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Comments: Maryland Statutory and Common Law Remedies for Misrepresentation in Securities Transactions

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COMMENTS

MARYLAND STATUTORY AND COMMON LAW REMEDIES FOR MISREPRESENTATION IN SECURITIES TRANSACTIONS

Victims of misrepresentation in securities transactions generally bring their claims into federal court under Rule 10b-5. Because some courts have constricted the scope of this federal remedy, other means of relief for misrepresentation have assumed greater importance. This comment explores Maryland's statutory and common law remedies and discusses certain advantages available through these avenues of relief.

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I. INTRODUCTION

The current popularity of federal remedies for securities fraud may sometimes lead litigants to ignore state relief. Inattention to state remedies may cause the loss of valuable opportunities for redress in either state court or, on the basis of pendent jurisdiction, federal court. Because federal courts have begun to narrow the reach of an implied remedy under Securities and Exchange Commission (SEC) Rule 10b-

5,¹ state remedies for securities fraud are acquiring greater importance. Common law theories that antedate both the federal and state securities statutes retain their vitality in modern securities litigation, and the private remedies approach offered by the Maryland Securities Act² (Act) is sufficiently distinct from Rule 10b-5 to warrant its use as a separate, rather than concurrent, avenue of redress. This article describes the remedies available under Maryland common law and the Act, and compares the state and federal securities laws to demonstrate their important differences.

II. MARYLAND COMMON LAW REMEDIES FOR SECURITIES FRAUD

Maryland courts allowed recovery for misrepresentations in securities transactions well before the adoption of the state and federal securities acts. These common law theories deal with both affirmative and negligent misrepresentations. The following will discuss significant elements of each cause of action to provide background for a subsequent comparison of the state and federal acts.

A. *Actions in Deceit*

Although Maryland decisional law occasionally mentions actions for fraud,³ "fraud" and "deceit" are synonymous terms, and the elements for any cause of action labeled fraud are identical to those for the traditional deceit action.⁴ Deceit actions have consistently provided a vehicle for recovery under theories of law⁵ and equity⁶ for affirmative

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1. 17 C.F.R. § 240.10b-5 (1983). Rule 10b-5 was issued under the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982). For a thorough discussion of the growing trend of the federal courts to limit the reach of Rule 10b-5, see 1 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 2.2(463) (1983) (reviewing the "contraction era" of Rule 10b-5).
 2. MD. CORPS. & ASS'NS CODE ANN. § 11-101 to -908 (1975 & Supp. 1984).
 3. See, e.g., *First Nat'l Bank of S. Md. v. United States Fidelity & Guar. Co.*, 275 Md. 400, 409, 340 A.2d 275, 283 (1975) (alleged fraudulent assignment of accounts to a third party); *Buschman v. Codd*, 52 Md. 202, 206 (1879) (action in fraud for misrepresentations that induced purchase of interest in business).
 4. Compare *Suburban Properties Management, Inc. v. Johnson*, 236 Md. 455, 460, 204 A.2d 326, 329 (1964) (listing elements of "legal fraud") with *Appel v. Hupfield*, 198 Md. 374, 378, 84 A.2d 94, 95-96 (1951) (listing same elements for an "action in deceit"). This comment will refer to all actions in deceit and fraud as actions in deceit.
 5. See, e.g., *Cook v. Gill*, 83 Md. 177, 34 A. 248 (1896) (damages awarded for fraudulent misrepresentations that induced purchase of mining shares); *McAleer v. Horsey*, 35 Md. 439 (1872) (damages recovered for fraudulently induced purchase of shares in a silver mine).
 6. See, e.g., *Shulton, Inc. v. Rubin*, 239 Md. 669, 212 A.2d 476 (1965) (rescission of contract for purchase of controlling shares in corporation granted because of material misrepresentations made by the seller); *Findlay v. Baltimore Trust & Guar. Co.*, 97 Md. 716, 55 A. 379 (1903) (presence of fraud in the sale of bonds will allow rescission of the contract to purchase); *Fear v. Bartlett*, 81 Md. 435, 32 A.

misrepresentations in the sale or purchase of securities.⁷

1. Affirmative Misrepresentation

Many torts include affirmative misrepresentation as an integral element.⁸ An action in deceit, however, is a separate tort that addresses affirmative misrepresentation as a distinct wrongful action.⁹ The Court of Appeals of Maryland first applied the theory of deceit to a typical securities transaction in *McAleer v. Horsey*,¹⁰ an 1872 decision. In *McAleer*, the defrauded purchaser of shares in a valueless Nevada silver mine successfully claimed damages caused by the seller's misrepresentations that induced the purchase. The court of appeals subsequently developed and refined five elements for an action in deceit: (1) speaker made a false representation; (2) speaker knew that the representation was false, or made it with such reckless indifference to the truth so as to impute his knowledge; (3) this misrepresentation was made for the purpose of defrauding another; (4) recipient relied, and had a right to rely, upon the speaker's misrepresentation; and (5) recipient suffered damage as a direct result of the misrepresentation.¹¹

Prior to examining the elements of deceit, it should be noted that a plaintiff may obtain recovery under this theory only by proving that the alleged misrepresentation is the proximate cause of his damages. Courts analyze each of the deceit elements to determine if the alleged misrepresentation should have been, and was in fact, reasonably relied

322 (1895) (defense of fraud available in equity to defeat action for unpaid balance of stock subscription when its purchase was fraudulently induced).

7. See, e.g., *Byrd v. Rautman*, 85 Md. 414, 417-19, 36 A. 1099, 1100 (1897) (court recognized but did not grant right to cause of action by defrauded seller of corporate shares); *McAleer v. Horsey*, 35 Md. 439 (1872) (remedy available for defrauded buyer of valueless mining corporation shares).

The continuing vitality of common law remedies for fraudulent securities transactions is demonstrated by a 1983 decision by the court of special appeals. *Kalb v. Vega*, 56 Md. App. 653, 468 A.2d 676 (1983) (seller of corporate shares, defrauded by purchaser's misstatements and omissions of fact, awarded damages for fraudulent conversion).

8. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 105 (4th ed. 1971) (misrepresentation of authority can be an element in an action for false imprisonment; misrepresentation that a dangerous substance is wholesome food may form an element of an action for battery; misrepresentation of identity or purpose may become an element in an action for conversion).

9. For a thorough discussion of the historical development of the action of deceit, see *id.*; see also Comment, *Deceit and Negligent Misrepresentation in Maryland*, 35 MD. L. REV. 651, 651-61 (1976).

10. 35 Md. 439 (1872). Maryland decisional law on fraud in transactions not involving traditional securities may be traced to *Joice v. Taylor*, 6 G. & J. 54 (Md. 1833) (rescission granted on mortgage that was fraudulently obtained).

11. *Suburban Properties Management, Inc. v. Johnson*, 236 Md. 455, 460, 204 A.2d 326, 329 (1964) (citing *Appel v. Hupfield*, 198 Md. 374, 84 A.2d 94 (1951)), cited in *First Nat'l Bank of S. Md. v. United States Fidelity & Guar. Co.*, 275 Md. 400, 411-12, 340 A.2d 275, 284 (1975); *Canatella v. Davis*, 264 Md. 190, 198-99, 286 A.2d 122, 126-27 (1972); *James v. Goldberg*, 256 Md. 520, 528-29, 261 A.2d 753, 758 (1970).

upon by the plaintiff to his detriment.¹² Many cases after *McAleer* that involved securities transactions focused upon each of these elements.¹³

Maryland courts will not sustain an action for deceit unless the affirmative misrepresentation concerns an ascertainable fact. For example, in *Buschman v. Codd*,¹⁴ the court of appeals focused upon whether a seller's statements regarding the soundness and profitability of the business he had sold to the defrauded purchaser constituted misrepresentations upon which a buyer might reasonably rely. The court held that an actionable misrepresentation could only be premised upon a statement of "ascertainable fact," and not upon an opinion, judgment, expectation or anything so indefinite that it should put the one hearing it upon inquiry.¹⁵ Since the *Buschman* decision dealt with representations that were "peculiarly" within the knowledge of the seller,¹⁶ and the purchaser had no other means of determining the truth of the representations, the court found the statements to be material facts upon which the buyer had a right to rely.¹⁷

Maryland decisional law fails to define explicitly what constitutes an ascertainable fact.¹⁸ Generally, the representation must "be of a

12. W. PROSSER, *supra* note 8, § 108, at 714-20.

13. For an overview of the development of Maryland decisional law on fraud in securities transactions and topics relating to corporate subjects, see *Shulton, Inc. v. Rubin*, 239 Md. 669, 212 A.2d 476 (1965) (misrepresentations of stock value and perfection of chemical production method to induce sale); *Schmidt v. Millhauser*, 212 Md. 585, 130 A.2d 572 (1956) (advertisement for sale of apartment complex induced purchase through misrepresentation); *Sears v. Barker*, 155 Md. 323, 141 A. 908 (1928) (allegations that misrepresentations in oil company prospectus induced purchase of shares); *Reynolds v. Evans*, 123 Md. 365, 912 A. 564 (1914) (allegations that misrepresentations induced purchase of stock); *Kalb v. Vega*, 56 Md. App. 653, 468 A.2d 676 (1983) (purchaser's nondisclosures and misstatements regarding the true financial condition of the corporation constituted fraudulent misrepresentations; damages awarded to defrauded seller of shares).

14. 52 Md. 202 (1879).

15. The *Buschman* court stated:

The representation to be material, must be in respect of an ascertainable fact as distinguishable from a mere matter of opinion. A representation which amounts to a statement of opinion, judgment or expectation, or is vague and indefinite in its nature and terms, or is merely a loose conjectural or exaggerated statement, is not sufficient to support an action. And for the reason, that such indefinite representations ought to put the person to whom they are made, upon the inquiry, and if he chooses to put faith in such statements, and abstracted from inquiry, he has no reason to complain.

Id. at 207; *accord* *Lewis v. Clark*, 86 Md. 327, 37 A. 1035 (1897) (mere statements that previous owner informed seller that water supplied by cistern was good in quality and quantity did not provide a basis for injured buyer who did not further investigate the water supply).

16. *Buschman*, 52 Md. at 208.

17. *Id.* at 208-09.

18. See *Fowler v. Benton*, 229 Md. 571, 578, 185 A.2d 344, 349 (1962); *Schnader v. Brooks*, 150 Md. 52, 132 A. 381 (1926); *Boulden v. Stilwell*, 100 Md. 543, 60 A. 609 (1905).

past or existing fact,"¹⁹ or a promise to perform,²⁰ which is definite and not merely vague or general. An actionable false representation, in its broadest sense, may include anything short of a warranty that creates a false impression conducive to some act.²¹ Maryland cases discussing securities fraud indicate that actionable facts include the specific value of shares;²² that another person is already a shareholder in the corporation;²³ that certain persons have agreed to become directors;²⁴ and certain statements contained in a prospectus.²⁵ Other actionable misrepresentations have been based upon misstatements of business costs;²⁶ the solvency of a business;²⁷ hidden encumbrances upon corporate assets;²⁸ that stock is authorized²⁹ or genuine;³⁰ that shares could not be purchased for less than a specific amount;³¹ and promises to perform.³² Nonactionable misrepresentations have included the motivation for selling shares;³³ mere opinions regarding stock value;³⁴ that a

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19. See *Fowler v. Benton*, 229 Md. 571, 578-79, 185 A.2d 344, 349 (1962).
 20. See *Tufts v. Poore*, 219 Md. 1, 11-12, 147 A.2d 717, 723 (1959) (fraud may be founded upon promises made with no intention to perform). *Contra Appel v. Hupfield*, 198 Md. 374, 399, 84 A.2d 94, 96 (1951) (cannot ordinarily predicate fraud upon promissory statements).
 21. *Fowler v. Benton*, 299 Md. 571, 579, 185 A.2d 344, 349 (1962); see also *Local 75 United Furniture Workers of Am. v. Regiec*, 19 Md. App. 406, 410, 311 A.2d 456, 458 (1973) (court noted that another case, *Johnson v. Maryland Trust Co.*, 176 Md. 557, 6 A.2d 383 (1939), was an "equity action which held that misrepresentations giving rise to relief in equity must relate to matters of fact and not to matters of expectations or opinions.").
 22. *Cook v. Gill*, 83 Md. 177, 187-90, 34 A. 248, 249-50 (1896) (statements regarding value of stock may present legally sufficient evidence of misrepresentations).
 23. *Wenstrom Consol. Dynamo & Motor Co. v. Purnell*, 75 Md. 113, 122, 23 A. 134, 134-36 (1891) (applies to equity actions to avoid contracts of subscription or sale where one party was bound by fraudulent inducements).
 24. *Id.*
 25. See, e.g., *Schmidt v. Millhauser*, 212 Md. 585, 588, 130 A.2d 572, 573 (1956) (advertisement represented apartment roof 25 to 30 years old as "recently installed"); *Sears v. Barker*, 155 Md. 323, 325-26, 141 A. 908, 909 (1928) (statements in prospectus that oil corporation owned certain property when corporation actually held an option); *Findlay v. Baltimore Trust & Guar. Co.*, 97 Md. 716, 718-21, 55 A. 379, 380-81 (1903) (complaint withstood demurrer when, among other representations, statements in prospectus indicated that the offered securities had been carefully investigated and were very safe).
 26. *Shulton, Inc. v. Rubin*, 239 Md. 669, 685, 212 A.2d 476, 485 (1965) (statements of fact regarding cost to purchase controlling shares may be considered material misrepresentations).
 27. *James Clark Co. v. Colton*, 91 Md. 195, 204, 46 A. 386, 391-92 (1900).
 28. *McGaw v. Hoen*, 133 Md. 672, 680, 106 A. 13, 16 (1919).
 29. *Tome v. Parkersburg Branch R.R.*, 39 Md. 36 (1873).
 30. *Western Md. R.R. v. Franklin Bank*, 60 Md. 36 (1883).
 31. *Cook v. Gill*, 83 Md. 177, 188-91, 34 A. 248, 249-50 (1896).
 32. See *supra* note 20.
 33. *Byrd v. Rautman*, 85 Md. 414, 419, 36 A. 1099, 1101 (1897).
 34. Compare *Reynolds v. Evans*, 123 Md. 365, 370-71, 91 A. 564, 566-67 (1914) (general assertions by seller that property is valuable are not statements of existing fact, but only a nonactionable opinion) with *Cook v. Gill*, 83 Md. 177, 186-88, 34 A. 248, 249 (1896) (statement that "eighty dollars is the price everybody paid" for stock was an actionable fact).

business was failing and that a shareholder-officer would be discharged;³⁵ that the purchasers of stock intended to resell for a profit;³⁶ representations regarding the true ownership of stock being sold;³⁷ and statements that a business is "prosperous and well-established"³⁸ and a "safe and profitable investment."³⁹

Once the plaintiff establishes the misrepresentation of an ascertainable fact, he must show that it was material to the transaction and that he relied upon it. A statement is material if without it,⁴⁰ or if it were known that the statement was untrue,⁴¹ the defrauded party would not have completed the transaction. In addition, materiality may be found when a contract clause designates certain misrepresentations as material.⁴² An objective standard is applied to determine the materiality of a misrepresentation. Under this standard, the question is whether a reasonable investor would have relied upon the misrepresentation in making the investment decision.⁴³

The issue of reliance is closely related to materiality. A finding that a misrepresentation is material because a transaction would not have been completed without it implies reliance upon the statement. To determine whether a party relied upon the material misrepresentation, however, a subjective test is applied. In this situation, the issue is

35. *Boulden v. Stilwell*, 100 Md. 543, 555-56, 60 A. 609, 612 (1905) (statements made to induce plaintiff to sell his shares were deemed mere "buyers talk" rather than misrepresentations of facts; court applied rule of caveat vendor).

