NOTES

A Bite from the Poisonous Apple: How the Supreme Court Missed a Chance to Settle the Existing Tension Between the PSLRA and Rule 15(a)

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I. Introduction

Queen: This is no ordinary apple. It's a magic wishing apple.
Snow White: A wishing apple?
Queen: Yes. One bite, and all your dreams will come true.
Snow White: Really?
Queen: Yes, girlie. Now, make a wish, and take a bite.[1]

Unfortunately for Snow White, one bite led to an impending sleeping death, only to be saved by a kiss from her true love, the Prince.[2] This famous fairy tale can be analogized to the pleading stage in securities fraud litigation.[3] Just as Snow White hoped that one bite from the magic wishing apple would eventually make all her dreams come true, plaintiffs hope that their complaint against a defendant for alleged securities fraud will survive the pleading stage and continue to discovery. Further, just as one bite can lead to a sleeping death only to be saved by true love's kiss, a complaint can lead to a dismissal only to be saved by a leave to amend[4] allowed by the court.

This analogy holds true in many federal circuits.[5] However, in the Sixth Circuit Court of Appeals, the analogy fails because there is no Prince to save Snow White; plaintiffs are not allowed to amend their original complaint, as they are dismissed with prejudice when they do not meet the Private Securities Litigation Reform Act's ("PSLRA")[6] heightened pleading standards.[7] In *Cole v. Harris*, over 200 plaintiffs alleged various claims of securities fraud based on an alleged Ponzi scheme by the defendants.[8] A magistrate judge dismissed the plaintiffs' complaint with prejudice for failing to plead fraud with particularity as required by Federal Rule of Civil Procedure 9(b) and the PSLRA.[9] The Sixth Circuit affirmed "for the reasons stated in the magistrate judge's

1. Snow White and the Seven Dwarfs (Walt Disney Productions 1937).

2. *Id*.

3. Securities fraud is governed by the Securities Exchange Act of 1934, which Congress enacted to provide laws for regulating the various securities exchange marketplaces and to authorize the creation of the Securities and Exchange Commission ("SEC"). *See* Brian S. Sommer, *The PSLRA Decade of Decadence: Improving Balance in the Private Securities Litigation Arena with a Screening Panel Approach*, 44 Washburn L.J. 413, 418–19 (2005). Section 10(b) of the Securities Exchange Act of 1934 forbids the "use or employ, in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b) (2012).

4. *See* discussion *infra* Part II.B.

5. *See* discussion *infra* Part III.B.i–iv.

6. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

7. *See* discussion *infra* Part III.A, IV.

8. *See* 444 F. App'x 888 (6th Cir. 2012), *cert. denied*, 133 S. Ct. 126 (2012).

9. *Id.*

Memorandum Opinion and Orders," stating in addition that the relevant case law "support[s] the denial of the motion to amend . . . ."[10] Plaintiffs filed a writ of certiorari, which was denied by the Supreme Court of the United States.[11]

This Article argues that the Supreme Court erred in not granting certiorari, as the circuit split on this issue of amendments to complaints in securities fraud litigation needs resolution. Part II summarizes the rules that govern pleadings and amendments in securities fraud litigation: the PSLRA and Federal Rule of Civil Procedure 15(a). Part III discusses current jurisprudence regarding whether amendments are allowed in this area of law, focusing on recent case law in the Sixth Circuit and the existing circuit split. Part IV examines the Sixth Circuit case of *Cole v. Harris*, summarizing the factual background, procedural history, and ruling in the case. Part V proffers that the Supreme Court should have granted certiorari in *Cole* and should have reversed the decision for various inconsistencies that the current rule creates. Finally, Part VI concludes by arguing that the Supreme Court should have reversed the rule in *Cole* and should have instead altered the rule so that plaintiffs bringing federal securities fraud claims may be allowed to freely amend when these claims are dismissed for not complying with the heightened pleading standards of the PSLRA, as is required by Federal Rule of Civil Procedure 15(a).

II. What Rules Govern Pleading and Amendments in Securities Fraud Litigation?

A. *Private Security Litigation Reform Act ("PSLRA")*

Congress enacted the PSLRA in December of 1995 to address problems plaguing securities class action litigation.[12] According to Congress, "[t]he private securities litigation system is too important to the integrity of the American capital markets to allow this system to be undermined by those who seek to line their own pockets by bringing abusive and meritless suits."[13] Congress heard substantial testimony that lawyers were filing frivolous "strike" suits alleging violations of the federal securities laws in the hope that defendants will quickly settle to avoid the expense of litigation.[14] Congress intended the PSLRA "(1) to encourage the voluntary disclosure of information by corporate issuers;

10. *Id.* at 889.
11. *Cole*, 133 S. Ct. at 126.
12. Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 Colum. L. Rev. 1489 (2006).
13. H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730.
14. *See* S. Rep. No.104-98, at 4 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683.

(2) to empower investors so that they—not their lawyers—exercise primary control over private securities litigation; and (3) to encourage plaintiffs' lawyers to pursue valid claims and defendants to fight abusive claims."[15] Congress enacted many reforms and raised the substantive bar as to the elements that must be proved to recover on the basis of securities fraud in order to discourage and eliminate meritless suits, which include an alteration to the pleading,[16] discovery, scienter, causation, and damages for cases brought under the federal securities laws.[17]

With regard to a heightened pleading standard, Congress heard testimony "on the need to establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits."[18] In 2007, the Supreme Court reiterated that "[s]etting a uniform pleading standard for § 10(b) actions was among Congress' objectives when it enacted the PSLRA."[19] The Supreme Court also recognized the PSLRA's twin goals: (1) "curb frivolous, lawyer-driven litigation," (2) "while preserving investors' ability to recover on meritorious claims."[20] The question of whether the liberal amendment policy of Rule 15(a) still applies under the heightened pleading requirements of the PSLRA was not before the Court in *Tellabs*, but the decision left room for debate and interpretation after the Court's ruling.[21]

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15. *Id.*

16. *See generally* Brian E. Casey, David C. Mahaffey & John F. Olson, *Pleading Reform, Plaintiff Qualification and Discovery Stays Under the Reform Act*, 51 Bus. Law. 1101, 1115–1135 (1996) (discussing the pleading requirements of the PSLRA).

17. *See* John M. Wunderlich, *Amending Pleadings in Securities Fraud Litigation After* Tellabs, 37 Sec. Reg. L.J. 361, 363 (2009); *see also* Choi & Thompson, *supra* note 12, at 1493.

18. H.R. Rep. No. 104-369, at 41.

19. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 320 (2007). Although the Court was dealing with the PSLRA's "strong inference of scienter" standard, its lengthy discussion about the interaction between the Federal Rules of Civil Procedure and the PSLRA is helpful to understanding the interplay between Rule 15 and the PSLRA. *See* Wunderlich, *supra* note 17, at 366–70; *see also infra* Part V.C; *accord* ACA Fin. Guar. Corp. v. Advest, Inc., 512 F.3d 46, 51 (1st Cir. 2008) (holding "that under the reasoning of *Tellabs*, the PSLRA does not alter the liberal amendment policy of Federal Rule of Civil Procedure 15"). However, some courts have decided the amendment issue of Rule 15 and the PSLRA without relying on or mentioning the Court's language in *Tellabs*. *See, e.g.*, Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1235 (11th Cir. 2008) ("Since '[t]he text of the [PSLRA] neither purports to affect Rule 15(a), nor . . . require[s] that all dismissals be with prejudice,' the normal Rule 15(a) standards apply."); Galvin v. McCarthy, 545 F. Supp. 2d, 1176, 1187 (D. Colo. 2008) (denying plaintiff's request for leave to amend because "caselaw [sic] suggests that leave to amend should not be so freely given under the [PSLRA]").

20. *See Tellabs*, 551 U.S. at 322.

21. *See* Geoffrey P. Miller, *Pleading After* Tellabs, 2009 Wis. L. Rev. 507, 526 (2009); *cf. supra* note 19 and accompanying text (discussion of relevant case law dealing with amendment issue after *Tellabs*).

