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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

RONALD M. GRASSI and
SALLY GRASSI,

Plaintiffs,

No. CIV S-09-0543 JAM DAD PS

v.

MOODY'S INVESTOR'S,
SERVICES, et al.,

ORDER

Defendants.

_____ /

This case came before the court on July 31, 2009, for hearing of defendants' motions to dismiss plaintiffs' claims pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b). Attorneys James J. Coster and David A. McCarthy appeared for defendant Moody's Investors Service, Inc. Attorneys Floyd Abrams, Brian T. Markley, and David Taro Biderman appeared for defendant The McGraw-Hill Companies, Inc., sued as Standard & Poor's. Attorneys Roberta A. Kaplan and Jonathan A. Patchen appeared for defendant Fitch, Inc. Plaintiffs Ronald Grassi and Sally Grassi are proceeding pro se in this action, and each appeared on his or her own behalf. The parties' arguments were heard, and the motions were submitted for decision.

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1 “the subject bonds.” The descriptions are abbreviated and cryptic. There is no allegation that
2 plaintiffs purchased these bonds and, but if the bonds were purchased by plaintiffs, there are no
3 details alleged concerning the purchase or purchases.

4 Plaintiffs’ fraud and deceit claim is identical to their negligence claim except that
5 defendants are alleged to have acted “intentionally,” rather than “negligently.” (Id., Ex. B at 5.)

6 Plaintiffs claim loss of use of property and “Punitive Damages based upon
7 defendants’s [sic] reckless disregard in publishing false and misleading information relating to
8 Lehman Brother’s bonds.” (Id., Ex. B at 3.) Plaintiffs pray for compensatory and punitive
9 damages. (Id.)

10 LEGAL STANDARDS APPLICABLE TO DEFENDANTS’ MOTIONS TO DISMISS

11 The purpose of a motion to dismiss pursuant to Rule 12(b)(6) is to test the legal
12 sufficiency of the complaint. N. Star Int’l v. Ariz. Corp. Comm’n, 720 F.2d 578, 581 (9th Cir.
13 1983). “Dismissal can be based on the lack of a cognizable legal theory or the absence of
14 sufficient facts alleged under a cognizable legal theory.” Balistreri v. Pacifica Police Dep’t, 901
15 F.2d 696, 699 (9th Cir. 1990). A plaintiff is required to allege “enough facts to state a claim to
16 relief that is plausible on its face.” Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007). Thus,
17 a defendant’s Rule 12(b)(6) motion challenges the court’s ability to grant any relief on the
18 plaintiff’s claims, even if the plaintiff’s allegations are true.

19 In determining whether a complaint states a claim on which relief may be granted,
20 the court generally accepts as true the allegations in the complaint and construes the allegations
21 in the light most favorable to the plaintiff. Hishon v. King & Spalding, 467 U.S. 69, 73 (1984);
22 Love v. United States, 915 F.2d 1242, 1245 (9th Cir. 1989). In general, pro se complaints are
23 held to less stringent standards than formal pleadings drafted by lawyers. Haines v. Kerner, 404
24 U.S. 519, 520-21 (1972). However, the court need not assume the truth of legal conclusions cast
25 in the form of factual allegations. W. Mining Council v. Watt, 643 F.2d 618, 624 (9th Cir.
26 1981). The court is permitted to consider material which is properly submitted as part of the

1 complaint, documents not physically attached to the complaint if their authenticity is not
2 contested and the plaintiff's complaint necessarily relies on them, and matters of public record.
3 See Lee v. City of Los Angeles, 250 F.3d 668, 688-89 (9th Cir. 2001) (on a motion to dismiss,
4 the court may consider matters of public record); MGIC Indem. Corp. v. Weisman, 803 F.2d 500,
5 504 (9th Cir. 1986) (on a motion to dismiss, the court may take judicial notice of matters of
6 public record outside the pleadings). Of course, a court may take judicial notice of its own files
7 and of documents filed in other courts. Reyn's Pasta Bella, LLC v. Visa USA, Inc., 442 F.3d
8 741, 746 n.6 (9th Cir. 2006) (taking judicial notice of documents related to a settlement in
9 another case that bore on whether the plaintiff was still able to assert its claims in the pending
10 case); Burbank-Glendale-Pasadena Airport Auth. v. City of Burbank, 136 F.3d 1360, 1364 (9th
11 Cir. 1998) (taking judicial notice of court filings in a state court case where the same plaintiff
12 asserted similar and related claims); Hott v. City of San Jose, 92 F. Supp. 2d 996, 998 (N.D. Cal.
13 2000) (taking judicial notice of relevant memoranda and orders filed in state court cases).