36. *Llewellyn v. Queen City Dairy*, 187 Md. 49, 59-60, 48 A.2d 322, 327-28 (1946).

37. *Cahill v. Applegarth*, 98 Md. 493, 505, 56 A. 794, 798 (1904).

38. *Robertson v. Parks*, 76 Md. 118, 127, 24 A. 411, 413 (1892) (statements of opinion of speculative belief are not ascertainable facts and place recipient upon inquiry notice).

39. *Id.* at 127, 132-33, 24 A. at 413-14.

40. *Boulden v. Stilwell*, 100 Md. 543, 552, 60 A. 609, 610 (1905) ("The fraud must be material, by which is meant that without it, the transaction would not have been made."); see also *Fowler v. Benton*, 229 Md. 571, 578-83, 185 A.2d 344, 349-51 (1962) (discussing actionable misrepresentations). See generally Annot., 80 A.L.R.3d 13 (1977 & Supp. 1983) (review of cases discussing materiality).

41. See *Shulton, Inc. v. Rubin*, 239 Md. 669, 685, 212 A.2d 476, 485 (1965); *Byrd v. Rautman*, 85 Md. 414, 416, 36 A. 1099, 1100 (1897).

42. See *Shulton, Inc. v. Rubin*, 239 Md. 669, 686, 212 A.2d 476, 485 (1965).

43. The court of appeals, in a 1950 decision, remarked:

[R]eliance upon either a fraudulent or an innocent misrepresentation of fact in a business transaction is justifiable only if the fact misrepresented is material. A fact is material if (1) its existence or nonexistence is a matter to which a reasonable man would attach importance in determining his choice of action in the transaction, or (2) the maker of the representation knows that its recipient is likely to regard the fact as important although a reasonable man would not so regard it.

Brodsky v. Hull, 196 Md. 509, 515-16, 77 A.2d 156, 159 (1950) (citing *Clark v. Kirsner*, 196 Md. 52, 74 A.2d 830 (1950); RESTATEMENT OF TORTS § 538 (1934)); see also W. PROSSER, *supra* note 8, § 108, at 714-20 (discussing interplay between the theories of reliance and materiality in actions for deceit); cf. *Clark*, 196 Md. at 56, 74 A.2d at 832 (materiality more important in proceeding for rescission than in case of fraudulent misrepresentation) (citing RESTATEMENT OF CONTRACTS § 476 comment b (1932)).

not whether "a reasonable investor would" consider the representation important, but whether *this* investor considered the false statement important when making his decision.⁴⁴

A close factual and legal nexus exists between the concepts of materiality and reliance. Essentially the same facts are analyzed to determine whether the defrauded party should have relied, and did rely, upon the misrepresentation. Materiality and reliance are both examined to establish the causation of the injury. Absent either element, as a matter of law the misrepresentation could not have been the proximate cause of the damages alleged. For example, a Maryland court will not analyze the issue of materiality if it finds that the plaintiff did not or could not have relied upon the asserted misrepresentation. For instance, in *Negley v. Hagerstown Manufacturing, Mining & Land Improvement Co.*,⁴⁵ the plaintiff claimed to have contracted to purchase certain shares solely upon misrepresentations set forth in the issuer's prospectus. The *Negley* court upheld the trial court's dismissal of the suit, noting that the uncontested facts demonstrated that the prospectus had not been published until three days *after* the plaintiff had purchased the shares. The court, which found reliance impossible in this situation, refused to entertain questions dealing with the materiality of the alleged misrepresentations.⁴⁶ Materiality and the right to rely upon representations contained in a prospectus are normally presumed by Maryland courts unless a situation analogous to that in *Negley* is presented.⁴⁷ Conversely, once a misrepresentation has been deemed

44. See *Shulton, Inc. v. Rubin*, 239 Md. 669, 689, 212 A.2d 476, 485 (1965) (plaintiff-investor "would not have agreed" to invest if the truth of the misrepresentations had been known to him).

45. 86 Md. 692, 39 A. 506 (1898).

46. The *Negley* court remarked:

It is morally certain that he could not have been induced by the statements contained in that prospectus to make the subscription when, in point of fact, the prospectus had no existence at the time the subscription was made. *And this is all we need to say. As thus presented the case does not call for an analysis of the statements contained in the prospectus.* . . .

Id. at 695, 39 A. at 507 (emphasis supplied). See generally James & Gray, *Misrepresentation—Part II*, 37 MD. L. REV. 488, 488-511 (1978) (reviewing historical development of the definition of justifiable reliance).

47. The stringent duty of complete and accurate disclosures in a prospectus imposed by the Maryland courts is best seen from the following passage from an 1894 court of appeals decision:

Those who issue a prospectus holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as a fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducements to take shares.

Findlay v. Baltimore Trust & Guar. Co., 97 Md. 716, 723, 55 A. 379, 381 (1903) (quoting *Savage v. Bartlett*, 78 Md. 561, 565, 28 A. 414, 415 (1894)).

immaterial, courts will find that the plaintiff had no right to rely upon it and they will deny recovery.⁴⁸

2. Fraudulent Omission

Intentional omissions of material fact are actionable in deceit in the same manner as affirmative representations.⁴⁹ The rationale for this approach is simply a recognition that “[f]raud may consist in a suppression of the truth as well as in the assertion of a falsehood.”⁵⁰ As in complaints alleging misrepresentations, courts must find intentional concealment of a fact for the purpose of defrauding the investor or seller.⁵¹

Maryland courts draw a distinction, however, between intentional concealment of facts and mere non-disclosure.⁵² Without a showing of intentional concealment, there is no duty to disclose unrequested information absent a special relationship imposing a higher duty of disclosure between the parties.⁵³ Examples of this relationship in securities transactions are those of the corporate officer to corporate shareholders⁵⁴ and creditors;⁵⁵ between the corporation and others dealing with

48. *Babb v. Bolyard*, 194 Md. 603, 610-11, 72 A.2d 13, 17 (1950) (automobile dealer's misrepresentations were not material; therefore, the court would not discuss the issue of reasonable reliance by the plaintiff); *see supra* notes 38-39 and accompanying text (because alleged misrepresentations were considered immaterial, the court found it unnecessary to evaluate the plaintiff's reliance).

49. *See supra* note 47.

50. *Schnader v. Brooks*, 150 Md. 52, 57, 132 A. 381, 383 (1926). In *Findlay v. Baltimore Trust & Guar. Co.*, 97 Md. 716, 55 A. 379 (1903), for example, the Court of Appeals of Maryland found the allegation that the seller of streetcar bonds had “withheld and suppressed the material information as to the value and safety of the bonds as an investment” constituted an averment of fraudulent misrepresentation, through omission of facts from a prospectus, sufficient to withstand demurrer. *Id.* at 722-23, 55 A. at 381; *see also* *Shulton, Inc. v. Rubin*, 239 Md. 669, 685, 212 A.2d 476, 487 (1965) (misrepresentations of material facts through misstatements and omissions induced sale of corporate shares).

51. *Compare* *Findlay v. Baltimore Trust & Guar. Co.*, 97 Md. 716, 55 A. 379 (1903) (omissions of fact from prospectus support an action for fraudulent misrepresentation) *with* *Robertson v. Parks*, 76 Md. 118, 133, 24 A. 411, 413 (1892) (failure to observe statutory bookkeeping requirements, i.e., failure to maintain business records would not constitute substantive ground for recovery in action for deceit; court requires intentional suppression).

52. *See* *Schnader v. Brooks*, 150 Md. 52, 58, 132 A. 381, 383 (1926) (noting distinction between suppression of fact and mere silence). These criteria apply only to actions in deceit for *fraudulent* omissions; Maryland may also recognize an action in negligence based upon an omission. *See infra* note 83 and accompanying text.

53. *Schnader v. Brooks*, 150 Md. 52, 58, 132 A. 381, 383 (1926) (“where there is an obligation to speak, a failure to speak will constitute the suppression of a fact; but where there is no obligation to speak, silence cannot be termed suppression”) (quoting *Chicora Fertilizer Co. v. Dunan*, 91 Md. 144, 159, 46 A. 347, 351 (1900)).

54. *Parish v. Milk Producers Ass'n*, 250 Md. 24, 74, 242 A.2d 512, 539 (1968) (officers and directors, because of their confidential relationship to the shareholders, owe a duty to reveal all facts material to the corporate transaction); *Ross Trans., Inc. v. Crothers*, 185 Md. 573, 583-85, 45 A.2d 267, 271-72 (1946) (sale of authorized but unissued shares by corporate directors to themselves voidable as constructive

the corporation;⁵⁶ or between partners.⁵⁷ When a relationship creates a duty to disclose, one party to the transaction occupies a position of trust and confidence, and possesses restricted or "inside" information. Omissions by those with access to this information may constitute a breach of trust or confidence if the concealment is intended to defraud those less informed.⁵⁸

fraud upon the other shareholders; court applied principle that trustees cannot purchase at their own sale); *Macgill v. Macgill*, 135 Md. 384, 393-94, 109 A. 72, 75 (1919) (under theories of agency and trusteeship, failure to disclose facts underlying allegedly "fraudulent" stock exchange promoted by corporate directors is a sufficient breach of duty to disallow a demurrer). *But cf.* *Twenty Seven Trust v. Realty Growth Investors & RGI Holding Co.*, 533 F. Supp. 1028, 1034 (D. Md. 1982) (federal case applying Maryland law held controlling shareholders under no duty through a fiduciary relationship to minority shareholders regarding their stock, absent a claim of fraud or other wrongful conduct); *Llewellyn v. Queen City Dairy*, 187 Md. 49, 58-60, 48 A.2d 322, 327-28 (1946) (corporate director's failure to reveal inside information when buying stock from a shareholder would not be considered a breach of a fiduciary relationship, absent attempts to mislead or perpetrate a fraud); *Kalb v. Vega*, 56 Md. App. 653, 661-62, 468 A.2d 676, 680-81 (1983) (interpreting *Llewellyn* as standing for the proposition that corporate directors have no fiduciary relationship with individual shareholders, but directors are liable for fraudulent activities practiced upon individual shareholders).

Llewellyn and *Twenty Seven Trust* may ignore that, but for the ownership of stock, no relationship would ever arise among shareholders and directors or among shareholders. The ownership of stock therefore arguably creates some degree of relationship between corporate directors and shareholders, rather than equating shareholders with those who own no shares and are thus complete strangers to the corporation.

55. *See James Clark Co. v. Colton*, 91 Md. 195, 209, 46 A. 386, 387-88 (1900) (in an action by the trustee in bankruptcy to declare certain transactions void as fraudulent preferences, the court recognized superior knowledge of corporate affairs by a director and that this knowledge could not be used to further his own interests at the expense of others).
56. *See McGraw v. Hoen*, 133 Md. 672, 680, 106 A. 13, 16 (1919) (corporate officers under affirmative duty to disclose hidden encumbrances to purchasers of corporate assets); *Tompkins v. Sperry, Jones & Co.*, 96 Md. 560, 582-83, 54 A. 254, 258 (1903) (fiduciary relationship extends between corporation and those whom it invites to enter into transactions and includes the duty "to practice no concealments"); *Western Md. R.R. v. Franklin Bank*, 60 Md. 36 (1883) (corporation liable for fraudulent misrepresentations and omissions by agent regarding genuineness of stock certificates).
57. *See Hambleton v. Rhind*, 84 Md. 456, 487-89, 36 A. 597, 602 (1897) (partners under affirmative duty to disclose all material facts to copartners).
58. *See generally* Annot., 80 A.L.R.3d 13 (1977 & Supp. 1983) (discussing when a duty to disclose material facts to stock purchasers arises); Annot., 22 A.L.R.3d 793 (1968) (discussing corporate insider's nondisclosure of information as a basis of liability under the federal securities acts).

In addition, corporate officers individually must be aware of the need to avoid fraud because Maryland courts have demonstrated a willingness to pierce the corporate veil of personal non-liability to prevent fraud or enforce a paramount equity. *See Colandrea v. Colandrea*, 42 Md. App. 421, 433, 401 A.2d 480, 484 (court disregarded corporate entity because of fraudulent conduct of sole shareholder), *cert. denied*, 286 Md. 745 (1979); *Fuller v. Horvarth*, 42 Md. App. 671, 684-87, 402 A.2d 134, 142-43 (1979) (fraud potentially existed and trial court could disregard corporate entity if it found fraud after remand of directed verdict). For cases where fraud was not found but the court reiterated the theory, see

As in cases involving misrepresentations, an omission must be material to provide a basis for recovery. Early Maryland cases held that in circumstances where a prospectus was issued⁵⁹ or a relationship of special trust existed,⁶⁰ a party is under a duty to omit no facts upon which a reasonable investor *might* rely.⁶¹ This low threshold standard for recovery on omissions may constitute too high a duty to disclose, however, and could present situations where the most trivial omissions would premise an action in deceit.⁶² Maryland courts appear to have at least implicitly accepted instead the reasonable investor "would have relied" standard⁶³ and will probably continue to use this standard because it is in substantial accordance with the prevailing standard in omission cases under federal law.⁶⁴

3. Scienter

Actions in deceit require scienter.⁶⁵ To prove scienter, or fraudulent intent, the defrauded party must demonstrate that the speaker knew the falsity of the statement he made, or was so reckless and indifferent to the truth of the matter asserted that scienter may be imputed to him.⁶⁶ Early Maryland cases often went to great lengths to distinguish where scienter-through-recklessness stopped and mere negligence began. One of the best examples of an effort to refine this distinction was provided in *Cahill v. Applegarth*,⁶⁷ a 1904 decision by the court of appeals. The *Cahill* court held that absent proof that the speaker knew

Bart Arconti & Sons, Inc. v. Ames-Ennis & Co., 275 Md. 295, 312, 340 A.2d 225, 235 (1975); *Damazo v. Wahby*, 259 Md. 627, 633, 270 A.2d 814, 817 (1970); *Ace Dev. Co. v. Harrison*, 196 Md. 357, 366-70, 76 A.2d 566, 570-71 (1950); *Wm. Danzer & Co. v. Western Md. Ry.*, 164 Md. 448, 457, 165 A. 463, 467 (1933); *Dixon v. Process Corp.*, 38 Md. App. 644, 655-59, 382 A.2d 893, 900-01 (1978); *see also* *Gordon v. S.S. Vedalin*, 346 F. Supp. 1178, 1180-81 (D. Md. 1972) (applying Maryland law to determine whether liability of defaulting purchaser should be assessed to the corporate entity or to an individual).

