

Pleading for Particularity

AS BOTH PLAINTIFFS and defendants vie for favor of the law in securities fraud actions, a continuing point of contention is the viability of the group pleading doctrine. Plaintiffs' ability to "group plead" allegations of securities fraud is under much debate in the wake of the enactment of the Private Securities Litigation Reform Act (PSL-

SLRA), and courts are split on the issue of whether the group pleading doctrine should remain viable. Several circuits recently declined to rule on the issue, allowing arguments to be further developed.

The judicially developed doctrine reduces plaintiffs' pleading burden to allege that multiple defendants violated § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, which, in general, prohibit any person from making material misrepresentations or omissions in connection with the purchase or sale of a security.¹ However, case law creates the presumption that the senior officers of a company are collectively responsible for misrepresentations or omissions made in a company's "group published" materials — for example, in press releases, financial statements, and SEC filings.² When such documents contain misstatements or omissions, plaintiffs may not know initially who wrote the document; therefore, judges created this pleading protocol to ease the plaintiffs' pleading burden.³

Although private actions under § 10(b) and Rule 10b-5 are subject to the heightened pleading requirement imposed by Rule 9(b) of the Federal Rules of Civil Procedure, which requires that "all averments of fraud or mistake ... be stated with particularity," Congress determined that Rule 9(b) fails to protect the interests of defendants in securities fraud actions adequately.⁴ As a result, in 1995, Congress enacted the Private Securities Litigation Reform Act, the first comprehensive revision of the laws dealing with securities.⁵ The PSLRA imposes substantial limitations on the filing and maintenance of securities fraud claims. Foremost among these limitations are rigorous, fact-specific pleading requirements.⁶ Congress envisioned that, together, Rule 9(b) and the PSLRA would "provide a filter at the earliest stage (the pleading stage) to screen out lawsuits that have no factual basis."⁷ Allowing the plaintiffs to group plead allegations of se-

curities fraud seemingly would contradict Congress' objective for enacting the PSLRA.

Despite persuasive arguments against the application of the doctrine since the PSLRA was enacted, the circuit courts of appeals have been hesitant to address the issue directly. Currently, the Fifth and the Seventh Circuits are the only ones to rule definitively on the issue — both rejecting the doctrine's post-PSLRA viability.⁸ In *Southland Sec. Corp. v. INSpire Ins. Solutions*, the Fifth Circuit was the first circuit to address — and to reject — the post-PSLRA viability of the doctrine. The court reasoned that the PSLRA never explicitly abolished the doctrine and that it was unnecessary to do so, because "Congress never made this judicial creation law to begin with."⁹ In addition, the doctrine conflicts with the PSLRA's "specific requirement that the untrue statements or omissions be set forth with particularity as to 'the defendant' and that scienter be pleaded with regard to 'each act or omission' sufficient to give 'rise to a strong inference that the defendant acted with the required state of mind.'"¹⁰ Therefore, the court required plaintiffs to "distinguish among those they sue and enlighten *each defendant* as to his or her particular part in the alleged fraud."¹¹ Two years later, in *Makor Issues & Rights Ltd. v. Tellabs Inc.*, the Seventh Circuit also rejected the post-PSLRA viability of the doctrine, relying heavily on the *Southland* decision as well as the language used in the PSLRA.¹²

Without adequate guidance from other circuit courts, however, district courts remain divided. Several circuit courts — including the Second, Third, Eighth, Ninth, and Tenth Circuits — have yet to address the issue of whether the group pleading doctrine remains viable in the wake of the PSLRA.¹³ Among those circuits, only district courts within the Third and Ninth Circuits have resolved the issue by rejecting the doctrine.¹⁴ Furthermore, those circuits expressly declining to address the viability of the doctrine (the First, Fourth, Sixth, and Eleventh Circuits) have left their respective district courts to split the issue.¹⁵ For example, despite both the Fourth and Eleventh Circuits' express refusal to rule on the viability of the doctrine, district courts within the Fourth Circuit may reject the doctrine under Rule 9(b) alone,¹⁶ whereas the district courts within the Eleventh Circuit "assume" the viability of the doctrine without further analysis.¹⁷

Also representative of the inconsistencies among opinions rendered by district courts is the emerging conflict within the Sixth Circuit. To date, 10 district courts within the Sixth Circuit have addressed the

issue.¹⁸ Although a majority view appears to have emerged within the Sixth Circuit (favoring application of the doctrine), a close review of these courts' rationales demonstrates that the doctrine is no longer an accurate reflection of Congress' intent and therefore should be rejected.

