C

United States Court of Appeals,
Eleventh Circuit.
MAGNA INVESTMENT CORP., Plaintiff-Appellant,
v.
JOHN DOES ONE THROUGH **TWO HUNDRED**, d/b/a Price Waterhouse & Co., Defendant-Appellee.
No. 90-5199.

May 13, 1991.

Investment corporation brought action against accounting firm, alleging violations of Securities Exchange Act in connection with firm's performing audit of and issuing opinion on financial state of second corporation. The United States District Court, Southern District of Florida, No. 88-8141-Civ-JAG, Jose A. Gonzalez, Jr., J., granted summary judgment in favor of accounting firm. On review, the Court of Appeals held that: (1) district court should have considered whether investment corporation alleged recklessness sufficient to satisfy scienter requirement of its § 10(b) and Rule 10b-5 claims, and (2) district court improperly placed burden of proof as to accounting firm's bad faith on investment corporation on corporation's claim under Securities Exchange Act for filing of misleading statements.

Vacated and remanded.

West Headnotes

[1] Federal Courts 170B 939

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(L) Determination and Disposition of Cause
170Bk937 Necessity for New Trial or Further Proceedings Below
170Bk939 k. Questions Not Passed on Below. Most Cited Cases
District court's failure to consider whether investment corporation alleged recklessness on part of defendant accounting firm sufficient to satisfy scienter requirement of corporation's § 10(b) and Rule 10b-5 claims warranted vacation of summary judgment for accounting firm and remand. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

[2] Securities Regulation 349B 60.33

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.33 k. Misleading Statements in Filed Documents. Most Cited Cases
(Formerly 349Bk25.25)
Under Securities Exchange Act section addressing liability for misleading statements, plaintiff must only plead and prove that defendant made or caused to be made material misstatement or omission in document filed with Securities and Exchange Commission and that plaintiff relied on misstatement or omission. Securities Exchange Act of 1934, § 18, as amended, 15 U.S.C.A. § 78r.

[3] Securities Regulation 349B 60.62

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.60 Evidence
349Bk60.62 k. Presumptions and Burden of Proof. Most Cited Cases
(Formerly 349Bk25.30)
Accounting firm had burden to prove that it acted in good faith in filing document with the Securities and Exchange Commission on which investor relied, rather than investor's burden to establish firm's bad faith. Securities Exchange Act of 1934, § 18, as amended, 15 U.S.C.A. § 78r.

[4] Securities Regulation 349B 60.33

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets

349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.33 k. Misleading Statements in Filed Documents. Most Cited Cases
(Formerly 349Bk25.21(3))
Intent to deceive is not an element of a civil action brought under Securities Exchange Act section proscribing filing misleading documents with the Securities and Exchange Commission. Securities Exchange Act of 1934, § 18, as amended, 15 U.S.C.A. § 78r.
***39** Mark T. Blake, Miami Beach, Fla., Guy Rasco, Zuckerman, Spaeder, Taylor & Evans, Miami, Fla., for plaintiff-appellant.

Richard E. Brodsky, Miami, Fla., for defendant-appellee.

Appeal from the United States District Court for the Southern District of Florida.

Before FAY and EDMONDSON, Circuit Judges, and TUTTLE, Senior Circuit Judge.

PER CURIAM:

Magna Investment Corporation brought suit against Price Waterhouse, an accounting firm. The suit alleges, among other things, violations of the Securities Exchange Act of 1934, §§ 10(b) and 18(a),[FN1] and Rule 10b-5, [FN2] in connection with the actions of Price Waterhouse in performing an audit of, and in issuing an opinion on the financial state of, Electronic Specialty Products, Inc.

FN1. Codified, as amended, at 15 U.S.C.A. § 78j(b) and 78r(a).

FN2. 17 C.F.R. 240.10b-5.

[1] The district court granted Price Waterhouse summary judgment on the section 10(b) and Rule 10b-5 claims based on its reading of the Supreme Court's decision in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). In *Hochfelder*, the Supreme Court held that a private cause of action cannot exist under section 10(b) and Rule 10b-5 without the element of scienter, 425 U.S. at 193, 96 S.Ct. at 1381, which the Court defined as "a mental state embracing intent to deceive, manipulate, or defraud," 425 U.S. at 193 n. 12, 96 S.Ct. at 1381 n. 12. The district court in this case concluded that, because Magna failed to show that Price Waterhouse "intentionally sought to deceive, manipulate or defraud through the issuance of the 1985 and 1986 F/S," Price Waterhouse did not possess the scienter necessary to establish liability under section 10(b) or Rule 10b-5.

As the district court noted, the Supreme Court in *Hochfelder* expressly declined to address the question "whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5." *Id.* at 193 n. 12, 96 S.Ct. at 1381 n. 12. But, we have addressed the question and answered it in the affirmative: "The rule in this circuit is that 'severe recklessness' satisfies the scienter requirement." *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1010 (11th Cir.1985); *see also Kennedy v. Tallant*, 710 F.2d 711, 720 (11th Cir.1983). Because the district court never considered whether Magna alleged recklessness sufficient to satisfy the scienter requirement, we vacate the district court's disposition of Magna's section 10(b) and Rule 10b-5 claims and remand.[FN3]

FN3. We have defined "severe recklessness" as

> highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.

Woods, 765 F.2d at 1010.

The district court also granted Price Waterhouse summary judgment on the section 18 claims, finding that "Magna has not met its burden of proving [Price Waterhouse] issued the 1985 or 1986 F/S with the intent to deceive the readers of the statements. Magna has also not met its burden of proving [Price Waterhouse] issued the 1985 and 1986 F/S in bad faith, or that [Price Waterhouse] is liable as an aider or abettor."

[2][3][4] Under section 18, a plaintiff must only plead and prove that the defendant made or caused to be made a material misstatement or omission in a document filed with the Securities Exchange Commission and that the plaintiff relied on the misstatement or omission. *See Hochfelder*, 425 U.S. at 211 n. 31, 96 S.Ct. at 1389 n. 31; *Ross v. A.H. Robins Co.*, 607 F.2d 545, 556 (2d Cir.1979); *see also* R. Jennings and H. Marsh, *Securities Regulation* 882-884 (6th ed. 1987). Section 18 accords a defendant the defense that he acted in "good ***40** faith and had no knowledge that such statement was false or misleading." [FN4] We, therefore, conclude that the district court erred in placing the burden of proof about Price Waterhouse's bad faith on Magna; it is the defendant's burden to prove, in the context of section 18, that it acted in good faith. In addition, nothing suggests that an intent to deceive is an element of a civil action under section 18. We, therefore, vacate the district court's disposition of Magna's section 18 claims and remand.

> FN4. The Supreme Court in *Hochfelder* stated, in this context, that the legislative history of the section "suggests something more than negligence on the part of the defendant is required for recovery." *See Hochfelder*, 425 U.S. at 211 n. 31, 96 S.Ct. at 1390 n. 31.

We VACATE the district court's disposition of the claims based on the Securities Exchange Act of 1934, §§ 10 and 18, and Rule 10b-5 and REMAND the case for further proceedings.[FN5]

> FN5. Because we are remanding the case for further proceedings, Price Waterhouse's request for judicial notice, or in the alternative, to supplement the record, is denied.

C.A.11 (Fla.),1991.
Magna Inv. Corp. v. John Does One Through Two Hundred
931 F.2d 38, Fed. Sec. L. Rep. P 96,080

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