59. *Findlay v. Baltimore Trust & Guar. Co.*, 97 Md. 716, 723, 55 A. 379, 381-82 (1903) (issuer of prospectus must state all facts accurately and must set forth all material information).

60. For instance, a relationship of special trust exists between a corporate promoter to a corporate bond purchaser, or with respect to a trustee under a mortgage. *Id.*

61. One issuing a prospectus has a duty to omit no facts "which *might* in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducements to take shares." *Id.* at 723, 55 A. at 381 (quoting *Savage v. Bartlett*, 78 Md. 561, 566, 28 A. 414, 415 (1894)) (emphasis supplied).

62. For a more thorough discussion of this policy and the federal standard for materiality of omissions, see generally *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 444-49 (1976).

63. *See Shulton, Inc. v. Rubin*, 239 Md. 669, 685, 212 A.2d 476, 485 (1965) (investor "would not have agreed" to purchase shares if he had known facts omitted by seller) (emphasis supplied).

64. 3 A. BROMBERG & L. LOWENFELS, *supra* note 1, at § 8.2 to .3.

65. *See supra* note 13 and accompanying text.

66. *Id.*

67. 98 Md. 493, 56 A. 794 (1904).

that his statement was false, the court could impute scienter if the defrauded party could prove that the speaker had no bona fide belief in his own statement, or if he pretended to have knowledge "which he must have known that he did not have," or the speaker had no reasonable grounds to believe the truth of the matter asserted, or "was utterly reckless and indifferent as to whether it was true."⁶⁸ Under no circumstances, however, could an action in deceit proceed upon negligence.⁶⁹

Equity courts, in contrast, applied a more lenient rule for deceit actions. Generally, this rule provided that misrepresentations of material fact, without more, might justify rescission of a contract alleged to have been fraudulently induced.⁷⁰ Older decisional law establishes that in some circumstances, accurate and complete knowledge of certain facts was presumed, and courts could thus impute scienter when incorrect statements were made. These situations usually involved corporate officers who made factual representations about their own corporation.⁷¹ This presumption is of less concern in actions for deceit today since the "should have known" standard is available in actions for negligent misrepresentations.⁷² Contrary to the general rule for civil actions in Maryland, proof of fraud must be established by "clear and satisfactory" evidence rather than by a mere preponderance of evidence.⁷³

B. Negligent Misrepresentations

By allowing recovery for negligent misrepresentations, Maryland has expanded the common law theories of recovery potentially applicable to misrepresentations in securities transactions. In *Virginia Dare*

68. *Id.* at 502-03, 56 A. at 796-97.

69. The *Cahill* court noted that a bank officer's liability for negligence would not necessarily make him liable for fraud. *Id.* at 503, 56 A. at 797.

70. *See Shulton, Inc. v. Rubin*, 239 Md. 665, 686, 212 A.2d 476, 486 (1965); *Clark v. Kirsner*, 196 Md. 52, 56, 74 A.2d 830, 832 (1950); *Euzent v. Barrash*, 180 Md. 451, 454, 25 A.2d 462, 464-65 (1942).

71. As the court of appeals noted in 1900:

As president and director of such a financial institution the law imputes the requisite knowledge [regarding the institution's solvency] and neither he nor they can be given, on account of their willful ignorance, a better standing than they would have had if they had performed their duties.

James Clark Co. v. Colton, 91 Md. 195, 204, 46 A. 386, 388 (1900) (case dealt with the issue of fraudulent preferences in a bankruptcy proceeding rather than an action in deceit). *Contra Cahill v. Applegarth*, 98 Md. 493, 502-03, 56 A. 794, 797 (1904) (mere negligence by a corporate officer in failing to know the true condition of his business does not satisfy the requirement of intent in deceit actions because honest negligence cannot sustain fraud under an intentional recklessness theory).

72. *See infra* notes 76-85 and accompanying text.

73. *First Nat'l Bank of S. Md. v. United States Fidelity & Guar. Co.*, 275 Md. 400, 411, 340 A.2d 275, 283 (1975). *But cf. Steadman v. SEC*, 450 U.S. 91 (1981) (in actions under federal antifraud provisions, SEC need merely offer proof to a level of preponderance of evidence standard).

Stores v. Schuman,⁷⁴ the Court of Appeals of Maryland held that in a case involving personal injury, negligent misrepresentation affords a permissible ground for recovery. Recovery under this theory is available when one relies on a negligently volunteered statement, the speaker knows that the recipient will likely act upon the statement, and that injury may ensue if the statement induces action.⁷⁵

Although post-*Virginia Dare* litigants have rarely invoked the theory of negligent misrepresentation,⁷⁶ the theory was later broadened to include actions for pecuniary loss as well as personal injury.⁷⁷ To remove any uncertainty regarding the elements of this relatively recent and infrequently used legal theory, the Court of Appeals of Maryland in 1982 set forth the elements in *Martens Chevrolet v. Seney*.⁷⁸ These elements are: (1) the speaker owes a duty of care to the recipient of the statement and the speaker negligently asserts a false statement; (2) the speaker intends the recipient to act upon the statement; (3) the speaker knows the recipient will probably rely upon the representation and, if it is erroneous, will cause pecuniary or personal injury; (4) the recipient justifiably acts in reliance upon the representation, and; (5) the recipient sustains damage as a proximate cause of the speaker's negligent statement.⁷⁹

74. 175 Md. 287, 1 A.2d 897 (1938).

75. *Id.* at 291-92, 1 A.2d at 899.

76. *See, e.g.*, *Vance v. Vance*, 286 Md. 490, 408 A.2d 728 (1979) (damages awarded for physical and emotional injuries induced by negligent misrepresentation by defendant that his divorce was final at the time he remarried); *Canatella v. Davis*, 264 Md. 190, 286 A.2d 122 (1972) (title company found liable for pecuniary damages incurred through negligent misrepresentations in title search); *Piper v. Jenkins*, 207 Md. 308, 113 A.2d 919 (1955) (recognizing liability of seller of real property when seller negligently indicated boundaries to buyer); *Holt v. Kolker*, 189 Md. 636, 57 A.2d 287 (1948) (sustaining recovery for injuries based upon negligent misrepresentations by landlord regarding safe condition of porch); *Local 75, United Furniture Workers of Am. v. Regiec*, 19 Md. App. 406, 311 A.2d 456 (1973) (pecuniary loss incurred by negligent misrepresentations regarding insurance coverage).

77. *See* *Brack v. Evans*, 230 Md. 548, 187 A.2d 880 (1963) (granting retrial for pecuniary loss suffered by alleged negligent misrepresentations made during a sale of corporate shares).

78. 292 Md. 328, 439 A.2d 534 (1982).

79. *Id.* at 336-37, 439 A.2d at 539. The court found it necessary to provide this clarification because of the confusion engendered by earlier decisions. *Compare id.* (action for negligent misrepresentation clarified and affirmed as a cause of action in Maryland) with *Delmarva Drill Co. v. Tuckahoe*, 268 Md. 417, 302 A.2d 37 (1973) (no recovery in deceit permitted when basis of allegation is negligent misrepresentation) and *Lambert v. Smith*, 235 Md. 284, 201 A.2d 491 (1964) (negligent misrepresentation did not provide the requisite showing of reckless disregard for the truth to allow recovery in deceit). *Scienter* must be proven in some form in an action for deceit, *Cahill v. Applegarth*, 98 Md. 493, 56 A. 794 (1904), but is never required in actions for negligent misrepresentations. The plaintiffs injured by negligent misrepresentations in *Delmarva Drill* and *Lambert* failed to bring suit in negligence. *See also* Comment, *supra* note 9, at 651-71 (discussing historical background and development of actions for deceit and negligent misrepresentation).

The potential impact of this theory of recovery for negligent misrepresentations in securities fraud cases is great. Unlike deceit, negligent misrepresentation requires neither proof of scienter⁸⁰ nor a "clear and convincing standard"⁸¹ of proof. When the plaintiff anticipates difficulty in proving deceit, an additional count in negligence may provide a concurrent path to recovery.⁸² Although untested by case law, the court of appeals recently intimated that a failure to speak (i.e., omission) in a transaction that creates a duty to do so might constitute an actionable negligent misrepresentation.⁸³

C. *Statute of Limitations and its Exceptions*

Limitations periods governing actions in deceit or negligent misrepresentation are governed by statute.⁸⁴ Maryland law provides a three year period in which these civil claims must be filed, and the limitations period runs from the time the misrepresentation occurs.⁸⁵ Although the limitations statutes contain no provision for tolling,⁸⁶ they do provide an important exception of particular relevance to any action based upon misrepresentation. Section 5-203⁸⁷ provides a statutory exception that arises in those instances where the plaintiff's ignorance of an available cause of action is induced by fraud. Under this provision, a plaintiff must show that: (1) his ignorance was induced by the fraud (initial or subsequent) of the defendant, and (2) the plaintiff used "ordinary diligence"⁸⁸ to discover any fraud and to protect his rights.⁸⁹ Constructive knowledge of the fraud may not be imputed in determining

80. See *supra* notes 65-72 and accompanying text.

81. See *supra* note 73 and accompanying text.

82. See *Brack v. Evans*, 230 Md. 548, 187 A.2d 880 (1963) (complaint alleged both fraud and negligence, based upon statements made by stockbroker to buyer; count in fraud dismissed but right to recovery remanded for trial under theory of negligent misrepresentation).

83. See *Leonard v. Sav-A-Stop Servs.*, 289 Md. 204, 213, 424 A.2d 336, 340 (1981) (assumed that where a party to a transaction has a duty to speak but fails to do so, that omission might constitute a negligent misrepresentation; however, court expressly reserved decision on this point).

84. Maryland law provides that "[a] civil action at law shall be filed within three years from the date it accrues unless another provision of the Code provides a different period of time within which an action shall be commenced." MD. CTS. & JUD. PROC. CODE ANN. § 5-101 (1984).

85. See *id.* §§ 5-101 to -205.

86. See *id.* § 5-101.

87. *Id.* § 5-203. This statute states: "If a party is kept in ignorance of a cause of action by the fraud of an adverse party, the cause of action shall be deemed to accrue at the time when the party discovered, or by the exercise of ordinary diligence should have discovered the fraud." *Id.*

88. See *id.* Although the court of appeals has also used the phrase "ordinary prudence," the phrase had its genesis in a quote in earlier case law. Maryland courts, however, have not indicated that "ordinary prudence" is markedly different from "ordinary diligence." *Cf. Poffenberger v. Risser*, 290 Md. 631, 637-38, 431 A.2d 677, 681 (1981) ("ordinary prudence" standard used when plaintiff had, or implicitly should have had, actual knowledge of the events giving rise to his cause of action); *Johnson v. Nadwodny*, 55 Md. App. 227, 232-33, 461 A.2d 67, 70 (1983)

the accrual date; only actual knowledge, or inquiry notice that suggests the plaintiff should have known the existence of the fraud, will suffice.⁹⁰ According to the allegations in each case, limitations may be exclusively a question of law or fact, or a combination of both.⁹¹

To ensure a favorable result on the issue of ordinary diligence, the plaintiff must allege and prove ignorance, the time and circumstances under which he discovered the fraudulent misrepresentation or concealment, and why the ignorance of his rights extended as long as it did.⁹²

In actions based on negligent misrepresentation, fraudulent conduct may delay discovery of the negligence.⁹³ Absent fraud of any type, Maryland courts have nevertheless expanded the statutory limitations exception⁹⁴ into a common law "discovery rule" in negligence actions.⁹⁵ The standard for application of this exception is that the action accrues when the "claimant in fact knew or reasonably should have known of the wrong."⁹⁶ The limitations on both intentional and negligent misrepresentations can thus conceivably run well past the statutory three year limit.⁹⁷

(discussing development of "ordinary diligence" or "ordinary prudence" tests through Maryland case law).

89. See *Piper v. Jenkins*, 207 Md. 308, 316-18, 113 A.2d 919, 924 (1955) (plaintiff must both use and affirmatively plead diligence to extend the limitations period).

90. See *Poffenberger v. Risser*, 290 Md. 631, 636-38, 431 A.2d 677, 680-81 (1981); accord *Johnson v. Nadwodny*, 55 Md. App. 227, 232-33, 461 A.2d 67, 70 (1983).

91. *Poffenberger v. Risser*, 290 Md. 631, 633-34, 431 A.2d 677, 679 (1981). Although the court of appeals has indicated that in all cases the determination of when an action accrues is one for "judicial determination," *Harig v. Johns-Manville Prods.*, 284 Md. 70, 74-75, 394 A.2d 299, 302 (1978); *Waldman v. Rohrbaugh*, 241 Md. 137, 145, 215 A.2d 825, 830 (1966), the court of special appeals has noted that this issue has historically been a question for the trier of fact, and that the court of appeals must clarify *Poffenberger* to resolve this point. *Johnson v. Nadwodny*, 55 Md. App. 227, 232-33, 461 A.2d 67, 70-71 (1983).

92. See *Piper v. Jenkins*, 207 Md. 308, 318, 113 A.2d 919, 924 (1955) (listing requirements of proof to extend limitations where plaintiff alleges fraud).

93. See *Brack v. Evans*, 230 Md. 548, 554-55, 187 A.2d 880, 884 (1963) (limitations for actions based upon negligent misrepresentations in sale of shares did not run until the equivalent of a fraudulent act by the seller was discovered by the buyer).

94. See *supra* note 87.

95. For a thorough discussion of the historical development of this rule in Maryland, see *Poffenberger v. Risser*, 290 Md. 631, 633-38, 431 A.2d 677, 679-81 (1981).

96. The *Poffenberger* court stated:

Having already broken the barrier confining the discovery principle to professional malpractice, and sensing no valid reason why that rule's sweep should not be applied to prevent an injustice in other types of cases, we now hold the discovery rule to be applicable generally in all actions and the cause of action accrues when the claimant in fact knew or reasonably should have known of the wrong.

