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Oregon Pub. Employees Ret. Fund v. Apollo Grp. Inc.: Ninth Circuit Applies Heightened Pleading Standards to All Elements of Securities Fraud Actions

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On December 16, 2014, the United States Court of Appeals for the Ninth Circuit issued its decision in *Oregon Pub. Employees Ret. Fund v. Apollo Grp. Inc.*, No. 12-16624, ___F.3d ___, 2014 WL 7139634 (9th Cir. Dec. 16, 2014), holding for the first time that the heightened pleading standards of Fed. R. Civ. P. 9(b) apply to all elements of a securities fraud action, including loss causation. The Court's decision will likely make it more difficult for actions alleging securities fraud to survive the motion to dismiss stage within the Ninth Circuit.

Circuit Split Persists

In *Dura Pharmaceuticals, Inc., v. Broudo*, the Supreme Court suggested the less stringent pleading standards of Rule 8(a)(2) might apply to the loss causation element of a securities fraud action, but declined to decide the issue. 544 U.S. 336, 346 (2005).

Since *Dura Pharmaceuticals*, Federal Circuits have reached differing conclusions. In issuing its decision, the Ninth Circuit agreed with the Fourth and Seventh Circuits that the heightened pleading standards apply. See *Katyle v. Penn Nat'l Gaming, Inc.*, 637 F.3d 462, 471 (4th Cir. 2011); *Tricontinental Indus. Ltd. v. PricewaterhouseCoopers, LLP*, 475 F.3d 824, 842 (7th Cir. 2007). The Fifth Circuit has concluded the heightened pleading standards do not apply to loss causation. See *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 258 (5th Cir. 2009). Although some district courts have addressed the issue, other Federal Circuits have yet to decide the appropriate pleading standards to be applied.

Case Background

Apollo Group, Inc. is a company that owns and operates postsecondary educational institutions. Investors brought a class action against Apollo and its officers and directors, alleging defendants made materially false and misleading statements concerning the company's enrollment and revenue growth, financial condition, organizational values, and business focus in violation of Section 10(b) of the Securities and Exchange Act and SEC Rule 10b-5. Plaintiffs also alleged Apollo failed to disclose the ability of its students to pay tuition. The district court dismissed plaintiffs' complaint for failure to state a claim under Rule 12(b)(6).

The Ninth Circuit affirmed the district court's dismissal, holding the material misrepresentations plaintiffs alleged were not objectively false misstatements, but rather lawful puffery that would not induce the reliance of a reasonable investor. The Ninth Circuit also held plaintiffs did not adequately plead scienter or loss causation, both of which were independent bases on which to affirm the district court's decision. Regarding scienter, the Ninth Circuit concluded plaintiffs failed to allege sufficient facts to establish a claim that either the defendants did not know or were consciously reckless of their deceptive practices. To prove loss causation, plaintiffs must show a causal connection between defendants' deceptive acts and the injury suffered by plaintiffs. The Ninth Circuit concluded plaintiffs failed to adequately plead there was a causal connection between public information contained in government reports criticizing student recruitment practices and subsequent market activity. Notably, while holding that the heightened pleading standards of Rule 9(b) would apply, the Ninth Circuit observed that plaintiffs' allegations would have failed to meet even the less stringent Rule 8(a)(2) pleading standard had it applied.

Application of Heightened Pleading Standards

Plaintiffs argued each of the six elements of their 10(b) claims was subject to the pleading standards of Rule 8(a)(2), which requires that a complaint "contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" See *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 554, 570 (2007)).

The Ninth Circuit disagreed, observing that securities fraud actions must meet the heightened pleading standards of Rule 9(b) and the Private Securities Litigation Reform Act (the "PSLRA").¹ Rule 9(b) requires that a party must "state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. P. 9(b). The PSLRA similarly requires a party to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2)(A).

The Ninth Circuit gave three reasons for applying heightened pleading standards to loss causation. First, the law governing securities actions is derived from common-law fraud, to which Rule 9(b) applies. Second, loss causation is one of the "circumstances" constituting fraud to which the heightened pleading standards apply under the language of Rule 9(b). Finally, application of the heightened pleading standards creates a consistent standard by which to assess securities fraud actions.

Potential Ramifications

Within the Ninth Circuit, the heightened pleading standards will likely make it more difficult for plaintiffs to bring securities fraud actions. In particular, such actions will be less likely to survive motions to dismiss, and could potentially impact settlement values.

It remains to be seen whether the widening circuit split, like the circuit split that led to review in *Dura Pharmaceuticals*, will attract the attention of the Supreme Court.

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¹ Interestingly, the Ninth Circuit's application of Rule 9(b) to the loss causation element is consistent with the arguments advanced on behalf of Dura Pharmaceuticals (by Paul Hastings LLP) and by the Solicitor General on behalf of the SEC in *Dura Pharmaceuticals*, but that the Supreme Court declined to resolve in 2005.

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