

Don't Allege Fraud In A Federal Securities PPM Claim Unless Scienter is an Element

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A Federal District Court in the Northern District of Illinois issued an unforgiving dismissal of a Federal securities law complaint earlier this year. The interesting twist to the case is that the Plaintiffs' 12(a)(2) 1933 Act claim was dismissed pursuant to Rule 9(b), even though such claims lack a fraud element. The Court acknowledged that Rule 9(b) actually applies to allegations rather than claims, but concluded it's rightful application to the Plaintiff's allegations rendered insufficient both the 12(a) and 10(b) claims once the fraud allegations were stricken for lack of specificity. The opinion's review of the Plaintiff's allegations, however, seems to undermine itself, at least as to the 12(a)(2) claim. The Plaintiff's undoubtedly pled that the Private Placement Memorandum at issue omitted to state a material fact, particularly when the Rule 12(b)(a) reasonable inference is applied. As such, the conclusion that the 12(a)(2) claim fails when stripped of the unnecessary scienter accusations is at least harsh if not incorrect. This is particularly true when coupled with the Court's concession that another district court in the Northern District held that "a Plaintiff should not be required to plead what it need not prove" just the year before.

Regardless, the Court's opinion clearly indicates that it was dissatisfied with what it considered insufficient allegations of motive, which are almost impossible to specify prior to discovery in arms-length transactions. For example, in this case, the Plaintiffs alleged that the Defendants from Advanced Equities, Inc. stated to the Plaintiffs that they were "significantly involved" for several months with the company whose shares they were promoting and yet the initial PPM issued by the Defendants omitted the fact that the company founder had a felony conviction for embezzlement. A supplemental PPM issued about 12 weeks after the first PPM and only five weeks after the Plaintiffs invested almost \$2,000,000 made belated disclosures of material obligations, litigation, and mismanagement. Whether or not the Defendants knew of the material issues prior to their issuance of the first PPM is irrelevant for §12(a)(2) liability, but since the Plaintiffs chose to allege that the Defendants did know and that their representations were fraudulent, they lost the entire claim for lack of specificity as to these allegations. The Court even dinged the Plaintiffs for failing to identify which of the two officer-Defendants made which representations and omissions within the Placement Memorandum. How any outside stock purchaser would be able to know that pre-discovery is a mystery the opinion fails to solve.

In sum, attorneys must be very careful not to plead too little – or too much – in certain courtrooms of the Northern District. The case is *Greer v. Advanced Equities, Inc.* and can be reviewed by clicking

[here](#).

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