Id. at 636, 431 A.2d at 680 (emphasis supplied).

97. See, e.g., *Citizens Bank v. Leffler*, 228 Md. 262, 179 A.2d 686 (1962) (concealed fraud in conveyance of real estate allowed court to hear action 98 months after transaction); *Sears v. Barker*, 155 Md. 323, 141 A. 908 (1928) (fraudulent misrepresentations in oil company prospectus extended action to approximately five

D. Punitive Damages

An additional facet of actions at common law is the availability of punitive damages. Although these damages may not be obtained in cases of "ordinary" fraud, Maryland recognizes certain special circumstances that might justify their imposition. In actions for deceit, punitive damages are appropriate when there is either a violation of a fiduciary duty or other relationship of trust, where the fraud is gross, or exceptional circumstances exist that clearly indicate intentional malice and call for the application of this remedy.⁹⁸ Punitive damages are not available when a party acts in good faith.⁹⁹ A plaintiff must clearly prove malice or equivalent willful recklessness.¹⁰⁰ Recovery for these damages is also recognized under actions in negligence, although a plaintiff must show actual malice or equivalent recklessness.¹⁰¹ A court cannot award punitive damages, however, unless it has also awarded nominal compensatory damages.¹⁰² Although litigants in Maryland courts rarely seek punitive damages in actions based upon fraudulent securities transactions, once the special criteria have been met, at least one court has considered the availability of these damages to defrauded sellers of securities.¹⁰³ In the United States Court of Appeals for the Fourth Circuit, actions at common law are the only method of obtaining punitive damages incidental to a securities transaction. They are neither available under the Act,¹⁰⁴ nor recognized in the Fourth

years after purchase of shares). For a more extensive discussion of the legal and historical development of the discovery rule of limitations, see generally Comment, *Limitations in Professional Malpractice Actions*, 28 MD. L. REV. 47 (1968); Annot., 43 A.L.R.3d 429 (1972); Annot., 39 A.L.R.3d 127 (1971).

98. See *Fowler v. Benton*, 245 Md. 540, 552-53, 226 A.2d 556, 564, cert. denied, 389 U.S. 851 (1967); *Loyola Fed. Sav. & Loan Assoc. v. Trenchcraft*, 17 Md. App. 646, 663, 303 A.2d 432, 441 (1973); see also *Goodman v. Poland*, 395 F. Supp. 660, 686 (D. Md. 1975) (citing to "general rule" that while punitive damages are not available in actions brought solely under Rule 10b-5, they may be awarded, if permissible under state law, when a state claim is joined with the Rule 10b-5 claim).
99. See *Heinz v. Murphy*, 180 Md. 423, 24 A.2d 917 (1942) (punitive damages not available when defendant acted in good faith).
100. See *Embrey v. Holly*, 293 Md. 128, 442 A.2d 966 (1982); *Wedeman v. City Chevrolet Co.*, 278 Md. 524, 366 A.2d 7 (1976); *General Motors Corp. v. Piskor*, 277 Md. 165, 352 A.2d 810 (1976); *H & R Block, Inc. v. Testerman*, 275 Md. 36, 338 A.2d 48 (1975). See generally *Strausberg, A Roadmap Through Malice, Actual or Implied: Punitive Damages in Torts Arising Out of Contract in Maryland*, 13 U. BALT. L. REV. 275 (1984) (discussing malice requirement for punitive damages in torts arising out of contracts).
101. See *H & R Block, Inc. v. Testerman*, 275 Md. 36, 338 A.2d 48 (1975); *American Laundry Mach. Indus. v. Horan*, 45 Md. App. 97, 412 A.2d 407 (1980).
102. See *Montgomery Ward & Co. v. Keulemans*, 275 Md. 441, 340 A.2d 705 (1975); *Shell Oil Co. v. Parker*, 265 Md. 631, 291 A.2d 64 (1972).
103. See *Goodman v. Poland*, 395 F. Supp. 660, 686-87 (D. Md. 1975) (action brought under federal securities acts; court referred to Maryland law for decision as to punitive damages).
104. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-101 to -908 (1975 & Supp. 1984). Section 11-703(b) of the Act limits a defendant's liability to the consideration paid for securities, 16% interest, and reasonable attorney's fees, less any income re-

Circuit under federal law.¹⁰⁵

III. THE MARYLAND SECURITIES ACT

A. *Purposes and Methods*

During the early 1900's, fraudulent sales of securities employing affirmative misrepresentations and omissions of material facts were pervasive.¹⁰⁶ The scope and gravity of this situation was so serious that by 1933, every state except Nevada had enacted some form of security regulations.¹⁰⁷ Maryland enacted its first securities act in 1920.¹⁰⁸ Its original form was supplanted in 1962 when Maryland adopted a slightly amended version of the Uniform Securities Act as the new state act.¹⁰⁹ Amendments made by the General Assembly in 1976 broadened certain remedies in the Act¹¹⁰ and brought the Act substantially to its present form.

The Act has four general purposes: (1) regulation of those buying or selling securities;¹¹¹ (2) regulation of certain security offerings to ensure full disclosure of facts relevant to investors;¹¹² (3) civil, criminal, and administrative sanctions for violations of the Act,¹¹³ and; (4) imposition of criteria to ensure honesty and veracity in every security transaction covered by the statute.¹¹⁴ Liability under the Act may be

ceived on the securities. When read in conjunction with § 11-703(i), which limits actions and remedies to those specified in the Act, punitive damages in actions are unavailable under § 11-703(b).

105. Securities Exchange Act of 1934 § 28(a), 15 U.S.C. § 78bb(a) (1982) (no recovery allowed under 1934 Act that exceeds "actual damages"); see *Carras v. Burns*, 516 F.2d 251, 258-60 (4th Cir. 1975); *Baumel v. Rosen*, 412 F.2d 571, 576 (4th Cir. 1969) (punitive damages not authorized in actions under Rule 10b-5), *cert. denied*, 396 U.S. 1037 (1970).
106. For a thorough review of the historical background of both the state and federal securities acts, see Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1 (1983).
107. Even this nearly universal adoption of securities acts by the states proved inadequate to combat the fraudulent practices of itinerant sellers who took refuge in neighboring states or used the mails; hence, beginning in 1933 Congress enacted the federal scheme for regulating securities transactions. *Id.* at 21 n.87.
108. See Miller, *A Prospectus on the Maryland Securities Act*, 23 MD. L. REV. 289, 289 (1963).
109. *Id.* at 291.
110. 1976 Md. Laws 615 (effective July 1, 1976). The amendment's most significant change was to afford a civil remedy to defrauded sellers. *Cf.* *Goodman v. Poland*, 395 F. Supp. 660, 681-82 (D. Md. 1975) (federal district court interpreting Maryland law refused to imply a remedy for a defrauded seller of securities under the pre-amendment version of the Act); see *infra* notes 131-37 and accompanying text.
111. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-301 to -302, -304, -401 (1975); see also Miller, *supra* note 108, at 291-92 (discussing purposes and policies of the Act).
112. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-303 to -304, -501 (1975).
113. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-412 to -417, -512, -603, -701 to -703 (1975 & Supp. 1984).
114. See *id.* §§ 11-301 to -304, -703.

premised upon violation of its registration requirements¹¹⁵ and certain technical requirements pertaining to those in the business of transacting securities¹¹⁶ and upon misrepresentations in the sale or purchase of securities.¹¹⁷ Prior to examining the civil liabilities for misrepresentations, the following will provide a brief overview of the general prohibitions and liabilities created by the Act.

Broker-dealers¹¹⁸ and their agents¹¹⁹ may not engage in securities transactions within Maryland unless they are registered with the Maryland Division of Securities (Division).¹²⁰ They may not offer or sell any security that is not registered, or properly exempted from registration, under the Act.¹²¹ In addition, those dealing in securities may not defraud those with whom they transact business by any fraudulent schemes or practices,¹²² misrepresentations or omissions of fact made to the Division under the Act,¹²³ or by misrepresentations or omissions to those to whom securities are being offered, sold, or from whom they are being purchased.¹²⁴

Section 11-703¹²⁵ of the Act defines the civil remedies available to

115. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-401 to -417, -501 to -513 (1975).

116. See *supra* note 114.

117. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-301 to -304, -703 (1975 & Supp. 1984).

118. MD. CORPS. & ASS'NS CODE ANN. § 11-101(c) (1975) (defining phrase).

119. *Id.* §§ 11-401 to -402 (defining term).

120. See *id.*

121. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-301 to -304, -703 (1975 & Supp. 1984).

122. See *id.*

123. See MD. CORPS. & ASS'NS CODE ANN. § 11-303 (1975).

124. See *supra* note 122.

125. Section 11-703 provides:

(a) When seller or purchaser is liable. — (1) A person is civilly liable to the person buying a security from him if he:

(i) Offers or sells the security in violation of §§ 11-304(b), 11-401, or 11-501 of this title, or of any rule or order under § 11-205 of this title which requires the affirmative approval of sales literature before it is used; or
(ii) Offers or sells the security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and if he does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

(2) A person is civilly liable to the person selling a security to him if he:

(i) Offers to purchase or purchases the security in violation of §§ 11-902, 11-903, 11-904, or 11-905 of this title; or
(ii) Offers to purchase or purchases the security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, the seller not knowing of the untruth or omission, and if he does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

MD. CORPS. & ASS'NS CODE ANN. § 11-703 (1975 & Supp. 1984).

offerees,¹²⁶ buyers, and sellers¹²⁷ defrauded in the course of securities transactions. This statute provides a basis for recovery for fraud through the misstatement or omission of material facts, although the Act modifies the elements for actionable fraud required in suits at common law.¹²⁸ Recovery under the Act requires proof that a transaction was made "by means of" a misrepresentation or omission of a material fact made under circumstances where the misrepresentation is misleading, and the offeree/defrauded party was either unaware of the untruth or omission, or "in the exercise of reasonable care could not have known of the untruth or omission."¹²⁹

The 1976 amendment is particularly noteworthy since it expressly broadened the statutory remedy. Prior to the amendment, the Act provided relief only for persons defrauded when buying securities.¹³⁰ In *Goodman v. Poland*,¹³¹ the plaintiff requested the United States District Court for the District of Maryland to imply a right of action for defrauded sellers under the pre-1976 version of section 11-703.¹³² The seller contended that section 11-703 was an almost "verbatim copy" of federal Rule 10b-5,¹³³ and thus embodied the federal decisional law that implied defrauded sellers rights under the federal law.¹³⁴ The *Goodman* court rejected the seller's argument, noting that the relevant sections of the Act had been adopted "verbatim" from the Uniform Securities Act (Uniform Act),¹³⁵ which in turn was modeled on Rule 10b-5.¹³⁶ The court reviewed sections 101 and 410(h) of the Uniform Act and noted that these sections clearly distinguished between the rights of defrauded buyers and sellers. Moreover, these sections were

126. See MD. CORPS. & ASS'NS CODE ANN. §§ 11-101(j) (defining offer), 11-703(a)(1)(ii), 11-703(a)(2)(ii) (liability to offerees) (1975 & Supp. 1984).

127. See *id.* §§ 11-703(a)(1)(ii), -703(a)(2)(ii); see also *supra* note 110 (development of civil right for defrauded sellers under the Act).

128. See MD. CORPS. & ASS'NS CODE ANN. § 11-102(b) (1975) ("As used in this title, 'fraud,' 'deceit' and 'defraud' are *not* limited to common law deceit.") (emphasis supplied).

129. Compare *Suburban Properties Management, Inc. v. Johnson*, 236 Md. 455, 460, 204 A.2d 326, 329 (1964) (elements required for common law deceit actions in Maryland) with MD. CORPS. & ASS'NS CODE ANN. § 11-703 (1975 & Supp. 1984) (civil liability for misrepresentation under the Act).

130. See MD. CORPS. & ASS'NS CODE ANN. § 11-703(a) (1975) (prior to the 1976 amendment, the Act did not provide an express remedy for defrauded sellers).

131. 395 F. Supp. 660 (D. Md. 1975).

132. *Id.* at 680-82 (court applied MD. ANN. CODE art. 32A, § 13 (1971), the predecessor to section 11-703).

133. 17 C.F.R. § 240.10b-5 (1983) (Rule 10b-5).

134. In support of this argument, the plaintiffs cited Brune, *Rule 10b-5 and the General Law as to Deceit in Securities Transactions in Maryland*, 33 MD. L. REV. 129, 139-40 (1973); Miller, *supra* note 108, at 294. *Goodman*, 395 F. Supp. at 681.

135. *Goodman*, 395 F. Supp. at 681; see MD. ANN. CODE. arts. 13, 34h (1971); 17 C.F.R. § 240.10b-5 (1983) (S.E.C. Rule 10b-5); UNIF. SEC. ACT §§ 101, 410h, 7A U.L.A. 567-698 (1978 & Supp. 1984).

136. See UNIF. SEC. ACT § 101, 7A U.L.A. 568 (1978 & Supp. 1984) (commissioners' notes cite origins of the Uniform Act).

expressly designed and drafted to preclude the development of an implied cause of action for defrauded sellers similar to that which arose under federal Rule 10b-5.¹³⁷

The *Goodman* court next reasoned that since the General Assembly had access to the commissioners' notes to the Uniform Act, the near verbatim adoption of the Uniform Act as state law clearly indicated a legislative intent not to afford an implied right of action to sellers.¹³⁸ Coupled with the express language of section 11-703(i) of the Act, the court felt restrained from attempting to imply any rights under the Act. Finally, because the Court of Appeals of Maryland had never analyzed the issue of an implied right for sellers under section 11-703, the *Goodman* court observed that the question was one that would be the proper subject of a certified question under the Uniform Certification of Questions of Law Act.¹³⁹ Since the court felt that the certification would "considerably delay the ultimate disposition" of the case,¹⁴⁰ and because the entire issue dealt with "merely a parallel state law claim to the federal claim alleged" in the first count,¹⁴¹ it dismissed the plaintiffs' state law claim under the defendant's motion for summary judgment.¹⁴²

In the year following *Goodman*, section 11-703 of the Maryland Securities Act was amended¹⁴³ to provide express protection to both defrauded sellers and buyers of securities.

B. State Decisional Law Under the Act

Maryland courts have had few opportunities to interpret the Act's antifraud provisions.¹⁴⁴ This situation is primarily attributable to the

137. *Goodman*, 395 F. Supp. at 681.

138. *Id.* at 681-82.

139. See MD. CTS. & JUD. PROC. CODE ANN. §§ 12-601 to -609 (1984) (establishing procedure whereby Court of Appeals of Maryland will decide cases of first impression arising under state law in federal court proceedings).

