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**WHEN MAY A LITIGANT RELY IN ITS OWN COMPLAINT  
ON ALLEGATIONS FROM ANOTHER COMPLAINT?—  
*LIPSKY V. COMMONWEALTH UNITED CORP.* AND ITS  
PROGENY – STILL AN UNRESOLVED QUESTION**

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**INTRODUCTION**

Since the Second Circuit decided *Lipsky v. Commonwealth United Corp.*<sup>1</sup> in 1976, district courts within the Second Circuit have differed regarding the extent to which a plaintiff, in making its own allegations, may refer to or rely on the allegations contained within a complaint filed by someone else. Some courts interpret *Lipsky* as articulating a bright line rule that precludes any reliance on other pleadings, on the theory that someone else's allegations are just that, unproven assertions that have not been tested and factually confirmed, and thus, cannot support another's pleading. Others have interpreted *Lipsky* as not precluding such reliance, at least in some circumstanc-

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<sup>1</sup> 551 F.2d 887 (2d Cir. 1976).

es. Still others have stated views regarding their interpretation of *Lipsky*, but resolved the cases before them under Rule 11. Recently, several courts, though mentioning Rule 11 and/or *Lipsky*, seem to be applying a standard rooted in the court's assessment of the apparent "plausibility" of the information in the foreign pleading's text. The cases are very much in conflict.

Part I discusses *Lipsky*, its assumptions and cases interpreting it as articulating a bright line test, precluding reference to or use of pleading content from other cases as the basis for one's own pleading. Part II discusses cases rejecting the bright line interpretation, and holding that *Lipsky* does not preclude reference to other pleadings, at least in some circumstances. Part III discusses cases that adopt an approach relying on Rule 11 and the concept of "reasonable investigation." Part III also discusses cases employing what amounts to a "plausibility" approach, in which the reviewing court tries to discern the likelihood that the allegations of a pleading in a different case are sufficiently "factual" to justify a pleader's reliance upon them in its own complaint. The authors conclude that, on balance, the majority, bright-line interpretation of *Lipsky* is the best among competing interpretive approaches.

## I. *LIPSKY'S ASSUMPTIONS AND THE BRIGHT LINE RULE CASES*

### A. *Lipsky and the Basis for its Ruling*

The Second Circuit, in *Lipsky*, addressed whether a plaintiff could rely in his complaint on a U.S. Securities and Exchange Commission ("SEC") complaint.<sup>2</sup> Bobby Darin's (a/k/a Walden Cassotto) Estate brought a claim for rescission of a stock purchase agreement based on material breach, contending that Commonwealth United Corporation ("CUC") failed to use its best efforts to cause its registration statement to become effective for shares it sold to Darin.<sup>3</sup> The Estate's complaint referenced paragraphs from (and attached) the SEC's civil complaint against CUC objecting to CUC's registration statement for other stock based on allegedly material omissions and

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<sup>2</sup> *Id.* at 891.

<sup>3</sup> *Id.* at 890.

misleading statements.<sup>4</sup> The SEC complaint had resulted in a consent judgment.<sup>5</sup> The plaintiff did not “dispute that the consent judgment, itself, or that the SEC complaint was inadmissible,” but it defended the materiality of those allegations to its pleading on the ground that the SEC’s position on CUC’s statements was relevant to whether CUC used its “best efforts” to register Darin’s stock.<sup>6</sup> CUC contended the consent judgment was inadmissible and, therefore, *a fortiori*, the SEC complaint was immaterial.<sup>7</sup> The district court struck those allegations from the Estate’s complaint pursuant to FRCP 12(f), without opinion.<sup>8</sup>

Rule 12(f) permits the court to strike from a pleading any immaterial matter. However, “[i]n deciding whether to strike a Rule 12(f) motion on the ground that the matter is impertinent and immaterial, it is settled that the motion will be denied, unless it can be shown that no evidence in support of the allegation would be admissible.”<sup>9</sup> The Second Circuit held that although the SEC complaint resulted in a consent judgment, that judgment was not the result of an actual adjudication of any of the issues and, therefore, could not be evidence in the litigation at bar.<sup>10</sup> The Court saw no relevant distinction, for Rule 12(f) purposes, between the SEC consent judgment, which was inadmissible (expressing the view that it could have “no possible bearing on the Darin action”), and the SEC complaint, which preceded the consent judgment.<sup>11</sup>

For that reason, *Lipsky* held the SEC complaint could not be

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<sup>4</sup> *Id.* at 890-91.

<sup>5</sup> *Id.* at 892.

<sup>6</sup> *Lipsky*, 551 F.2d at 893.

<sup>7</sup> *Id.* at 893.

<sup>8</sup> *Id.* at 892-93.

<sup>9</sup> *Id.* at 893.

<sup>10</sup> *Id.* at 893-94. The *Lipsky* court made clear that it viewed the issues in the case as *evidentiary*, stating as part of the preface to its analysis:

Evidentiary questions, such as the one present in this case, should especially be avoided at such a preliminary stage of the proceedings. Usually the questions of relevancy and admissibility in general require the context of an ongoing and unfolding trial in which to be properly decided. And ordinarily neither a district court nor an appellate court should decide to strike a portion of the complaint on the grounds that the material could not possibly be relevant on the sterile field of the pleadings alone.

*Lipsky*, 551 F.2d at 893-94.

<sup>11</sup> *Id.* at 894

properly cited or referenced in the pleading before the district court.<sup>12</sup> The Second Circuit held:

This is a consent judgment between a federal agency and a private corporation[,] which is not the result of an actual adjudication of any of the issues. Consequently, it can not [sic] be used as evidence in subsequent litigation between that corporation and another party. Fed. Rules Evid., Rule 410, 28 U.S.C.A., prohibits a plea of nolo contendere from being later used against the party who so pleaded. . . . The reason for this equivalence is that both consent decrees and pleas of nolo contendere are not true adjudications of the underlying issues; a prior judgment can only be introduced in a later trial for collateral estoppel purposes if the issues sought to be precluded were actually adjudicated in the prior trial. . . . *The consent decree entered into by the SEC and CUC was the result of private bargaining, and there was no hearing or rulings or any form of decision on the merits by the district court.*

*Since it is clear that the SEC-CUC consent judgment, itself, can have no possible bearing on the Darin action, the SEC complaint which preceded the consent judgment is also immaterial, for the purposes of Rule 12(f).*

We agree that the SEC's opinion on the sufficiency of the various statements may be relevant and may be admissible. But we do not agree that it necessarily follows that its complaint is appropriately within the pleadings.<sup>13</sup>

Because Darin's estate was making allegations unnecessary to its pleading of its claim for rescission due to breach, the Second Circuit concluded its allegations were inadmissible. Faced with an appeal from an order striking the allegations (without decision), and failing to see "how Darin is harmed by the elimination of the SEC

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 893-94 (emphasis added) (citations and footnotes omitted).

references,”<sup>14</sup> it affirmed the order. Although the *Lipsky* Court explained that the SEC complaint might be relevant to the question whether CUC used best efforts, “neither a complaint nor references to a complaint which results in a consent judgment may properly be cited in the pleadings under the facts of this case.”<sup>15</sup>

### B. *Lipsky and Cases Following a Bright Line Rule*

Since *Lipsky*, a majority of cases within the Second Circuit have held that where a complaint’s allegations are either based on or rely upon complaints in other actions that have been dismissed or settled *or are otherwise not resolved*, they must be immaterial under Rule 12(f).

In *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*,<sup>16</sup> for example, allegations in a class action securities complaint were stricken because they referred to or relied upon, *inter alia*, unresolved SEC complaints against the same parties. The court dismissed the complaint with leave to replead, cautioning the plaintiffs not to include such allegations, stating Second Circuit law was clear “that references to preliminary steps in litigations and administrative proceedings that did not result in an adjudication on the merits or legal or permissible findings of fact are, as a matter of law, immaterial under Rule 12(f).”<sup>17</sup> In support of its holding, the court cited, among other cases, *Lipsky*,<sup>18</sup> *U.S. v. Gilbert*,<sup>19</sup> and *Brotman v. Nat’l Life Ins.*

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<sup>14</sup> *Lipsky*, 551 F.2d at 893-94.

<sup>15</sup> *Id.* at 893.

<sup>16</sup> 218 F.R.D. 76 (S.D.N.Y. 2003).

<sup>17</sup> *Id.* at 78.

<sup>18</sup> *Id.* (citing *Lipsky*, 551 F.2d at 892–94) (observing that *Lipsky* had likened a consent decree between defendants and the SEC in a separate action to a plea of *nolo contendere*, and citing Fed. R. Evid. 410, which declares *nolo* pleas inadmissible, to hold that the consent decree and the SEC complaint which preceded it were both immaterial under Rule 12(f) and could not be used to prove liability).

<sup>19</sup> *Id.* at 78-79 (citing *Gilbert*, 668 F.2d 94, 97 (2d Cir. 1981) and observing that *Gilbert* had reasoned:

[T]hat a consent decree was more appropriately likened to the settlement of a civil suit than to a *nolo contendere* plea, so the governing Rule of Evidence was 408, not 410, but preserving *Lipsky*’s holding that if an SEC complaint did not result or has not yet resulted in an adjudication on the merits, a plaintiff may not cite the complaint to prove underlying facts of liability.)

*Merrill Lynch*, 218 F.R.D. 78-79.

Co.<sup>20</sup> The court continued:

Similarly, references to an Attorney General's conclusory report following a preliminary investigation in a case that never was presented for nor reached an adjudication upon the merits, are also immaterial under Rule 12(f). See *Ledford v. Rapid-American Corp.*, No. 86 Civ. 9116, 1988 WL 3428, at \*1–2 (S.D.N.Y. Jan. 8, 1988) (Keenan, J.) (relying on *Lipsky* and striking allegations in a complaint that referred to an investigation and report by the New York State Division of Human Rights which was a non-adjudicative step in the administrative proceeding where there had been no findings of fact); *Shahzad v. H.J. Meyers & Co., Inc.*, No. 95 Civ. 6196(DAB), 1997 WL 47817, at \*13–14 (S.D.N.Y. Feb. 6, 1997) (Batts, J.) (striking the affidavit of an SEC investigator filed in a separate action as unrelated and serving no purpose in the present case other than to inflame the reader).

