUESTION: Well, is the question with respect to those defendants who are subject to liability under section 11, is the question whether Congress intended their liability under that section to be exclusive? Is that the question?

MR. JAFFE: I think that's the question which is being put. My clients are saying, since Congress did not provide this class of person would be liable for fraud, of the type of fraud found by the jury here, he is exempt, he can get away with it. He can commit fraud with impunity.

QUESTION: So you are saying that's just a reason for saying Congress didn't intend their liability to be exclusive under that section?

MR. JAFFE: Yes, Your Honor. I don't think they intended the liability to be exclusive under that

section. I think Congress intended that when the Commission was --

QUESTION: Well, why provide for it at all?

MR. JAFFE: What's that, Your Honor?

QUESTION: Why have section 11 at all?

MR. JAFFE: Because it's a very strict liability section for negligence. Now, where a person states in the prospectus, I am, you can rely upon me as an expert, and he makes a gross mistake without intent, and that's the whole point --

QUESTION: He is stuck?

MR. JAFFE: He is stuck.

QUESTION: Not so under another section?

MR. JAFFE: No, Your Honor, not under -- there's no other section providing for negligence standard. Certainly, 10(b)5 is not a negligence standard.

QUESTION: Yes.

MR. JAFFE: Before you can catch in that catch-all section of the 1934 Act --

QUESTION: He has got to be more than negligent?

MR. JAFFE: A lot more than negligent, Your Honor. It has to be, I think, a proof that can meet rule 9(b) first in the pleading before you even get near

trial. The court is now uniformly looking at Rule 9(b) to plead fraud with particularity, particularly in securities cases, as the key way to knock out these strike and nuisance suits. And I think that's a -- that is the kind of procedure limitation which you are not going to have in a section 11.

Section 11, you'll say, look, there was a mistake, gross mistake, it's material. And now they have to come in and defend,justify; they have to come in and prove their due diligence, show the chart that they followed through, making sure they did everything.

It's not so in a 10(b)5 action. 10(b)5 action to allege fraud, that court's going to say, particularlity. In fact, there's a second part of that 10(b) which says you can aver malice or intent with generality, but the courts, I think, are looking at the particularization of fraud even through the intent portion.

The second line of offense, Herman & MacLean argues that this Court allows a private right of action under Rule 10(b)5 with respect to a fraud involving preparation and delivery of a false and misleading prospectus. It would nullify the procedure restrictions, i.e., bring in those procedural restrictions then on 10(b)5.

Well, it's forgotten one of the procedure restrictions is the posting of a bond. But that bond was posted for two purposes, not only to prevent blackmail suits but to prevent defense against the purely contentious litigation on the part of the defendant. So I think that that type of restriction would cut two ways.

Very briefly, as to the statute of limitations again, this Court has looked at the statute of limitations question and in the sense of one of the footnotes in Hochfelder saying that the state statute of limitations apply. It well may be that this Court believes some additional procedural limitations may be applicable to 10(b)5. But it has not so ruled, and I think the plaintiffs have been under Rule 10(b)5, have appropriately been following the decision of the Court.

If Congress wanted to have a limitation, as they did in another situation in the 1934 Act, in 1938 they amended a certain provision under 15(c)1 to provide for a 1-year and 3-year statute of limitations. They could have done so. They have not done so. It seems they have acquiesced in the decision of the courts to allow a statute of limitations under 10(b)5 relating to the fraud, generally fraud, statute of the forum state.

In short, I believe that this Court should

rule that in this -- this case is the -- the facts of this case bring out the need not to have one remedy exclude the other, but for the kind of relief which Hochfelder saw would be appropriate, but in Scienter, when an accountant acts under Scienter in connection with false and misleading prospectus he can held liable under 10(b)5.

They also say that this case again is a good case. It's money damages. Herman & MacLean has not alleged in any way they're prevented from making a living then of going -- they don't have to participate in the fraud in the prospectus.

They have that choice. They don't have to. And if they don't want to participate in the fraud, instead of not giving a comfort letter, what they could -- or of excluding -- rather, giving a comfort letter, excluding the question of construction, they said, they should have said, let's not go forward with this issue, we can't give you the comfort because we know that those costs have greatly exceeded that in the prospectus; therefore, let us revise the prospectus, be sure it sets forth the accurate figures. And then they would have been free of any liability. Thank you.

CHIEF JUSTICE BURGER: Mr. Gonson.

ORAL ARGUMENT OF PAUL GONSON, ESQ.,

ON BEHALF OF AMICUS CURIAE

MR. GONSON: Mr. Chief Justice, and may it please the Court:

In the Hochfelder case, the accountants there urged that they should not be liable under section 10(b) for mere negligence. This Court agreed and held that Scienter was required, becomes here have been found by a jury to have acted with Scienter. They ask this Court that they should not be held liable under section 10(b) because section 11 provides for liability for negligence. And they also argue that their conduct is not covered under section 11.