Not one of the six courts to uphold the viability of the doctrine offers any rationale beyond a brief and conclusory assertion that most of the courts that have addressed the issue allow for post-PSLRA group pleading.¹⁹ Conversely, Judge Gerald E. Rosen, writing for the Eastern District of Michigan, offered a thoughtful and persuasive rationale for rejecting the viability of the doctrine. For the first time, a court within the Sixth Circuit refused to shy away from definitively addressing the issue and recognized that "the doctrine is at odds with [the PSLRA's] plain language and pleading requirements."²⁰ The court reasoned that the doctrine (1) runs afoul of the Supreme Court's holding in *Central Bank*;²¹ (2) fails to meet the specificity requirements imposed by Rule 9(b); and (3) fails to meet the heightened pleading standards defined in the PSLRA.²² Furthermore, the court rejected the reasoning of the district courts that have upheld the doctrine: "Although a number of district courts within the Sixth Circuit have acknowledged the existence of the group pleading doctrine in post-PSLRA cases, those courts that allowed application of the doctrine have done so either without explanation or in reliance upon pre-PSLRA authority."²³

Judge Rosen is not alone in his reasoning. Courts rejecting the doctrine post-PSLRA have relied upon the plain language of — and the policy behind — the legislation. In *Makor*, the Seventh Circuit stated that "[t]he answer, in our view, lies in the language of the statute."²⁴ Similarly, the Fifth Circuit held that "PSLRA references to 'the defendant' may only reasonably be understood to mean 'each defendant' in multiple defendant cases."²⁵

Missing from any of these courts' analyses, however, is the recognition that a refusal to give to plaintiffs this presumption does not dramatically increase plaintiffs' pleading burden. A comparison of the pleading requirements imposed by those courts that reject the doctrine with those courts upholding the viability of the doctrine shows that there is actually little discrepancy on this issue among these courts. For example, in *Winer Family Trust v. Queen*, the court held that the plaintiffs could not rely on the doctrine, because permitting "a judicial presumption as to particularity simply cannot be reconciled with the statutory mandate that plaintiffs must plead specific facts as to each act or omission by the defendant."²⁶ Following the heightened pleading requirement imposed by the PSLRA, the court required plaintiffs to state with particularity all facts on which this belief is based.²⁷ For example, "if the alleged misleading statement appears in a press release issued by a company discussing financial performance, a plaintiff could plead on in-

formation and belief that the chief financial officer is responsible for making the statement if the plaintiff can plead with specificity why the officer's position directly involves such duties or why a specific corporate policy requires that the chief financial officer make such releases."²⁸

In contrast to this ruling, in *The Pension Committee of the U. of Montreal Pension Plan v. Banc of America Sec. Litig. LLC*, the court upheld the viability of the doctrine but nevertheless imposed a heightened pleading burden on plaintiffs. The court required the plaintiffs to plead that the defendants were insiders of the "group" that published the group-published materials: "[A] bare allegation that a defendant has inside information, in the absence of any allegation to support a reasonable inference that the defendant had control over the content of the allegedly fraudulent statement, is not sufficient."²⁹ Therefore, when it comes to the factual bases for allegations, despite inconsistent holdings regarding the viability of the doctrine, the better-reasoned decisions ultimately require plaintiffs to present specific allegations linking the defendants to the purported misstatements or omissions.³⁰

Rejection of the doctrine is appropriate and necessary. A bright-line rule that refuses to ease plaintiffs' pleading burden allows courts to focus on the significant issues of the factual bases for allegations, maintain consistent application of the securities laws, and effectuate the intent of Congress. The split among the federal courts needs to be resolved. The bench as well as the bar must not perpetuate an outdated and unwarranted presumption. **TFL**

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Endnotes

¹15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

²*Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 363–364 (5th Cir. 2004) ("The doctrine allows plaintiffs to rely on a presumption that statements in prospectuses, registration statements, annual reports, press releases, or other group-published information, are the collective work of those individuals with direct involvement in the everyday business of the company.") (Internal quotation marks and citations omitted.)

³*See Wool v. Tandem Computers Inc.*, 818 F.2d 1433, 1440 (9th Cir. 1987); *Luce v. Edelstein*, 802 F.2d 49 (2d Cir. 1986); *DiVittorio v. Equidyne Extractive Industries Inc.*, 822 F.2d 1242 (2d Cir. 1987); *Ouaknine v. MacFarlane*, 897 F.2d 75 (2d Cir. 1990).