B. *Federal Rule of Civil Procedure 15(a)*

Federal Rule of Civil Procedure 15 governs amended and supplemental pleadings.[22] For pre-trial amendments, Rule 15(a) allows for an amendment "as a matter of course" if it is made "within 21 days after serving [the pleading]."[23] If not made within 21 days, then "a party may amend its pleading only with the opposing party's written consent or the court's leave."[24] However, the rule makes clear that the "court should freely give leave when justice so requires."[25]

The Supreme Court has stated that the mandate of "when justice so requires" is "to be heeded."[26] "If the underlying facts or circumstances relied upon by a plaintiff may be a proper subject of relief, he ought to be afforded an opportunity to test his claim on the merits."[27] The Court further stated:

> [T]he grant or denial of an opportunity to amend is within the discretion of the District Court, but outright refusal to grant the leave without any justifying reason appearing for the denial is not an exercise of discretion; it is merely abuse of that discretion and inconsistent with the spirit of the Federal Rules.[28]

This "spirit" with regards to Rule 15 and a court granting leave to amend can best be described as a liberal policy.[29] However, the right to amend is not absolute.[30] A court may deny a party leave to amend only if there is undue delay caused by the moving party, bad faith caused by the moving party, or prejudice to the opposing party.[31] The Supreme Court has described in more detail when an amendment may not be allowed:

> In the absence of any apparent or declared reason—such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.—the leave sought should, as

22. *See* FED. R. CIV. P. 15.
23. FED. R. CIV. P. 15(a)(1)(A).
24. FED. R. CIV. P. 15(a)(1)(B).
25. *Id.*
26. Foman v. Davis, 371 U.S. 178, 182 (1962).
27. *Id.*
28. *Id.*
29. *See* F.D.I.C. v. Bates, 42 F.3d 369, 373 (6th Cir. 1994) (acknowledging "the liberal position of the federal rules on granting amendments"); *accord* Carrol v. Fort James Corp., 470 F.3d 1171, 1174 (5th Cir. 2006) ("The policy of the Federal Rules is to permit liberal amendment."); Adams v. Gould Inc., 739 F.2d 858, 864 (3d Cir. 1984) ("Fed.R.Civ.P. 15 embodies the liberal pleading philosophy of the federal rules."); C.I.R. v. Finley, 265 F.2d 885, 888 (10th Cir. 1959) ("In the interest of justice, the trend of court decisions is for a liberal construction of rules authorizing the amendment of pleadings.").
30. Bediako v. Stein Mart, Inc., 354 F.3d 835, 841 (8th Cir. 2004).
31. *See Foman*, 371 U.S. at 182.

the rules require, be "freely given."[32]

Overall, Rule 15's liberal amendment policy "limits the district court's discretion to deny leave to amend."[33]

III. Does the PSLRA Restrict the Liberal Amendment Policy Embodied in Rule 15(a)?

Nowhere in the text of the PSLRA is there any mention of Rule 15(a). Nevertheless, there is ample case law on the issue of whether the PSLRA restricts Rule 15(a) and its liberal amendment policy.[34] Because there is disagreement among the federal circuits, this section will examine the current jurisprudence in certain circuits.

A. *Current Sixth Circuit Jurisprudence*

The Sixth Circuit is one of two circuits that have held that the PSLRA restricts the liberal amendment policy of Rule 15(a).[35] Before *Cole*, the Sixth Circuit had dealt with this amendment issue multiple times.[36] However, its current interpretation of the issue was first established in *Miller v. Champion Enterprises Inc*.[37]

In *Miller*, the Sixth Circuit affirmed the district court's decision both to dismiss a complaint that did not meet the heightened pleading standards of the PSLRA and to deny leave to file a proposed amended complaint.[38] A shareholder sued a corporation and its Chief Executive Officer under, *inter alia*, various sections of the Securities Exchange Act of 1934, alleging that the defendants "made various false or misleading statements related to the bankruptcy of its largest customer."[39] When the defendants filed a motion to dismiss the complaint, the plaintiff filed a

32. *Id.*

33. *Adams*, 739 F.2d at 864. Additionally, Rule 15 reflects two of the most important policies of the federal rules: (1) courts should provide a maximum opportunity for each claim to be decided on its merits rather than procedural technicalities; and (2) the federal rules assign pleadings the limited role of providing the parties with notice. *See* Wunderlich, *supra* note 17, at 362; *see also* 6 Charles Alan Wright, Arthur R. Miller, Mary Kay Kane & Richard L. Marcus, Federal Practice and Procedure § 1471 (3d ed. 2012).

34. *See* discussion *infra* Part III.A–B, IV.

35. The Third Circuit is the only other federal circuit that agrees with the Sixth Circuit. *See, e.g.*, In re NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1332 (3d Cir. 2002) (adopting the conclusion "that the PSLRA limits the application of Federal Rule of Civil Procedure 15 in securities fraud cases").

36. *See* Fidel v. Farley, 392 F.3d 220, 236 (6th Cir. 2004); Stambaugh v. Corrpro Cos., Inc., 116 F. App'x 592, 598 (6th Cir. 2004); PR Diamonds, Inc. v. Chandler, 364 F.3d 671 (6th Cir. 2004).

37. *See* 346 F.3d 660 (6th Cir. 2003).

38. *See id.* at 666.

39. *Id.*

motion for leave to file an amended complaint.[40] Although the Sixth Circuit found that the complaint pled scienter with sufficient particularity, it held that the complaint "did not contain allegations sufficient to state a claim under the heightened pleading requirements of the PSLRA."[41]

The Sixth Circuit held that the district court "did not err in denying plaintiff's motion for leave to file the [amended complaint]."[42] The court made this ruling despite prior case law stating that "[i]n the securities litigation context, leave to amend is particularly appropriate where the complaint does not allege fraud with particularity."[43] The court based its holding on two grounds: (1) "the amendments provided in the [amended complaint] were futile"[44] and (2) "allowing the repeated filing of amended complaints would frustrate the purpose of the PSLRA."[45] Much of the district court's reasoning was incorporated by the Sixth Circuit, as it concluded that the PSLRA "could not achieve [its] purpose if plaintiffs were allowed to amend and amend until they got it right."[46] In fact, the Sixth Circuit quoted some of the district court's language:

> In this case, it appears that plaintiffs are contending that since discovery procedures are not available to them, that a court must be lenient in allowing amendments to pleadings. Contending that Rule 15 permits this, they purposely seek to circumvent the [PSLRA's] strict requirements preventing discovery. But this is precisely the device that Congress intended to be used, i.e., to prevent suits in which a foundation for the suit cannot be pleaded.
>
> The stay of discovery and the heightened pleading standards are separate and distinct, yet complimentary mechanisms. The stay of discovery operates to prevent plaintiffs with baseless claims from squeezing a nuisance settlement from an innocent defendant. The pleading requirement is more than simply a line the plaintiffs must cross to get to discovery; it is the heart of the [PSLRA]. This stringent requirement operates to discourage baseless suits altogether. It evinces Congress's acknowledgment of the burden an allegation of

40. *See id.* at 669.

41. *Id.* at 673–76. The court looked primarily at six separate communications that plaintiff contended were false or misleading, finding that "[s]ome of [the] communications fall within the safe harbor for 'forward-looking statements' provided by the PSLRA, while the others do not give rise to a strong inference that [defendants] acted with sufficient scienter to survive a Rule 12(b)(6) motion dismiss under the heightened pleading requirements of the PSLRA." *Id.* at 676.

42. *See id.* at 689.

43. Morse v. McWhorter, 290 F.3d 795, 800 (6th Cir. 2002).

44. Futility of amendment is an acceptable justification for denying leave to amend. Foman v. Davis, 371 U.S. 178, 182 (1962). However, many times complaints are dismissed solely for the fact that they do not meet the heightened pleading standards of the PSLRA. *See* discussion *infra* Part V.

45. *Miller*, 346 F.3d at 689.

46. *Id.* at 690.