140. *Goodman*, 395 F. Supp. at 682.

141. *Id.* The plaintiffs' counts included allegations of misrepresentation under Rule 10b-5, violation of a fiduciary duty between controlling shareholders under Maryland common law, misrepresentations in contravention of the antifraud provisions of the Act, and a count seeking punitive damages. *Id.* at 670-71.

142. *Id.* at 680-82.

143. 1976 Md. Laws 615.

144. As one federal court recently noted, claims under the Act have rarely been litigated in Maryland's courts. *O'Neil v. Marriott Corp.*, 538 F. Supp. 1026, 1032 (D. Md. 1982). For a review of the very few reported state cases in which the Act was involved, see *Shulton, Inc. v. Rubin*, 239 Md. 669, 686-87, 212 A.2d 476, 486-87 (1965) (court granted rescission of contract for purchase of controlling shares in corporation because of material misstatements and omissions under Maryland common law, the Act, and the Securities Act of 1933); *Mountain Manor Realty, Inc. v. Buccheri*, 55 Md. App. 185, 194, 461 A.2d 45, 51 (1983) (in an action seeking a declaratory judgment that a sale of shares was void, court noted that no claims had been presented by the litigants under § 11-301 of the Act); *Wartzman v. Hightower Prods., Ltd.*, 53 Md. App. 656, 659-60, 456 A.2d 82, 84-85 (1983) (legal malpractice suit precipitated by failure of an attorney to comply with the

availability of federal pendent jurisdiction.¹⁴⁵ Because the Act closely parallels federal securities law,¹⁴⁶ a misrepresentation in a securities transaction will often violate both. Actions are therefore most frequently brought in federal court, with state claims under the Act heard through federal pendent jurisdiction.¹⁴⁷

The foregoing demonstrates that plaintiffs should consider several matters when prosecuting a state Act claim in state court. First, although state courts will often refer to federal decisions for guidance, they are not bound by federal court interpretations of state law.¹⁴⁸ Second, and closely related, the notable absence of significant state law may allow the skillful practitioner to create favorable case law in the state courts.¹⁴⁹ The countervailing consideration is that the lack of exposure to actions under the Act has practically relegated it to *terra incognita* within the state courts, and has placed the state judiciary in a position where an advocate may be required to instruct as well as argue. Although dealing with criminal liability under the Act, a 1979 decision by the court of special appeals, *Hohensee v. State*,¹⁵⁰ illustrates this point. This careful opinion traced the history of the Act¹⁵¹ and contained extensive statutory quotations.¹⁵² Despite the court's willingness to examine thoroughly the historical background, legislative intent, and statutory construction of the Act, its holding regarding criminal liability under section 11-402 has been criticized for misinterpreting the Act's private offering registration exemption.¹⁵³

disclosure provisions of the Act); *Hohensee v. State*, 42 Md. App. 329, 339-40, 400 A.2d 455, 461 (1979) (reversing criminal conviction under § 11-402 of the Act).

145. See *infra* notes 271-98 and accompanying text.

146. See *Miller, supra* note 108, at 294; *accord* O'Neil v. Marriott Corp., 538 F. Supp. 1026, 1032 (D. Md. 1982) (identity of statutory terms between state and federal securities acts); *Evans v. Chesapeake & Potomac Tel. Co. of Md.*, 535 F. Supp. 499, 508 (D. Md. 1982) (in a civil rights case, court observed that federal Rule 10b-5 was nearly identical to fraud provisions in the Act) (dictum).

147. For a discussion of federal pendent jurisdiction of state securities claims, see *infra* notes 271-98 and accompanying text.

148. See *Wiggins v. State*, 275 Md. 689, 690-91, 344 A.2d 80, 81 (1975); *Lahocki v. Contee Sand & Gravel Co.*, 41 Md. App. 579, 398 A.2d 490 (1979), *rev'd on other grounds*, 286 Md. 714, 410 A.2d 1039 (1980).

149. This potential flexibility of securities law at the state level will rarely broaden the scope of remedies available under the federal acts without a determined effort to emphasize the differences between the state and federal regulations. See O'Neil v. Marriott Corp., 538 F. Supp. 1026 (D. Md. 1982), where the court remarked:

There is a dearth of Maryland law on the reach of the state [Act]. . . . In light of the identity of the statutory terms and in the absence of state law to the contrary, the reasonable conclusion is that the Maryland courts would not find a cause of action under state law when there is none under federal law.

Id. at 1032 (emphasis supplied).

150. 42 Md. App. 329, 400 A.2d 455 (1979).

151. *Id.* at 330-33, 400 A.2d at 456-57.

152. *Id.* at 333-36, 400 A.2d at 457-59.

153. See Sargent, *State Limited and Private Offering Exemptions: The Maryland Experience in a National Perspective*, 13 U. BALT. L. REV. 496 (1984).

Despite the freedom of state courts to disregard federal court decisions on state law,¹⁵⁴ the paucity of state court decisions concerning the Act¹⁵⁵ makes it necessary to review federal district court decisions that bear upon the Act. These decisions highlight the distinctions drawn by one court system between the Act, common law, and federal regulations and thus provide fertile ground for development of the Act through case law at the state level. These federal decisions likewise serve to emphasize differences between the state and federal securities laws that federal courts, which will hear any claims under state law through pendent jurisdiction, have found significant.

IV. COMPARISON OF STATE AND FEDERAL SECURITIES STATUTES

A. *Standing*

Section 11-703 of the Act provides express civil liability for a number of specific misrepresentations that might be made during a securities transaction,¹⁵⁶ as well as a broad remedy for misrepresentations generally.¹⁵⁷ A seller is liable under the Act if he misrepresents that the security registration certificate issued by the Commissioner of the Division signifies that the Division found the securities prospectus to be truthful and not misleading, or that the Commissioner has approved or recommended either the security or its sale.¹⁵⁸ Finally, sellers and purchasers of securities are civilly liable whenever a transaction is made "by means of any untrue statement of material fact or omission to state a material fact."¹⁵⁹

As several courts have noted, the goal of the Act is comparable to that of the federal regulatory scheme.¹⁶⁰ For instance, section 12(2)¹⁶¹ of the Securities Act of 1933¹⁶² expressly allows recovery for a seller's misrepresentations or omissions made in a prospectus or oral communication. Section 17(a)¹⁶³ of the 1933 Act is apparently a penal provision that prohibits the sale of securities through fraudulent schemes, practices, misrepresentations, or omissions. The Fourth Circuit has

154. *See supra* note 148.

155. *See supra* note 144 and accompanying text.

156. MD. CORPS. & ASS'NS CODE ANN. §§ 11-703(a)(1)(i), -703(b)(1)(i) (1975 & Supp. 1984).

157. *Id.* §§ 11-703(a)(1)(ii), -703(b)(1)(ii).

158. *See supra* note 125.

159. *See infra* note 160. A private right of action also arises under the following circumstances: a seller is not registered as a broker-dealer or agent under the Act; a security sold was not properly registered or exempted from registration under the Act; or a seller fails to file the prospectus or other advertising literature that describes the securities he is selling. *See* MD. CORPS. & ASS'NS CODE ANN. § 11-703(a)(1)(i) (1975 & Supp. 1984).

160. *See* sources cited *supra* note 146.

161. 15 U.S.C. § 771(2) (1982).

162. *Id.* §§ 77a to 77aa.

163. *Id.* § 77q(a).

held, however, that section 17(a) provides an implied civil right to defrauded buyers as well.¹⁶⁴ Section 10(b)¹⁶⁵ of the Securities Exchange Act of 1934¹⁶⁶ and its accompanying Rule 10b-5¹⁶⁷ is another penal provision under which courts have implied civil liability.¹⁶⁸ Rule 10b-5 is thus analogous to both the criminal provisions of section 11-301¹⁶⁹ and the civil provisions of section 11-703¹⁷⁰ of the Act.

Distinctions between the statutory schemes arise, however, based upon whether the civil liability is express (as in the Act) or implied (as under Rule 10b-5). Section 11-703(i)¹⁷¹ states that all rights and remedies provided by the Act are "in addition to any other rights or actions that exist in law or equity, but this title [11] does not *create* any cause of action not specified in this section. . . ."¹⁷² Implied remedies therefore may not be fashioned to increase the protection afforded by the express remedies in the state Act, which as noted above is contrary to the development of the federal protections.¹⁷³ Although it was once assumed that the close similarity between the state and federal statutes assured that the Act would consequently "inherit a long line of federal judicial and administrative precedent,"¹⁷⁴ this proposition was analyzed and rejected in a 1975 federal district court decision, based upon a strict construction of section 11-703(i).¹⁷⁵ This tension between the state and federal acts provides a backdrop for several distinctions that arise under actions based upon either regulatory scheme.

164. *See, e.g.,* Newman v. Prior, 518 F.2d 97, 98 (4th Cir. 1975); Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 464 F. Supp. 528, 537 (D. Md. 1978); Oliver v. Bostetter, 426 F. Supp. 1082, 1087 (D. Md. 1977) (implied private right under section 17(a) for defrauded purchasers). The Supreme Court has expressly reserved decision on the availability of a private remedy under section 17(a). *See* Herman & MacLean v. Huddleston, 103 S. Ct. 683, 685 n.2 (1983). For a complete listing of the federal courts of appeals cases that have analyzed this implied right, *see* 3 A. BROMBERG & L. LOWENFELS, *supra* note 1, § 8.5, at 331-32; L. LOSS, SECURITIES REGULATION 1784-91 (2d ed. 1961 & Supp. 1969).

165. 15 U.S.C. § 78j (1982).

166. *Id.* §§ 78a to 78kk (codified at 17 C.F.R. §§ 240.0-1 to .31-1 (1983)).

167. 17 C.F.R. § 240.10b-5 (1983).

168. The first case to deal with the implied civil liability aspect of Rule 10b-5 was decided in 1946. Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946). For an overview of the development of subsequent cases, *see* 1 A. BROMBERG & L. LOWENFELS, *supra* note 1, § 2.4(000)-(110), at 2:57-2:62 (1983).

169. *Compare* Rule 10b-5 with MD. CORPS. & ASS'NS CODE ANN. § 11-301 (1975).

170. *Compare* Rule 10b-5 with MD. CORPS. & ASS'NS CODE ANN. § 11-301 (1975).

171. MD. CORPS. & ASS'NS CODE ANN. § 11-703(i) (1975 & Supp. 1984).

172. *Id.* (emphasis supplied).

173. *Compare* Goodman v. Poland, 395 F. Supp. 660 (D. Md. 1975) (refusing to imply right to defrauded buyer under pre-1976 version of the Act) with 1 A. BROMBERG & L. LOWENFELS, *supra* note 1, § 2.2(462), at 2:35-2:41 (tracing historical expansion of implied remedies under Rule 10b-5 through federal decisional law).

174. *See* Miller, *supra* note 108, at 294.

175. Goodman v. Poland, 395 F. Supp. 660, 680-82 (D. Md. 1975).

B. *Scienter*: "Fraud" v. "Misleading"

Rule 10b-5, the major source of federal administrative and civil authority in regulating securities transactions, expressly prohibits "fraud," "deceit," and attempts to "defraud."¹⁷⁶ In *Ernst & Ernst v. Hochfelder*,¹⁷⁷ the Supreme Court scrutinized the wording and legislative history of Rule 10b-5, and held that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that Section 10(b) was intended to proscribe knowing or intentional misconduct."¹⁷⁸ The *Hochfelder* Court read the statutory language as expressing a congressional intent *not* to impose a standard of negligence under Rule 10b-5.¹⁷⁹ The additional consideration that the civil remedy under Rule 10b-5 was a "judicially implied liability"¹⁸⁰ argued for a strict construction of the statutory language. The Court thus held that the element of scienter is required for recovery in Rule 10b-5 civil actions. Under Rule 10b-5, one federal court has inferred scienter through recklessness, in much the same manner as in common law actions.¹⁸¹ A plaintiff must prove scienter whether the misrepresentation is caused by either an untrue statement or an omission.¹⁸²

The implied federal remedy is in sharp contrast to the express civil remedies detailed in section 11-703 of the Act. Absent from section 11-703 are such words as "fraud," "deceit," or "manipulate"; rather, the section prohibits the use of untrue statements or omissions of material facts in any securities transaction. Without reference to any type of intentional conduct or ulterior schemes or motives, section 11-703 simply prohibits any omissions that are "misleading." The lack of prohibitions specifying fraudulent or other intentional conduct, coupled with the inclusion of a "misleading" standard, suggest that scienter is not a requirement under the Act. Consequently, untrue statements or omissions negligently made are arguably as actionable as intentional ones.

The United States District Court for the District of Maryland has apparently, at least in dictum, reached this precise conclusion. In *O'Hara v. Kovens*,¹⁸³ the plaintiff requested the Fourth Circuit to apply the three year statute of limitations for common law suits in Maryland to an action under Rule 10b-5, rather than the one year limitation under the Act. The plaintiff contended that the scienter requirement in

176. See 17 C.F.R. § 240.10b-5 (1983).

177. 425 U.S. 185 (1976).

178. *Id.* at 197.

179. *Id.* at 206-14.

180. *Id.* at 200-01.

181. See *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, 537 (D. Md. 1978) (a showing of recklessness may be sufficient to satisfy the scienter requirement of Rule 10b-5).

182. See *Johns Hopkins Univ. v. Hutton*, 326 F. Supp. 250, 255-57 (D. Md. 1971), *on remand*, 488 F.2d 912 (4th Cir. 1973) (discussing methods of proving scienter in omission cases), *cert. denied*, 416 U.S. 916 (1974).

183. 625 F.2d 15 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124 (1981).

both Rule 10b-5 and common law fraud actions compelled the use of the longer limitations period. The *O'Hara* court observed that Rule 10b-5 afforded protection to investors more closely analogous to that offered by the Act than the common law and thus applied the one year limitation, although noting that "there appears to be no requirement of scienter under Maryland's blue sky statute."¹⁸⁴

The presence or absence of scienter is thus of crucial importance when selecting a forum and in determining whether to include alternative or additional counts in a securities action. Provided the plaintiff can establish an intent to defraud, the action may be brought in federal court with an additional count under the provisions of section 11-703, and a count in common law fraud. If, however, it appears that the suit must be premised upon a negligence theory, Rule 10b-5 cannot be used as the sole cause of action under federal law¹⁸⁵ without risking dismissal. In the event no other federal statute is implicated, bringing suit in state court under section 11-703 of the Act and an additional common law count for negligent misrepresentation would appear to be the best approach.

