

CIVIL PROCEDURE

Courts Divide on Use of Prior Unadjudicated Complaints

By Michael W. Ross and Justin O. Spiegel

Within the Second Circuit, there is a split of authority—which has deepened in the last few years—about whether a complaint may rely on facts derived from a previous complaint that was never adjudicated on the merits. This split can be traced to *Lipsky v. Commonwealth United*, 551 F.2d 887 (2d Cir. 1976), which affirmed a district court decision under Rule 12(f)¹ to strike allegations based on an earlier unadjudicated complaint that had been filed against the same defendant by the Securities and Exchange Commission (SEC). Some courts have read *Lipsky* as stating a bright line rule that pleadings may never rely on or make reference to previous, unadjudicated complaints. Other courts have limited *Lipsky* and allowed the use of unadjudicated allegations—from both government and private complaints—in subsequent civil pleadings.

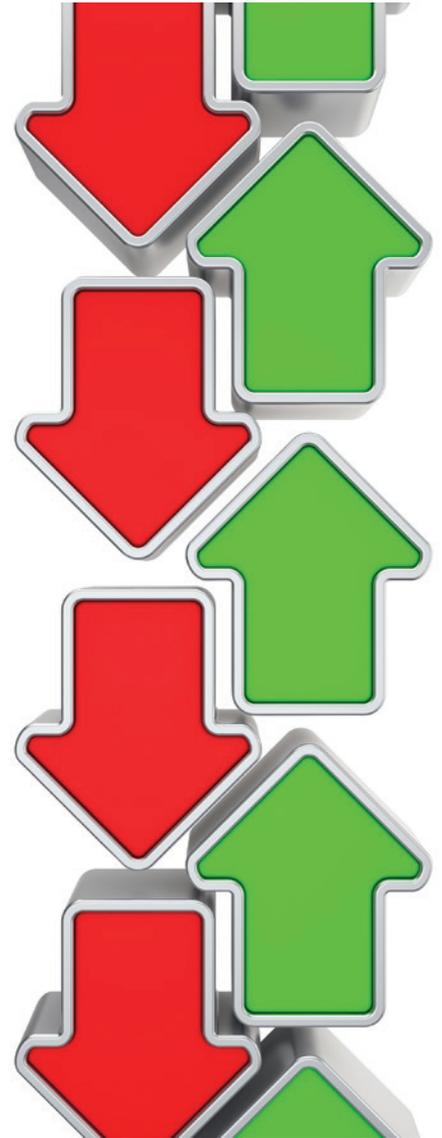
This article describes the differing approaches to reliance on prior unadjudicated complaints within the Second Circuit—primarily within the Southern District of New York—under Rules 11 and 12.² Until those differences are resolved by the Second Circuit, litigants will need to take care when

considering or confronting allegations based on prior complaints.³

'LIPSKY'

The plaintiff in *Lipsky* alleged that the defendants, corporate entities in which he held certain stock, failed to use their best efforts to register the stock with the SEC (as required by the parties' stock-transfer agreement), because the defendants had filed misleading registration statements. The plaintiff, the executor of the estate of the entertainer Bobby Darin, brought a claim for rescission of that agreement. In support of the claim, the plaintiff alleged that the SEC had previously filed a complaint claiming that different registration statements filed by the same defendants were also materially misleading. The plaintiff argued that because those earlier registration statements were "basically duplicates" of the statements related to his stock, the SEC's complaint was probative of whether the defendants had used their best efforts to register the stock. *Id.* at 891. The defendants moved to strike those allegations pursuant to Rule 12(f), arguing that the SEC's complaint resulted in a consent judgment, which would not be admissible in a trial on the merits, so the allegations relying on the SEC complaint were "immaterial." *Id.* at 893. The district court granted the motion. *Id.* at 891.