> securities fraud places on the innocent defendant even without discovery. The [PSLRA] requires a uniform pleading standard; this standard is meaningless if judges on a case-by-case basis grant leave to amend numerous times.[47]

Interestingly, the Sixth Circuit relied on almost identical reasoning used by the Third Circuit on the same issue.[48] Part of that reasoning detailed that "the stay of discovery procedures adopted in conjunction with the heightened pleading standards under the PSLRA is a reflection of the objective of Congress 'to provide a filter at the earliest stage (the pleading stage) to screen out lawsuits that have no factual basis.' "[49]

B. *Circuit Split*

The blanket rule articulated by the Third and Sixth Circuits—that complaints should be dismissed with prejudice if they do not meet the heightened pleading standards required by the PSLRA—has not been adopted as the universal rule across all the federal circuits. Four other circuits have adopted the opposite rule in four relevant decisions: *Eminence Capital v. Aspeon, Inc.*,[50] *Belizan v. Hershon*,[51] *ACA Financial Guaranty Corp. v. Advest, Inc.*,[52] and *Mizzaro v. Home Depot, Inc.*[53] This circuit split is one of the main reasons why the Supreme Court erred and should have granted certiorari in *Cole*.[54]

i. Ninth Circuit: *Eminence Capital v. Aspeon, Inc.*

In *Eminence Capital*, the Ninth Circuit reversed the judgment of the district court that dismissed the first amended consolidated complaint with prejudice for failure to state a claim.[55] This was a class action securities fraud case, in which investors alleged various violations of the Securities Exchange Act of 1934 and Rule 10b-5.[56] Plaintiffs alleged that they were misled into believing that the defendants' "profitability and financial prospects" were doing quite well when, in actuality, the defendants recorded an income loss of 21%.[57] These losses led to a

47. *Id.* at 691.
48. *Id.*
49. *Id.* at 691–92 (quoting In re NAHC, Inc. Secs. Litig., 306 F.3d 1314, 1332–33 (3d Cir. 2002)).
50. 316 F.3d 1048 (9th Cir. 2003) (per curiam).
51. 434 F.3d 579 (D.C. Cir. 2006).
52. 512 F.3d 46 (1st Cir. 2008).
53. 544 F.3d 1230 (11th Cir. 2008).
54. *See* discussion *infra* Part V.
55. 316 F.3d at 1049 ("Because the district court failed to provide sufficient reasons to overcome the presumption in favor of granting leave to amend, we reverse the judgment.").
56. *Id.* at 1050–51.
57. *See id.* at 1050.

decline of income available to shareholders and a drastic drop in the defendants' stock price.[58] Eight other isolated shareholder suits were filed against the defendant, resulting in a consolidation of the cases.[59] Eventually, the district court dismissed the first amended consolidated complaint with prejudice, reasoning that "[p]laintiffs have had three 'bites at the apple'[60] and defend the dismissal without prejudice only on grounds that the special committee will release a report that will provide all the requisite details [required to plead a case under PSLRA]."[61]

This judgment disintegrated on appeal as the Ninth Circuit reversed, holding that the principles[62] embodied in freely allowing leave to amend are "especially important in the context of the PSLRA."[63] The court explained how the heightened pleading standards of the PSLRA are not easy to comply with.[64] The PSLRA requires a plaintiff to plead a claim of securities fraud with an unprecedented degree of specificity and detail, "giving rise to a strong inference of deliberate recklessness."[65] Because of these difficult standards, the court concluded that there is no "bright-line rule" with regards to pleading requirements of the PSLRA, and it logically follows that plaintiffs should be freely allowed to amend

58. *Id.* The net income available to shareholders was only $1,717.00. *Id.* The stock price fell to $1.50 per share in October, after being $30 per share in January. *Id.*

59. *Id.* at 1051.

60. This is not the first instance the "apple" analogy has been used in this article. *See supra* text accompanying notes 1–2. Nor will it be the last. *See infra* Part V. However, it is important to recognize the dangers of using such an analogy. *See Eminence Capital*, 316 F.3d at 1053–54 (Reinhardt, J., concurring). Judge Reinhardt wrote separately to express his concern "regarding the use of clichés in judicial opinions, a technique that aids neither litigants nor judges, and fails to advance our understanding of the law." *Id.* at 1053. He continued:

> The per curiam opinion regrettably (but deliberately) reiterates the same cliche used by the district court. Metaphors enrich writing only to the extent that they add something to more pedestrian descriptions. Cliches do the opposite; they deaden our senses to the nuances of language so often critical to our common law tradition. The interpretation and application of statutes, rules, and case law frequently depends on whether we can discriminate among subtle differences of meaning. The biting of apples does not help us.

Id. at 1054.

61. *Id.* at 1053.

62. In its per curiam opinion, the Ninth Circuit discussed at length these principles. *See id.* at 1051–52. The court emphasized that the policy behind Rule 15(a) should be "applied with extreme liberality." *Id.* at 1051 (quoting Morongo Band of Mission Indians v. Rose, 893 F.2d 1074, 1079 (9th Cir. 1990) (internal quotations omitted)). It also listed the factors laid out in *Foman v. Davis*, acknowledging that potential prejudice on the opposing party carries greater weight than the other factors. *See id.* at 1052 ("Absent prejudice, or a strong showing of any of the remaining *Foman* factors, there exists a presumption under Rule 15(a) in favor of granting leave to amend.").

63. *Id.* at 1052.

64. *Id.*

65. *Id.* (quoting *In re* Silicon Graphics, 183 F.3d 970, 979 (9th Cir. 1999)).

consistent with Rule 15(a).[66] Unless it is clear that the complaint could not be saved and amendment would be futile, dismissal with prejudice and without leave to amend is inappropriate.[67] The decision was subsequently reversed and remanded back to the district court.[68]

ii. D.C. Circuit: *Belizan v. Hershon*

After the Ninth Circuit's decision in *Eminence Capital*, other circuit courts of appeal began tackling the amendment in securities fraud cases with a similar approach. The Circuit Court of Appeals for the District of Columbia confronted the issue in *Belizan v. Hershon*.[69] There, debt securities purchasers "filed securities fraud suits against the investment fund owner, its independent auditor, and seller."[70] Plaintiffs alleged that they purchased debt securities from defendants and were victims "of a 'Ponzi scheme,' wherein proceeds from successive securities offerings were used to make interest payments to those who had invested in prior offerings."[71] After all of the investors' suits were consolidated, the United States District Court for the District of Columbia denied plaintiffs' "oral motion to amend complaint, and dismissed complaint[72] with prejudice."[73] The district court explained that counsel's references to the possibility of amending the complaint did not "amount to formal motions for leave to amend" and that, even if they did, the PSLRA "counsel[s] restraint in granting leave to amend."[74] As for the dismissal being with prejudice, the court cited *In re Champion Enterprises Inc. Securities Litigation*,[75] for the proposition that "the [PSLRA] . . . set[s] a high standard of pleading which if not met results in a mandatory dismissal . . . with prejudice."[76]

66. *Id.*

67. *Id.*

68. *See id.* at 1053. With respect to the specific facts of the case, the court concluded that "plaintiffs' allegations were not frivolous, plaintiffs were endeavoring in good faith to meet the heightened pleading requirements and to comply with court guidance, and, most importantly, it appears that plaintiffs had a reasonable chance of successfully stating a claim if given another opportunity." *Id.*

69. 434 F.3d 579 (D.C. Cir. 2006).

70. *Id.*

71. *See id.* at 580.

72. With respect to the alleged violations of section 10 and Rule 10b-5, the district court held plaintiffs "had failed adequately to: (1) plead scienter; (2) allege claims with the specificity required by Rule 9(b) and the PSLRA; and (3) plead causation." *Id.* at 581. The district court also held that plaintiffs "failed properly to plead a violation of section 11, her claim under section 12(a)(1) was time-barred, and she and [they] lacked standing to bring the claim under section 12(a)(2)." *Id.*

73. *Id.* at 579.

74. *Id.* at 581.

75. 145 F. Supp. 2d 871, 873 (E.D. Mich. 2001).

76. *Belizan*, 434 F.3d at 581 (internal quotations omitted).