C. *Misstatements and Omissions*

With its rules for interpretation, the Act allows somewhat more liberal theories of recovery than those offered by the common law. Section 11-102(b)¹⁸⁶ states that use of the terms "fraud," "deceit," and "defrauded" are not limited to common law deceit. As noted previously,¹⁸⁷ a defrauded plaintiff may recover under section 11-703 for the negligent misrepresentations of another party despite the common law limitation that actions in deceit could never be based upon negligence.¹⁸⁸ Other aspects of actions under both the federal and state acts, however, remain consistent with common law standards and criteria.

An action under section 11-703 of the Act requires proof of an untrue statement or omission of material fact. With a view to Maryland's common law, state courts are likely to insist that untrue statements relate to a past or existing ascertainable fact in § 11-703 actions,¹⁸⁹ or a definite promise to perform.¹⁹⁰ Because the Act does

184. *O'Hara*, 625 F.2d at 17. At trial, the same argument was presented but was not found dispositive by the court. See *O'Hara v. Kovens*, 473 F. Supp. 1161, 1165 (D. Md. 1979) ("Although scienter is now required as an element of a 10b-5 offense, it is only partially relevant to picking the appropriate limitations period."), *aff'd*, 625 F.2d 15 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124 (1981).

185. Recovery under a negligence theory is available under sections 11, 12(2) and 15 of the Securities Act of 1933 (codified at 15 U.S.C. §§ 77k, 77l(2), 77o (1982)). See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 208-09 (1976).

186. MD. CORPS. & ASS'NS CODE ANN. § 11-102(b) (1975).

187. See *supra* notes 176-84 and accompanying text.

188. See *supra* notes 65-73 and accompanying text (action in deceit requires scienter).

189. See *supra* notes 18-21 and accompanying text.

190. *Id.*

not limit its scope to common law deceit,¹⁹¹ however, it is conceivable that recovery under the Act might be premised upon strong opinions spoken by the defendant to induce some action by the claimant.¹⁹² There is some precedent for this approach in federal law. Although federal courts still recognize that some "puffing" in sales transactions will not create liability for misrepresentation,¹⁹³ any statement or opinion in a technical report that lacks factual foundation may become a source of liability.¹⁹⁴

D. Materiality

1. Misstatements of Fact

To recover under section 11-703, a misrepresentation must be material to the securities transaction. Once a plaintiff alleges an affirmative or negligent misrepresentation, Maryland courts will find materiality if, without the misrepresentation, or if the falsity had been known, the transaction would not have been completed.¹⁹⁵ No compelling policy reason apparently exists for using a different standard for materiality under the Act than the one used in actions at common law. In *Shulton, Inc. v. Rubin*,¹⁹⁶ the Court of Appeals of Maryland implicitly used the same standard for materiality in an action alleging common law fraud and violations of the state and federal securities acts.¹⁹⁷ Moreover, this approach comports with the definition of materiality used in federal securities law.¹⁹⁸

2. Omissions of Fact

Determining the materiality of, and reliance upon, an omission has historically presented a more challenging task.¹⁹⁹ Because a statement is not the source of liability in a case involving an omission, it is clear that the plaintiff will encounter difficulty in proving that what was

191. See *supra* notes 171-72 and accompanying text.

192. The remedial nature of section 11-703 may be extended to great lengths if Maryland state courts hold that "the monumental incredulity of the victim is no shield for the accused." *Deaver v. United States*, 155 F.2d 740, 744-45 (D.C. Cir.), *cert. denied*, 329 U.S. 766 (1946).

193. See L. Loss, *supra* note 164, at 1438 n.28.

194. For an extensive line of cases supporting this proposition, see *id.* at 1436-37 nn.23-26.

195. See *supra* notes 40-43 and accompanying text.

196. 239 Md. 669, 212 A.2d 476 (1965).

197. *Id.* at 685-87, 212 A.2d at 485-86 (no distinctions made by court regarding the standard for materiality in an action at common law for rescission, and under the Securities Exchange Act of 1933, and the Act).

198. See *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965) (a representation is material if a reasonable person would attach importance to it in determining his choice of action).

199. For a discussion of the development of decisional law in this area under Rule 10b-5, see Note, *The Reliance Requirement in Private Actions Under S.E.C. Rule 10b-5*, 88 HARV. L. REV. 584 (1975).

not said was material to the transaction and that he relied upon something *not* done by the defendant.²⁰⁰

Under the Act, it is more likely that the standard for materiality in omissions cases will comport with those for common law actions, since a body of pre-Act decisional law exists on this subject²⁰¹ and the Act manifests no intention of ignoring or significantly modifying this common law element. Essentially, proof of materiality will require a showing that a reasonable investor would have relied upon the omitted information when deciding whether to enter into the transaction.

Nondisclosure cases under the federal acts hold the threshold of materiality at a slightly higher level. In short, a nondisclosure is material if there is "a *substantial* likelihood that a reasonable shareholder would consider it important. . . ." ²⁰²

E. Reliance

Reliance is statutorily required under the Act because the transaction must be made "by means" of a material misrepresentation.²⁰³ Reliance upon a misrepresentation is apparently implicit within any finding that a misrepresentation is material. This proposition rests on the rationale that if a transaction would not have been consummated "but for" the representation, thus making the misrepresentation material,²⁰⁴ the aggrieved party must necessarily have relied upon the material misrepresentation.²⁰⁵ In actions at common law²⁰⁶ as well as under the federal securities acts, the test for reliance is a narrowing of the standard for materiality to determine if the misrepresentation is the proximate cause of the damage alleged. The issue thus focuses upon whether the specific plaintiff, rather than the reasonable person, would have completed the transaction but for the material misstatement.²⁰⁷ A litigant may prove reliance in an omission case under the Act by showing that the specific plaintiff would not have entered into the transac-

200. *Id.* at 590 nn.30-32 and accompanying text.

201. *See supra* notes 59-64 and accompanying text.

202. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445-50 (1975) (emphasis supplied). *Northway* dealt with the materiality of an omission under Section 14a of the Securities Exchange Act of 1934, S.E.C. Rule 14a-9 (codified at 17 C.F.R. § 240-14a-9 (1983)). Because the broad policy considerations underlying Rule 14a-9 are analogous to those behind Rule 10b-5, the same standard thus appears applicable to both. *See Northway*, 426 U.S. at 449 n.10.

203. *MD. CORPS. & ASS'NS CODE ANN.* § 11-703(a)(1)(ii) (1975 & Supp. 1984).

204. *See supra* notes 40-43 and accompanying text.

205. *See Carras v. Burns*, 516 F.2d 251, 257 (4th Cir. 1975) ("when a broker misrepresents a material fact . . . it may be inferred that the customer would have relied on the broker's statement. . . .") (citing *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972)).

206. *See List v. Fashion Park, Inc.*, 340 F.2d 457, 462-63 (2d Cir. 1965) (discussing interplay and applicability of common law elements of materiality and reliance to actions under Rule 10b-5).

207. *See supra* note 205.

tion if the omitted representation had been known to him.²⁰⁸ By contrast, reliance in an omission case under federal securities law may allow a somewhat lower standard of proof. In *Affiliated Ute Citizens v. United States*,²⁰⁹ the Supreme Court held that in an omission case under Rule 10b-5, affirmative proof of reliance upon the omitted facts was not a prerequisite to recovery. Rather, a court would presume reliance whenever it was shown that the defendant owed a duty to disclose and did not disclose a material fact to the investor.²¹⁰ After *Affiliated Ute*, some federal courts of appeals have applied this presumption narrowly.²¹¹ The Fourth Circuit in 1973, in *Johns Hopkins University v. Hutton*,²¹² stated that *Affiliated Ute* "cast some doubt upon the part played by reliance in Rule 10b-5 cases. . . ."²¹³ Rather than attempting to resolve this doubt, however, the *Hutton* court held that the "essentiality" of the omitted information to the plaintiff in that case satisfied the reliance standard for misrepresentation as expressed in *List v. Fashion Park, Inc.*²¹⁴ and ended all analysis at that point.²¹⁵ Two years later the Fourth Circuit cited *Affiliated Ute* as controlling when it held that "it may be inferred" that a customer would have relied upon material facts withheld by a broker.²¹⁶ Although *Affiliated Ute* does not eliminate the need to prove reliance in nondisclosure cases under the federal securities acts, the threshold of proof is lowered to demonstrating a misrepresentation through an omission to state a material fact.²¹⁷

F. Due Diligence

Section 11-703 of the Act requires the plaintiff to bear the burden of proving that "in the exercise of reasonable care [he] could not have known of the untruth or omission."²¹⁸ The plaintiff's failure to prove the exercise of reasonable care thus will result in dismissal.

208. See, e.g., *Shulton, Inc. v. Rubin*, 239 Md. 669, 685, 212 A.2d 476, 485 (1965) ("It seems apparent that if Shulton had known [the truth of the matters misrepresented by the defendant] it would not have agreed to make a \$300,000 investment").

209. 406 U.S. 128 (1972).

210. *Id.* at 152-54; see also Note, *supra* note 199, at 584, 586-89.

211. See Note, *supra* note 199, at nn.22-28 and accompanying text.

212. 448 F.2d 912 (4th Cir. 1973), *cert. denied*, 416 U.S. 916 (1974).

213. *Hutton*, 448 F.2d at 914.

214. 340 F.2d 457, 462-63 (2d Cir. 1965).

215. *Hutton*, 448 F.2d at 914-15 (citing *List*, 340 F.2d 457); *Baumel v. Rosen*, 283 F. Supp. 128, 140 (D. Md. 1968), *rev'd on other grounds*, 412 F.2d 571 (4th Cir. 1969), *cert. denied*, 396 U.S. 1037 (1970).

216. *Carras v. Burns*, 516 F.2d 251, 257 (4th Cir. 1975); see Note, *supra* note 199, at 587 nn.17-21 and accompanying text.

217. For a thorough discussion of the development of the reliance standard in actions under the federal securities acts, see 5 A. JACOBS, *THE IMPACT OF RULE 10b-5* § 64.01 (rev. ed. 1980).

218. MD. CORPS. & ASS'NS CODE ANN. § 11-703(a)(1)(ii), -703(a)(2)(ii) (1975 & Supp. 1984). For the text of these provisions, see *supra* note 125.

Because the Act provides no standard for determining the level of reasonable care required to satisfy the burden of proof, and because there are no cases defining the standard, guidance in analyzing the issue of reasonable care may be obtained from surveying the analogous issue of due diligence in cases that were decided upon the issue of limitations.²¹⁹ The standard for due diligence is flexible and is usually resolved on a case-by-case basis.²²⁰ Essentially, the standard is whether the plaintiff "should have had knowledge of facts giving rise to his right or cause of action."²²¹

Due diligence does not dictate that a plaintiff proceed immediately to verify all representations.²²² Relevant circumstances or factors include the relative situation of the parties, the extent of their access to information, large fluctuations in value, the absence of probable grounds for imputing intentional fraud, the loss of evidence, and the presence or absence of any impediments to the assertion of the claim.²²³

The use of due diligence in actions under federal securities law is a more difficult question, and there is no simple or uniform standard among the federal courts.²²⁴ In essence, this confusion stems from determining whether the plaintiff must plead due diligence, or whether it must be asserted by the defendant as an affirmative defense.²²⁵

Due diligence by the plaintiff is most often the subject of close

219. See *supra* notes 80-96 and accompanying text; *cf.* Atholwood Dev. Co. v. Houston, 179 Md. 441, 446, 19 A.2d 706, 708 (1941) (although not a securities transactions case, the court held that "[t]he manner in which a person of ordinary diligence would presumably act under similar circumstances is the standard by which the court should determine whether this duty was properly performed.").
220. "There is no inflexible rule as to what constitutes, or what does not constitute laches; hence its existence must be determined by the facts and circumstances of each case." Skeen v. McCarthy, 46 Md. App. 434, 438, 418 A.2d 1214, 1217 (1980) (quoting Parker v. Board of Election Supervisors, 230 Md. 126, 130, 186 A.2d 195, 197 (1962)). The defense of laches requires proof that the party against whom it is being asserted unreasonably delayed in bringing his action through a want of due diligence and that this delay prejudiced the defendant. See also Brady v. Berke, 33 Md. App. 27, 34-35, 363 A.2d 537, 541-42 (1976) (time cannot run for the purposes of laches until the party charged should have had knowledge of his cause of action) (citations omitted).
221. Brady v. Berke, 33 Md. App. 27, 34-35, 363 A.2d 537, 541 (1976) (citations omitted), *quoted in* Skeen v. McCarthy, 46 Md. App. 434, 439, 418 A.2d 1214, 1217 (1980).
222. Marbury v. Stonestreet, 1 Md. 147, 161 (1852) ("When one party to a contract makes a representation on which the other relies, it is not laches in him not to proceed immediately to verify that statement.").
223. Skeen v. McCarthy, 46 Md. App. 434, 438, 418 A.2d 1214, 1217 (1980) (quoting Akin v. Evans, 221 Md. 125, 132-33, 156 A.2d 219, 224 (1959)).
224. This comment is limited to highlighting certain cases to illustrate both the complexity of the due diligence defense and standards for its use in securities transactions, and emphasizing that it must be addressed in all securities cases. For an extensive discussion of the various views among the federal courts on this subject, see 5 A. JACOBS, *supra* note 217, § 63, at 3-180.24.
225. *Id.* § 64.01[b], at 3-206 nn.69.01-81 and accompanying text (federal decisional law discussing due diligence).

review when the defendant raises the defense of limitations.²²⁶ In a civil action brought under Rule 10b-5, the Fourth Circuit in *Baumel v. Rosen*²²⁷ found that the defrauded plaintiff had lost his right to rescission of the sale of his shares for failure to file his action "within a reasonable time after discovery of the ground for rescission,"²²⁸ yet allowed the plaintiff to recover damages because the defendant had acquired the shares fraudulently.²²⁹ Although the plaintiff was not found to have acted diligently, the court nonetheless granted recovery.²³⁰

Courts have also imposed a standard of due diligence upon plaintiffs to ascertain the truth of all representations made by the defendant during the course of the transaction.²³¹ After the Supreme Court's decision in *Ernst & Ernst v. Hochfelder*²³² removed the negligence standard in Rule 10b-5 actions, some courts indicated that it would be unfair to hold harmless those who make negligent misrepresentations, while concurrently demanding that plaintiffs meet a negligence-derived standard of due diligence.²³³ These courts have thus held that a plaintiff need not demonstrate due diligence to support recovery, or have made the plaintiff's duty more flexible and less rigorous.²³⁴ Even in the absence of a rigorous due diligence duty, however, courts will not allow the plaintiff to rely upon a statement that he should have known to be obviously false or when inquiry notice arises.²³⁵

Due diligence is also used as a standard to judge the culpability of the defendant's conduct.²³⁶ Since Rule 10b-5 requires scienter, a defendant cannot be held strictly liable for a negligent investigation,²³⁷ although in some circumstances a failure to use due diligence might be

226. See *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1041 (10th Cir. 1980) ("Under both Colorado and federal law, the limitations period begins to run when the aggrieved party discovers, or should have discovered by the exercise of reasonable diligence, the facts constituting the fraud.") (emphasis supplied); see also 5 A. JACOBS, *supra* note 217, § 235.03 (determining when limitations periods begin to run under the federal securities acts).