Although the Second Circuit acknowl-



edged that "courts should not tamper with the pleadings unless there is a strong reason for so doing," it affirmed the district court's order striking the allegations. *Id.* at 893. It held that although "the opinion of the SEC may well be relevant to the question whether [the defendant] used its best efforts, ... neither a complaint nor references to a complaint which results in a consent judgment may properly be cited in the pleadings under the facts of

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this case." *Id.* The Second Circuit explained that because the consent judgment resulting from the SEC's complaint was "not the result of an actual adjudication," it would be inadmissible as evidence against the defendant. *Id.* Since the consent judgment could "have no possible bearing on" the plaintiff's claim, the court concluded that "the SEC complaint which preceded the consent judgment is also immaterial, for the purposes of Rule 12(f)." *Id.* at 894.

Lipsky makes clear that there are circumstances in which reliance on unadjudicated allegations from an earlier complaint is impermissible. Although not unambiguous, the reported decision indicates that the *Lipsky* plaintiff was barred from using the SEC's unadjudicated legal conclusion that statements in a related case were unlawful in order to buttress his challenge to statements made in his own case. In doing so, the Second Circuit suggested that the plaintiff might still be permitted to introduce the underlying "testimony or documents from the SEC," even if he could not "allude to this evidence in his complaint as a condition for its admission." *Id.* at 894. In all, the Second Circuit simply did not explain the contours of the rule it was applying, and instead expressly limited its holding to "the facts of this case." *Id.* at 893. Courts within the Circuit have subsequently struggled to define those boundaries.

APPLICATION OF 'LIPSKY' UNDER RULE 12

In the last several years, there have been numerous decisions in the Second Circuit addressing plaintiffs' reliance on facts derived from unadjudicated complaints in earlier actions.⁴ This increase may in some respects be attributable to the heightened pleading standards imposed on plaintiffs in the last decade by *Bell Atl. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). Moreover, although not all these decisions involve securities claims, the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 (PSLRA) may also explain the increased litigation over this issue in recent years. That is, plaintiffs may be relying more frequently on details of prior government complaints to meet standards

of specificity and plausibility that they might otherwise fail to overcome.

Against this backdrop, courts facing motions to strike or disregard factual allegations derived from prior unadjudicated complaints have gone in either of two directions. In one group of decisions, district courts have extended *Lipsky* to strike or disregard any allegations derived from or referencing prior unadjudicated complaints, regardless of how the complaint used those prior allegations. Other courts have read *Lipsky* narrowly by permitting factual allegations based on factual information in prior complaints—both government and private—particularly where the prior complaints have had indicia of reliability, such as references to published studies or a high degree of detail. Analysis of the reported decisions, however, reveals no apparent rationale for the distinction in outcomes.

The Broad Reading of 'Lipsky'. Although *Lipsky* seemingly barred the use of the SEC's unadjudicated legal conclusions—i.e., the "opinion of the SEC"—several decisions have extended *Lipsky* to bar the use of prior unadjudicated complaints for any purpose. For example, in *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 218 F.R.D. 76 (S.D.N.Y. 2003), defendants moved to strike allegations in a complaint that referred to and relied on complaints filed in several previous actions against the defendant, including some filed by the SEC. Citing *Lipsky*, the district court granted the motion, holding that "Second Circuit case law makes it clear that references to preliminary steps in litigations and administrative proceedings that did not result in an adjudication on the merits or legal or permissible findings of fact are, as a matter of law, immaterial under Rule 12(f) of the Federal Rules of Civil Procedure." *Id.* at 78. Without reference to the purpose for which the plaintiff sought to rely on the earlier actions, the district court held that any allegations that "refer to or rely on" earlier unadjudicated complaints are improper. *Id.* at 79. Several other courts have also applied *Lipsky* to bar reliance on prior unadjudicated government complaints as a per se rule.⁵ Courts have

similarly stricken allegations based on unadjudicated private complaints.⁶

These cases do not indicate that there are any circumstances in which reliance on allegations from prior filings is proper, thereby suggesting that any allegation relying on a prior unadjudicated complaint should be stricken or disregarded.