Plaintiffs appealed, contesting, *inter alia*, the district court's decision to dismiss their complaint "with prejudice."[77] Plaintiffs argued that "failure to satisfy these heightened pleading standards did not necessitate the dismissal of the complaint with prejudice because the PSLRA does not supercede the procedure for moving to amend a complaint under Rule 15(a)."[78] Plaintiffs referenced *Eminence Capital* to lend support to their argument, as in that case, the court explained that because the PSLRA "requires a plaintiff to plead a complaint of securities fraud with an unprecedented degree of specificity and detail," it is important that the district court "consider the relevant factors and articulate why dismissal should be with prejudice instead of without prejudice."[79] Conversely, defendants cited *Miller* in response, contending that "the heightened pleading standards of the PSLRA logically limit the application of Rule 15(a) and concomitantly imply dismissal with prejudice is indicated in securities fraud cases that do not measure up to those standards."[80]

The D.C. Circuit sided with the plaintiffs, "vacat[ing] the order of dismissal and remand[ing] the case to the district court to enter a new order either dismissing without prejudice or explaining its dismissal with prejudice."[81] The court was quite confused with the original ruling, believing it was clear that the complaint should not have been dismissed with prejudice nor should the PSLRA have factored into its decision.[82] Dismissing with prejudice is fatal,[83] and it thus logically follows that the standard for it be set quite high.[84] The court explained that although the PSLRA provides that "[d]ismissal for failure to meet pleading requirements" is appropriate,[85] the PSLRA does not say whether such dismissal should be with or without prejudice.[86] If Congress wanted dismissals to be with prejudice and for the PSLRA to restrict Rule 15(a), the text of

77. *Id.* at 582.

78. *Id.* at 583. Plaintiffs relied on *United States v. Microsoft Corp.*, a previous decision rendered by the D.C. Circuit that held under Rules Enabling Act, rules of civil procedure are deemed to supercede conflicting statute except insofar as a substantive right is involved. *See* 165 F.3d 952, 958 (D.C. Cir. 1999).

79. *Belizan*, 434 F.3d at 583 (citing 316 F.3d 1048, 1052 (9th Cir. 2003)).

80. *Id.* (citing 346 F.3d 660, 690–92 (6th Cir. 2003)).

81. *Id.* at 584.

82. *See id.* at 583 ("We are uncertain why the district court dismissed the complaint with prejudice, and what role the PSLRA played in its thinking.").

83. Dismissal with prejudice "operates as a rejection of the plaintiff's claims on the merits and [ultimately] precludes further litigation" of them. *Id.* (quoting Jaramillo v. Burkhart, 59 F.3d 78, 79 (8th Cir. 1995)).

84. *Id.*

85. 15 U.S.C. § 78u-4(b)(3)(A) (2012).

86. *Belizan*, 434 F.3d at 583.

the PSLRA should have so provided.[87] Because the PSLRA does not provide any guidance on the issue, the court concluded that the issue was governed solely by Rule 15(a).[88] Finally, the court drew a comparison to the heightened pleading standards of Rule 9(b) for allegations of fraud, standards which do not alter the operation of Rule 15(a).[89]

iii. First Circuit: *ACA Financial Guaranty Corp. v. Advest, Inc.*

The First Circuit followed the lead of the Ninth Circuit and D.C. Circuit, becoming the third federal circuit court of appeal to hold that the PSLRA in securities fraud cases did not alter the policy for liberal amendment of pleadings under Rule 15(a).[90] In *ACA Financial*, "bond purchasers brought suit alleging violations of federal securities laws in the May 1998 offering of bonds of Bradford College in Massachusetts."[91] The college defaulted on its bond obligations, leading plaintiffs to contend they were misled by the "Official Statement" attached to the offering, which allegedly concealed Bradford's ominous financial position and failure to pay the bond debt.[92] The lower court dismissed the amended complaint with prejudice for failure to meet the heightened pleading standards of the PSLRA.[93]

Unlike the previous two discussed cases, the First Circuit used the Supreme Court's decision in *Tellabs* as guidance.[94] The court first cited to *Belizan*, agreeing that "had the Congress wished to make dismissal with prejudice the norm, and to that extent supercede the ordinary application of Rule 15(a), we would expect the text of the PSLRA so to provide."[95] Next, the court acknowledged that the *Tellabs* decision provided an important lesson: "In the absence of a legislative directive to the con-

87. *Id.* at 584. Contributing to its opinion, the court referenced the Biomaterials Access Assurance Act of 1998, which clearly states in its text Congress' intent for dismissals to be with prejudice: "[A]n order granting a motion to dismiss" in a suit against a supplier to a manufacturer of medical devices "shall be entered with prejudice." *Id.* (citing 21 U.S.C. § 1605(e) (1998)).

88. *Id.* The court observed that Rule 15(a) allows for "maximum opportunity for each claim to be decided on its merits rather than on procedural technicalities." *Id.* (citing United States v. Hicks, 283 F.3d 380, 387 (D.C. Cir. 2002)).

89. *Id.* (citing Bly-Magee v. California, 236 F.3d 1014, 1019 (9th Cir. 2001)).

90. ACA Fin. Guar. Corp. v. Advest, Inc., 512 F.3d 46 (1st Cir. 2008).

91. *Id.* at 51. Plaintiffs, in their amended complaint, alleged violations of section 10(b) of the Securities Exchange Act of 1934 and the concomitant Rule 10b-5 for material omissions and misrepresentations in the Official Statement. *Id.* at 54.

92. *Id.* at 51–52.

93. *Id.* at 51.

94. *Id.* at 52 ("This is our first occasion to apply the Supreme Court's recent guidance regarding the standards for pleadings under the PSLRA in *Tellabs* . . . .").

95. *Id.* at 56 (quoting 434 F.3d 579, 584 (D.C. Cir. 2006)).

trary, Rule 15 applies as in the normal course."[96] The court continued: "Interpreting the PSLRA as constricting the operation of Rule 15(a) would be contrary to the purposes of the [PSLRA]."[97] The court reiterated the twin goals of the PSLRA that were announced in *Tellabs*: "to curb frivolous, lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims."[98] Consistent with the twin goals, the court reasoned that the heightened pleading standard helps to achieve "the goal of deterring frivolous litigation by erecting a significant hurdle for a plaintiff to clear before her complaint can survive a motion to dismiss . . . [a] blanket rule that the PSLRA modifies Rule 15(a) would tip the scales too far, undermining plaintiffs' ability to have meritorious claims presented in court."[99] Any reading to the contrary could possibly "disturb the legislative balance struck by the [PSLRA]."[100] Although the district court's decision was eventually affirmed,[101] the First Circuit court held that PSLRA in securities fraud cases did not alter policy for liberal amendment of pleadings.[102]

iv. Eleventh Circuit: *Mizzaro v. Home Depot, Inc.*

The fourth and final federal circuit court of appeal to adopt the rule that the PSLRA does not restrict the liberal amendment policy of Rule 15(a) was the Eleventh Circuit.[103] In *Mizzaro*, corporate retailer investors brought a securities fraud class action lawsuit against Home Depot, Inc.[104] Plaintiffs alleged that Home Depot, Inc. and its insiders

> committed fraud in failing to disclose that corporate earnings had been inflated as the alleged result of the retail stores' widespread practice of falsely reporting products delivered to stores by suppliers as defective in order to obtain unwarranted chargebacks for goods that had been lost to shoplifters or that the store later sold, after obtaining chargebacks, at zero cost.[105]

Defendants filed a motion to dismiss, and as that motion was pending, plaintiffs moved for leave to amend if the district court granted the

96. *Id.* The *Tellabs* opinion dealt with applying Rule 12(b)(6) standard that all factual allegations in a complaint must be accepted as true in the securities fraud context, but as the First Circuit recognizes, it is helpful in understanding whether or not the PSLRA restricts the liberal amendment policy of Rule 15. *See supra* notes 19–21 and accompanying text.

97. *ACA Fin.*, 512 F.3d at 56.

98. *Id.* (quoting 551 U.S. 308, 322 (2007) (internal quotations omitted)).

99. *Id.*

100. *Id.*

101. Dismissal with prejudice was appropriate because plaintiffs had unduly delayed bringing their second motion to amend. *Id.* at 46.

102. *Id.*

103. Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1235 (11th Cir. 2008).

104. *Id.* at 1230.

