IN THE SUPREME COURT
STATE OF GEORGIA

LINDA G. KEOGLER and HELEN M. KEOGLER,	)	
Petitioners,	)	
vs.	)	**Case No. S04C1876**
ROBERT M. KRASNOFF, BARBARA C. KRASNOFF, and THE KRASNOFF FAMILY IRREVOCABLE TRUST,	)	
Respondents.	)	

AMICUS CURIAE BRIEF ON BEHALF OF THE PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION IN SUPPORT OF THE PETITION FOR CERTIORARI

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August 13, 2004

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I. Statement of Interest

The Public Investors Arbitration Bar Association, Inc. ("PIABA") is a national non-profit voluntary public bar association dedicated to the representation of public investors in private arbitrations involving securities matters. Founded in 1990, PIABA now has approximately 750 member attorneys in 44 states and Puerto Rico. The vast majority of all disputes arising in Georgia between securities broker-dealers and their customers are resolved by submission to arbitration.

The interest of PIABA in this case arises from the fact that a number of its members are currently representing investors in private arbitrations in which

claims for violations of Section 12 (a)(2)(B) of the Georgia Securities Act of 1973, O.C.G.A. § 10-5-1 et seq. ("the Georgia Act") have been asserted pursuant to Section 14 (a) of the Georgia Act. The issues decided in this case may influence the outcome of these arbitrations.

The interest of PIABA is also aligned with that of the investing public generally. State securities (or "Blue Sky") laws were designed to be enforced primarily by civil suits brought by citizens. *See* 3 Loss, *Securities Regulation*, 1631, 1643 (1961); *accord*, *Criticare Systems, Inc. v. Sentek, Inc.*, 159 Wis.2d 639,651, 465 N.W.2d 216, 221 (1990). Therefore, beyond its impact on the cases currently in arbitration, this case will determine the scope of the protections afforded to the investing public by the Georgia Act, whether those protections are sought to be enforced by private claimants or state regulators.

II. Summary of the Argument

The Court should grant certiorari because the present case is of great concern, gravity, and importance to the public within the meaning of Rule 40 of this Court.

If the opinion of the Court of Appeals is allowed to stand, Georgia will stand as the first and only state to find a scienter requirement under a civil liability provision modeled on Section 410 of the Uniform Securities

Act ("the U.S.A.") and Section 12 (a)(2) of the Securities Act of 1933, 15 U.S.C. § 771(2) et seq. ("the Securities Act"). In addition, Georgia will join a distinct minority of states (presently consisting only of Louisiana) in imposing a due diligence requirement upon purchasers of securities, thereby restoring the rule of *caveat emptor*.

This development would do considerable harm to the investing public in Georgia by limiting the range of prohibited conduct relating to the sale of securities that can be enjoined and punished by state regulators, and by narrowing the scope of civil remedies for injured investors. The decision would radically shift the balance of responsibilities between sellers and purchasers of securities. If sellers are only liable for misrepresentations made with fraudulent or reckless intent, they will no longer have any incentive to perform due diligence to determine the truth of their representations. Purchasers, however, would bear the undue burden of using reasonable care to determine the truth of representations made by the seller. The Court of Appeals opinion is a devastating one-two punch that effectively knocks out central tenets of investor protection embodied in the Georgia Act.

Before the Court of Appeals issued its decision in the present case, it was generally accepted, based upon case law interpreting the Blue Sky laws of other states and upon an Eleventh Circuit case interpreting Section 12 (a)(2)(B) of the Georgia Act, that proof of scienter and reliance is not required to establish civil liability based upon an alleged violation of that subsection. The decision of the Court of Appeals, while purporting to be an extension of precedent, is widely viewed as changing the law. For example, an Atlanta-based law firm, Powell Goldstein Frazer & Murphy, LLP, recently posted a Client Alert on its website in which it states, in commenting on the opinion of the Court of Appeals in this case, "it now appears that a plaintiff bears a significantly more difficult burden in order to state a claim than may have been previously thought." (*See* Exhibit "A" hereto).