Their argument is that Congress intended the section 11 be the exclusive remedy for false statements in a registered securities offering even where the victims of that falsity cannot recover because section 11 does not apply to the persons or the conduct involved.

I will develop two responses. First, the Congress intended in 1975 when it comprehensively amended the Securities and Exchange Act to continue the section 10(b) remedy, including its cumulative nature, and that the accountants have not carried their burden of demonstrating that Congress intended to carve out from that 10(b)5 remedy protection for buyers for securities and registered offerings.

Second, that the section 11 and 10(b) remedies are very much different. And an analysis of those differences demonstrates Congress' intent that they should coexist.

The central inquiry, we agree, as asked by Justice White, is legislative intent. And this Court noted in the Curran case that the inquiry logically differs depending upon whether a court is considering new legislation or legislation that Congress amended following its enactment.

We point out in our brief that the Securities Acts have been amended on a number of occasions; the Securities Exchange Act in 1964, 1975, and 1977. I will focus on 1975 because in that year Congress comprehensively examined and strengthened the Securities and Exchange Act. It added 55 provisions to that Act, amended 47 provisions, and left 85 provisions unchanged.

It established a new national market system, a new system to clear and settle transactions in securities, and a new system bringing municipal securities dealers under federal regulation, greatly strengthen SEC regulatory authority over securities brokers and securities exchanges. It strengthened the remedies available for SEC enforcement, but no new private remedies were added, nor were any changes made

in the express private remedies, nor was section 10(b) touched.

Now, there can be no doubt that in 1975 the consensus of judicial opinion regarding the availability of the section 10(b) private action was older and even more overwhelming than the development of the implied private action under the Commodity Exchange Act that was upheld in Curran.

The extensive section 10(b) case law included many federal court decisions holding that a section 10(b) remedy was available even though the conduct may have been covered by express remedy, including courts of appeals decisions from six circuits. In addition, there were a great many decisions allowing recovery under section 10(b) without any discussion at all of whether an express remedy would apply, although from the facts of those cases it appears that such express remedies probably would have applied, again establishing the widespread acceptance of the cumulative nature of the 10(b) remedy.

Congress was also presumably aware in 1975 of this Court's statement in 1969 in the National Securities case that section 10(b) was the most litigated provision of the federal securities laws and that some overlap in section 10(b) with other sections

is neither unusual nor inappropriate.

So thus for the same reasons that Congress' reexamination and amendment of the securities laws serves to ratify the existence of a private right of action generally under section 10(b), it serves also to ratify conspicuous and a uniformly accepted characteristic of that right of action in 1975, its cumulative and supplemental nature.

Indeed, the argument for the cumulative nature of the 10(b) remedy is a fortiori from Curran. There this Court held that new remedies added in 1974 to the Commodities Exchange Act, arbitration and reparations, were limited and narrow in scope. It did not substitute for the implied remedy either as a means of compensating injured traders or as a means of enforcing compliance with the statute.

As mentioned, Congress created no new remedies in the Securities Exchange Act of 1975, adding strength to the presumption that it intended to continue the cumulative nature of the 10(b)5 remedy very well established in the case law.

In addition to legislative ratification applying to the cumulative nature of the 10(b)5 remedy, there is no evidence that Congress intended section 11 to be the exclusive remedy for investors defrauded in a

registered securities offering. In section 16 of the Securities Act Congress stated the rights and remedies in that Act shall be in addition to any and all other rights which may exist in law and equity. And there is a similar provision in the Securities and Exchange Act.

Beyond that, Congress declared the purpose in section 2 of the Securities and Exchange Act to impose requirements necessary to securities regulation and control reasonably complete and effective. This comported with President Roosevelt's call for securities legislation with teeth in it.

And now to the comparison of the section 11 and 10(b)5 remedies. Section 11 is a remedy which, while detailed, is quite narrow in what it covers. As has already been pointed out, it reaches a list of direct participants in an offering for registering -- for misstatements in a registration statement. It doesn't reach others who may have played a role in the alleged fraud, such as, in this very case, accountants other than with respect to what we now refer to as the expertised portion of the document.

To the extent section 11 does apply, it greatly expands liability imposed in common law. It does not require proof of fraud. In Ultramares, for example, cited by this Court in its Hochfelder decision,

Judge Cardozo, writing for the New York Cour of Appeals, held that accountants owed a duty to investors to make their certificates without fraud but did not owe a duty to investors to make that certificate without negligence.

But section 11 creates a duty on accountants running to investors to make their certificate without negligence. And section 11 doesn't require proof of reliance or causation. 10(b) is more like the common law, requiring Scienter, causation, and reliance. And not only in 10(b) must the plaintiff prove Scienter, but he has the burden of proving Scienter.

In a section 11 action the defendant has the burden of showing absence for negligence. As the Second Circuit pointed out in Ross v. Robbins, cited in our brief, there is often a failure of proof and the party who has the burden then, of course, loses.