105. *Id.*

motion to dismiss their complaint.[106] The district court granted the defendants' motion to dismiss after concluding that the amended complaint did not meet the heightened pleading standards of the PSLRA.[107] The Eleventh Circuit affirmed this specific part of the ruling.[108]

Additionally, the district court held that "granting leave would be futile because the additional facts presented in the motion for leave would not change that result."[109] Although plaintiffs did not submit a proposed amended complaint, its motion for leave to amend cited three newly discovered facts that allegedly strengthened the inference of scienter.[110] The district court concluded that these additional facts would not make any difference with regards to pleading scienter, "even when viewed in concert with those alleged in the amended complaint."[111] In its final ruling, the Eleventh Circuit agreed with the district court's decision.[112] But the decision was based on the additional facts that would have been included in an amended complaint being futile in it surviving the heightened pleading standards, rather than the PSLRA restricting the liberal amendment policy of Rule 15(a).[113] The Eleventh Circuit made clear in its opinion that "[s]ince '[t]he text of the [PSLRA] neither purports to affect Rule 15(a), nor . . . require[s] that all dismissals be with prejudice,' the normal Rule 15(a) standards apply here."[114]

IV. Examination of *Cole v. Harris*

In *Cole*, the Sixth Circuit once again had an opportunity to decide a case involving the tension between the PSLRA and Rule 15(a). Unfortunately, the Sixth Circuit followed the ruling in *Miller*,[115] and the Supreme Court subsequently denied certiorari.[116]

A. *Factual Background*

The plaintiffs in *Cole* brought a federal securities fraud action

106. *Id.* at 1235.

107. *Id.* The court stated that to survive a motion to dismiss under the PSLRA, the factual allegations contained in a private securities fraud class action complaint must raise a "strong inference," one that is "cogent and compelling," that the named defendants acted with the requisite scienter. *Id.* The district court did not believe this standard was met, as "the amended complaint had failed to adequately plead scienter." *Id.* at 1236.

108. *Id.* at 1235.

109. *Id.*

110. *Id.* at 1255.

111. *Id.*

112. *Id.*

113. *See id.* at 1255–57.

114. *Id.* at 1255 (quoting ACA Fin. Guar. Corp. v. Advest, Inc., 512 F.3d 46, 56 (1st Cir. 2008)).

115. *See* 444 F. App'x 888, 889 (6th Cir. 2012).

116. 133 S. Ct. 126 (2012).

against various defendants.[117] Plaintiffs were more than 200 individuals and small businesses, almost all of whom were citizens of Canada.[118] They alleged

> that the three individual [d]efendants, Kevin Harris, Keelan Harris, and Karen Starr, used the two business-entity [d]efendants, Complete Developments, LLC and a company known both as International Investments, Inc. and as I3, LLC, based in Warren, Ohio, to conduct a multi-million-dollar Ponzi scheme, pretending to use Plaintiffs' investments to trade foreign currencies while actually using the funds of newer investors to pay fake profits to earlier ones, and taking millions of dollars for themselves.[119]

Plaintiffs claimed that over a period of time that spanned more than a year, the defendants were able to acquire a total of $22 million from plaintiffs by falsely representing to them that their money contributions would be invested in a currency-trading program that was very low-risk and would provide profits of more than five percent every month.[120] Plaintiffs further claimed that defendants' "representations were false and made with actual knowledge of the falsity or with reckless disregard to their truth in order to induce [p]laintiff and his assignors to invest their monies with [d]efendants."[121] Plaintiff alleged that defendants acted in this deceiving fashion because they did not have a scheme or plan that would pay plaintiffs with what they were originally promised.[122] These representations were material to plaintiffs in their assessments to invest large amounts of money with defendants.[123] When plaintiffs demanded the return of all of their money, the defendants declined to comply with the request.[124]

B. *Procedural History*

This class action suit was brought in the United States District Court for the Northern District of Ohio on June 3, 2009, by a singular plaintiff acting for himself and other unnamed investors, pursuing total damages of $22 million.[125]

Defendants filed a motion to dismiss for lack of jurisdiction and failure to join indispensable parties, arguing that the singular plaintiff "had not shown sufficient authorization to represent others and that the

117. Petition for Writ of Certiorari at 2, *Cole*, 133 S. Ct. 126 (2012) (No. 11–1334).
118. *Id.* at ii.
119. *Id.* at 2–3.
120. *Cole*, No. 4:09CV1270, 2010 U.S. Dist. LEXIS 2689, at *5 (N.D. Ohio Jan. 4, 2010).
121. *Id.* at *5–6.
122. *Id.* at *6.
123. *Id.*
124. *Id.*
125. Petition for Writ of Certiorari, *supra* note 117, at 3.

failure to join all investors prejudiced defendants."[126] Defendants also filed a "Notice" invoking their "Fifth Amendment Right Against Self-Incrimination," and asserting "an objective and reasonable belief that their submission to any civil discovery or testimony may subject them to criminal prosecution."[127] Judge Peter C. Economus denied defendants' motion to dismiss, "ruling that under Federal Rule of Civil Procedure 17(a)(3), plaintiff should be given time to join all real parties in interest."[128] Subsequently, the case was assigned to Magistrate Judge George J. Limbert, as the parties stipulated to have him handle all facets of the case.[129] On September 29, 2009, over 200 plaintiffs were listed in an amended complaint filed by plaintiffs.[130] Defendants filed a motion to dismiss the amended complaint, for, *inter alia*, "failure to plead fraud with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure and by provisions of the [PSLRA]."[131]

After a hearing, Magistrate Judge Limbert granted defendants' motion to dismiss for failing to meet the requirements of Rule 9(b) and the PSLRA.[132] Although the common-law fraud claim asserted by plaintiffs was dismissed without prejudice, the federal securities fraud claims were dismissed with prejudice "upon a finding that that result was warranted by the PSLRA."[133] Plaintiffs responded by filing motions for reconsideration and summary judgment, supplementing and supporting these motions with information received in expedited discovery.[134] Defendants filed nothing in opposition to these motions, but plaintiffs' motions were nonetheless denied.[135]

Plaintiffs appealed[136] to the Sixth Circuit, but that court ultimately affirmed the lower court's decision "for the reasons stated in the magistrate judge's Memorandum Opinion and Orders," stating, in addition,

126. *Id.*

127. *Id.* at 4.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.* Defendant Keelan Harris, represented by new counsel, joined in that motion. *Id.*

132. Cole v. Harris, No. 4:09CV1270, 2010 U.S. Dist. LEXIS 2689, at *21 (N.D. Ohio Jan. 4, 2010).

133. *See id.* at *21–23.

134. Petition for Writ of Certiorari, *supra* note 117, at 5–6 (Plaintiffs "included hundreds of pages of bank statements . . . showing the Ponzi scheme fraud.").

135. *Id.* at 6.

136. "While the appeal was pending, the federal government brought a civil case against, *inter alia*, the same defendants, based on the fraud plaintiffs had alleged." Petition for Writ of Certiorari, *supra* note 117, at 6 (citing U.S. Commodities Futures Trading Comm'n v. Complete Devs., LLC, 10-cv-2287 (N.D. Ohio filed Oct. 7, 2010)). Additionally, the federal government brought a criminal case against Kevin Harris. *Id.* (citing United States v. Harris, 10-cr-0437 (N.D. Ohio filed Oct. 7, 2010)). "Mr. Harris pleaded guilty to the fraud and was sentenced to serve more than seven years in prison, and to pay restitution to, *inter alia*, the plaintiffs in this case." *Id.*

that the relevant case law "support[s] the denial of the motion to amend . . . ."[137] The Sixth Circuit denied plaintiffs' petition for rehearing en banc.[138]

Finally, plaintiffs filed a Petition for Writ of Certiorari on May 2, 2012.[139] The question presented to the Supreme Court was:

> Victims of securities fraud who sue the wrongdoers for damages in federal court must file a complaint that meets the requirement of Rule 9(b) FRCP that the circumstances of the fraud be stated "with particularity" and additional requirements added by the Private Securities Litigation Reform Act of 1995 ("PSLRA"), including the requirement to plead facts "giving rise to a strong inference" of scienter. If a complaint is dismissed for failing to meet these requirements, should the dismissal be "with prejudice," despite the general provision of Rule 15(a)(2) FRCP that courts should "freely give" leave to amend a pleading "when justice so requires," on the grounds that to allow a plaintiff to file an amended complaint with more detail would "frustrate the purpose" of the PSLRA?[140]

On October 1, 2012, the Supreme Court denied the petition for writ of certiorari.[141]

C. *Decision and Reasoning*

The basis of the Sixth Circuit's decision was grounded in the reasoning set forth by Magistrate Judge Limbert in the district court.[142] In its unpublished opinion, the Sixth Circuit court stated:

> After carefully reviewing the record, the law, and the arguments on appeal, we conclude that the court's orders correctly set out the applicable law and correctly apply that law to the facts in the record. The issuance of a full written opinion by this court would serve no useful purpose. Accordingly, for the reasons stated in the magistrate judge's Memorandum Opinion and Orders, we affirm.[143]