⁴Federal Rules of Civil Procedure, Rule 9(b).

⁵Relevant portions of the PSLRA can be found at 15 U.S.C. § 78u-4.

⁶15 U.S.C. § 78u-4(b)(1)–(2); H.R. Conf. Rep. No. 104-369.

⁷*Miller v. Champion Enters. Inc.*, 346 F.3d 660, 692 (6th Cir. 2003). (Internal quotation marks and citations omitted.)

⁸*Southland*, 365 F.3d at 365; *Makor Issues & Rights Ltd. v. Tellabs Inc.*, 437 F.3d 588, 602–603 (7th Cir. 2006).

⁹*Southland*, 365 F.3d at 364.

¹⁰*Id.* (quoting 15 U.S.C. § 78u-4(b)). The Fifth Circuit, however, “never adopted the ‘group pleading’ doctrine, even before the PSLRA.” *Id.*

¹¹*Id.* at 365. (Emphasis in the original.)

¹²437 F.3d at 602–603.

¹³*Payne v. DeLuca*, No. 02-1927, 2006 U.S. Dist. LEXIS 25621, at *53 (W.D. Pa. May 2, 2006) (“Although ‘the Third Circuit has not expressly determined whether group pleading has survived enactment of the PSLRA ... the prevailing authority within this District counsels that group pleading has been abolished.’”) (citation omitted); *In re American Italian Pasta Co. Sec. Litig.*, No. 05-0725-CV-W-ODS, 2006 U.S. Dist. LEXIS 40548, at *24 n.4 (W.D. Mo. June 19, 2006) (rejecting plaintiffs’ reliance on the group pleading doctrine for “several reasons,” the court stated that “Plaintiffs have not identified any authority indicating the Eighth Circuit has (1) adopted this doctrine or (2) determined it survives the PSLRA”); but see *In re McLeod USA Inc. Sec. Litig.*, No. C02-001-MWB, 2004 U.S. Dist. LEXIS 8538, at *14 (N.D. Iowa Mar. 31, 2004) (without expressly acknowledging that the Eighth Circuit has yet to address the issue, “[t]he court concurs with the majority of courts that have held that the rationale behind group pleading doctrine remains sound in the wake of the passage of the [PSLRA]”); *In re Dura Pharmaceuticals Inc. Sec. Litig.*, No. 99cv0151-L(NLS), 2006 U.S. Dist. LEXIS 41193, at *62 (S.D. Cal. June 2, 2006) (“The Ninth Circuit has not opined whether this doctrine remains viable after the enactment of the PSLRA.”); *In re Sprint Corp. Sec. Litig.*, 232 F. Supp. 2d 1193, 1225 (D. Kan. 2002) (“The Tenth Circuit has recognized the group pleading doctrine. ...”) (citing *Schwartz v. Celestial Seasonings Inc.*, 124 F.3d 1246, 1254 (10th Cir. 1997) (recognizing the doctrine without discussing its viability post-PSLRA)).

Although the Second Circuit has also yet to decide on the viability of the doctrine expressly, courts within the circuit appear to be ignoring the issue altogether and assuming viability. *In re GeoPharma Inc. Sec. Litig.*, 411 F. Supp. 2d 434, 451–52 (S.D.N.Y. 2006) (Scheindlin, J.) (analyzing the case under the assumption that the doctrine survived the PSLRA); *Greentree Capital LP and TMI Integrated Holdings Corp.*, No. 05 Civ 2986, 2006 U.S. Dist. LEXIS 22400, at *6 (S.D.N.Y. Apr. 24, 2006) (Baer, J.) (same); but see *The Pension Committee of the U. of Montreal Pension Plan v. Banc of America Sec. Litig. LLC*, No. 05 Civ 9016, 2006 U.S.

Dist. LEXIS 49954, at *32–33 (S.D.N.Y. July 20, 2006) (Scheindlin, J.) (“The Second Circuit has held that ‘[e]ven with the heightened pleading standard under Rule 9(b) and the Securities Reform Act we do not require the pleading of detailed evidentiary matter in securities litigation.’”) (quoting *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 72 (2d Cir. 2001)).

