



Apr 24, 2023

Categories:

[Securities](#)

Authors:

[Samuel I. Portnoy](#)

Securities Plaintiffs Beware: Third Circuit Holds Initiating Suit to Force Settlement May Violate Rule 11 and Can Lead to Mandatory Sanctions Under the PSLRA

With the 30th anniversary of the Private Securities Litigation Reform Act (PSLRA) on the horizon, the Third Circuit's recent precedential opinion in [Scott v. Vantage Corp.](#) provides timely guidance on an important aspect of the landmark statute that may not always be top of mind – its interplay with Rule 11. The PSLRA, in its effort to curb frivolous securities litigation, not only imposes heightened pleading requirements and an automatic stay of discovery pending motions to dismiss, but also requires Rule 11 compliance findings as to each party and attorney based on what they knew at the time suit was filed. In *Scott*, the Third Circuit reiterated these principles and held that district courts **must** impose some form of sanction for any Rule 11 violation, no matter how insubstantial the violation – a characteristic unique to the application of Rule 11 in PSLRA cases. The decision also reminds us that the PSLRA creates a presumption in favor of awarding attorneys' fees in cases of "substantial failure" to comply with Rule 11, which is defined by the court in the opinion. Finally, the decision stands for the remarkable proposition that filing a complaint to force settlement may violate Rule 11 even when the claims asserted are sufficient to withstand a motion to dismiss.

In *Scott*, a Regulation D offering for shares in Vantage Corporation resulted in a lawsuit in the District of Delaware against Vantage and two of its officers. The complaint included federal securities claims under the 1933 Act (improper sale of unregistered securities to unaccredited investors and misrepresentations) and the 1934 Act (Rule 10b-5 securities fraud) against one of the individual defendants. The claims, which survived a Rule 12 motion to dismiss, were ultimately dismissed on summary judgment. The 1933 Act claims were dismissed because the defendant reasonably believed

all investors were accredited and for insufficient evidence of any broad public offering. The 10b-5 claim was dismissed for lack of evidence of loss causation. After those rulings were affirmed on appeal, the District Court addressed the defendant's motion for Rule 11 sanctions.

Based largely on an email from the plaintiff to his counsel stating "[t]he strategy was to file these complaints to force a settlement," the District Court held (presumably after resolving assertions of privilege) that the complaint was filed for an improper purpose in violation of Rule 11(b)(1). That ruling was also based on evidence that one plaintiff did not know whether her Vantage investment had declined in value when suit was filed and that the other plaintiff sought to get his money out for a different venture. The District Court also held that the plaintiffs' 1933 Act claims violated Rule 11(b)(3) – alleging claims without factual support – because the plaintiffs did not know at the time the complaint was filed that shares were sold to a minor and someone in bankruptcy (facts learned in discovery), nor did they know of evidence of any sufficiently broad solicitation campaign. Notably, however, the District Court found that the plaintiffs' Rule 10b-5 claim did not violate Rule 11 because they alleged a series of misrepresentations that the defendant did not rebut on summary judgment (his motion focused on the elements of reliance and loss causation). Because the District Court viewed the 10b-5 claim as the heart of the plaintiffs' complaint, it found the complaint as a whole did not substantially fail to comply with Rule 11. On that basis, the District Court declined to impose any sanction. Cross-appeals followed.

The Third Circuit reviewed the District Court's Rule 11 determinations for abuse of discretion. On the issue of filing for an improper purpose, the Third Circuit cautioned that colorable claims brought with the ultimate goal of, or an "eye toward," settlement do not violate Rule 11. But the court went on to hold that the evidence cited by the District Court, particularly the plaintiff's email stating the complaint was filed "to force a settlement," was sufficient to support the determination that the plaintiffs crossed the line. The Third Circuit also upheld the District Court's determination that the plaintiffs' 1933 Act claims violated Rule 11, confirming the analysis must be based on the facts known at the time suit is filed, without

regard to facts learned in discovery.

The Third Circuit also affirmed the District Court's ruling that the plaintiffs' various violations did not amount to a substantial failure to comply with Rule 11, based on a new framework it adopted from the Fourth Circuit. Specifically, where some, but not all, claims in a PSLRA case violate Rule 11, the court must "examine the claims collectively to assess whether the Rule 11 violations render the complaint, as a whole, frivolous."

Finally, the Third Circuit reviewed the District Court's decision not to impose sanctions. Under the PSLRA, an award of attorneys' fees is the presumptively appropriate sanction for a substantial failure to comply with Rule 11. Here, because the District Court properly found no substantial failure, its refusal to award attorneys' fees was appropriate. But the District Court's refusal to impose **any** sanction was an abuse of discretion. As the Third Circuit explained, unlike Rule 11 itself, which gives courts discretion to decline to impose sanctions, the PSLRA provides that courts "shall" impose sanctions for Rule 11 violations. As a result, the PSLRA plainly requires district courts to impose some form of sanction for even insubstantial Rule 11 violations, like those here.

The *Scott* decision is not only significant for its guidance on the proper application of Rule 11 in PSLRA cases, but it also has potential implications for the scope of discovery in those cases. If Rule 11 findings are required in every PSLRA case based on what parties and counsel knew at the time of filing, then discovery into the plaintiffs' pre-claim investigations and strategy are arguably fair game. Indeed, in this case, an email between the plaintiff and his counsel regarding litigation strategy was the key piece of evidence. Judicial pronouncements in the wake of *Scott* on the permissible reach of discovery into a plaintiff's bases and motivations for bringing securities claims will be important to monitor.

More generally, in a landscape where federal securities claims against issuers and their officers seem to follow stock-price drops like night follows day, the opinion is an important reminder that Rule 11 sanctions remain in play even for claims sufficient to withstand a motion to dismiss. The Third Circuit's decision in *Scott* makes clear

that if parties and practitioners ignore the PSLRA's Rule 11 provisions, they do so at their peril.

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.