227. 412 F.2d 571 (4th Cir. 1969), *cert. denied*, 396 U.S. 1037 (1970).

228. *Baumel*, 412 F.2d at 574.

229. *Id.* at 575-76.

230. *Id.* at 574-76.

231. 5 A. JACOBS, *supra* note 217, § 64.01[b], at 3-206 nn.70-76 and accompanying notes.

232. 425 U.S. 185 (1976). For a discussion of *Hochfelder*, see *supra* notes 176-82 and accompanying text.

233. See 5 A. JACOBS, *supra* note 217, § 64.01[b], at 3-209, nn.76.01-76.03 and accompanying text.

234. *Id.*

235. *Id.* § 64.01[b], at 3-208 nn.75-76.

236. See *Hochfelder v. Ernst & Ernst*, 503 F.2d 1100, 1115 (9th Cir. 1974) (accountant's due diligence might be found inadequate through inquiry notice when he fails to disclose variation of internal office procedures in audited corporation), *rev'd*, 425 U.S. 185 (1976).

237. Under the strict liability provisions of section 12(c) of the Securities Act of 1933, a defendant arguably could be penalized for making any statements that he cannot verify through reasonable diligence.

viewed as willful and reckless behavior sufficient to imply an intent to defraud.²³⁸

Although no appellate court has ever decided the issue, it appears that section 11-703 does not provide similar refuge for defendants. The Act specifies diligence, or reasonable care, of the plaintiff,²³⁹ but is silent as to either a due diligence duty or defense for a defendant. Coupled with the apparent lack of a scienter requirement, the defendant's inability to verify the truth of the misrepresentation will probably not afford a basis for defense.²⁴⁰

G. Statutes of Limitations

The statute of limitations contained in the Act²⁴¹ dictates that a civil action for misrepresentation be brought "within one year after the discovery of the untrue statement or omission, or after the discovery should have been made by the exercise of reasonable diligence."²⁴² The Act further provides that, in any event, no suit may be brought later than three years after the date of contract of any purchase or sale of securities.²⁴³

This statute, however, is the starting rather than ending point for a discussion of the limitations period under the Act. Although the Act contains no provisions for tolling limitations,²⁴⁴ the Act's limitations must be construed in conjunction with two other factors. First, the general statutory²⁴⁵ exception to limitations, which directs that "if a party is kept in ignorance of a *cause of action* by the fraud of an adverse party," provides that limitations do not run until the fraud is, or should have been, discovered.²⁴⁶ The second factor is the impact of *Poffenberger v. Risser*,²⁴⁷ in which the Court of Appeals of Maryland

238. 5 A. JACOBS, *supra* note 217, § 63, at 3-180.7 nn.22-32 and accompanying text.

239. MD. CORPS. & ASS'NS CODE ANN. § 11-703(a)(1)(ii), -703(a)(2)(ii) (1975 & Supp. 1984).

240. *See supra* notes 186-88 and accompanying text. In addition, a very narrow reading of the Act suggests at least the possibility of strict liability in civil actions.

241. MD. CORPS. & ASS'NS CODE ANN. § 11-703(f) (1975 & Supp. 1984).

242. *Id.* § 11-703(f)(2)(ii).

243. *Id.* § 11-703(f)(1).

244. *Id.*; *see also* O'Hara v. Kovens, 625 F.2d 15, 18-19 (4th Cir. 1980) (noting that the Act makes no provision for tolling due to incompetency; because the court adopted the limitations period in the Act for an action under Rule 10b-5, it felt it was "not empowered to engraft such a [tolling] provision onto the Maryland Code, and the facts of this case do not warrant an application of federal equitable relief."), *cert. denied*, 449 U.S. 1124 (1981).

245. MD. CTS. & JUD. PROC. CODE ANN. § 5-203 (1984).

246. *Id.* (emphasis supplied). There is no restriction within the statutory language of this exception that would appear to prohibit expressly or implicitly its application to actions under the Act. For the full text of the statute, *see supra* note 87. The Maryland federal district court, however, noted that it will never be applied to actions under Rule 10b-5 because of the availability of the comparable federal tolling doctrine. O'Hara v. Kovens, 473 F. Supp. 1161, 1167 (D. Md. 1979), *aff'd*, 625 F.2d 15 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124 (1981).

247. 290 Md. 631, 431 A.2d 677 (1981).

held that the discovery rule of limitations applies generally to all civil actions under state law.²⁴⁸ In sum, despite the statutory limitations, a civil cause of action does not accrue in Maryland until the plaintiff discovers, or reasonably should have discovered, the wrong that gave rise to his cause of action.²⁴⁹

No state appellate court has ever decided the relationship or implication of section 5-203²⁵⁰ or *Poffenberger* to the limitations set forth in section 11-703(f) of the Act. A careful reading of 11-703(f) together with these two additional factors suggests that a plaintiff under section 11-703 of the Act may maintain his action beyond the limitation of three years from the date of contract,²⁵¹ if he can demonstrate that he brought his action within one year of the date of discovery of the alleged misrepresentation. It remains unclear, however, whether courts will stand squarely behind *Poffenberger* in actions under the Act. In any event, an action based upon a misrepresentation in a securities transaction under common law theories presently enjoys the protection afforded by the discovery rule.²⁵²

Limitations periods in actions for misrepresentations brought under federal Rule 10b-5 present a somewhat more complex issue than those under the Act. Rule 10b-5 is not governed by any federal statute of limitations.²⁵³ Federal courts therefore adopt the statute of limitations that apply to the state action considered most closely analogous to Rule 10b-5.²⁵⁴ The choice of the state law available to the federal courts is usually between the statute of limitations for common law

248. The *Poffenberger* court remarked:

[H]aving already broken the barrier confining the discovery principle to professional malpractice, and sensing no valid reason why the rule's sweep should not be applied to prevent an injustice in other types of cases, we now hold the discovery rule to be applicable generally in *all actions* and the cause of action accrues when the claimant in fact first knew or reasonably should have known of the wrong.

Id. at 636, 431 A.2d at 680 (emphasis supplied); see Note, *Poffenberger v. Risser—The Discovery Principle is the Rule, Not the Exception*, 41 MD. L. REV. 451 (1982) (discussing development of the discovery rule in Maryland).

249. *Poffenberger*, 290 Md. at 636, 431 A.2d at 680.

250. MD. CTS. & JUD. PROC. CODE ANN. § 5-203 (1984). For the text of this statute, see *supra* note 87.

251. See *supra* notes 241-43 and accompanying text.

252. See *supra* notes 84-97 and accompanying text.

253. See 1 A. BROMBERG & L. LOWENFELS, *supra* note 1, § 2.5(1); 5A A. JACOBS, *supra* note 217, § 235.02 (listing cases and various considerations affecting limitations in securities transactions).

254. The limitations under the Act are identical to those that govern actions under section 13 of the Securities Act of 1933 (suits under sections 11 and 12(2) of the latter Act must be brought within one year of discovery or when it should have been discovered, but in any event within three years of the contract date) and sections 9(e), 18(c) and 29(b) of the Securities Exchange Act of 1934 (same). See 5A A. JACOBS, *supra* note 217, § 235.02 n.3. Despite a similarity between the federal and state limitations in securities actions, the state rather than federal provisions will apply. *Id.* § 35.02 nn.5-6.

fraud actions or that under the state blue sky act.²⁵⁵ Although there is no uniformity among the federal courts,²⁵⁶ suits brought under Rule 10b-5 in Maryland federal district court are governed by section 11-703(f) of the Act, because the Act more clearly addresses the policy purposes of Rule 10b-5 than actions at common law.²⁵⁷

Two further considerations will affect any federal decision on Rule 10b-5 limitations. First, federal courts are bound by the language and construction of section 11-703 as it is amended or developed, and are not bound by earlier versions or interpretations of its content. In *Fox v. Kane-Miller Corp.*,²⁵⁸ the Fourth Circuit reversed the district court decision²⁵⁹ to employ the limitations period contained in section 11-703 prior to its amendment in 1968. The trial court's rationale for this choice was that once a federal court had chosen a state limitations period for Rule 10b-5 actions, it could not thereafter consider subsequent changes in the state limitations period without the risk of moving the "federal Rule 10b-5 limitations period up and down like a yo-yo on a string."²⁶⁰ The Fourth Circuit rejected this contention, holding that federal law and policy considerations mandate that Rule 10b-5 actions be governed by the limitations period of the most current analogous state law.²⁶¹ This decision demonstrates that actions in federal courts for securities misrepresentations should receive at least the equivalent limitations period as found under section 11-703(f). Further, it indicates a flexibility within the federal courts to respond to changes in state law.

In light of *Fox*, federal courts quite possibly might be persuaded to follow *Poffenberger*²⁶² in future Rule 10b-5 actions. This possibility is unlikely, however, because of the second consideration that affects limitations actions under Rule 10b-5. Although state law will govern limitations of civil suits under Rule 10b-5, federal law controls when the limitations period commences to run.²⁶³ Thus, in appropriate cir-

255. See *O'Hara v. Kovens*, 625 F.2d 15 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124 (1981).

256. See 5A A. JACOBS, *supra* note 217 at § 235.02 nn.20-102 and accompanying text.

257. See *O'Hara v. Kovens*, 625 F.2d 15, 17-19 (4th Cir. 1980) (citing *Fox v. Kane-Miller Corp.*, 542 F.2d 915, 917-18 (4th Cir. 1976), *cert. denied*, 449 U.S. 1124 (1981)); *Newman v. Prior*, 518 F.2d 97 (4th Cir. 1975); *accord Hill v. Equitable Trust Co.*, 562 F. Supp. 1324 (D. Del. 1983) (Maryland blue sky limitations apply to actions under Rule 10b-5).

258. 542 F.2d 915 (4th Cir. 1976).

259. *Fox v. Kane-Miller Corp.*, 398 F. Supp. 609 (D. Md. 1975), *aff'd on other grounds*, 542 F.2d 915 (4th Cir. 1976).

260. *Fox*, 398 F. Supp. at 641; *quoted in Fox*, 542 F.2d at 917.

261. *Fox*, 542 F.2d at 917-18; *see also Boulder v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Nos. 84-152L & 84-1513 (4th Cir. Sept. 21, 1984) (claims under the Commodity Exchange Act, 7 U.S.C. § 6b (1982), and claims for common law fraud are controlled by one year limitation in the Act).

262. *Poffenberger v. Risser*, 290 Md. 631, 431 A.2d 677 (1981); *see notes 244-52 and accompanying text.*

263. *See Newman v. Prior*, 518 F.2d 97, 100 (4th Cir. 1975) (citing *Vanderboom v.*

cumstances, the federal tolling doctrine²⁶⁴ may be invoked in suits under Rule 10b-5. This rule states that limitations "do not begin to run until the *fraud* is either actually known or should have been discovered by the exercise of due diligence."²⁶⁵ The federal tolling doctrine is distinguishable from the *Poffenberger* rule because the imposition of the federal tolling doctrine requires the presence of *fraud* in the transaction. By contrast, the *Poffenberger* rule operates whenever the plaintiff uses reasonable efforts to discover the wrong alleged, which may or may not include an allegation of fraud.²⁶⁶ Relief from the statutory limitations in section 11-703(f) actions available in Maryland courts under *Poffenberger* therefore may not be available in federal courts, absent a showing of fraud related to the securities transaction.²⁶⁷ Because some form of scienter is a threshold requirement to maintain any action under Rule 10b-5,²⁶⁸ however, the federal tolling doctrine appears to afford adequate flexibility to the issue of limitations in any suit brought under the rule. Once the plaintiff establishes scienter in the securities transaction, federal courts will examine whether the plaintiff used due diligence to discover the misrepresentation. In addition, the courts may invoke the federal tolling doctrine in a manner similar to the state provision that extends limitations whenever fraud is present.²⁶⁹

V. PENDENT JURISDICTION

An appreciation of both the availability and prudential character of federal pendent jurisdiction is essential in cases that allege misrepresentation in securities transactions because it is the rule, rather than the exception, that these transactions will include potential claims under

Sexton, 422 F.2d 1233, 1240 (8th Cir. 1970); *Maine v. Leonard*, 353 F. Supp. 968, 971 (W.D. Va. 1973)).

264. *Newman v. Prior*, 518 F.2d 97, 100 (4th Cir. 1975).

265. *Id.* (emphasis supplied); see also A. BROMBERG & L. LOWENFELS, *supra* note 1, § 2.5(1), at n.107 (listing cases that indicate degree of fraud federal courts have found sufficient to invoke tolling doctrine); 5A A. JACOBS, *supra* note 217, § 235.03 to .04 (discussing interplay between state statutory limitations periods and federal law in securities litigation and termination of the federal tolling doctrine).

266. See *supra* note 248.

267. In effect, the federal tolling doctrine is identical to MD. CTS. & JUD. PROC. CODE ANN. § 5-203 (1984). For the text of this provision, see *supra* note 87.

268. See *supra* notes 176-82 and accompanying text.

269. Under both the federal tolling doctrine and MD. CTS. & JUD. PROC. CODE ANN. § 5-203 (1984), the presence of *any* fraud in a transaction is sufficient to trigger the exceptions to limitations, and a plaintiff is not required to prove a separate concealment of the cause of action by additional fraudulent acts. Compare *Janigan v. Taylor*, 344 F.2d 781, 784 (1st Cir. 1965) ("[W]here fraud is involved the cause of action is, so-to-speak, automatically concealed. . . .") with *Piper v. Jenkins*, 207 Md. 308, 113 A.2d 919 (1955) (fraud need not be concealed by special additional efforts or circumstances). But see *O'Hara v. Kovens*, 473 F. Supp. 1161, 1167 (D. Md. 1979) (§ 5-203 does not apply to limitations of federal securities laws), 625 F.2d 15 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124 (1981).

both state and federal law.²⁷⁰

Pendent jurisdiction allows federal courts to decide claims arising under state law when adjudicating closely related claims under federal law.²⁷¹ The seminal Supreme Court decision on pendent jurisdiction is *United Mine Workers of America v. Gibbs*.²⁷² The *Gibbs* Court held that once it has been demonstrated that the federal and state claims are derived from a common nucleus of operative fact,²⁷³ involve claims a plaintiff "would ordinarily be expected to try . . . all in one judicial proceeding,"²⁷⁴ and include a substantial federal issue,²⁷⁵ federal courts have jurisdiction over all claims presented.