. . . [T]he allegations of the present Amended Complaint contained in paragraphs . . . that refer to or rely on the SEC's complaints against Merrill Lynch and Henry Blodget, on the NASD's complaint against Phua Young, on the 309 complaints in the ongoing IPO Securities Litigation, on the complaint and appendices in the ongoing IPO Antitrust Litigation, and on the Dinallo Affidavit are hereby stricken under Rule 12(f) and may not be included in any amended pleadings hereafter.<sup>21</sup>

In *RSM Prod. Corp. v. Fridman*,<sup>22</sup> the court held that the reference to the two complaints setting forth claims not resolved on the merits was improper.<sup>23</sup> *RSM* quoted *Merrill Lynch* in striking the complaints as immaterial, as a matter of law,<sup>24</sup> dismissing the plead-

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<sup>20</sup> *Id.* at 79 (citing *Bratmen v. Nat'l Life Ins. Comp.*, No. 94 CV 3468, 1999 WL 33109 at \*2 (E.D.N.Y. Jan. 22, 1999) and observing that *Bratmen* had reconciled holdings in *Lipsky* and *Gilbert*).

<sup>21</sup> *Id.*

<sup>22</sup> 643 F. Supp. 2d 382 (S.D.N.Y. 2009).

<sup>23</sup> *Id.* at 403-04.

<sup>24</sup> *Id.* at 404.

ing with prejudice, for failure to state a cause of action:

TNK–BP’s request that the court strike those exhibits that reference two complaints filed in actions that have not been resolved on the merits, as well as the paragraphs in the Third Amended Complaint based on those exhibits, is granted because neither complaint resulted in an adjudication on the merits or “legally permissible findings of fact.” . . . That request is granted because Exhibits B and C are copies of complaints filed in actions that were never resolved on the merits and, thus, did not result in any findings of law or fact. Second Circuit case law is clear that paragraphs in a complaint that are either based on, or rely on, complaints in other actions that have been dismissed, settled, or otherwise not resolved, are, as a matter of law, immaterial within the meaning of Fed. R. Civ. P. 12(f).<sup>25</sup>

As to the two complaints from other actions, which the plaintiff had attached as exhibits to its own amended pleading: one was dismissed for lack of subject-matter jurisdiction and the other was discontinued via stipulation. They were deemed “preliminary steps in litigations . . . that did not result in an adjudication on the merits or legal permissible findings of fact.”<sup>26</sup> The *RSM* court held both complaints immaterial, as a matter of law, citing *Merrill Lynch*, and struck the other complaints as well as paragraphs in the complaint before the court relying solely on the stricken complaints.<sup>27</sup>

In *Platinum and Palladium Commodities Litig.*,<sup>28</sup> the defend-

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<sup>25</sup> *Id.* at 403 (discussing *Lipsky*, the court explained:

In *Lipsky*, the court struck a consent decree between defendants and the SEC, as well as the underlying complaint filed with the SEC, as immaterial. The court reasoned that, because the consent decree was the result of a private bargain between the parties and was not a hearing or ruling or any form of decision on the merits by the . . . court, . . . it could have no possible bearing on the dispute before the court. *For the same reasons, the complaint that preceded the consent judgment was stricken as immaterial.* More recently, this reasoning has been applied to strike all paragraphs that referred to or relied on complaints in ongoing disputes.)

*Id.* (emphasis added) (citation omitted).

<sup>26</sup> *RSM Prod. Corp.*, 643 F. Supp. 2d at 404. *RSM* is often cited as a precedent.

<sup>27</sup> *Id.* at 404.

<sup>28</sup> 828 F. Supp. 2d 588 (S.D.N.Y. 2011).



ants moved to strike and dismiss the complaint that derived its allegations “wholesale” from an order of the Commodities Futures Trading Commission (“CFTC”), which instituted administrative proceedings, made findings of fact, and imposed sanctions and a \$25 million fine against them.<sup>29</sup> The CFTC order was issued after the defendants had submitted an offer of settlement, which the CFTC accepted.<sup>30</sup> The court held the CFTC order, itself, was inadmissible<sup>31</sup> and that the complaint allegations were a “model” of the kind of pleading *Lipsky* prohibited,<sup>32</sup> and explained:

Although the CFTC Order included certain factual findings, it nevertheless was the product of a settlement between the CFTC and the Respondents, not an adjudication of the underlying issues in the CFTC proceeding. Plaintiffs are therefore prohibited from

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<sup>29</sup> *Id.* at 591.

<sup>30</sup> *Id.* at 592.

<sup>31</sup> *Id.* at 593. Observing that:

As courts in this Circuit have found repeatedly, *Lipsky* teaches that references to preliminary steps in litigations and administrative proceedings that did not result in an adjudication on the merits or legal or permissible findings of fact are, as a matter of law, immaterial under Rule 12(f) . . . . See *Gotlin v. Lederman*, 367 F. Supp. 2d 349, 363 (E.D.N.Y. 2005) (“[c]ourts hold that references in pleadings to agreements with state or federal agencies may properly be stricken on a Rule 12(f) motion.”); *Ledford v. Rapid-American Corp.*, No. 86 Civ. 9116(JFK), 1988 WL 3428, at \*1 (S.D.N.Y. Jan. 8, 1988) (“[r]efferences in a complaint to proceedings which do not adjudicate underlying issues may be stricken.”); *Sec. Investor Prot. Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293, 336 (Bankr. S.D.N.Y. 1999) (The Second Circuit has clearly held that consent judgments . . . are not the result of actual adjudications on the merits and therefore cannot be used as evidence in subsequent litigation between the parties.”)

*Id.* (citation omitted).

<sup>32</sup> *In re Platinum*, 828 F. Supp. 2d at 593 (observing that:

For example, Paragraph 81 alleges that the CFTC’s charges involved what the CFTC found to be a manipulative scheme in NYMEX platinum and palladium futures contracts traded in this District during the period of at least November 2007 through May 2008 . . . . Similarly, Paragraph 83 asserts that [a]s the CFTC’s holding that the Moore Capital Defendants violated Section 9(a)(2) shows, in devising, entering or causing others to enter these ‘bang the close’ orders, Defendant Pia was, in fact, an employee, agent and other person acting on behalf of each of the Moore Defendants . . . . These allegations are paradigms of the type of pleading prohibited by *Lipsky* and its progeny.)

*Id.* (citation omitted).

relying on the CFTC Order to plead the “underlying facts of liability.” *United States v. Gilbert*, 668 F.2d 94, 97 (2d Cir. 1981); see *Footbridge Ltd. v. Country-wide Home Loans, Inc.*, No. 09 Civ. 4050(PKC), 2010 WL 3790810, at \*5 (S.D.N.Y. Sept. 28, 2010) (“[D]efendants’ motion to strike is granted with respect to the allegations . . . insofar as they are based on pleadings, settlements, and government investigations in other cases.”); *Sec. Investor Prot. Corp.*, 234 B.R. at 336 (striking references to an SEC consent order); *Dent v. U.S. Tennis Ass’n, Inc.*, No. 08 Civ. 1533, 2008 WL 2483288, at \*3 (E.D.N.Y. Jun. 17, 2008) (striking references to a settlement with the New York Attorney General).<sup>33</sup>

The court held the plaintiffs were prohibited from relying on the CFTC Order to plead the “underlying facts of liability”<sup>34</sup> and dismissed their claims.<sup>35</sup>

In a particularly clear statement of the absolute interpretation of *Lipsky*, Judge Rakoff, in *S.E.C. v. Citigroup Global Mkt. Inc.*,<sup>36</sup> set forth the traditional justification for the bright line interpretation of *Lipsky*:

As a matter of law, an allegation that is neither admitted nor denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect. It is precisely for this reason that the Second Circuit held long ago . . . that a consent judgment between a federal agency and a private corporation,

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<sup>33</sup> *Id.* at 594. Plaintiffs argued that the CFTC Order was material to their claims because it would be admissible at trial, but the court rejected the argument. The admissibility of “a civil consent decree” such as the CFTC Order, the court held, would be governed by Rule 408, citing *Gilbert*, 668 F.2d at 97, and that Rule 408 “bars evidence of a compromise to prove liability for the claim, but specifically permits use of such evidence for other purposes.” *Id.* In pleading the facts supporting their claims, Plaintiffs had quoted extensively from the CFTC Order – “indicating an express purpose to employ the CFTC Order to prove liability.” *Id.* The court further noted plaintiffs’ purpose to do so was “manifest in Plaintiffs’ argument that the Court should accord deference to the CFTC’s findings of liability” under *Chevron U.S.A., Inc. v. Natural Res. Defense Council*, 467 U.S. 837 (1984).

<sup>34</sup> *Id.* at 594 (quoting *Gilbert*, 668 F.2d at 97).

<sup>35</sup> *Id.* at 595. The court also struck from the Complaint terms such as “frequent” or “often” taken directly from the CFTC Order.

<sup>36</sup> 827 F. Supp. 2d 328 (S.D.N.Y. 2011).

which is not the result of an actual adjudication of any of the issues . . . can not [sic] be used as evidence in subsequent litigation . . . . It follows that the allegations of the complaint that gives rise to the consent judgment are not evidence of anything either. Indeed the *Lipsky* court went so far as to hold that neither [an S.E.C.] complaint nor reference to [such] a complaint which results in a consent judgment may properly be cited in the pleadings in a parallel private action and must instead be stricken.<sup>37</sup>

*In re CRM Holdings Ltd. Sec. Litig.*<sup>38</sup> involved a securities fraud complaint. The district court denied reconsideration of its decision dismissing the complaint with prejudice and excluding allegations relying on a New York State Workers' Compensation Board letter and complaint and an Attorney General Notice as "unproven" and, thus, having "no evidentiary bearing."<sup>39</sup> *CRM* relied on *Lipsky*, *RSM*, and *Merrill Lynch*. While the district court noted the existence of contrary authority on this issue, it found such authority not binding and *Lipsky* controlling:

Plaintiffs' arguments fail to show that reconsideration of the decision to exclude these materials is warranted. As the Opinion explained, allegations of wrongdoing contained in the WCB Letter, the NYAG Notice, and the WCB complaint were excluded because the allegations therein were unproven and thus the allegations had no evidentiary bearing on Plaintiffs' case . . . . In so doing, this Court relied on *Lipsky* . . . which upheld a district court's decision to strike portions of a com-

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<sup>37</sup> *Id.* at 333 (citation omitted).