The court in *Cole* failed to articulate any analysis whatsoever as to why this was the proper ruling, besides relying on Magistrate Judge Limbert's opinion.[144] Relying on prior Sixth Circuit case law, the court stated "allowing repeated filing of amended complaints would frustrate

137. Cole v. Harris, 444 F. App'x 888, 889 (6th Cir. 2012).
138. Petition for Writ of Certiorari, *supra* note 117, at 6.
139. *Id.*
140. *Id.* at i.
141. Cole v. Harris, 133 S. Ct. at 126 (2012). After the denial, the United States District Court for the Northern District of Ohio, Eastern Division ruled on Plaintiffs' pending motion to reopen the case. Cole v. Harris, No. 4:09CV1270, 2012 WL 5830524, at *2 (N.D. Ohio Nov. 12, 2012). The court denied Plaintiffs' motion filed pursuant to Rule 60(b)(2) and Rule 15(d). *Id.* at *6.
142. *Cole*, 444 F. App'x at 888–89.
143. *Id.* at 889.
144. *Id.*

the purpose of the PSLRA."[145] The court went on to state that "[t]he [district] court denied the plaintiffs an opportunity to further amend their complaint because they had already argued—in response to both motions to dismiss for lack of particularity—that the complaint was fine as written and no amendment was necessary."[146] Interestingly enough, this seems inaccurate, as the district court made no mention of dismissing the claim with prejudice because Plaintiffs believed complaint to be "fine as written."[147]

V. The Supreme Court Should Have Granted Certiorari and Reversed *Cole v. Harris*

By not granting certiorari in *Cole*, the Supreme Court missed an opportunity to cure the existing tension between the PSLRA and Rule 15(a). Moreover, this Article argues that with that grant of certiorari, the Supreme Court should have reversed *Cole*, finding that the PSLRA did not intend to restrict or limit Rule 15(a) in any way. This rule would make dismissals of securities fraud claims with prejudice based *solely* on that they did not meet the heightened pleading standards of the PSLRA improper. A blanket rule similar to the one in *Cole* permitting automatic dismissals with prejudice is inappropriate because it is inconsistent with: (A) the text and legislative history of the PSLRA; (B) the important principles embodied in Rule 15(a); (C) the Supreme Court's language in *Tellabs*; and (D) one of the twin aims of the PSLRA: preserving investors' ability to recover on meritorious claims.

A. *Text and Legislative History of the PSLRA*

The existing rule in the Sixth Circuit is incorrect and the Supreme Court should have granted certiorari in *Cole*, ultimately reversing the decision because neither the text nor the legislative history of the PSLRA supports a bright-line rule that all dismissals for not meeting the heightened pleading standards should be with prejudice. Rule 15(a), amendments, and dismissals with prejudice are *not* mentioned in the PSLRA. The PSLRA discusses heightened pleading standards,[148] but it

145. *Id.* at 888.

146. *Id.* at 888–89.

147. *See* Cole v. Harris, No. 4:09CV1270, 2010 U.S. Dist. LEXIS 2689, at *21 (N.D. Ohio Jan. 4, 2010) ("This dismissal is based *solely* upon Plaintiffs' failure to meet the technical pleading requirements of Rule 9(b) and 15 U.S.C. § 78u-4(b)(1)." (emphasis added)).

148. 15 U.S.C. § 78u-4(b) (2012). The relevant provisions of the PSLRA on pleading state:

> (b) Requirements for securities fraud actions
>
> (1) Misleading statements and omissions
>
> In any private action arising under this chapter in which the plaintiff alleges that the defendant—

does not speak whatsoever about heightened pleading standards and their effect on possible amendment after dismissal. It does, however, mention dismissals for failing to meet the pleading requirements, stating: "In any private action arising under this chapter, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met."[149] The text thus requires complaints that do not meet the pleading requirements to be dismissed, but does not require them to be with prejudice. If Congress wanted dismissals to be with prejudice, it would have written it into the PSLRA. As the D.C. Circuit stated in *Belizan*, "[H]ad the Congress wished to make dismissal with prejudice the norm, and to that extent supercede the ordinary application of Rule 15(a), we would expect the text of the PSLRA so to provide."[150]

Furthermore, nothing in the legislative history of the PSLRA alludes to Rule 15(a), amendments, or dismissals with prejudice. Specifically referencing the heightened pleading standards, Congress stated:

(A) made an untrue statement of a material fact; or

(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;

the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

(2) Required state of mind

(A) In general

Except as provided in subparagraph (B), in any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

(B) Exception in the case of an action for money damages brought against a credit rating agency or a controlling person under this chapter, it shall be sufficient, for purposes of pleading any required state of mind in relation to such action, that the complaint state with particularity facts giving rise to a strong inference that the credit rating agency knowingly or recklessly failed—

(i) to conduct a reasonable investigation of the rated security with respect to the factual elements relied upon by its own methodology for evaluating credit risk; or

(ii) to obtain reasonable verification of such factual elements (which verification may be based on a sampling technique that does not amount to an audit) from other sources that the credit rating agency considered to be competent and that were independent of the issuer and underwriter.

149. § 78u-4(b)(3)(A).

150. 434 F.3d 579, 584 (D.C. Cir. 2006).

> Naming a party in a civil suit for fraud is a serious matter. Unwarranted fraud claims can lead to serious injury to reputation for which our legal system effectively offers no redress. For this reason, among others, Rule 9(b) of the Federal Rules of Civil Procedure requires that plaintiffs plead allegations of fraud with "particularity." The Rule has not prevented abuse of the securities laws by private litigants. Moreover, the courts of appeals have interpreted Rule 9(b)'s requirement in conflicting ways, creating distinctly different standards among the circuits. The House and Senate hearings on securities litigation reform included testimony on the need to establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits.
>
> The Conference Committee language is based in part on the pleading standard of the Second Circuit. The standard also is specifically written to conform the language to Rule 9(b)'s notion of pleading with "particularity."
>
> Regarded as the most stringent pleading standard, the Second Circuit requirement is that the plaintiff state facts with particularity, and that these facts, in turn, must give rise to a "strong inference" of the defendant's fraudulent intent. Because the Conference Committee intends to strengthen existing pleading requirements, it does not intend to codify the Second Circuit's case law interpreting this pleading standard. The plaintiff must also specifically plead with particularity each statement alleged to have been misleading. The reason or reasons why the statement is misleading must also be set forth in the compliant in detail. If an allegation is made on information and belief, the plaintiff must state with particularity all facts in the plaintiff's possession on which the belief is formed.[151]

It can be reasonably inferred that Congress had no intention of restricting Rule 15(a), but only altering the pleading standards of Rule 9(b). Rule 9(b) is not the only Federal Rule of Civil Procedure mentioned in the House Conference Report, as Rule 11 is mentioned repeatedly as well.[152] In fact, Congress made it clear that it wanted Rule 11 applied differently, it wanted to reduce the filing of meritless securities lawsuits by "strengthening the application of Rule 11 of the Federal Rules of Civil Procedure in private securities actions."[153] Based on the above examples of Rule 9(b) and Rule 11 in the PSLRA, in no way could Congress have intended Rule 15(a) to be restricted. If it wished to alter Rule 15(a), it would have done so just like it did with Rule 9(b) and Rule 11.

151. H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 740.

152. *See id.* at 738–40.

153. *Id.* at 738.