Gibbs further held that pendent jurisdiction "is a doctrine of discretion, not of plaintiff's right."²⁷⁶ In determining whether to grant or withhold pendent jurisdiction, a federal court weighs policy considerations such as "judicial economy, convenience and fairness to litigants,"²⁷⁷ as well as the closeness of the state claim to questions of federal policy.²⁷⁸ Considerations militating against the exercise of federal pendent jurisdiction may include a reluctance to make "needless decisions of state law,"²⁷⁹ or the likelihood of jury confusion because of presence of divergent legal theories of relief.²⁸⁰ Finally, when the federal court dismisses federal claims before trial, it should also dismiss the state claims.²⁸¹

Federal courts do not automatically grant pendent jurisdiction in all securities cases. An excellent example of the denial of pendent jurisdiction in a securities case is *Stowell v. Ted S. Finkel Investment Services, Inc.*²⁸² The *Stowell* trial court was presented with claims alleging violations of various federal securities laws, Florida's blue sky statute, and a count alleging common law fraud.²⁸³ In reviewing the theories of legal recovery applicable to each of the plaintiff's counts, the court noted that under Rule 10b-5, if the jury found that the defendant intended to deceive the plaintiff, it could only award actual or compensa-

270. This comment will emphasize certain considerations concerning federal pendent jurisdiction that are relevant to securities transactions cases. For a thorough discussion of the practical and policy considerations that affect a court's decision to grant or withhold federal pendent jurisdiction, see generally Annot., 5 A.L.R.3d 1040 (1983) (federal pendent jurisdiction over nonfederal claims).

271. *Id.*

272. 383 U.S. 715 (1966).

273. *Id.* at 725.

274. *Id.*

275. *Id.*

276. *Id.* at 726.

277. *Id.*

278. *Id.* at 727.

279. *Id.* at 726.

280. *Id.* at 727.

281. *Id.* at 726.

282. 489 F. Supp. 1209 (S.D. Fla. 1980), *aff'd on other grounds*, 641 F.2d 323 (5th Cir. 1981).

283. *Stowell*, 489 F. Supp. at 1211.

tory damages.²⁸⁴ Under Florida common law, however, actions in fraud may be premised upon negligent conduct, and punitive damages may be available.²⁸⁵ The trial court thus felt that the jury would be confused by the two divergent legal theories of recovery: although a defendant who intentionally defrauds is liable only for actual damages under the securities laws, a "less culpable" negligent defendant is subject to greater liability under the common law because of the availability of punitive damages.²⁸⁶ The *Stowell* court dismissed without prejudice the common law count because of the potential for jury confusion.²⁸⁷ The Fourth Circuit has apparently yet to decide this precise issue.²⁸⁸

The Fourth Circuit has almost routinely granted pendent jurisdiction to hear actions based upon facts substantially relating to the same securities transaction, in suits that allege violations of federal and state securities regulations, and the common law.²⁸⁹ Implicit in these deci-

284. *Id.* at 1214-18.

285. *Id.* at 1216-18.

286. *Id.* at 1217 (citing *United Mine Workers of America v. Gibbs*, 383 U.S. 715 (1966)); *accord Summers v. Land & Leisure, Inc.*, 591 F. Supp. 380, 383-84 (S.D. Fla. 1983).

287. *Stowell*, 489 F. Supp. at 1217, 1227. Dismissal based on jury confusion among other theories of recovery is analogous to dismissal from jury consideration issues deemed to be "too complex." For an overview of decisions on the issue of complexity, see 5 J. MOORE, J. LUCAS & J. WICKER, *MOORE'S FEDERAL PRACTICE* ¶ 38.11[10] (2d ed. 1982 & Supp. 1984); *In re United States Fin. Sec. Litig.*, 609 F.2d 411 (9th Cir. 1979) (despite likelihood of trial lasting two years and exhibits totaling over 100,000 pages, there is no "complexity exception" to the seventh amendment right to jury trial), *cert. denied*, 446 U.S. 929 (1980).

At least one Maryland court has already entertained an action for securities fraud based upon claims under the Act, common law, and concurrent jurisdiction under the Securities Act of 1933, 15 C.F.R. § 77v (1981). *Shulton, Inc. v. Rubin*, 239 Md. 669, 682, 212 A.2d 476, 483 (1965).

288. Pendent common law counts have been dismissed in cases that allege violations of federal securities laws. *See Carras v. Burns*, 516 F.2d 251, 259-60 (4th Cir. 1975) (court upheld dismissal of pendent state claims that sought punitive damages because Rule 10b-5 was found to provide an adequate basis of relief; court refused to decide whether federal policy should control decisions of district courts to try pendent state claims for punitive damages in securities cases). *Contra Oliver v. Bostetter*, 426 F. Supp. 1082, 1090 (D. Md. 1977) (in suit under federal securities law, pendent state common law counts that included punitive damages upheld against motion to dismiss); *Goodman v. Poland*, 395 F. Supp. 660, 685-87 (D. Md. 1975) (pendent common law claims that sought punitive damages upheld against motion to dismiss, because while actions under Rule 10b-5 alone cannot recover punitive damages, these damages may be awarded under a state common law claim brought with a Rule 10b-5 claim and are therefore properly before the court). *See also A. BROMBERG & L. LOWENFELS, supra* note 1, § 2.7(3), at nn.164-69 and accompanying text (considerations that affect the exercise of federal pendent jurisdiction with a listing of related securities cases).

289. *See, e.g., Gurlley v. Documentation, Inc.*, 674 F.2d 253 (4th Cir. 1982) (lower court decision found no cause of action under Rule 10b-5 and hence state claims dismissed and remanded for application of federal tolling doctrine); *O'Neil v. Marriott Corp.*, 538 F. Supp. 1026, 1033-35 (D. Md. 1982) (pendent common law claims retained when court dismissed federal securities claims but retained federal ER-

sions is a recognition that, on balance, the policy considerations articu-

ISA claims); *Twenty Seven Trust v. Realty Growth Investors & RGI Holding Co.*, 533 F. Supp. 1028 (D. Md. 1982) (court granted defendant's motion for summary judgment as to federal securities and certain common law counts, but retained jurisdiction over other counts under the Act and common law); *O'Hara v. Kovens*, 473 F. Supp. 1161 (D. Md. 1979) (dismissal of federal securities claims required dismissal of claims under Act and common law), *aff'd*, 625 F.2d 15 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124 (1981); *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528 (D. Md. 1978) (common law counts upheld against defendant's motion for summary judgment where plaintiff also alleged federal securities violations); *Sasso v. Koehler*, 445 F. Supp. 762 (D. Md. 1978) (court dismissed federal securities law claims, but retained jurisdiction over federal Renegotiation Act claim and common law counts of fraud, conspiracy, breach of fiduciary duty, and tortious interference with contract); *Houlihan v. Anderson-Stokes, Inc.*, 434 F. Supp. 1324 (D.D.C. 1977) (dismissal of claims under federal securities laws argued for dismissal of pendent state claims); *Fox v. Kane-Miller Corp.*, 398 F. Supp. 609 (D. Md. 1975) (common law counts submitted to jury with claims under federal and state securities laws), *aff'd*, 542 F.2d 915 (4th Cir. 1976); *Goodman v. Poland*, 395 F. Supp. 660 (D. Md. 1975) (claims under Rule 10b-5 and common law fraud upheld although court dismissed claims under state securities act and for common law breach of fiduciary duty). *But see* *Amdur v. Lizars*, 39 F.R.D. 29 (D. Md. 1965) (no single cause of action found among federal and state claims that would support pendent jurisdiction).

Other considerations will bear upon litigation of claims under the Act or common law in federal court. First, Maryland courts have never decided whether filing a state claim in federal court tolls the limitations of the state claim, and the federal district courts assume that it does not provide tolling. *See* *O'Neil v. Marriott Corp.*, 538 F. Supp. 1026, 1034-35 (D. Md. 1982) ("The running of the limitations period is tolled by the filing of suit, but there is no indication that Maryland courts would hold that filing suit in federal court similarly tolls the running of the statute."); *accord* *Sasso v. Koehler*, 445 F. Supp. 762, 765 (D. Md. 1978) ("An analysis of Maryland law leads to the conclusion that plaintiff's prior claim [filed in another federal district court] did not interrupt the running of limitations [in his action filed in the United States District Court for the District of Maryland]").

Second, dismissal of state claims from federal court that were timely filed but exceeded the statute of limitations at the date of dismissal (in states, such as Maryland, which have no statutory or decisional law on this aspect of tolling) may constitute an abuse of judicial discretion. *See, e.g.,* *Rheume v. Texas Dept. of Pub. Safety*, 666 F.2d 925, 931-32 (5th Cir. 1982) (upon remand, district court must determine whether pendent state claim is barred by limitations; if pendent claim dismissed but state courts refuse to grant jurisdiction because of limitations, then district court should grant rehearing to reconsider question of pendent jurisdiction); *Pharo v. Smith*, 625 F.2d 1226, 1227 (5th Cir. 1980) (federal courts should retain pendent jurisdiction over state claims when there is a substantial possibility that the state claim is barred in state court); *O'Brien v. Continental Ill. Nat'l Bank & Trust*, 593 F.2d 54, 63-65 (7th Cir. 1979) (after district court dismissed substantial federal claim under Rule 10b-5, dismissal of time-barred pendent state claims constitutes an abuse of discretion); *Elson v. Geiger*, 506 F. Supp. 238, 244 (E.D. Mich. 1980) (after court dismisses claims under federal securities acts, it may dismiss state claims not barred by limitations). For an example where the plaintiff's initial choice of forum later restricted his recourse to federal courts, *see* *Amdur v. Lizars*, 39 F.R.D. 29 (D. Md. 1965) (plaintiff initially filed state claims for misrepresentation in securities transaction in state court; claim under Rule 10b-5 later added to state claims and filed in federal court; federal court stayed decision on state claims until they were litigated in state court; federal court reluctant to allow plaintiff to move his claims to a federal forum when sole

lated in *Gibbs*²⁹⁰ favor granting pendent jurisdiction over state blue sky and common law claims when the plaintiff also alleges violations of federal securities laws.

The potential for jury confusion that prompted the *Stowell* court to dismiss the pendent common law claim presents an interesting policy argument. In *Stowell*, the court felt that the perceived confusion could not be overcome by careful jury instructions.²⁹¹ Although many other courts have not found this potential for confusion sufficient to warrant discussion, let alone dismissal, it does not necessarily mean that the *Stowell* court arrived at an invalid conclusion.²⁹² Dismissal, however, is not the only judicial response available when a party raises the issue of jury confusion.

For example, in *Fox v. Kane-Miller Corp.*,²⁹³ the plaintiff brought claims under the federal and Maryland securities acts and for common law fraud.²⁹⁴ Rather than applying a *Stowell*-type analysis and dismissing the common law count as possibly confusing, the court handled the presence of multiple legal theories of recovery by isolating the elements under each count into fifty-two discrete questions that the jury answered individually.²⁹⁵ Using this verdict format, the *Fox* court was able to minimize the effect of any confusion that might have resulted from the divergent theories of recovery.²⁹⁶ In addition, this technique represents an implicit recognition that the policies of "judicial economy, convenience and fairness to litigants"²⁹⁷ were best served by granting federal pendent jurisdiction over all state claims in this securities case.²⁹⁸ The Maryland federal district court should continue this

reason was for plaintiff to avoid posting a security bond directed by the state court).

290. *See* *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 726-27 (1966); *supra* notes 276-81 and accompanying text.

291. *Stowell v. Ted S. Finkel Inv. Servs., Inc.*, 489 F. Supp. 1209, 1217 (S.D. Fla. 1980), *aff'd on other grounds*, 641 F.2d 323 (5th Cir. 1981).

292. *See* *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 727 (1966).

293. 398 F. Supp. 609 (D. Md. 1975), *aff'd*, 542 F.2d 915 (4th Cir. 1976).

294. *Fox*, 398 F. Supp. at 614.

295. *Id.* at 630-31, 641 n.26, 642 n.28.

296. Although it is arguable that 52 special questions may generate jury confusion because of the volume of issues the jury must consider, the *Gibbs* Court did not indicate that jury confusion through mere volume or complexity of evidence, or a large number of certified questions, are sufficient reasons to deny pendent jurisdiction. Indeed, *Gibbs* noted that the possibility of jury confusion may be lessened by resort to a special verdict form. *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 729 (1965). In addition, greater complexity of evidence is not a sufficient ground to deny a seventh amendment right to jury trial. *In re United States Fin. Sec. Litig.*, 609 F.2d 411 (9th Cir. 1979), *cert. denied*, 446 U.S. 929 (1980). Some amount of jury confusion, however, is inevitable in any jury trial. Indeed, the *Fox* court found that some jury confusion arose but was able to overcome it by careful examination of the certified answers returned by the jury. *See supra* notes 293-95 and accompanying text.

297. *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 726 (1965).

298. It would appear to be judicially uneconomical, inconvenient, and inequitable to litigants to require them to pursue two actions, in two different court systems,

approach, at least until the Court of Appeals of Maryland decides whether state limitations are tolled by filing in federal court, under the Uniform Certification of Questions of Law Act.

VI. CONCLUSION

Despite the general similarity between section 11-703 of the Act and federal Rule 10b-5, litigants must weigh several distinctions and considerations prior to deciding which claims to file. For plaintiffs, the foremost issue is their ability to prove scienter. Absent scienter, courts will dismiss any suit under Rule 10b-5, with the probable subsequent dismissal of any pendent state claims. In addition, timely filing of an action in which scienter is absent will not trigger the federal tolling doctrine. Claims under section 11-703, however, need not include an allegation of scienter, and the *Poffenberger* discovery rule does not require fraud to extend limitations under the Act.

Although federal pendent jurisdiction is not automatically assured for any state claims because of the possibility of the "jury confusion" issue, the Fourth Circuit has indicated a willingness to grant it in the majority of securities cases. Actions under common law theories of deceit or negligent misrepresentation remain viable separate actions at the state level or as additional counts in a federal forum, and offer the possibility of recovering punitive damages. Overall, the narrowing of remedies under Rule 10b-5 should be balanced against the relative unfamiliarity of the state courts with claims brought under the Act. The differences among the common law and statutory schemes of remedy for misrepresentation in securities transactions provide the practitioner with a wealth of choices and alternatives that virtually assure that a cause of action may be found and pursued at either the state or federal level.

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potentially under two separate appellate systems, and force them to suffer the increased burdens of cost, delay, and appeals for actions that stem from substantially one separate set of facts.