<sup>38</sup> No. 10 CIV 00975 (RPP), 2013 WL 787970 (S.D.N.Y. Mar. 4, 2013).

<sup>39</sup> *Id.* at \*16, n. 15. Arguing:

The specific allegations of wrongdoing contained in the WCB letter and paragraph 151 of the CAC are not recited here, as they are unproven allegations and thus have no evidentiary bearing in this proceeding. See *RSM*, 643 F. Supp. 2d at 403 (S.D.N.Y. 2009) (citing *Lipsky*, 551 F.2d at 892-94) ("Second Circuit case law is clear that paragraphs in a complaint that are either based on, or rely on, complaints in other actions that have been dismissed, settled, or otherwise not resolved, are, as a matter of law, immaterial within the meaning of Fed. R. Civ. P. 12(f).").

*Id.*

plaint that were based on allegations from a separate legal action that had not been fully adjudicated . . . . Plaintiffs claim that this reliance was improper because, after *Lipsky*, the Supreme Court and the Second Circuit have permitted plaintiffs to rely upon complaints filed in other actions to allege securities fraud . . . .

Plaintiffs fail, however, to cite any controlling authority overturning or vacating the Second Circuit's holding in *Lipsky*. Instead, Plaintiffs cite several district court cases for the proposition that neither Circuit precedent nor logic supports an absolute rule that any portion of a pleading that relies on unadjudicated allegations in another complaint is immaterial under Rule 12(f).<sup>40</sup>

The court stated that the district court cases that had rejected the absolute interpretation of *Lipsky* were not binding and that other courts had:

[A]dopted a position in line with the decision advanced in the Opinion – that paragraphs in a complaint . . . based on, or rely on, complaints from other actions dismissed, settled, or otherwise not resolved, are, as a matter of law, immaterial within the meaning of Fed. R. Civ. P. 12(f).<sup>41</sup>

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<sup>40</sup> *Id.* at \*5-6. (citation omitted).

<sup>41</sup> *Id.* at \*6 (citing *RSM* and *Merrill Lynch*); *see generally* Waterford Twp. Police & Fire Ret. Sys. v. Smithtown Bancorp, Inc., No. 10-CV-864 (SLT)(RER), 2014 WL 3569338, at \*3-4 (E.D.N.Y. July 17, 2014) (striking facts drawn from confidential witness statements referenced in a separate state court complaint that was the result of a consent agreement that was the product of a settlement with a federal agency, relying primarily on *Lipsky*, *Merrill Lynch*, and *In re Platinum & Palladium*); *Precimed v. ECA Med. Instrument*, 2014 WL 1883584, at \* 2 (W.D.N.Y. May 12, 2014), (striking allegations made in prior lawsuits, which had no bearing on issues in the current matter, noting it was unlikely allegations would be admissible at trial and would be prejudicial, and observing cases from which the allegations taken were dismissed shortly after being filed without affirmative relief being granted, citing *Lipsky* and *RSM* -- but denying motion to strike allegations from prior lawsuits referenced in counterclaim regarding financial condition and difficulties in business area in issue on ground that they were relevant to allegations regarding breach of agreement for financial and business reasons).

## II. LIPSKY AND THE NOT-SO-BRIGHT LINE RULE CASES

A separate line of cases rejects *Lipsky* as articulating a bright line rule and concludes that, at least in some circumstances, other pleadings may be cited and/or relied upon.

In *SEC v. Lee*,<sup>42</sup> for example, four complaints were filed by the New York Mercantile Exchange (“NYMEX”), CFTC, SEC and Bank of Montreal (“BMO”), respectively, arising from the same fraudulent scheme employed by a trader and his supervisor at BMO involving brokerages. The district court denied various defendants’ motions to dismiss the complaints and to strike those portions of NYMEX’s complaint, which relied for some of its allegations on the companion complaints of the SEC and the CFTC.<sup>43</sup>

In denying the motion to strike, the court stated that there is no absolute bar on (i) “relying on government pleadings or proceedings in order to meet” pleading standards, or (ii) using “information contained in an SEC complaint as evidence to support” claims.<sup>44</sup> The court had already satisfied itself as to the sufficiency of similar claims pled in the other complaints and also found NYMEX was not solely reliant on the other complaints inasmuch as the basis for some of NYMEX’s allegations included direct dealings between it and the defendants themselves.<sup>45</sup>

Similarly, in *In re Bear Stearns Mortg. Pass-Through Certificates Litig.*,<sup>46</sup> the district court permitted the class action plaintiffs in a securities fraud action involving mortgage-backed securities to rely on allegations set forth in other complaints, such as one summarizing a study of loan documents and the breaches of representations contained therein.<sup>47</sup> The district court held that *Lipsky* does not support an absolute rule barring such reliance.<sup>48</sup> In observing that “[n]ot all complaints are created equal”, the court held that “[i]t makes little sense to say that information from [] a study . . . is immaterial simply because it is conveyed in an adjudicated complaint.”<sup>49</sup>

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<sup>42</sup> 720 F. Supp. 2d 305 (S.D.N.Y. 2010).

<sup>43</sup> *Id.* at 335.

<sup>44</sup> *Id.* at 340-41.

<sup>45</sup> *Id.* at 341.

<sup>46</sup> 851 F. Supp. 2d 746 (S.D.N.Y. 2012).

<sup>47</sup> *Id.* at 767-68 n.24.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

Notably, however, the court stated that the balance of the complaint contained sufficient factual allegations to support the claims regardless of whether it struck the borrowed allegations.<sup>50</sup> Defendants argued complaint sections relying on allegations from other litigants' complaints should be disregarded or stricken, under *Lipsky*, but the court set forth a different understanding of *Lipsky*'s rationale and ruling than the absolute interpretation cases:

The Circuit's rationale was that the consent decree was inadmissible under Fed. R. Evid. 410; thus, the plaintiff could not derive any evidentiary benefit from the complaint that proceeded it. . . . The Circuit reiterated the strong presumption against striking portions of the pleadings and cautioned that its holding was limited to "the facts of this case." . . . Nonetheless, some courts in this district have stretched the holding in *Lipsky* to mean that any portion of a pleading that relies on unadjudicated allegations in another complaint is immaterial under Rule 12(f) . . . . *Neither Circuit precedent nor logic supports such an absolute*

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<sup>50</sup> *Id.*; see generally *Brotman*, 1999 WL 33109, at \*2 (citing *Lipsky*, 551 F.2d at 893-94). Stating:

Plaintiff next argues that the consent orders are inadmissible because they did not formally adjudicate any of the facts recited therein. *See Lipsky v. Commonwealth United Corp.*, 551 F.2d at 893-94 (holding that consent judgment may not be used for collateral estoppel purposes, since the underlying issues have not been litigated and decided on the merits); *Halyalkar v. Bd. of Regents*, 527 N.E.2d 1222, 1226-27 (N.Y. 1988) (admission of guilt pursuant to New Jersey consent order did not collaterally estop physician from denying "knowing and willful misconduct" in subsequent New York proceeding). Here, however, the evidence would be offered not to prove the truth of the underlying factual matters recited in the consent orders, but to show that Plaintiff may have had an ulterior motive for filing a disability claim and to attack his credibility with respect to his professed reasons for seeking benefits. Such use of negotiations or agreements to compromise a claim is permissible under Rule 408 of the [Fed. R. Evid.] Rule 404(b), while barring the use of other crimes, wrongs, or acts to prove the character of a person in order to show action in conformity therewith, similarly permits the admission of such evidence to prove motive, intent, knowledge, and for other purposes. *See* Fed. R. Evid. 404(b); *Gilbert*, 668 F.2d at 97 (2d Cir. 1981) (SEC civil consent decree admissible under Rule 404(b) in subsequent criminal trial regarding securities law violations to show defendant knew of reporting requirements involved in the decree).

*Id.* (alternation in citations) (footnotes omitted).

*rule. Not all complaints are created equal—while some barely satisfy the pleading requirement, others are replete with detailed factual information of obvious relevance to the case at hand. To take but one example, the Ambac complaint . . . recounts a detailed study by Ambac Assurance Corp. that revealed widespread breaches of representations in almost 80 percent of the documents supporting the loans it reviewed. It makes little sense to say that information from such a study — which the TAC could unquestionably rely on if it were mentioned in a news clipping or public testimony — is immaterial simply because it is conveyed in an unadjudicated complaint. The other complaints on which the TAC relies are of a similar character. Accordingly, the [c]ourt will not strike references to them from the TAC. In any event, nothing rides on how much weight the [c]ourt gives the sections of the TAC that rely on other parties' pleadings. Even if the Court struck every such paragraph, the TAC would still contain sufficient factual allegations to plead claims under Sections 11 and 12(a) (2).<sup>51</sup>*

Thus, when an independent factual basis for the subject allegations can be discerned from the face of a complaint, or the allegations, generally, have some indicia of reliability, some district courts

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<sup>51</sup> *In re Bears*, 851 F. Supp. 2d at 768 n.24 (emphasis added) (citations omitted); *see generally Gilbert*, 668 F.2d at 97 (rejecting the argument that the judge improperly admitted into evidence an earlier SEC civil consent decree, holding:

The decree was clearly admissible under Fed. R. Evid. 404(b) to show defendant knew SEC reporting requirements involved in the decree; the decree's prejudicial potential was not great, and [judge] . . . cautioned the jury as to the limited inferences they could permissibly draw from it. Though we have previously recognized that a consent decree and a *nolo contendere* plea are somewhat analogous in that neither may be used to prove underlying facts of liability . . . a *nolo* plea encounters the bar of Fed. R. Evid. 410, while a civil consent decree, as the settlement of a civil suit, is governed by Fed. R. Evid. 408. The latter rule bars evidence of a compromise to prove liability for the claim, but specifically permits use of such evidence for other purposes.