The Narrow Reading of 'Lipsky'. In contrast, other courts have held that plaintiffs may use an earlier unadjudicated complaint as the basis for factual allegations. In *In re Fannie Mae 2008 Sec. Litig.*, 891 F. Supp. 2d 458 (S.D.N.Y. 2012), for example, plaintiffs supported a securities fraud claim with allegations closely tracking those in an earlier SEC action, as well as with statements made in a non-prosecution agreement entered into by Fannie Mae. The court rejected a motion to strike those allegations, explaining that "*Lipsky* does not ... stand for the proposition that any factual allegation derived from a government investigation or pleading must be stricken from a private plaintiff's complaint." *Id.* at 471. The court held that there is "nothing improper about utilizing information contained in an SEC complaint as evidence to support private claims under the PSLRA." *Id.* (quoting *SEC v. Lee*, 720 F. Supp. 2d 305, 341 (S.D.N.Y. 2010)). Other courts have similarly permitted use of facts derived from earlier unadjudicated allegations in government complaints.⁷

Some courts have even permitted reliance on factual allegations from prior private complaints. The broadest articulation of the reasoning behind that approach is set forth in *In re Bear Stearns Mortg. Pass-Through Certificates Litig.*, 851 F. Supp. 2d 746 (S.D.N.Y. 2012). That court denied a request to strike or disregard such allegations, and concluded that *Lipsky* did not create an "absolute rule" barring the use of facts derived from prior unadjudicated complaints. *Id.* at 768 n.24. The court reasoned that a blanket rule that would preclude use of factual allegations derived from earlier unadjudicated actions was too broad:

Not all complaints are created equal—while some barely satisfy the pleading requirement, others

are replete with detailed factual information of obvious relevance to the case at hand.

Id. The court found that the earlier private complaints upon which the *Bear Stearns* plaintiffs sought to rely met this standard by recounting detailed factual studies regarding the precise issues involved in the lawsuit. The court concluded that "[i]t makes little sense to say that information from such a study—which [a complaint] could unquestionably rely on if it were mentioned in a news clipping or public testimony—is immaterial simply because it is conveyed in an adjudicated complaint." Id. Several subsequent opinions have relied on *Bear Stearns* in permitting the use of factual allegations derived from adjudicated private complaints.⁸

Although they permit the use of facts derived from earlier complaints, many of these cases do not distinguish *Lipsky*, and several do not address *Lipsky* at all. One case that does provide an explanation is *VNB Realty v. Bank of Am.* In that case, the court explained that the plaintiff in *Lipsky* was attempting to rely on allegations about offering documents different from those at issue in the case at hand, making them "immaterial." *VNB Realty*, 2013 U.S. Dist. LEXIS 132250, at *9-10. Thus, the rationale for disregarding those borrowed allegations in *Lipsky* was inapplicable to the case before it, where the prior allegations did relate to the claim before the court. Id. at *10. Another court found that *Lipsky* bars the use of complaints only when they "ultimately result[] in a consent decree or nolo contendere plea." *In re OSG Sec. Litig.*, 12 F. Supp. 3d at 621.9 None of these cases, however, offers a rationale for limiting *Lipsky* that reconciles the varying approaches of courts within the Second Circuit.

USE OF UNADJUDICATED ALLEGATIONS

Although an increasing number of courts have refused to strike or disregard facts derived from an earlier adjudicated complaint in assessing motions under Rule 12, some courts have nevertheless found that Rule 11 imposes its own requirements that could bar the

use of such allegations.¹⁰ In *Strougo v. Barclays*, a putative class of investors brought a securities fraud class action against Barclays. As support for their claims, the plaintiffs "[b]orrow[ed] heavily" from an adjudicated complaint filed against Barclays by the New York Attorney General. 2015 U.S. Dist. LEXIS 54059, at *2. Although the court denied Barclays' motion to strike allegations derived from the Attorney General's complaint, it admonished:

While there is no basis to strike the Complaint at this time, plaintiffs have an ongoing obligation under Rule 11. Plaintiffs should amend the Complaint to eliminate any allegations that are false or inaccurate. At that time, plaintiffs should also describe the independent investigations they have done to verify the allegations in the Complaint.