¹⁴*Majer v. Sonex Research Inc.*, No. 05-606, 2006 U.S. Dist. LEXIS 49531, at *27 (E.D. Pa. July 19, 2006) (“Group pleading ... is insufficient under the [PSLRA].”) (citations omitted); *Payne*, 2006 U.S. Dist. LEXIS 25621, at *53; *Limantour v. Cray Inc.*, No. C05-943Z, 2006 U.S. Dist. LEXIS 27186, at *20–21 (W.D. Wash. Apr. 28, 2006) (declining to decide whether the doctrine remains viable post-PSLRA, the court noted the then equal split within the circuit); *Dura*, 2006 U.S. Dist. LEXIS 41193, at *62 (decided approximately one month after *Limantour*, the court tipped the balance in favor of rejecting the doctrine within the Ninth Circuit: “[T]his Court has joined other courts in this district and concluded the group pleading doctrine did not survive the PSLRA.”).

The emerging trend among courts within the Ninth Circuit is significant. As stated above, the doctrine is a judicial creation and the Ninth Circuit was one of its pioneers. *Wool*, 818 F.2d at 1440. Rejection of the doctrine’s viability by these courts further supports the waning applicability of the doctrine.

¹⁵The First, Fourth, Sixth, and Eleventh Circuits have had the opportunity to address the issue but declined to do so for various reasons. *In re Cabletron Sys. Inc.*, 311 F.3d 11, 40 (1st Cir. 2002) (setting aside the issue of whether the doctrine survived the PSLRA); *Dunn v. Borta*, 369 F.3d 421, 434 (4th Cir. 2004) (declining to “address[] the issue of whether the doctrine should be recognized in [the Fourth] Circuit” without discussion of the PSLRA); *City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 690 (6th Cir.), *cert. denied*, 126 S. Ct. 423 (2005); *Phillips v. Scientific-Atlantic Inc.*, 374 F.3d 1015, 1019 (11th Cir. 2004) (although the issue was specifically brought before the court, the court held that it was “not necessary to address the group pleading doctrine for the disposition of this appeal”).

¹⁶*Iron Workers Local 16 Pension Fund v. HILB Rogal & Hobbs Co.*, No. 1:05-735, 2006 U.S. Dist. LEXIS 29460, at *62 (E.D. Va. Apr. 24, 2006) (holding that “group pleading is insufficient to plead with particularity, as required by Rule 9(b)”) (Lee, J.); but see *In re Cable & Wireless PLC Sec. Litig.*, 321 F. Supp. 2d 749, 773 (E.D. Va. 2004) (Lee, J.) (“group pleading goes against the grain of the particularity requirement of both PSLRA and Fed. R. Civ. P. 9(b)”). (Emphasis added.)

¹⁷*In re Friedman’s Inc. Sec. Litig.*, 385 F. Supp. 2d 1345, 1363 n.17 (N.D. Ga. 2005) (although the Eleventh Circuit has not definitively ruled on the issue, “[t]he Court assumes that the doctrine applies.”).

¹⁸Compare those district courts that have upheld the viability of the doctrine post-PSLRA: *In re Cardinal Health Inc. Sec. Litig.*, No. C2-04-575, 2006 U.S. Dist. LEXIS 18687, at *141 (S.D. Ohio Apr. 12, 2006) (Marbley, J.); *In re FirstEnergy Corp. Sec. Litig.*, 316 F. Supp. 2d 581, 599–600 (N.D. Ohio 2004) (Gwin, J.); *In re Century Bus. Servs. Sec. Litig.*, No. 1:99CV02200, 2002 U.S. Dist. LEXIS 26964, at *47 (N.D. Ohio June 27, 2002) (Matia, J.); *In re SmartTalk Teleservs. Inc. Sec. Litig.*, 124 F. Supp. 2d 487, 501-02 (S.D. Ohio 2000) (Sargus, J.); *New England Health Care Employees Pension Fund v. Fruit of the Loom*, No. 1:98-CV-99-M, 1999 U.S. Dist. LEXIS 12999, at *16 n.4 (W.D. Ky. Aug. 18, 1999) (McKinley, J.); *Morse v. McWhorter*, 200 F. Supp. 2d 853, 902–903 (M.D. Tenn. 1998) (Haynes, J.), *adopted and approved with modifications*, 200 F. Supp. 2d 853 (M.D. Tenn. 2000) (Higgins, J.) (without discussion of the doctrine), with those district courts that have rejected the viability of the doctrine post-PSLRA: *In re Goodyear Tire & Rubber Co. Sec. Litig.*, No. 5:03CV2166, 2006 U.S. Dist. LEXIS 11914, at *64–66 (N.D. Ohio Mar. 22, 2006) (Adams, J.); *D.E. & J. Ltd. P'ship v. Conaway*, 284 F. Supp. 2d 719, 730–33 (E.D. Mich. 2003) (Rosen, J.), *aff'd*, 133 Fed. Appx. 994 (6th Cir. 2005), and with those district courts that have declined to rule on the viability of the doctrine post-PSLRA: *In re Nat'l Century Fin. Enters. Inc., Inv. Litig.*, No. 2:03-md-1565, 2006 U.S. Dist. LEXIS 16612, at *57–58 (S.D. Ohio Feb. 27, 2006) (Graham, J.); *In re SCB Computer Tech Inc. Sec. Litig.*, 149 F. Supp. 2d 334, 345–346 (W.D. Tenn. 2001) (Gibbons, J.).