*Id.* (emphasis added) (citation omitted).

have been inclined to permit reliance on borrowed allegations.<sup>52</sup> The converse is also true. To make such determinations, however, the reviewing court will need to make highly subjective assessments of the reliability of pleadings not before the court, based on their intuitions about the verisimilitude of untested allegations, made by interested pleaders, in advocacy documents.

In *VNB Realty, Inc. v. Bank of America Corp.*,<sup>53</sup> plaintiff VNB Realty, Inc. (“VNB”), a real estate investment trust, purchased Residential Mortgage Backed Securities (“RMBS”) from the defendants. The plaintiffs claimed the “genesis” of this case was a filing by the Federal Housing Finance Agency (“FHFA”) against the defendants in connection with the purchase by Fannie Mae and Freddie Mac (collectively, the “GSEs”) of certificates like those purchased by VNB (the “FHFA action”).<sup>54</sup> The FHFA action was one of seventeen actions filed by FHFA and being coordinated before Judge Cote, the presiding judge in VNB, of which thirteen were then unresolved.<sup>55</sup>

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<sup>52</sup> In *Ho v. Duoyuan Global Water, Inc.*, 887 F. Supp. 2d 547, 563-64 (S.D.N.Y. 2012), for example, class plaintiffs relied upon an analyst report of well-known short seller, Muddy Waters Report, and defendants moved to strike arguing it was unreliable and unsubstantiated, and thus, had no bearing on the issue in dispute citing, *inter alia*, *Lipsky*, as support for striking “allegations of adjudicated facts taken from a complaint in a separate proceeding.” The court held that although “defendants questioned the reliability of the anonymously written Muddy Waters Report, an analyst’s report ‘does not implicate the same skepticism as a ‘traditional’ anonymous source.’” *Id.* at 564. (citing *In re China Educ. Alliance, Inc. Sec. Litig.*, CV 10–9239 CAS JCX, 2011 WL 4978483 at \*4 (C.D. Cal. Oct. 11, 2011)). The *Ho* court explained “that a ruling that [would] find[] financial analysts’ reports as suspect would mean . . . a plaintiff would never be able to rely on an unsigned analyst’s report to support a securities fraud allegation.” Although Defendants argued that Muddy Waters, as a short seller of the stock being attacked, was biased, and that Muddy Waters “openly admitted the possible inaccuracy of the Report,” the court, further stated that “the reliability of the report is a question of fact.” *Id.* The Muddy Waters Report cannot, the court held, “be said to clearly ha[ve] no bearing on the issue in dispute.” *Id.* (citing *Global View Ltd. Venture Capital v. Great Cent. Basin Exploration*, 288 F. Supp. 2d 473, 481 (S.D.N.Y. 2003)). The court denied Defendants’ motion to strike the report, *Lipsky* notwithstanding.

<sup>53</sup> No. 11 Civ. 6805 (DLC), 2013 WL 5179197 (S.D.N.Y. Sept. 16, 2013).

<sup>54</sup> *Id.* at \*1.

<sup>55</sup> The *VNB* court summarized the facts as follows:

VNB contends that it purchased RMBS issued from a single securitization: Banc of America Alternative Loan Trust, Series 2006–1 (“BOAA 2006–1”). RMBS are securities entitling the holder to income payments from pools of residential mortgage loans (“Supporting Loan Groups” or “SLGs”) that are held by a trust. For the securities at issue here, the offering process began with a “sponsor,” defendant Bank of America, National Association (“BOA National”), which originated the mortgage loans that were to be included in the offering. The sponsor then transferred a portfolio of loans to a trust that was created specific-



Plaintiffs claimed certain Offering Documents contained materially false and misleading statements about the loans' characteristics and defendants moved to strike portions of the pleading on the ground they improperly imported passages from complaints in other cases, relying on *Lipsky*, and to dismiss.<sup>56</sup>

The court began by noting that Rule 12(f) allows a court to strike from a pleading "any redundant, immaterial, impertinent, or scandalous matter," and that the Second Circuit, in *Lipsky*, had stated that "courts should not tamper with the pleadings unless there is a strong reason for so doing,"<sup>57</sup> and has emphasized that Rule 12(f) is "designed for excision of material from a pleading, not for dismissal of claims in their entirety."<sup>58</sup> Judge Cote noted that striking a portion of a pleading is a disfavored, drastic remedy intended as a means to avoid "expenditure of time and money litigating spurious issues by dispensing with them prior to trial."<sup>59</sup> She noted: "general judicial agreement, . . . that motions to strike . . . should be denied unless the challenged allegations have no possible relation or logical connection to the subject matter of the controversy and may cause some form of

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ly for that securitization; this task was accomplished through the involvement of an intermediary known as a "depositor," defendant Banc of America Mortgage Securities, Inc. ("BOA Mortgage"). The trust then issued certificates to the underwriter, defendant Banc of America Securities, LLC ("BOA Securities"), which in turn sold them to plaintiff VNB. All three of these entities were wholly owned subsidiaries of defendant Bank of America Corporation ("BOA Corp.").

The certificates were backed by the underlying mortgages. Thus, their value depended on the ability of mortgagors to repay the loan principal and interest and the adequacy of the collateral in the event of default. VNB purchased Class 4CB1 certificates. The certificates purchased by VNB were backed by a different Supporting Loan Group and came from a lower tranche than the certificates purchased by the GSEs but were nevertheless also rated AAA at the time of issuance and purchase. The certificates were offered pursuant to a shelf registration statement, a prospectus, and a prospectus supplement filed with the Securities and Exchange Commission ("SEC"). These documents together constitute the "Offering Documents" (or "Offering Materials").

*Id.* at \*1.

<sup>56</sup> *Id.* at \*2.

<sup>57</sup> *Id.* at \*2 (quoting *Lipsky*, 551 F.2d at 893).

<sup>58</sup> *VNB Realty, Inc.*, 2013 WL 5179197, at \*2 (quoting *Day v. Moscow*, 955 F.2d 807, 811 (2d Cir. 1992)).

<sup>59</sup> *Id.* (quoting *Whittlestone, Inc. v. Handi-Craft Co.*, 618 F.3d 970, 973 (9th Cir. 2010)).

significant prejudice to one or more of the parties to the action.”<sup>60</sup>

Defendants relied on *Lipsky* and certain of its progeny in support of “the proposition that references to preliminary steps in litigations and administrative proceedings that did not result in an adjudication on the merits or legal or permissible findings of fact are, as a matter of law, immaterial under Rule 12(f),”<sup>61</sup> which proposition the court noted traced to *Lipsky*, which had been read with “varying degrees of breadth.”<sup>62</sup> Although Judge Cote would decide the case on other grounds, she sided with the courts that did not interpret *Lipsky* as articulating a bright line rule precluding citation to complaints from other actions:

A close reading of *Lipsky* reveals that it does not mandate the elimination of material from a complaint simply because the material is copied from another complaint. *Lipsky* principally addressed whether a complaint had adequately pleaded that the offering documents filed by the defendants in connection with the plaintiff’s shares contained material omissions and misrepresentations. . . . Instead of discussing its own offering documents, the plaintiff had copied passages from an SEC complaint with allegations about *other* offering documents. . . . While the plaintiff claimed that the sets of documents were “basically duplicates,” its pleading had not actually alleged that its own offering documents were defective. The Court of Appeals remanded the action to the district court to permit the plaintiff to amend its complaint to allege inadequacies in its own offering documents.<sup>63</sup>

She continued:

Given this context, *Lipsky*’s discussion of Rule

<sup>60</sup> *Id.* at \*3 (citing 5C. WRIGHT & MILLER, FEDERAL PRACTICE § 1382 (3d ed. 2011); U.S. v. Coney, 689 F.3d 365, 379 (5th Cir. 2012); *In re Gitto Global Corp.*, 422 F.3d 1, 12 (1st Cir. 2005); *Talbot v. Robert Matthews Distrib. Co.*, 961 F.2d 654, 664 (7th Cir. 1992)).

<sup>61</sup> *Id.* (quoting *In re Merrill Lynch*, 218 F.R.D. at 78).

<sup>62</sup> *Id.* (comparing *RSM*, 643 F. Supp. 2d at 403) (observing that “[p]aragraphs in a complaint that are either based on, or rely on, complaints in other actions that have been dismissed, settled, or otherwise not resolved are . . . immaterial . . .”) with *In re Bear Stearns*, 851 F. Supp. 2d at 768 (“[n]either Circuit precedent nor logic supports such an absolute rule.” (discussing *RSM*)).

<sup>63</sup> *VNB Realty, Inc.*, 2013 WL 5179197, at \*3.

12(f), and in particular its examination of whether references to other pleadings should be stricken as “immaterial,” has limited utility if a plaintiff has adequately identified the material omissions and misstatements in the offering documents relevant to his claim. As the *Lipsky* court stressed, its holding was confined to the “facts of this case.” . . . It stated, “we hold that neither a complaint nor references to a complaint which results in a consent judgment may properly be cited in the pleadings *under the facts of this case.*” . . . The more general teaching of *Lipsky* that courts should not tamper with the pleadings unless there is a strong reason for so doing, . . . has broader applicability, as does its admonition that Rule 12(f) should be construed strictly against striking portions of the pleadings on the grounds of immateriality, and if the motion is granted at all, the complaint should be pruned with care.<sup>64</sup>

Defendants argued numerous complaint paragraphs were copied verbatim, or with minimal alterations from the other complaints, without even an explicit reference to them.

Nevertheless, Judge Cote, noting that while the plaintiffs’ counsel chose to copy the wording used by other lawyers, there is no evidentiary rule against “plagiarism.”<sup>65</sup> Plaintiffs referenced a forensic loan file review performed by the FHFA in another case and, in language largely copied from the FHFA’s complaint, the pleading reported the forensic loan file review had involved taking a sample of 1,000 randomly selected loans from each Supporting Loan Group and reviewing them to determine whether, for instance, loan to value ratios reported in the Prospectus Supplements were accurate.<sup>66</sup> The court held the description of the FHFA review did not need be stricken.