Now, because this remedy under section 11 favored plaintiffs so substantially, Congress did not extend this remedy to all conduct or to all persons. And moreover, to prevent abuse of the remedy, Congress provided for costs, attorney's fees in some cases, and a short statute of limitations. That, in a sense, is the trade-off.

Our point is that because 10(b) is a different remedy and a more difficult one to sustain, if the

plaintiff is able to sustain it and proves fraud and the other components of the remedy, then he ought to be entitled to the remedy. And there is no reason to give the defendants the trade-off advantages of the short statute, security for costs and so on that are found in section 11.

Indeed, more than 30 years ago Fishman v. Raytheon pointed out that the recognition that section 10(b) as a different remedy provided the classical reconciliation of the express and the implied remedies. Fishman was noted by this Court in Hochfelder where this Court's holding that Scienter is required under section 10(b) rested, in part, on the premise that the 10(b) remedy is cumulative of the express remedies in the Securities Act.

As this Court noted in Hochfelder, precisely because conduct which is actionable under sections 11 and 12(2) also is actionable under section 10(b). Adoption of the negligence standard under10(b), as was urged in that case, would "allow causes of action covered by sections 11 and 12(2) to be brought instead under section 10(b) and thereby nullify the efectiveness of the carefully drawn procedural restrictions on those express actions. So this overlap provided a reason for a higher culpability standard under section 10(b).

I close on the point I opened with: The defendant is an accounting firm. It is one of the persons who can be sued under section 11, but only as an expert, where their conduct is alleged to have gone -- to go much beyond that. Mr. Truitt referred to allegations. The jury found that. There should not -- it is difficult to impute to Congress an intention that the law in some cases should provide a remedy for negligence --

QUESTION: What time is it now, Mr. Gonson?

MR. GONSON: Thank you, Your Honor.

CHIEF JUSTICE BURGER: Do you have anything further, Mr. Truitt?

MR. TRUITT: Yes, Your Honor.

CHIEF JUSTICE BURGER: You have three minutes.

ORAL ARGUMENT OF MR. JAMES L. TRUITT, ESQ.,
ON BEHALF OF THE PETITIONER -- REBUTTAL

MR. TRUITT: Thank you. I want to address myself first to the what I understand to be the line of argument that this Court in Hochfelder has approved the holding in Fishman. I think that's not true. I think this Court in the Hochfelder case assumed the possibility that the Fishman analysis was correct and the possibility that there were overlapping remedies. I think it's important to note that in that place in the

Hochfelder opinion where the language is found to which counsel refers, the Court cites not only the Fishman case, which holds that there is an overlapping remedy, it also cites the Rosenberg case, which holds that there is not.

I think it's clearly the case because of the fact that the Court has left open the implied remedy issue, not only where the overlap is between 10(b)5 and 11 but also in other situations where the overlap is between 10(b)5 and section 18 of the '34 Act. It is important to note that the Court has left that issue open. I don't think it's appropriate to say that the Court held in Hochfelder that the implied remedies, that overlapping remedies are to be permitted.

Now, if I can address my attention just for a moment to the legislative renactment line of argument. It seems to me that that line of argument, in effect, reverses the role of Congress and the courts. It assumes first that it is the function of this Court to enact legislation to establish remedies. That is the function of Congress, and where Congress has enacted legislation, to establish remedies, and where it has said that a person may be liable in them circumstances and not in those, it's not appropriate for the Court through exercising a trade-off or in any other fashion

to override those limitations established by Congress.

Even more importantly for the legislative renactment argument, it assumes that it is the function of the Congress to monitor the rulings of the lower federal courts and where those rulings are incorrect, to reverse them by means of amendatory legislation. That's not the function of Congress; that's the function of the courts of appeals and of this Court.

One other serious problem with the legislative reenactment doctrine is that it applies only in those circumstances where the holding in question does not bear the weight of legal analysis. If the holding in question bore the weight of legal analysis, it would not be necessary to make reference to legislative reenactment as providing some sort of independent support. One could look simply at the holding under question and hold that that -- that that is correct.

Thirdly, I think that there is a distinction which is sometimes missed between awareness of a holding and ratification of that holding. For example, the Commission points to the enactment of 21(g) of the 1934 Act which provides that an implied cause of action may not be consolidated or -- excuse me, not an implied cause of action -- that a private action whether implied or express may not be consolidated with a Commission

action in the absence of the consent by the Commission.

Now, indeed, that statute does indicate an awareness but, I submit, does not indicate an approval. Thank you.

CHIEF JUSTICE BURGER: Thank you, gentlemen.

The case is submitted.

(Whereupon, at 2:43 p.m., the case in the above-entitled matter was submitted.)

# CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:

HERMAN & MacLEAN v. RALPH E. HUDDLESTON ET AL.; and RALPH E. HUDDLESTON ET AL., v. HERMAN & MacLEAN ET AL # 81-680 & 81-1076

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BY Pirie Hammond

(REPORTER)