¹⁹*In re Cardinal Health Inc. Sec. Litig.*, 2006 U.S. Dist. LEXIS 18687, at *140 n.67, *141; *In re FirstEnergy Corp. Sec. Litig.*, 316 F. Supp. 2d at 599–600 (“overwhelming majority of district courts within the Sixth Circuit have allowed for group pleading in post-PSLRA cases”); *In re Century Bus. Servs. Sec. Litig.*, 2002 U.S. Dist. LEXIS 26964, at *46–47 (stating that a “plethora” of district court decisions within the Sixth Circuit supports continued viability, and a “vast majority” of cases nationwide recognize the doctrine); *Fruit of the Loom*, 1999 U.S. Dist. LEXIS 12999, at *16 n.4 (stating that “several” courts have affirmed that the doctrine still exists).

²⁰*D.E. & J. Ltd. P'ship v. Conaway*, 284 F. Supp. 2d 719, 730–733 (E.D. Mich. 2003), *aff'd*, 133 Fed. Appx. 994 (6th Cir. 2005) (affirming without discussion of the doctrine).

²¹In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 183–184 (1994), the Supreme Court held that a defendant cannot be held liable for “aiding and abetting” the alleged misleading statements (or omissions) in a private section 10(b) and Rule 10b-5 case. Rather, a defendant may only be held liable “for the false or misleading statements that he actually makes.” *Conaway*, 284 F. Supp. 2d at 730.

²²*Id.*

²³*Id.* at 731 n.12.

²⁴*Makor*, 437 F.3d at 602 (quoting 15 U.S.C. § 78u-4(b)(2)).

²⁵*Southland*, 365 F.3d at 364–365. *Accord: In re Am. Bus. Fin. Servs. Inc. Sec. Litig.*, 413 F. Supp. 2d 378, 394 (E.D. Pa. 2005) (holding that “without allegations connecting individuals to allegedly misleading statements or omissions made in group-published documents, [the group pleading doctrine] can no longer be used to create liability for individuals under Section 10(b) and Rule 10b-5”).

²⁶*Winer Family Trust v. Queen*, No. 03-4318, 2004 U.S. Dist. LEXIS 19244, at *17 (E.D. Pa. Sept. 27, 2004). (Internal quotations and citation omitted.)

²⁷*Id.* at *18 (citing 15 U.S.C. 78u-4(b)(1)).

²⁸*Id.* at *18–19. (Internal quotations and citation omitted.)

²⁹*Pension Committee*, 2006 U.S. Dist. LEXIS 49954, at *33, *48.

³⁰*See also Cabletron*, 311 F.3d at 40 (stating that the First Circuit recognizes a “very limited version of the group pleading doctrine for securities fraud”) (citing *Serabian v. Amoskeag Bank Shares Inc.*, 24 F.3d 357, 361, 367–368 (1st Cir. 1994) (pre-PSLRA case)); *In re Raytheon Sec. Litig.*, 157 F. Supp. 2d 131, 152–154 (D. Mass. 2001) (Saris, J.) (acknowledging the survival of the doctrine post-PSLRA; however, “[t]he doctrine is limited in scope and applies only to ‘clearly cognizable corporate insiders with active daily roles in the relevant companies or transactions’”) (quoting *Polar International Brokerage Corp. v. Reeve*, 108 F. Supp. 2d 225, 238 (S.D.N.Y. 2000)); *In re Stone & Webster Inc. Sec. Litig.*, 253 F. Supp. 2d 102, 112 (D. Mass. 2003) (Lindsay, J.) (“While the First Circuit had accepted the group-published information doctrine before the adoption of the PSLRA, it has not yet ruled on whether the doctrine survived the passage of the PSLRA. Even assuming that the doctrine remains viable in this circuit, the plaintiffs still must make ‘sufficiently particularized allegations that the individual officer knew about the fraud’ in order to attribute statements by [the company] to [the defendants].”) (citing *Cabletron* and *Raytheon*).