The complaint cited a different complaint as the source of certain factual allegations that apparently originated with “confidential witnesses.” The allegations contained in the sub-paragraphs were, in

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<sup>64</sup> *Id.* at \*4.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 4.

turn, copied almost verbatim from five paragraphs of the different complaint, containing allegations attributed to confidential sources. The court described this part of the pleading as “problematic,” insofar as it relied on confidential sources quoted in another complaint, i.e., individuals with whom VNB’s counsel did not have “direct contact.”<sup>67</sup> However, Judge Cote held “[a]ny deficiency in this regard . . . must be tested under the standards arising under Rule 9(b), and may not be stricken in advance of that analysis through application of Rule 12(f).”<sup>68</sup>

In *In re OSG Sec. Litig.*,<sup>69</sup> the district court granted the class action plaintiffs’ motion to amend their securities complaint to add allegations derived from a motion to dismiss made in another lawsuit.<sup>70</sup> The defendants argued *Lipsky* precluded such addition, but the court concluded that *Lipsky* did not hold that a complaint might *never* reference allegations from a separate proceeding regardless of circumstances.<sup>71</sup> Distinguishing cases interpreting *Lipsky* as articulating a broad, bright line rule precluding all reference to allegations to complaints in other proceedings, the court held that *Lipsky* had not gone that far:

[S]ome district courts in this Circuit have adopted the broad rule that a complaint may never reference allegations from a separate proceeding that has not been decided on the merits. . . (citation omitted). However, no Second Circuit precedent indicates such a broad rule. In 1976, in *Lipsky v. Commonwealth United Corporation*, the Second Circuit held that “neither a complaint nor references to a complaint which results in a consent judgment may properly be cited in the pleadings under the facts of this case” (citation omitted). However, *Lipsky* relied on the fact that Federal Rule of Evidence (“FRE”) 410 “prohibits a plea of nolo contendere from being later used against the party who so pleaded,” and noted that “nolo pleas have been equated with consent decrees” for purposes of the pro-

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<sup>67</sup> *Id.*

<sup>68</sup> *VNB Realty, Inc.*, 2013 WL 5179197, at \*4.

<sup>69</sup> 12 F. Supp. 3d 619 (S.D.N.Y. 2014).

<sup>70</sup> *Id.* at 620.

<sup>71</sup> *Id.*

vision at issue . . . (citation omitted). Because the consent decree could not be used as evidence in a subsequent lawsuit, the court reasoned that the complaint from that action was also immaterial under Federal Rule of Civil Procedure 12(f) (citation omitted).<sup>72</sup>

*Lipsky*, the court explained, emphasized the general rule that motions to strike pleadings as immaterial should be denied unless it can be shown that no evidence in support of the allegation would be admissible. However, the court further stated that it did not hold that complaints may never reference allegations from a separate proceeding, under any circumstances. Rather, *Lipsky*'s holding was limited to complaints that ultimately resulted in a consent decree or *nolo contendere* plea, protected by FRE 410.<sup>73</sup>

The court continued:

The Second Circuit later [post-*Lipsky*] clarified in *United States v. Gilbert* that civil settlements and consent decrees are governed by FRE 410, not FRE 408 . . . (note omitted). While settlements are inadmissible as evidence of liability, they are admissible for other purposes, including proof of knowledge . . . (note omitted). It follows that reference to the complaints or allegations in such actions would be permissible for the same reasons. Thus, it would make little sense to strike references to pleadings in ongoing actions, which do not trigger the protections or policy concerns of FRE 410 or FRE 408 . . . (note omitted).<sup>74</sup>

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<sup>72</sup> *Id.* at 620-21 (citing as examples, *Id.* at n.3, *In re CRM Holdings, Ltd. Sec. Litig.*, No. 10 Civ. 975, 2012 WL 1646888 (S.D.N.Y. May 10, 2012) (plaintiffs' citation to unproven allegations made in other complaints do not constitute factual allegations and must be stricken); *Low v. Robb*, No. 11 Civ. 2321, 2012 WL 173472 (S.D.N.Y. Jan. 20, 2012) (It is well settled that allegations in a complaint that are either based on, or rely on, complaints in other actions that have been dismissed, settled, or otherwise not resolved, are, as a matter of law, immaterial within the meaning of Rule 12(f)); *RSM Prod. Corp. v. Fridman*, 643 F. Supp. 2d 382, 403 (S.D.N.Y. 2009) (striking references to complaints filed in other actions that had not been resolved on the merits), *aff'd on other grds*, 387 Fed. Appx. 72 (2d Cir. 2010); *In re Merrill Lynch & Co., Inc. Research Reports Secs. Litig.*, 218 F.R.D. 76, 78 (S.D.N.Y. 2003) ("references to preliminary steps in litigations and administrative proceedings that did not result in an adjudication on the merits or legal or permissible findings of fact are, as a matter of law, immaterial . . .").

<sup>73</sup> *In re OSG Sec. Litig.*, 12 F. Supp. 3d at 621.

<sup>74</sup> *Id.*

At note 8 of the decision, the court explained that *Lipsky* had itself noted—*in dicta*—that a consent decree could not be used as evidence in subsequent litigation because it was not the result of an actual adjudication of any of the issues, and that many district courts interpreted this *dicta* to preclude any reference to an action or complaint not decided on the merits. Noting that several district courts recognized *Lipsky*'s “limited holding” and the “illogic of a bright line rule” against citing allegations from other proceedings,<sup>75</sup> the court held:

While allegations from another lawsuit are not evidence and cannot be “introduced in a later trial for collateral estoppel purposes” (citation omitted) plaintiffs need not provide admissible proof at this stage. The Federal Rules of Civil Procedure permit discovery on relevant matters that appear “reasonably calculated to lead to the discovery of admissible evidence.” (citation omitted). Similarly, plaintiffs may plead facts contained in the Proskauer motion upon information and belief, and find admissible evidence to support those allegations at a later stage. “ (citation omitted). Even allegations of fraud can be made upon information and belief where the matters alleged are “peculiarly within the opposing party’s knowledge” (citation omitted) as

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<sup>75</sup> *Id.* at n.8. The court cited as examples *VNB Realty, Inc. v. Bank of Am. Corp.*, No. 11 Civ. 6805, 2013 WL 5179197 (S.D.N.Y. Sept. 16, 2013) (declining to strike portions of a complaint citing a complaint in another ongoing action, and noting that whether the allegations met plaintiffs’ pleading burden was a separate question); *In re Bear Stearns Mortg. Pass-Through Certificates Litig.*, 851 F. Supp. 2d 746, 768 n. 24 (S.D.N.Y.2012) (“some courts in this district have stretched the holding in *Lipsky* to mean that any portion of a pleading that relies on unadjudicated allegations in another complaint is immaterial under Rule 12(f) . . . . Neither Circuit precedent nor logic supports such an absolute rule.”); *Johnson v. M & M Commc’ns, Inc.*, 242 F.R.D. 187, 189 (D. Conn. 2007) (allowing allegations from another lawsuit to remain in the complaint and noting that “whether evidence of the prior investigations will be admissible at trial is an issue to be resolved at a later stage of the litigation”). See generally *Baron v. Miller*, 2014 WL 3956562, at 12-13 (N.D.N.Y. Aug. 13 2014) (Scullin, J.) (adopting magistrate report, Peebles, J., which recommended that that although paragraphs from a complaint might ultimately be found to be immaterial to the cause of action asserted in the instant pleading, they were not “so impertinent” as to justify striking them, given the liberal pleading standard applicable to the motion under consideration, recommending denial of motion to strike). See also *HSN Nordbank AG v. RBS Holdings USA Inc.*, 2015 WL 1307189 at 4 (S.D.N.Y. March 23, 2015) (Gardephe, J.) (some courts, e.g., *RSM*, have “stretched” the holding of *Lipsky*, and following, instead, the *Bear Stearns* approach, allowing reliance on study “conveyed in an unadjudicated complaint.”).

long as plaintiffs “provide a statement of facts upon which the belief is founded.” (Citation omitted).<sup>76</sup>

### III. THE RULE 11 APPROACH

Recently, rather than relying on an interpretation of *Lipsky* to resolve whether reliance on another litigant’s pleadings is permitted, some judges have looked to Rule 11 for the analysis.

#### A. Rule 11 – What is a Proper Investigation?

In both 1983 and 1993, FRCP 11 was amended with respect to the necessary level of pre-filing inquiry into alleged facts. FRCP 11(b)(3) currently requires the filer to certify “that to the best of the person’s knowledge, information and belief, formed after an inquiry reasonable under the circumstances. . . the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery.”<sup>77</sup> The Advisory Committee Notes to the ‘93 amendments reiterate that the filer must conduct a reasonable inquiry into the facts and does not have license to make claims without any factual basis. As the Supreme Court has made clear:

[T]he purpose of Rule 11 as a whole is to bring home to the individual signer his personal, nondelegable responsibility. It is at least arguable that *these* purposes are better served by a provision which makes clear that, just as the court expects the signer personally-and not some nameless person within his law firm-to validate the truth and legal reasonableness of the papers filed, so also it will visit upon him personally-and not his law firm-its retribution for failing in that responsibility. The message thereby conveyed to the attorney, that this is not a “team effort” but in the last analysis

<sup>76</sup> 2014 WL 504078, at \*2. Some courts noting conflicting decisions have refused to “wade into the debate.” See, e.g., *Moses v. Apple Hospitality Reit Inc.*, 2015 WL 1014327, at 2 (S.D.N.Y. March 9, 2015) (referencing *Lipsky*, and competing interpretations in *Merrill Lynch, VBN* and *Bear Stearns* and stating issues would be resolved on other grounds). See also *UPS Store, Inc. v. Hagan*, 2015 WL 1456654, at 11 (S.D.N.Y. March 24, 2015) (discussing *Lipsky* and *VBN*).

<sup>77</sup> FED. R. CIV. P. 11(b)(3).