The opinion of the Court of Appeals ignores the purposes and legislative history of the Georgia Act, violates canons of statutory construction, and disregards applicable state and federal precedent. Because this case represents a matter of great public concern, the Court should grant certiorari to review the decision of the Court of Appeals.

III. Argument and Citation of Authority

A. Section 14 (a) of the Georgia Act implicitly provides that a seller of securities who violates Section 12 (a)(2)(B) of the Georgia Act by means of a negligent misrepresentation or omission is liable to a purchaser who did not have actual knowledge of the misrepresentation or omission.

The Court of Appeals erred by violating well-established rules of statutory construction in interpreting Sections 14 (a) and 12 (a)(2)(B) of the Georgia Act to require scienter and investor due diligence.

One of the enumerations of error raised by petitioners in the Court of Appeals was that the trial court erred in charging the jury that proof of scienter and reliance are required in order to establish a claim brought pursuant to Section 14 (a) based upon an alleged violation of Section 12 (a)(2)(B). The trial court defined "scienter" as "a false statement . . . knowingly made with a false design or . . . in a severely reckless manner. Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve *not merely simple or even an excusable negligence, but an extreme departure from the standards of ordinary care.*" (emphasis added) *Keogler v. Krasnoff, et.al.*, 2004 WL 1472687. With respect to reliance, the court charged the jury, "[t]o show justifiable reliance on the misrepresentation or omitted information sufficient to constitute securities fraud, the

plaintiffs must show *that with the exercise of reasonable diligence they still could not have discovered the truth behind the fraudulent misrepresentation or omission.*" (emphasis added) *Id.* The type of reliance referred to in the court's charge is customarily referred to in the securities law context as "investor due diligence." *See generally*, Joseph Long, *Blue Sky Law* § 9:30.

O.C.G.A. § 10-5-14 (a) provides, in relevant part:

> Any person who violates subsection (a) of Code Section 10-5-12 shall be liable to the person buying such security; and such buyer may sue in any court of competent jurisdiction to recover the consideration paid in cash . . . for the security with interest thereon . . . upon the tender, where practicable, of the security . . . or for damages if he no longer owns the security. . . . *A person who offers or sells a security in violation of paragraph (2) of subsection (a) of Code Section 10-5-12 is not liable under this subsection if:*
>
> *(1) the purchaser knew of the untrue statement of a material fact or omission of a statement of a material fact; or*
>
> *(2) the seller did not know and in the exercise of reasonable care could not have known of the untrue statement or misleading omission.* (emphasis added).

Petitioners brought their claim under the above-quoted section, alleging a violation of O.C.G.A. § 10-5-12 (a) (2) (B), which provides:

> (a) It shall be unlawful for any person:
> . . .
> (2) In connection with an offer to sell, sale, offer to purchase, or purchase of any security, directly or indirectly:
>
> (B) To make an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading . . . .

Because the Georgia Act is remedial in nature and intended for the protection of investors, it should be broadly and liberally construed to effectuate its aim. *Dunwoody Country Club v. Fortson*, 243 Ga. 236, 242, 253 S.E.2d 700, 705 (1979). In interpreting a statute, the courts must give sensible and intelligent effect to each part of the statute. *Transportation Ins. Co. v. El Chico Restaurants*, 271 Ga. 774, 776, 524 S.E.2d 486 (1999). Moreover, in all statutory interpretation, the ordinary signification shall be applied to all words, except words of art or words connected with a particular trade or subject matter. O.C.G.A. § 1-3-1 (b).

Section 14 (a)(1) of the Georgia Act contains an exception from liability if the purchaser has *actual* knowledge of the misrepresentation or omission, but does not impose a requirement of reasonable care to conduct an independent due diligence inquiry. It is a basic canon of

statutory construction that the inclusion of one thing excludes another. *Morton v. Bell*, 241 Ga. 832, 833, 452 S.E.2d 103 (1995). That the very next subsection, Section 14 (a)(2), contains language imposing a standard of reasonable care upon sellers shows that the General Assembly knew how to impose a requirement of reasonable care expressly upon the purchaser. As one Court has put it, the imposition of a reasonable care requirement on the seller "tends to establish that the drafters did not intend to require reasonable inquiry by the purchaser." *In re Olympic Brewing Co. Sec. Lit.*, 612 F. Supp. 1367, 1370 (N.D. Ill. 1985).