Id. at *21-22. Similarly, in *VNB Realty*, the court refused to strike allegations copied from complaints filed by the Federal Housing Finance Agency and AIG, but nonetheless found that some of the allegations that were taken from the AIG complaint did not satisfy Rule 11 (or the PSLRA's heightened pleading standards), i.e., allegations that the AIG complaint had attributed to "confidential witnesses interviewed by AIG prior to the filing of th[e] complaint." 2013 U.S. Dist. LEXIS 132250, at *20 (internal quotation marks omitted). According to the court:

By drawing its factual allegations from the statements of confidential witnesses in AIG's complaint, VNB is attempting to rely on the substance of those allegations without being held responsible for certifying that they are supported by some factual basis, or at least that the witnesses did in fact make such statements. Unlike AIG, VNB presumably does not even know who these witnesses are.

Id. at *21. Thus, even where Rule 12(f) does not require allegations drawn from earlier complaints to be stricken, these decisions impose higher standards under Rule 11 that some allegations cannot meet.

By contrast, another district court refused to find a violation of Rule 11

where a private plaintiff relied on an earlier unadjudicated SEC complaint. In *De La Fuente v. DCI Telecomms.*, 259 F. Supp. 2d 250 (S.D.N.Y. 2003), a defendant brought a motion for Rule 11 sanctions against a plaintiff, arguing that by "simply cop[ying an] SEC complaint," the plaintiff had failed to "conduct[an] investigation reasonable under the circumstances." Id. at 259 (internal quotation marks omitted). The court declined to find those allegations sanctionable, holding that "there is nothing improper about utilizing information from the SEC as evidence to support private claims," particularly because "a complaint predicated on the results of an SEC investigation has far more 'evidentiary support' than one based on rumor and innuendo gleaned from 'Heard on the Street.'" Id. at 260.¹¹

Together, these cases indicate that Rule 11 requires some independent investigation or indicia of reliability in order for a plaintiff permissibly to rely upon allegations from earlier unadjudicated complaints. Thus, even where *Lipsky* does not require that such allegations be stricken, litigants must nonetheless take into account the additional demands of Rule 11.

CONCLUSION

Ultimately, the extent to which a new complaint may rely on facts derived from an earlier, unadjudicated complaint remains unresolved in the Second Circuit. Parties considering whether such allegations are permissible might therefore keep in mind the following:

- It may not be sufficient to rely entirely on factual allegations copied from prior unadjudicated complaints; instead, relying on such allegations alongside other, independent allegations that can support the claim may be more likely to pass muster.
- Reliance on prior unadjudicated complaints may be more likely to be approved if plaintiffs can show that the facts alleged in the earlier complaint are reliable. For example, facts derived from complaints filed

by government agencies after an investigation may be less likely to be stricken than private complaints that do not disclose the basis for their allegations.

- For Rule 11 purposes, allegations derived from unadjudicated complaints will likely require that the plaintiff demonstrate some independent ground for the allegations.

- Given the split in approaches, litigants have to be aware that different judges may take different approaches to this issue.

In sum, the conflicting district court rulings on this issue mean that all litigants will need to tread carefully and make their own considered judgments about how best to approach this issue until it is resolved by the Second Circuit.

ENDNOTES:

1. Rule 12(f) provides in relevant part that "[t]he court may strike from a pleading ... any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f).

2. This article limits its discussion to the treatment of this issue in the Second Circuit. Courts in other circuits have also reached varying conclusions.

3. This article addresses the ability of a plaintiff to rely on facts derived from unadjudicated pleadings in a complaint; for a discussion of the ability of a plaintiff to rely on a consent order, see Kevin Levenberg, Comment, "Read My *Lipsky*: Reliance on Consent Orders in Pleadings," 162 U. Pa. L. Rev. 421 (2014) (finding that courts are split as to whether reliance on consent orders is proper under Rules 12(f) and 11).

4. Those cases analyzing whether the use of allegations derived from prior unadjudicated complaints is proper under *Lipsky* have done so pursuant to both formal motions to strike under Rule 12(f), as well as in response to requests by defendants to disregard certain allegations in considering a Rule 12(b) (6) motion to dismiss.