B. *Importance of Adhering to Rule 15(a)*

Secondly, the existing rule in the Sixth Circuit is incorrect and *Cole* should have been granted certiorari by the Supreme Court and reversed because of the importance of adhering to Rule 15(a), for a variety of reasons. These reasons include: (i) the liberal amendment policy embodied in Rule 15(a); (ii) the consistency with which courts have applied this liberal amendment policy in other instances of heightened pleading standards; and (iii) the need to stay consistent with the Rules Enabling Act.

i. Liberal Amendment Policy

As discussed above, Rule 15(a) is understood to employ a liberal amendment policy.[154] Rule 15(a) "embodies the liberal pleading philosophy of the federal rules."[155] This liberal amendment philosophy limits the district court's discretion to deny leave to amend.[156] The liberal amendment policy is well-known and understood:

> Rule 15(a) complements the liberal pleading and joinder provisions of the federal rules by establishing a time period during which the pleadings may be amended automatically and by granting the court broad discretion to allow amendments to be made to the pleadings after that period has expired. Rule 15(a) therefore reinforces one of the basic policies of the federal rules—that pleadings are not an end in themselves but are only a means to assist in the presentation of a case to enable it to be decided on the merits. In order to further this policy, the court, on its own initiative, may require the parties to amend to avoid dismissal and subdivision (a)(2) provides that when a party moves to amend the court "should freely give leave when justice so requires." Applying this flexible standard, one court has stated that "when any defendant appears generally in an action, he is deemed to have made an appearance with the knowledge that amendments are granted liberally and will be allowed and freely given when justice requires it."[157]

In fact, the liberal amendment policy is consistent with the purpose of the Federal Rules as a whole, which "[should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding."[158] If Rule 15(a) were read any differently or narrowly, it would go against one of the Federal Rules' overall purpose of seeking and achieving justice.

154. *See supra* notes 22–33 and accompanying text.
155. *E.g.*, Adams v. Gould Inc., 739 F.2d 858, 864 (3d Cir. 1984).
156. *Id.*
157. Wright, Miller, Kane & Marcus, *supra* note 33, at § 1473.
158. Fed. R. Civ. P. 1.

ii. Rule 15(a) Still Applies to Other Heightened Pleading Standards

Consistent with the liberal amendment policy, Rule 15(a) has not been applied any differently in other instances that call for heightened pleading standards. To illustrate, prior to the PSLRA, Rule 9(b) required a heightened pleading standard for securities fraud litigation. Rule 9(b) states: "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally."[159] However, courts still applied the liberal standard of Rule 15(a) when complaints were dismissed for not meeting the heightened pleading standards of Rule 9(b).[160] This is true even in the Sixth Circuit, which held that leave to amend should be freely given pursuant to Rule 15(a) even though the complaint was dismissed for not meeting the heightened pleading standards of Rule 9(b).[161]

By the same token, the application of Rule 15(a) has not changed after the pleading standards required by Rule 8 were interpreted in *Bell Atlantic Corp. v. Twombly*[162] and *Ashcroft v. Iqbal*.[163] These cases analyzed Rule 8's short and plain statement rule required for a complaint to be sufficient and for the "pleader to be entitled to relief."[164] The interpretation was changed from the implication that a complaint should not be dismissed unless the pleader could prove "no set of facts entitling him to relief"[165] to complaints needing to "state a claim to relief that is plausible on its face."[166] Many scholars have reasoned that this change resulted in heightened pleading standards.[167] Even with this change in pleading standards, most courts have held that Rule 15(a)'s liberal amendment policy applies unchanged.[168] Thus, even when normal pleading standards are heightened, in no context has Rule 15(a) been

159. Fed. R. Civ. P. 9(b).

160. *See* Belizan v. Hershon, 434 F.3d 579, 584 (D.C. Cir. 2006) (citing Bly-Magee v. California, 236 F.3d 1014, 1019 (9th Cir. 2001)).

161. *See* United States v. Cmty. Health Sys., Inc., 342 F.3d 634, 644 (6th Cir. 2003) ("Given that 'federal courts must be liberal in allowing parties to amend their complaints,' we will remand the case to the district court to allow Relator to comply with Rule 9(b) by amending his amended complaint.").

162. 550 U.S. 34 (2007).

163. 556 U.S. 662 (2009).

164. Fed. R. Civ. P. 8(a)(2).

165. Conley v. Gibson, 355 U.S. 41, 45–46 (1957).

166. *Iqbal*, 556 U.S. at 678 (quoting *Twombly*, 550 U.S. at 570).

167. *See, e.g.*, Suja A. Thomas, *The New Summary Judgment Motion: The Motion to Dismiss Under Iqbal and Twombly*, 14 Lewis & Clark L. Rev. 15 (2010).

168. *See, e.g.*, HDC, LLC v. City of Ann Arbor, 675 F.3d 608, 615 (6th Cir. 2012) (acknowledging that leave to amend is "freely given when justice so requires" after *Iqbal*).

applied differently because of it. Why would heightened pleading standards under the PSLRA be any different?

iii. Rule 15(a) in No Way Has Been Properly Altered

Nowhere in the PSLRA is Rule 15(a) or denying leaves to amend mentioned, leaving Rule 15(a) unaltered. Without Congress expressly changing Rule 15(a), courts need to be cautious not to overstep the boundaries and limits of proper judicial authority. The Supreme Court has stated that "questions regarding pleading, discovery, and summary judgment are most frequently and most effectively resolved either by the rulemaking process or the legislative process."[169]

Britton is a prime example of a court overstepping its judicial authority in trying to alter the application of a specific Federal Rule of Civil Procedure. There, the Supreme Court vacated the judgment of the D.C. Circuit, holding that the D.C. Circuit "erred in fashioning a heightened burden of proof for unconstitutional-motive cases against public officials."[170] In its reasoning, the Supreme Court stated that "[n]either the text of § 1983 or any other federal statute, nor the Federal Rules of Civil Procedure, provide any support for imposing the clear and convincing burden of proof on plaintiffs either at the summary judgment stage or in the trial itself."[171] Congress had already spoken on the issue by instituting the Prison Litigation Reform Act in April 1996,[172] which left out any change in pleading standards.[173] The Supreme Court inferred that Congress did not intend to alter the rules in this way because Congress did not directly advocate or require this change:

> Most significantly, the statute draws no distinction between constitutional claims that require proof of an improper motive and those that do not. If there is a compelling need to frame new rules of law based on such a distinction, presumably Congress either would have dealt with the problem in the Reform Act, or will respond to it in future legislation.[174]

Interestingly enough, this was not the first time that the Supreme Court

169. Crawford-El v. Britton, 523 U.S. 574, 595 (1998) (citing Leatherman v. Tarrot Cnty. Narcotics Intelligence & Coordination Unit, 507 U.S. 163, 168–69 (1993)).

170. *Id.* at 574. (That court adopted a clear and convincing evidence requirement to deal with a potentially serious problem: because an official's state of mind is easy to allege and hard to disprove, insubstantial claims turning on improper intent may be less amenable to summary disposition than other types of claims against government officials. The standard was intended to protect public servants from the burdens of trial and discovery that may impair the performance of their official duties.).

171. *Id.* at 594.

172. Pub. L. 104-134, 110 Stat. 1321.

173. *See Britton*, 523 U.S. at 596–97.

174. *Id.* at 597.

declined similar invitations to revise established rules.[175] Therefore, this precedent unequivocally establishes the proper avenues that need to be taken in order to alter a Federal Rule of Civil Procedure. A court overstepping its judicial limits in its statutory interpretation of a piece of congressional legislation is not a permissive avenue. This is exactly what was done by the Sixth Circuit in *Miller* and reaffirmed in *Cole*.

iv. Consistency with the Rules Enabling Act

The Rules Enabling Act[176] is a uniform federal bill authorizing the Supreme Court to promulgate rules of procedures at civil actions of law.[177] The Rules Enabling Act in its entirety reads:

> (a) The Supreme Court shall have the power to prescribe general rules of practice and procedure and rules of evidence for cases in the United States district courts (including proceedings before magistrate judges thereof) and courts of appeals.
> (b) Such rules shall not abridge, enlarge or modify any substantive right. All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect.
> (c) Such rules may define when a ruling of a district court is final for the purposes of appeal under section 1291 of this title.[178]

Pursuant to the Rules Enabling Act, when a Federal Rule of Civil Procedure and another statute conflict, the statute is deemed superseded, unless such supersession would "abridge, enlarge, or modify [a] substantive right."[179] Thus, even if the Sixth Circuit is correct in ruling that the PSLRA restricts Rule 15(a) in some way, the Rules Enabling Act requires that Rule 15(a) supersede the PSLRA.

C. *Inconsistency with* Tellabs

The Supreme Court's reasoning in *Tellabs* is yet another reason why the existing rule in the Sixth Circuit is incorrect, thus the Supreme Court should have granted certiorari in *Cole* and reversed. In *Tellabs*, the Supreme Court also recognized the PSLRA's twin goals: (1) "curb frivolous, lawyer-driven litigation," (2) "while preserving investors' ability to recover on meritorious claims."[180] The First Circuit in *ACA*

175. *See, e.g.*, Johnson v. Jones, 515 U.S. 304, 317–18 (1995); Leatherman v. Tarrot Cnty. Narcotics Intelligence & Coordination Unit, 507 U.S. 163, 164–69 (1993); Gomez v. Toledo, 446 U.S. 635, 639–40 (1980).