*yours alone*, is precisely the point of Rule 11. Moreover, psychological effect aside, there will be greater economic deterrence upon the signing attorney, who will know for certain that the district court will impose its sanction entirely upon him, and not divert part of it to a partnership of which he may not (if he is only an associate) be a member, or which (if he is a member) may not choose to seek recompense from him.<sup>78</sup>

In *In re Lehman Bros. Sec. and Erisa Litig.*,<sup>79</sup> “[d]efendants argued [plaintiff] could not rely on confidential witnesses cited in another complaint to meet its pleading burden. [Noting that] the Second Circuit had not ruled on the exact issue, [the court observed] many district courts had held allegations relying on allegations drawn from other complaints is improper,”<sup>80</sup> but that at least one court had held it was “appropriate for a plaintiff, at the pleading stage, to rely on confidential witness statements, as recounted in other complaints.”<sup>81</sup> The court held “it would be inappropriate to give any weight to the alleged confidential witness statements” because there was “no suggestion counsel had spoken with these confidential witnesses or even knows who they are.”<sup>82</sup> When citing alleged confidential witnesses in a complaint, the court held, a Rule 11 “certification means that counsel has spoken with these confidential witnesses and knows who they are.”<sup>83</sup>

Allowing counsel to rely on confidential witness statements recounted in a different complaint would, the court held, provide little assurance that factual contentions have evidentiary support.<sup>84</sup> The court observed that while plaintiffs may rely in their complaints on witness statements recounted in newspaper articles and government reports, their probative value is “much greater than that of confiden-

<sup>78</sup> *Pavelic & LeFlore v. Marvel Entm’t Grp.*, 493 U.S. 120, 126-27, 110 S.Ct. 456, 459-60 (1989).

<sup>79</sup> 2013 WL 3989066 (S.D.N.Y. 2013) (Kaplan, J.).

<sup>80</sup> *Id.* at \*4 (citing *RSM Prod. Corp. v. Fridman*, 643 F. Supp. 2d 382, 403 (S.D.N.Y.2009) (citing *Lipsky v. Commonwealth United Corp.*, 551 F.2d 887, 892-94 (2d Cir.1976)).

<sup>81</sup> *Id.* at \*4 (citing 380544 *Canada, Inc. v. Aspen Tech., Inc.*, 544 F. Supp. 2d 199, 224-25 (S.D.N.Y. 2008) (“Although the confidential informants are not personally known to Plaintiffs or Plaintiffs’ counsel, the fact that the informants’ accounts are derived from an earlier pleading in a different case simply does not render the instant pleading inadequate.”)

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> 2013 WL 3989066, at \*4.



tial witness statements, recounted in . . . [complaints].”<sup>85</sup> The court observed that “[t]here is significant motive and opportunity for counsel in any case to misuse or mischaracterize confidential witness statements in a[n advocacy] pleading.”<sup>86</sup> Also, courts have the ability to remedy abuses through sanctions, but sanctions are often ineffective because misconduct will normally come to light, if ever, only during or after discovery, when damage is already done.<sup>87</sup> As such, “[t]he unfairness of permitting a plaintiff in a separate action to rely blindly at the pleading stage primarily on confidential witness statements from another case to meet its pleading burden is patent.”<sup>88</sup>

In *Homeward Residential, Inc. v. Sand Canyon Corp.*,<sup>89</sup> the court noted that “[t]he Second Circuit ha[d] not yet ruled on whether plaintiffs can rely on confidential witnesses cited in another complaint to meet their pleading burden[,]”<sup>90</sup> and that while several courts had permitted “utiliz[ation] of allegations drawn from other complaints[,]”<sup>91</sup> others had rejected such use.<sup>92</sup> The court noted it is not a plaintiff’s burden “to show it is permissible for it to quote accounts of confidential sources from a separate proceeding [, but] rather . . . [d]efendant’s burden to show . . . [p]laintiff may not do so.”<sup>93</sup> Defendant argued that Rule 11 “prohibits the use of confidential witness statements from a different complaint because . . . it requires counsel to certify that he has [personally] spoken with the confidential witnesses and knows who they are.”<sup>94</sup> The court rejected that interpretation, holding:

Rule 11 only requires counsel to certify “that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the cir-

<sup>85</sup> *Id.*; see generally *Ho v. Duoyuan Global Water, Inc.*, 887 F. Supp. 2d 547, 563-64 (S.D.N.Y. 2012) (distinguishing citation of news reports and confidential sources).

<sup>86</sup> 2013 WL 3989066, at \*4.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> 298 F.R.D. 116 (S.D.N.Y. 2014).

<sup>90</sup> *Id.* at 125. (citing *Lehman Bros.*, 2013 WL 3989066, at \*4 (“the Second Circuit does not appear to have ruled on this exact issue”)).

<sup>91</sup> *Id.* at 126 (citing *In re Bear Stearns Mortgage Pass-Through Certificates Litig.*, 851 F. Supp. 2d 746, 768 n. 24 (S.D.N.Y. 2012); *380544 Canada, Inc. v. Aspen Tech., Inc.*, 544 F. Supp. 2d 199, 224-25 (S.D.N.Y. 2008)).

<sup>92</sup> *Id.* at 126 (citing *VNB Realty, Inc. v. Bank of Am. Corp.*, No. 11 Civ. 6805, 2013 WL 5179197, at \*7 (S.D.N.Y. Sept. 16, 2013); *Lehman Bros.*, 2013 WL 3989066, at \*4).

<sup>93</sup> *Id.* at 126 (quoting *380544 Canada, Inc.*, 544 F. Supp. 2d at 224).

<sup>94</sup> *Homeward Residential*, 298 F.R.D. at 126.

cumstances . . . the factual contentions have evidentiary support or, *if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery.*"<sup>95</sup>

The court held Rule 11 "allow[s] incorporation of allegations from other complaints if . . . combined with material the plaintiff has investigated personally . . . lend[s] credence to the borrowed allegations."<sup>96</sup> The complaint before the court stated that the confidential witness statements were included "on information and belief in their truth and on reasonable belief that further inquiry and discovery from [D]efendant and others will provide evidence of [their] truth" and that the confidential witness statements were supported by allegations of bad appraisals in the loans at issue.<sup>97</sup> The court noted that the statements contained their own "indicia of reliability," because the quotes were from different employees rather than from, for example, one possibly disgruntled or vindictive employee, and also that witnesses worked in different geographic areas and in different positions throughout the company.<sup>98</sup> Because the witnesses reported a consistent pattern of behavior, the court had more "faith in their accuracy" and, citing *Bear Stearns*, held the allegations of appraisal fraud in the complaint satisfied Rule 9(b).<sup>99</sup>

Essentially, the court found that because the alleged confidential witness statements, although borrowed from a different complaint, were openly pled on information and belief, contained their own indicia of reliability, and were buttressed by independent allegations of bad loan appraisals, their incorporation into the complaint was permissible.<sup>100</sup> Other courts, relying on Rule 11, however, have taken a different view. In *Garr v. U.S. Healthcare, Inc.*,<sup>101</sup> for example, the court explained why citation to the factual content of other

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<sup>95</sup> *Id.* (emphasis added) (quoting FED. R. CIV. P. 11(b)(3)).

<sup>96</sup> *Id.* (citing *In re Connetics Corp. Secs. Litig.*, 542 F. Supp. 2d 996, 1005 (N.D. Cal. 2008) ("attorney may rely in part on other sources as part of his or her [factual] investigation"); *In re Cylink Secs. Litig.*, 178 F. Supp. 2d 1077, 1080 (N.D. Cal. 2001) (complaint may combine plaintiff's own allegations with SEC complaint allegations)).

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Homeward Residential*, 298 F.R.D. at 126 (citing *Bear Stearns*, 851 F. Supp. 2d at 767-68.) (proposing complaints replete with detailed factual information are better for borrowing than others).

<sup>100</sup> *Id.*

<sup>101</sup> 22 F.3d 1274 (3d Cir. 1994).

complaints violates Rule 11:

[The attorneys] abdicated their own responsibilities and relied excessively on Malone contrary to Rule 11 . . . they did not rely on Malone only as to some small portion of the case. Rather, they relied on his inquiry to justify the entire cause of action. Indeed, they filed the complaint Malone had prepared, changing only the name of the plaintiffs and the number of shares owned . . . . Rule 11 requires that an attorney signing a pleading must make a reasonable inquiry *personally*. The advantage of duplicate personal inquiries is manifest: while one attorney might find a complaint well founded in fact and warranted by the law, another, even after examining the materials available to the first attorney, could come to a contrary conclusion.<sup>102</sup>

Thus, some rulings focus on the nature of the borrowed allegation and whether sufficient ground exists for concluding that the filer has sufficient corroborative knowledge to support the allegation. “Filing a complaint in federal court is no trifling undertaking. An attorney’s signature on a complaint is tantamount to a warranty that the complaint is well grounded in fact . . . .”<sup>103</sup> Rule 11(b) states that by presenting a pleading to the Court, an attorney “certifies that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances . . . the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery.”<sup>104</sup> Attorneys have a duty, prior to filing a complaint, to conduct a “reasonable” factual investigation but at the pleading stage, plaintiffs need only plead facts, not produce admissible evidence.<sup>105</sup>

In *In re Connetics Corp. Sec. Litig.*,<sup>106</sup> the court explained in some detail what types of sources could be relied upon and the reasons why such reliance would be permissible:

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<sup>102</sup> *Id.* at 1280.

<sup>103</sup> *Christian v. Mattel*, 286 F.3d 1118, 1127 (9th Cir. 2002).

<sup>104</sup> FED. R. CIV. P. 11(b)(3).

<sup>105</sup> *See In re McKesson HBOC Sec. Litig.*, 126 F. Supp. 2d 1248, 1272 (N.D. Cal. 2000).

<sup>106</sup> 542 F. Supp. 2d 996 (N.D. Cal. 2008).