5. See, e.g., *In re CRM Holdings Sec. Litig.*, No. 10 Civ. 975, 2012 U.S. Dist.

LEXIS 66034, at *77-78 (S.D.N.Y. May 10, 2012) (refusing, on motion to dismiss, to consider allegations of facts derived from complaints filed by the New York State Workers' Compensation Board and the New York Attorney General); *Footbridge Ltd. Trust v. Countrywide Home Loans*, No. 09 Civ. 4050, 2010 U.S. Dist. LEXIS 102134, at *14 (S.D.N.Y. Sept. 28, 2010) (granting motion to strike factual allegations "based on pleadings and settlements in other cases and government investigations"); *Dexia SA/NV v. Deutsche Bank AG*, No. 11 Civ. 6141, 2013 U.S. Dist. LEXIS 3482, at *3 n.1 (S.D.N.Y. Jan. 4, 2013) (holding that, if plaintiffs filed amended complaint, "the Court would strike, pursuant to *Lipsky* ... any paragraphs based on unproven allegations in unresolved cases").

6. See, e.g., *RSM Prod. v. Fridman*, 643 F. Supp. 2d 382, 403 (S.D.N.Y. 2009) (citing *Lipsky* in striking use of prior unadjudicated complaints filed by private plaintiffs to establish defendant's history of corrupt practices); *In re Gentiva Sec. Litig.*, 971 F. Supp. 2d 305, 322 (E.D.N.Y. 2013) (citing *RSM* in refusing to consider facts derived from earlier private complaint to establish pattern of fraud).

7. See *Strougo v. Barclays PLC*, No. 14-cv-5797, 2015 U.S. Dist. LEXIS 54059, at *20-21 (S.D.N.Y. April 24, 2015); *VNB Realty v. Bank of Am.*, No. 11 Civ. 6805, 2013 U.S. Dist. LEXIS 132250, at *6-13 (S.D.N.Y. Sept. 16, 2013) (denying motion to strike allegations derived from Federal Housing Finance Agency complaint, and holding that *Lipsky* "does not mandate the elimination of material from a complaint simply because the material is copied from another complaint"); *SEC v. Lee*, 720 F. Supp. 2d at 340-41 (refusing to strike allegations that relied upon prior SEC and CFTC actions, and noting that reliance on those complaints did "not demonstrate that [the plaintiff] lack[ed] evidentiary support, but rather provides it with the necessary evidentiary support"); *Fraternity Fund v. Beacon Hill Asset Mgmt.*, 376 F. Supp. 2d 385, 395 (S.D.N.Y. 2005) (factual allegations that relied on, among other

things, an SEC complaint that resulted in a consent judgment, were "adequate for Rule 9(b) and PSLRA purposes"); see also *Vanleeuwen v. Keyuan Petrochemicals*, No. 13 Civ. 6057, 2014 U.S. Dist. LEXIS 110255, at *12-13 (S.D.N.Y. Aug. 8, 2014) (in denying motion to dismiss, holding that there was nothing improper in plaintiff's use of information contained in an SEC complaint that resulted in consent judgment).

8. See *HSH Nordbank AG v. RBS Holdings USA*, No. 13 Civ. 3303, 2015 U.S. Dist. LEXIS 36087, at *8-9 (S.D.N.Y. March 23, 2015) (rejecting motion to strike allegations regarding a forensic study detailed in a prior unadjudicated private complaint); *In re OSG Sec. Litig.*, 12 F. Supp. 3d 619, 620 (S.D.N.Y. 2014) (allowing plaintiff to amend complaint to include factual allegations derived from another pending lawsuit, and rejecting the "broad rule that a complaint may never reference allegations from a separate proceeding that has not been decided on the merits").

9. In doing so, that court reasoned that, in the absence of a consent decree or other negotiated disposition, "the protections or policy concerns" of Fed. R. Evid. 408 and 410, which would prevent such reliance, were not at issue.

10. In relevant part, Rule 11 provides that "[b]y presenting to the court a pleading, written motion, or other paper ... an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances," inter alia, the claims are warranted by the law and the factual contentions have evidentiary support. Fed. R. Civ. P. 11(b).

11. An enforcement action filed by the SEC must be preceded by an investigation into the conduct at issue, as well as approval by the Commission itself following an examination of the factual and legal foundation for the action. See SEC Enforcement Manual, Chapter 2.