Subsection 14 (a)(2) relieves a seller from liability if he is not negligent in making a misrepresentation or omission. The necessary implication is that a seller is liable for negligent misrepresentations or omissions. In finding a requirement of scienter, or a knowing or reckless state of mind, the Court of Appeals rendered Section 14 (a)(2) meaningless, since any knowing or reckless misrepresentation is by definition knowable in the exercise of reasonable care. The Court of Appeals opinion is wrong because it cannot be presumed that the legislature intended that any part of a statute would be without meaning and

therefore mere surplusage. *Transportation Ins. Co*, 271 Ga. at 776.

B. Sections 14 and 12 (a)(2)(B) of the Georgia Act are similar to, and should be interpreted consistently with, U.S.A. § 410 and Section 12 (a)(2) of the Securities Act of 1933

The Court of Appeals also erred in equating the elements of claims brought for violations of Section 12 (a)(2)(B) of the Georgia Act to SEC Rule 10b-5 promulgated under the Securities Exchange Act, 17 C.F.R. § 240.10b-5 ("Rule 10b-5").[1] If the Court of Appeals had considered Section 14 (a) of the Georgia Act *in pari materia* with Section 12 (a)(2)(B), it would have recognized that Section 12 (a)(2)(B) of the Georgia Act more closely resembles U.S.A. § 410[2] and Section 12(a)(2) of the Securities Act.[3]

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[1] 17 C.F.R. § 240.10b-5: "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme, artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

[2] U.S.A. § 410: "Civil liabilities. (a) Any person who . . . (2) offers or sells a security by means of any untrue statement of a material fat or any omission to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission) and who does not sustain the burden of

It is those statutes, rather than Rule 10b-5, that should be analyzed in interpreting Section 12 (a)(2)(B) of the Georgia Act.

Other state Blue Sky laws patterned after U.S.A. § 410 (a)(2) have been interpreted to require only negligence as a basis for liability. *Pottern v. Bache Halsey Stuart*, Inc., 41 Colo. App. 451, 453, 589 P.2d 1378, 1379 (Colo. App. 1978)(§ 11-51-125(1) C.R.S. does not require scienter); *Bradley v. Hullander*, 272 S.C. 6, 21, 249 S.E.2d

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proof that he did not know, and in the exercise or reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security."

[3] 15 U.S.C. § 77l(2): "Civil liabilities arising in connection with prospectuses and communications. Any person who . . . (2) offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission) and, who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

486, 494 (1978)(S.C. Sec. 62-309(2) requires only negligence); *Sprangers v. Interactive Technologies, Inc.*, 394 N.W. 2d 498, 503 (Minn. App. 1986)(Minn. Stat. 80A.23(b) requires only negligence); *Rousseff v. Dean Witter & Co.*, 453 F. Supp. 774, 779 (N.D. Ind. 1978)(Ind. Code § 23-2-1-19 (a)(2) does not require scienter); *Kittleson v. Ford*, 93 Wash. 2d 223, 608 P.2d 264, 265, 66 (Wash. 1980)(no requirement of scienter). *See generally* J. Long, *Blue Sky Law* § 1:74. [4]

Blue Sky laws patterned after U.S.A. § 410 (a)(2) likewise do not require proof of investor due diligence as a prerequisite for recovery. *Bradley*, 272 S.C. at 21, 249 S.E.2d at 494; *Duperier v. Texas State Bank*, 28 S.W. 3d 740, 745 (Tex. Civ. App., Aug. 24, 2000); *McCrachen v. Edward D. Jones & Co.*, 445 N.W.2d 375 (Iowa App. 1989)(Iowa Securities Act does not allow reduction of damages based upon comparative fault); *but see Landry v. Thibaut*, 523 So.2d 1370 (La. App. 1988). As the Indiana Court of Appeals said in *Kelsey v. Nagy*, 410 N.E.2d 1333 (Ind. App. 1980):

[4] Because the Georgia legislature has expressed a policy of "uniform interpretation" of the Georgia Act with the securities laws of other states, O.C.G.A. § 10-5-10 (g), these interpretations should be given considerable weight in questions of interpretation of the Georgia Act.