When drafting a complaint, an attorney may rely in part on other sources, such as a newspaper article . . . as part of his or her investigation into the facts, but plaintiffs cite no authority that stands for the proposition that an attorney may rely *entirely* on another complaint as the *sole* basis for his or her allegations . . . Here, as to the particular paragraphs that defendants ask the Court to strike, there apparently were no “investigative efforts” to combine with plaintiffs’ reliance on the SEC complaint. Although plaintiffs contend that the SEC complaint is one of many bases for plaintiffs’ complaint, they do not contend that they conducted independent investigation into the facts alleged in the SEC complaint or had any additional bases for the specific allegations pertaining to [defendants] . . . . Instead, the SEC complaint appears to be *the only basis* for the allegations . . . .<sup>107</sup>

Because, under Rule 11(b), an attorney has a “nondelegable responsibility” to “personally . . . validate the truth and legal reasonableness of the papers filed,”<sup>108</sup> and “to conduct a reasonable factual investigation,”<sup>109</sup> the court held that it would make little sense that an attorney “somehow can rely on the analysis of attorneys in *different actions* and who are presumably from different law firms.”<sup>110</sup> The

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<sup>107</sup> *Id.* at 1005. The court distinguished several cases plaintiffs argued supported their argument that they could properly incorporate the allegations of the SEC complaint into their own complaint. In *re* Cylink Sec. Litig. was “inapposite because the question there was whether a complaint filed by the SEC may come into the mix of materials considered . . . on a motion to dismiss,” not whether incorporation of complaint allegations that relied entirely on an SEC complaint was permissible, under Rule 11-- “[T]hese allegations, especially *when combined with* the other transactions detailed in the SEC complaint, provide strong circumstantial evidence . . . .” (emphasis added). 178 F. Supp. 2d 1077, 80-83 (N.D. Cal. 2001). In *De La Fuente v. DCI Telecomm., Inc.*, the court considered Rule 11 but noted that the plaintiff had stated “that every allegation in the complaint was verified by plaintiff’s counsel through independent investigation.” 259 F. Supp. 2d 250, 260 (S.D.N.Y. 2003). The court held that In *re* McKesson actually supported defendants’ arguments -- “[t]o the extent that a newspaper article *corroborates plaintiff’s own investigation* and provides detailed factual allegations, it can— *at least in combination with plaintiff’s investigative efforts*—be a reasonable source of information and belief allegations.” (emphasis added). 126 F. Supp. 2d 1248, 1272 (N.D. Cal. 2000).

<sup>108</sup> *Id.* (quoting *Pavelic & LeFlore v. Marvel Entm’t Grp.*, 493 U.S. 120, 126 (1989)).

<sup>109</sup> *Id.* (quoting *Christian v. Mattel, Inc.*, 286 F.3d 1118, 1127 (9th Cir. 2002)).

<sup>110</sup> *Id.* (quoting *Geinko v. Padda*, 2002 WL 276236, \*6 (N.D. Ill. Feb. 27, 2002)); *see also* *VNB Realty, Inc. v. Bank of America Corp.*, 2013 WL 5179197, at \*7 (S.D.N.Y. Sept. 16,

plaintiffs, however, had failed to inform the court as to what other sources of information besides the SEC complaint and press release they relied on in formulating their specific claims against the defendants. The complaint, as well, failed to indicate any other sources were used to formulate the claims in issue. “The Court agree[d] with defendants that, under Rule 11(b), plaintiffs did not personally investigate their claims against defendants.”<sup>111</sup> It struck each paragraph for which the SEC complaint was the sole source of factual support as well as all paragraphs containing facts taken directly from the SEC complaint, without further investigation.<sup>112</sup>

### ***B. Implications of the PSLRA on Securities Fraud Pleadings***

For securities fraud claims, additional considerations are raised by the Private Securities Litigation Reform Act (“PSLRA”)<sup>113</sup>—enacted in 1995 to deter securities fraud strike suits. The PSLRA brought with it a higher pleading standard for securities fraud claims as it relates to misrepresentations and omissions and the elements of scienter and loss causation (and a stay of all discovery

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2013) (“By drawing its factual allegations from the statements of confidential witnesses in AIG’s complaint, VNB is attempting to rely on the substance of those allegations without being held responsible for certifying that they are supported by some factual basis, or at least that the witnesses did in fact make such statements. Unlike AIG, VNB presumably does not even know who these witnesses are. *See* *Stichting Pensioenfonds ABP v. Merrill Lynch & Co., Inc.*, No. 10 Civ. 6637(LAK), 2013 WL 3989066, at \*4 (S.D.N.Y. July 31, 2013). Such reliance is impermissible, particularly in light of counsel’s “personal, non-delegable responsibility” under Rule 11 to “validate the truth and legal reasonableness of the papers filed.” *Pavelic & LeFlore v. Marvel Entertainment Group*, 493 U.S. 120, 126 (1989); *see also Stichting*, 2013 WL 3989066, at \*4 (“Allowing counsel to rely on confidential witness statements recounted in a separate complaint would provide the Court little assurance that the factual contentions have any evidentiary support.”). Judge Cote further observed that by “allowing parties to rely on confidential witness statements drawn from another complaint, the potential existed to incentivize collusion and raises the possibility of complaints that are stocked with fabricated confidential witness statements placed in other complaints.”). VBN, 2013 WL 5179197, at n. 6.

<sup>111</sup> *In re Connecticut*, 542 F. Supp. 2d at 1005-06; *see generally* *VNB Realty, Inc. v. Bank of America Corp.*, 2013 WL 5179197, at \*11 (S.D.N.Y. 2013) (“Rule 11 concerns . . . are heightened here, where VNB has stripped from the FAC any mention of the AIG complaint, while preserving the attribution of the statements to confidential witnesses. This creates the apparently erroneous impression that counsel for VNB has actually spoken with these witnesses and can affirm that they did in fact make the statements attributed to them.”).

<sup>112</sup> *In re Connecticut*, 542 F. Supp. 2d at 1006.

<sup>113</sup> 15 U.S.C. §§ 78u-4 (2012).

pending a motion to dismiss).<sup>114</sup> It requires one who pleads misrepresentations and omissions on the basis of information and belief to “state with particularity all facts on which that belief is formed.”<sup>115</sup>

In *Faulkner v. Verizon Communications, Inc.*,<sup>116</sup> plaintiffs sought to lift a PSLRA discovery stay so they could uncover “facts” to support their fraud allegations.<sup>117</sup> The district court held the sufficiency of the complaint had to be determined prior to lifting the stay because the discovery stay contemplates “discovery should be permitted in securities class actions only after the court has sustained the legal sufficiency of the complaint.”<sup>118</sup> The PSLRA requires the trial court to dismiss the complaint if it fails to satisfy the Act’s heightened pleading standards.<sup>119</sup> As a matter of law, failure to muster facts sufficient to meet the Act’s pleading requirements does not constitute the requisite “undue prejudice” to the plaintiff justifying a lift of discovery stay under § 78u-4(b)(3)(B). To hold otherwise would contravene the purpose of the Act’s heightened pleading standards.<sup>120</sup>

While the PSLRA expressly requires that sources of information and belief be alleged, the underpinning of this requirement applies equally to a non-PSLRA complaint.<sup>121</sup> Such disclosure ena-

<sup>114</sup> 15 U.S.C. §§ 78u-4(b)(1)-(3)(B) (2012). The PSLRA has been interpreted to require the pleader to “muster facts” sufficient to meet its heightened pleading standards without the aid of discovery. *See Faulkner v. Verizon Comm.*, 156 F. Supp. 2d 384, 403-04 (S.D.N.Y. 2001). To hold otherwise would contravene the very purpose of those standards. *Id.* Fed. R. Civ. P. 9(b) also imposes a heightened pleading standard for alleging fraud, which is applicable to securities fraud claims.

<sup>115</sup> 15 U.S.C. § 78u-4(b)(1) (2012).

<sup>116</sup> 156 F. Supp. 2d 384 (S.D.N.Y. 2001).

<sup>117</sup> *Id.* at 402.

<sup>118</sup> *See id.* at 402-03 (quoting S.Rep. No. 104-98, 1, 14 (1995)).

<sup>119</sup> *See* 15 U.S.C.A § 78u-4(b)(3)(A) (2010).

<sup>120</sup> *Id.* at (b)(3)(B); *see also* *Medhekar v. United States Dist. Court for the N. Dist. of Cal.*, 99 F.3d 325, 328 (9th Cir. 1996) (holding “Congress clearly intended that complaints in these securities actions should stand or fall based on the actual knowledge of the plaintiffs rather than information produced by defendants after the action has been filed.”); *see also* *In re Carnegie Int’l Corp. Sec. Litig.*, 107 F. Supp. 2d 676, 681 (D. Md. 2000) (holding that the stay also precludes defendants from acquiring documents from a third party).

<sup>121</sup> *See ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 579 F.3d 143, 152 (2d Cir. 2009).  
Holding:

The express congressional purpose of the PSLRA provision was to increase the frequency of Rule 11 sanctions in the securities context, and thus tilt the “balance” toward greater deterrence of frivolous securities claims. “Recognizing what it termed ‘the need to reduce significantly the filing of meritless securities lawsuits without hindering the ability of victims of fraud to pursue legitimate claims,’ and commenting that the ‘[e]xisting Rule 11 has not deterred abusive securities litigation,’ the

bles the district court to evaluate the sufficiency of the alleged belief, by considering the adequacy and reliability of the sources upon which the complaint relies.<sup>122</sup>

While *VNB Realty v. Bank of Am. Corp.*<sup>123</sup> did not involve the PSLRA, the decision does identify some of the pleading concerns raised by relying on another's complaint.

**C. What kind of “information” and what kind of “belief” is really at issue?**

Clearly, a filer may make allegations based upon information and belief.<sup>124</sup> When the filer properly discloses that he has relied on another complaint, it becomes incumbent on the district court to evaluate the sufficiency and reliability of that complaint as the filer's source.

In *In re Optionable Sec. Litig.*,<sup>125</sup> the plaintiffs relied on newspaper articles, which purported to describe a report compiled by Deloitte and Touche, LLP, as forensic auditor. The court began its analysis by explaining that: “[N]ewspaper articles should be credited only to the extent that other factual allegations would be - if they are

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104th Congress included in the [PSLRA] a measure intended to put ‘teeth’ in Rule 11.” *Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group, Inc.*, 186 F.3d 157, 166–67 (2d Cir. 1999). By virtue of this statutory notice, consideration of sanctions in the PSLRA context can never be *sua sponte* and can never come as a surprise, because Congress, not the court, has prompted and *mandated* a Rule 11 finding.