176. 28 U.S.C. § 2072 (2006).

177. Stephen B. Burbank, *The Rules Enabling Act of 1934*, 130 U. Pa. L. Rev. 1015, 1024 (1982).

178. 28 U.S.C. § 2072.

179. United States v. Microsoft Corp., 165 F.3d 952, 958 (D.C. Cir. 1999) (citing Henderson v. United States, 517 U.S. 654, 663 (1996)).

180. *See* 551 U.S. 308, 320 (2007).

Financial used *Tellabs* as support for its holding that the PSLRA did not restrict the liberal amendment policy embodied in Rule 15(a).[181] One of the lessons of *Tellabs*, highlighted by the First Circuit in *ACA Financial*, is that "in the absence of a legislative directive to the contrary, the [Federal Rules of Civil Procedure] appl[y] as in the normal course."[182] As discussed previously, the text and the legislative history of the PSLRA makes no mention of Rule 15(a),[183] making it, according to the lesson of *Tellabs*, apply in its normal course.

Critics of this view will argue that the holding in *Cole* is consistent with *Tellabs*, alluding to the twin goals of the PSLRA and how repeated amendments may prove contrary to these twin goals. Certain jurisdictions have already made a parallel between the goals of the PSLRA and a blanket rule on denying amendment, such as in *Miller*, where the Sixth Circuit court stated: "[T]he purpose of the PSLRA would be frustrated if district courts were required to allow repeated amendments to complaints filed under the PSLRA."[184] But not only is deterring frivolous lawsuits a goal of the PSLRA, so too is the salvaging of meritorious claims.[185] "A blanket rule that the PSLRA modifies Rule 15(a) would tip the scales too far, compromising plaintiffs' ability to have meritorious claims presented in court."[186] "To read the PSLRA to constrict Rule 15(a) would distort and corrupt the legislative balance struck by the Act."[187] So although there may be a minor argument that critics can assert, in no way is it strong enough to merit such a catastrophic rule.

D. *The Salvaging of Possible Meritorious Claims*

The language in *Tellabs* parallels the most important point as to why the existing rule in the Sixth Circuit is incorrect and *Cole* should have been granted certiorari by the Supreme Court and reversed: the need for a clear and consistent rule to help salvage meritorious claims.

The PSLRA requires "an unprecedented degree of specificity and detail."[188] The difficulty the PSLRA presents plaintiffs and their lawyers makes it very easy to make a mistake in pleading a proper securities fraud complaint.[189] This was not the intention of Congress when it

181. *See supra* Part III.B.iii.
182. 512 F.3d 46, 56 (1st Cir. 2008).
183. *See supra* Part V.A.
184. 346 F.3d 660, 692 (6th Cir. 2003).
185. *See Tellabs*, 551 U.S. at 320.
186. *ACA Fin.*, 512 F.3d at 56.
187. *Id.*
188. Eminence Capital, LLC v. Aspeon, Inc., 316 F.3d 1048, 1052 (9th Cir. 2003) (per curiam).
189. *See generally*, Hon. H. Brent Knight, *Pleading Fraud Under the PSLRA*, 11 PRAC. LITIG. 45, 55 (2000). Judge Knight concluded

enacted the PSLRA, as it wished to "establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits."[190] However, this has been the unquestioned result. Because of Congress's uncertainty and vagueness as to what the established standard would be, the pleading standards of the PSLRA are as far from "uniform" as they were when Rule 9(b) was the standard for pleading fraud.[191] With these difficult pleading standards to meet and the inconsistency in which it is interpreted by the courts, it is not out of the realm of possibility that many meritorious claims may be dismissed because they fail to meet these standards. This is not because they are frivolous strike suits;[192] they are actually meritorious claims, with actual aggrieved plaintiffs, whose complaint failed to meet the heightened pleading standards for some other reason (high degree of detail not met, confusing interpretations, et cetera). "The liberal amendment policy serves the second aim of the PSLRA by preventing merited claims from being dismissed because of hyper-technical rules of pleading."[193]

Likewise, there needs to be protection in place to save possible meritorious claims, not just because of the technical and difficult pleading requirements of the PSLRA, but also because of the abundance of fraud present in general, and plaintiffs' need to be protected. Studies conducted on the PSLRA and its effects after its first ten years in existence are enlightening.[194] Studies have shown that settlements after the enactment of the PSLRA include a higher percentage of meritorious litigation, while at the same time, the filing of lawsuits is increasing.[195] One scholar suggested that more fraud is occurring since the enactment of the PSLRA than that which occurred previously.[196]

With this possible increase in fraud, occurring while meritorious

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> As with scienter, so with particularity: The law is in flux. A uniform standard is wanted by many, but delivered as yet by none. Until the Supreme Court weighs in on these issues, counsel should be aware of the differences, even within the circuits themselves, of the decisions interpreting the PSLRA and proceed with care. Counsel should also be mindful of the legislative history and the role it could play in developing consensus.

Id.

190. H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 740.

191. James D. Cox, Randall S. Thomas, & Lynn Bai, *Do Differences in Pleading Standards Cause Forum Shopping in Securities Class Actions?: Doctrinal and Empirical Analysis*, 2009 Wis. L. Rev. 421, 430–32 (2009).

192. Frivolous strike suits are one of the reasons Congress enacted the PSLRA and raised the pleading standards for securities fraud cases. *See supra* note 14 and accompanying text.

193. *See* Wunderlich, *supra* note 17, at 368.

194. *See generally* Choi & Thompson, *supra* note 12 (surveying the empirical evidence on the impact of the PSLRA).

195. *See id.* at 1500.

196. Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. Ill.

litigation is litigated and settled, one arrives at the indisputable conclusion that there is no need to have a bright-line and blanket rule that dismisses all complaints with prejudice that do not meet the heightened pleading requirements of the PSLRA. Let the plight of the potential victims and plaintiffs in the securities fraud context not be forgotten. Congress itself has stated,

> Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs. This legislation seeks to return the securities litigation system to that high standard.[197]

The possibility that meritorious claims are being dismissed because of such a rule is not consistent with any form of justice, let alone justice in the securities fraud context, as evidenced above.

VI. Conclusion

In the arena of complex securities fraud litigation, plaintiffs deserve more than just one bite at the apple with regards to the filing of a complaint. This is not to say that plaintiffs should be afforded an unlimited amount of bites at the apple. Traditional federal amendment rules should apply, incorporating the liberal amendment policy of Rule 15(a) that is both consistent with the federal rules and the pleading regime in general. If Congress intended the PSLRA to have required dismissals to always be with prejudice, it would have implemented this per se poisonous apple itself in the text of the PSLRA or made it clear in the lead-up to its passing.

The Supreme Court missed a crucial opportunity to cure a grave injustice by not granting certiorari and reversing the decision in *Cole*. The Sixth Circuit's blanket rule is too extreme and devastating to plaintiffs, who risk dismissal with prejudice of their possibly meritorious claims for failing to meet the heightened pleading standards required by the PSLRA.[198] This holding goes completely against any textual or statutory interpretation of the PSLRA, as well as any inquiry into the PSLRA's legislative history. A core tension has been created with Rule 15(a), as the rule in *Cole* constrains the liberal thrust that reigns in Rule 15(a)'s interpretation and application throughout history. Hope is not out

L. Rev. 913 (2003) (presenting an empirical analysis that suggests that there has been an increase in class action filings).

197. H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730.

198. *See* Cole v. Harris, 444 F. App'x 888, 889 (6th Cir. 2012).

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of the question, as in 2007, the Supreme Court in *Tellabs* decided a case dealing with a circuit split on a specific interpretation of the PSLRA.[199] Seeing as only five federal circuits have ruled on the issue at hand, more litigation involving securities fraud suits that are dismissed for not meeting the heightened pleading standards of the PSLRA are sure to come. But, for now, securities fraud plaintiffs must be wary of the poisonous apple that is alive and well in certain jurisdictions in this country; one bite from the poisonous apple is likely fatal to the plaintiffs' claim, with no kiss from the Prince in sight.

199. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007).