> [I]f the legislature had intended to impose a duty to investigate upon the buyer, it would have expressly included such in the wording of the statute. The proscriptions of [Section 410 (a)(2)], however, embrace a fundamental purpose of substituting a policy of full disclosure for that of caveat emptor. That policy would not be served by imposing a duty of investigation upon the buyer. *Id*. at 1336.

Furthermore, U.S.A. § 410 (a)(2) is itself modeled upon Section 12 (a)(2) of the Securities Act. *Pottern*, 589 P.2d at 1379; Official Comment to U.S.A. § 410. Section 12 (a)(2) of the Securities Act does not require proof of either scienter or investor due diligence. *Franklin Savings Bank of New York v. Levy*, 551 F.2d 521 (2d Cir. 1977)(no scienter required); *Cassella, 883 F.2d at 809 (*constructive knowledge by investor is not a bar to recovery*); Midamerica Fed. Sav. & Loan Assoc. v. Shearson/American Express, Inc., 886 F.2d 1249* (10th Cir. 1989*); Currie v. Cayman Resources Corp.*, 835 F. 2d 780, 782 (11th Cir. 1988)(no reliance element in claims brought under §12(a)(2) of the Securities Act of 1933). The Eleventh Circuit Court of Appeals, while not ruling directly on whether the Georgia Act requires proof of scienter, has observed that "[a]rguably, because the language of [Section 12 (a) of the Georgia Act] tracks the language of Section 410(a) of the Uniform Securites Act and

Section 12(2) of the Securities Act of 1933, . . . scienter is not required." *Diamond v. Lamotte*, 709 F.2d 1419, 1423 (11th Cir. 1983).

The Court of Appeals, relying upon its prior decision in *GCA Strategic Investment Fund, Ltd. v. Joseph Charles & Associates*, 245 Ga. App. 460, 537 S.E. 2d 677 (Ga. App. 2000), erroneously interpreted Section 12 (a)(2) of the Georgia Act by reference to federal court interpretations of Rule 10b-5. While there are clearly similarities between Rule 10b-5 and Section 12 (a) of the Georgia Act, the Court of Appeals failed to consider the application of Section 14(a) of the Georgia Act to claims brought under Section 12 (a)(2)(B). Had it done so, it would have recognized that, unlike Section 14 (a) of the Georgia Act, Rule 10b-5 does not contain an express cause of action by a buyer against a seller for rescission, and does not contain the exceptions from liability that form the crux of the matter that is the subject of the present petition, namely the exceptions based upon the purchaser's knowledge or the seller's lack of negligence. By contrast, Section 12 (a)(2) of the Securities Act contains all of the above characteristics.

Courts have held that plaintiffs seeking to recover under section 12(a)(2) of the Securities Act “must only

prove that the defendants sold or offered to sell these securities. . . and that the defendants misrepresented or omitted material facts." *Currie v. Cayman Resources Corporation, et al.*, 835 F.2d 780, 783 (11th Cir. 1988). In addition, just as under 14(a)(1) of the Georgia Act, plaintiffs must prove that they "had no knowledge of any untruth or omission." *Id.* Therefore, because of these similar characteristics to Section 12(a)(2)(B) and 14 of the Georgia Act, Section 12(a)(2) of the Securities Act is more analogous to 12(a)(2)(B) than 10b-5.[5] *See E.F. Hutton & Co., Inc. v. Rousseff*, 537 So.2d 978, 980-81 (Fla. 1989).

Furthermore, the origin of subsection (b) to Rule 10b-5 is Section 17 (a)(2) of the Securities Act, 15 U.S.C. § 77(q)(a).[6] *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212, n.32 (1976). That section itself has been interpreted

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[5] *GCA Strategic Investment Fund* and *Goldberg* are distinguishable because it is not clear whether the claims described as "securities fraud claims" in those two cases were brought under Section (a)(2)(B). To the extent they are interpreted to apply to such claims, they should be disapproved.