*Id.*

<sup>122</sup> See generally *De la Fuente v. DCI Telecommunications, Inc.*, 259 F. Supp. 2d 250, 260 (S.D.N.Y. 2003). Holding:

There is nothing improper about utilizing information from the SEC as evidence to support private claims. Indeed, as plaintiff notes “it would have been irresponsible for plaintiff to have ignored the SEC’s highly relevant allegations and findings.” (Plaintiff’s Opp., p. 4.) The striking similarity between the SEC’s allegations and plaintiff’s allegations does not demonstrate that plaintiff lacked evidentiary support. Rather, the SEC allegations provided plaintiff with evidentiary support. The PSLRA does not require that a plaintiff re-invent the wheel before filing a complaint; and one could argue that a complaint predicated on the results of an SEC investigation has far more “evidentiary support” than one based on rumor and innuendo gleaned from “Heard on the Street.”

*Id.*

<sup>123</sup> 2003 WL 51791971, \*7 (S.D.N.Y. Sept. 16, 2003).

<sup>124</sup> FED. R. CIV. P. 11.

<sup>125</sup> 577 F. Supp. 2d 681 (S.D.N.Y. 2008).

sufficiently particular and detailed to indicate their reliability. Conclusory allegations of wrongdoing are no more sufficient if they come from a newspaper article than from plaintiff's counsel."<sup>126</sup> The first article described the source of the Deloitte report as "a source familiar with the report" and the second failed to identify a basis for its description.<sup>127</sup> The plaintiffs, nevertheless, argued the articles were sufficient sources to base their information pleading, because newspapers are credible and the reporters are diligent.<sup>128</sup>

The court noted that the articles provided no basis for believing that the unidentified source was likely to have known the relevant facts about the Deloitte report.<sup>129</sup> Additionally, the article allegations lacked specificity.<sup>130</sup> Nevertheless, the court held, for motion purposes, that it would assume the plaintiffs identified an adequate source for their claim that *Optionable* provided *some* inaccurate prices.<sup>131</sup> The court stated that the articles supported that "limited allegation," but not the proposition that plaintiff's losses were attributable to *Optionable's* alleged mispricing or intentional provision of inaccurate prices.<sup>132</sup> Plaintiffs had also alleged someone received payments from *Optionable* based on statements of a confidential witness (an alleged analyst who followed *Optionable* during the relevant time period).<sup>133</sup> Although plaintiffs had identified their source, the court held this was insufficient - in addition to identifying the source, the source must be affirmatively shown to be likely to know the relevant facts,<sup>134</sup> and, in the case before the court, there was no reason to believe the "analyst" was likely to have known such facts.<sup>135</sup> As the court stated, "[a]llegations based on the investigation of counsel are

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<sup>126</sup> *Id.* at 690 (quoting *In re Wet Seal, Inc. Sec. Litig.*, 518 F. Supp. 2d 1148, 1172 (C.D. Cal. 2007)).

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Optionable*, 577 F. Supp. 2d at 690.

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.* at 691.

<sup>134</sup> *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*, 376 F. Supp. 2d 385, 395 (S.D.N.Y. 2005) (citing *In re NTL, Inc. Sec. Litig.*, 347 F. Supp. 2d 15, 23 (S.D.N.Y. 2004)); *Optionable*, 577 F. Supp. 2d at 691.

<sup>135</sup> *Optionable*, 577 F. Supp. 2d at 690. (The allegation, moreover, lacked detail that might have suggested this analyst had personal knowledge, as it did not describe the time, amount, or method of payment, but simply argued their claim was based on plaintiff's investigation).



deemed to be made on ‘information and belief’<sup>136</sup> and “the phrase ‘investigation of counsel’ is meaningless . . . . ‘[N]o amount of investigation can transform information and belief-hearsay, essentially into personal knowledge.’”<sup>137</sup>

Sometimes, reliance on another complaint, coupled with other reliable sources, has been found to be adequate. For example, in *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*,<sup>138</sup> the district court permitted reliance on an SEC complaint, which resulted in a consent judgment, when coupled with statements to investors and a court-liquidator’s report. The court explained:

Where allegations are made on information and belief, two separate inquiries are required to determine whether plaintiffs have pleaded with particularity facts sufficient to support their beliefs. First, plaintiffs’ factual allegations must be based on adequate sources. Plaintiffs must identify sufficiently the sources upon which their beliefs are based and those sources must have been likely to have known the relevant facts. Second, the underlying factual allegations must justify the inference that plaintiffs urge. In other words, plaintiffs must allege facts sufficient to justify the assertion that the NAVs were inflated and that the amount of the inflation would have been material to a reasonable investor.<sup>139</sup>

Generally, the stronger the factual basis for the filer’s belief, that is, the more corroborating sources and the more reliable those sources are, the more inclined some district courts may be to sustain the allegation. If a pleading clearly demonstrates that a filer abdicated his responsibility to conduct a reasonable inquiry and investigation, it cannot be relied upon by a different pleading, whether viewed

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<sup>136</sup> See *id.* at 691 (citing *Malin v. XL Capital Ltd.*, 499 F. Supp. 2d 117, 136 (D. Conn. 2007)).

<sup>137</sup> See *id.* (quoting *In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 356 (S.D.N.Y. 2003)).

<sup>138</sup> 376 F. Supp. 2d 385 (S.D.N.Y. 2005).

<sup>139</sup> *Id.* at 395 (notes omitted) (“Here, the subsidiary factual allegations that plaintiffs rely upon are based upon the Liquidator’s Report . . . statements made by Beacon Hill to investors, and the SEC Complaint. These are adequate for Rule 9(b) and PSLRA purposes. The question therefore is whether the factual allegations drawn from these sources support the conclusion that the NAVs were materially false and misleading.”).

from the perspective of *Lipsky* or Rule 11. But absent such clear demonstration, if there is some indicia of reliability as to the sources relied upon, and some plausibility to the claims, the plausibility approach could result in a court sustaining the second complaint or its content.

## CONCLUSION

The question whether the content of pleadings from other cases may be properly inserted into one's own pleading has no easy answer. As demonstrated above, courts are not only reading *Lipsky* in different ways, but looking to other authorities to provide guidance for their decisions, including Rule 11 analyses and "plausibility" approaches. The different approaches have their own benefits and disadvantages, as summarized below.

The absolute interpretation of *Lipsky* as a bright line test is easy to apply, and its application will likely reduce judicial time and litigation costs. It does so by eliminating the need for judges to enter into detailed (likely intuitive) determinations as to the "factual credibility" of the content of pleadings not before the court. On the other hand, there may be factual allegations in the pleadings of other cases which present indicia of plausibility that suggest their content could be reliable and viewed as "some evidence" of the underlying facts.

The not-so-bright line interpretation cases largely rely on an interpretation of the evidentiary rules the *Lipsky* Court cited, bolstered by the *Lipsky* Court's statement that pleadings should not be tampered with absent a good reason for so doing. Untested foreign pleadings are, at least in principle, made in compliance with Rule 11. Therefore, they seem to be more reliable than just naked assertions. Nevertheless, it is hard to see how a reviewing court's views as to the reliability of a foreign pleading could not be substantially subjective—of the "I know it when I see it" type. Consideration of such allegations also portend the possibility of conflicting outcomes, for example, where the case from which the allegations derive is still being litigated. With no practical way to monitor the correctness of a foreign pleading or assess that pleader's good faith in interposing those allegations, the current pleader is effectively given a "free pass" on his own pleading, which is inconsistent with and impermissible under Rule 11.

The Rule 11 approach avoids *Lipsky* interpretation fights, a

definite advantage, but it raises its own questions. To conduct a Rule 11 “reasonable investigation,” an attorney must review documents reasonably expected to contain information material to his or her case. Pleadings, however, are advocacy documents and exaggerations or falsehoods frequently find their way into them, Rule 11 notwithstanding. Allowing a pleader to take the content of a complaint from another case that he happens to review is not equivalent to a personal, good faith basis for alleging the facts upon which the pleading supervenes. Even if one assumes the initial pleader’s certification under Rule 11 was in good faith, this is not equivalent to the current pleader’s own Rule 11 certification of a personal, good faith belief in a fact interposed.

The “plausibility approach,” too, has advantages and disadvantages. There is substantial case law and commentary on how the “plausibility” concept is applied in current motion practice. Basically, the question is whether the particular wrongdoing that the plaintiff alleges caused the loss in issue is at least as likely an explanation for the loss as the reason(s) the defense musters to support its argument for dismissal. If plaintiff’s explanation in favor of liability is at least as likely as defendant’s explanation, the complaint survives. Courts, however, in the present context, should not be making such subjective judgments about sentences authored by lawyers not before the court in pleadings not before the court, in cases not before the court.

On balance, the absolute interpretation approach remains the best approach available notwithstanding that courts adopting other approaches have arguments in their favor. The over-all problem is that each of the other approaches cannot help but involve the court in making what are likely to be highly intuitive assessments of foreign pleadings, the truth of which cannot be determined by the motion court, on a Rule 12 motion. Efforts to make such assessments would, of necessity, disregard the undeniable reality that bias and exaggeration is often present in many pleadings, Rule 11 certifications notwithstanding.

Such subjective/intuitive approaches would, moreover, be particularly problematic in securities litigation. Under the PSLRA, securities plaintiffs are required to plead their cases on a pre-discovery basis. Discovery is stayed unless and until the complaint survives dismissal. Allowing pleaders to interpose allegations from other cases – including potentially SEC complaints—would allow

plaintiffs to effectively circumvent the PSLRA, particularly where, based on happenstance, the SEC happens to file a complaint with perceived helpful allegations/content to plaintiff.

The absolute interpretation of *Lipsky* protects litigants from a reliance on documents from other cases whose merits have not been proved. It protects trial courts, which should not be engaged in making intuitive assessments of the factual content or the likely merit of the content of sentences in advocacy documents, drafted by interested parties not before the court, which portend inconsistent results among courts potentially addressing the same factual complexes. In light of the different approaches courts are currently taking, it is likely a Second Circuit decision will be needed to clarify *Lipsky* and to determine if (or under what circumstances) pleaders in one case may properly allege the content of complaints crafted by other pleaders in other cases.