[6] 15 U.S.C. § 77 (q)(a): "It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly . . . (2) to obtain money or property 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 the light of the circumstances under which they were made, not misleading . . . ."

not to require scienter. *Aaron v. Securities and Exchange Commission*, 446 U.S. 680, 695 (1980)(Section 17(a)(2) is "devoid of any suggestion whatsoever of a scienter requirement.") *Id*. at 695. While it is true that Rule 10b-5(b), which is nearly identical to Section 17 (a)(2), has been interpreted as requiring scienter, the reason for the different interpretations does not exist under the Georgia Act. Specifically, Rule 10b-5(b) must be interpreted in light of the statute that enabled its passage, namely Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b)[7]. In *Hochfelder*, the U.S. Supreme Court acknowledged that "viewed in isolation, the language of subsection (b). . . could be read as proscribing. . . any type of material misstatement of omission. . . that has the effect of defrauding investors, whether the wrongdoing was intentional or not." 425 U.S. at 212. Nevertheless, the Court declined to interpret subsection (b) that broadly, because to do so would have exceeded the power granted by Congress under Section 10(b) of the Securities Exchange Act of 1934. *Id*. Since the

[7] 15 U.S.C. § 78 (q)(a) makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . ., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public investor for the protection of investors."

Georgia Act was not promulgated pursuant to Section 10(b) of the Securities Exchange Act of 1934 and does not contain an equivalent provision, violations of Section 12(a)(2)(B) of the Georgia Act should not be limited to severely reckless conduct.

IV. Conclusion

In conclusion, this Court should grant certiorari because the outcome of this case will have a significant impact on the investing public in the State of Georgia, who rely on Section 12(a)(2)(B) of the Georgia Securities Act of 1973. As a result of the Court of Appeals opinion, those seeking a remedy under Section 14 of the Georgia Securities Act for violations of Section 12(a)(2)(B) are required to prove two additional elements, scienter and reliance. These additional elements create undue burdens that were never intended by the plain language of the statute or supported by legislative history.

The Court of Appeals erred in its decision by failing to consider the application of Section 14(a) of the Georgia Act to claims brought under Section 12(a)(2)(B). In doing so, the Court of Appeals violated well-established rules of statutory construction. The Court of Appeals improperly imposed a scienter requirement, notwithstanding that Section 14(a)(2) of the Georgia Act imposes liability on

violators for negligent misstatements or omissions. With regards to reliance, the Court of Appeals improperly imposed a due diligence requirement on a purchaser, notwithstanding that Section 14(a)(1) of the Georgia Act only bars recovery if a purchaser has actual knowledge of the untrue statement or omission of fact.

In addition, as a result of its failure to consider the application of Section 14(a) of the Georgia Act, the Court of Appeals incorrectly analogized violations of Section 12(a)(2)(B) to violations of Rule 10b-5 of the Securities Exchange Commission. Section 14(a) of the Georgia Act, when read in conjunction with Section 12(a)(2)(B), is patterned after U.S.A. § 410, which in turn was derived from Section 12(a)(2) of the Securities Act of 1933. Other state Blue Sky laws similar to the Georgia provisions at issue are interpreted in the same light as Section 12(a)(2) of the Securities Act of 1933 and impose liability for negligent misstatements and omissions and, furthermore, do not impose a due diligence or reliance requirement on plaintiffs.

For all of the above stated reasons, the Public Investors Arbitration Bar Association respectfully requests that the Supreme Court of Georgia grant the petition of certiorari.

This _____ day of August 2004.

Respectfully submitted,

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Certificate of Service

This is to certify that I have this day served upon counsel a true and correct copy of the foregoing BRIEF OF AMICUS CURIAE ON BEHALF OF THE PUBLIC INVESTORS BAR ASSOCIATION by first class mail, postage prepaid, to:

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This 13th day of August, 2004

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