14 When a plaintiff alleges fraud, "the circumstances constituting fraud . . . shall be
15 stated with particularity." Fed. R. Civ. P. 9(b). "Rule 9(b) serves not only to give notice to
16 defendants of the specific fraudulent conduct against which they must defend, but also 'to deter
17 the filing of complaints as a pretext for the discovery of unknown wrongs, to protect [defendants]
18 from the harm that comes from being subject to fraud charges, and to prohibit plaintiffs from
19 unilaterally imposing upon the court, the parties and society enormous social and economic costs
20 absent some factual basis.'" Bly-Magee v. California, 236 F.3d 1014, 1018 (9th Cir. 2001)
21 (quoting In re Stac Elec. Sec. Litig., 89 F.3d 1399, 1405 (9th Cir. 1996)).

22 Thus, pursuant to Rule 9(b), a plaintiff must, at a minimum, plead evidentiary
23 facts such as time, place, persons, statements and explanations of why allegedly misleading
24 statements are misleading. In re GlenFed, Inc. Sec. Litig., 42 F. 3d 1541, 1547 n.7 (9th Cir.
25 1994). In addition, a plaintiff proceeding on a state fraud claim in federal court must allege facts
26 demonstrating the existence of the elements of such a claim. Vess v. Ciba-Geigy Corp. USA,

1 317 F.3d 1097, 1105-06 (9th Cir. 2003) (quoting Moore v. Brewster, 96 F.3d 1240, 1245 (9th
2 Cir. 1996)) (“Under California law, the ‘indispensable elements of a fraud claim include a false
3 representation, knowledge of its falsity, intent to defraud, justifiable reliance, and damages.”);
4 Fecht v. Price Co., 70 F.3d 1078, 1082 (9th Cir. 1995).

5 ANALYSIS

6 I. The Parties’ Arguments

7 The defendants are credit rating companies, and all three seek dismissal of
8 plaintiffs’ claims with prejudice. Although defendants’ arguments vary to some degree, all
9 defendants move to dismiss plaintiff’s claims pursuant to Rule 12(b)(6) on the ground that
10 plaintiffs’ pleading fails to state any claim on which relief can be granted. Defendant Moody’s
11 Investors Service, Inc. (Moody’s) also seeks dismissal of plaintiffs’ fraud claim pursuant to Rule
12 9(b) for failure to plead circumstances of fraud with sufficient particularity.

13 Defendants treat plaintiffs’ negligence claim as a claim of negligent
14 misrepresentation because, as defendant The McGraw-Hill Companies, Inc. (McGraw-Hill)
15 explains, defendants’ alleged misconduct lay in the dissemination of their ratings to potential
16 investors and investment advisors. (Def. McGraw-Hill’s Mot. to Dismiss, Mem. of P. & A. at 2
17 n.2. In this regard, defendant McGraw-Hill cites to California court decisions finding that the
18 plaintiffs’ negligence claims in those cases were more precisely considered claims of negligent
19 misrepresentation. (Id.)

20 Defendants argue that plaintiffs’ claim of negligent misrepresentation fails
21 because, as a matter of law, defendants owed no duty of care to plaintiffs. Defendants point out
22 that plaintiffs have not alleged any relationship or contact of any kind with any of the defendants,
23 let alone the kind of relationship required to establish a duty of care. Defendants cite both to
24 New York law holding that a provider of information cannot be held liable for negligent
25 misrepresentation absent pleading and proof of a special relationship approximating privity, and
26 also California law holding that a negligent misrepresentation claim requires pleading and proof

1 that the plaintiff is a member of a “limited group” of intended beneficiaries of the representation.
2 Defendants view plaintiffs as belonging to the unlimited audience of readers and viewers of their
3 ratings. Such a view appears to be consistent with plaintiffs’ complaint, in which plaintiffs
4 allege that defendants negligently over-rated the quality and value of Lehman Brothers’ bonds
5 “knowing that potential investors and investment advisors would rely on the ratings.”

6 Defendants contend that plaintiffs’ claim of negligent misrepresentation also fails
7 because plaintiffs did not plead with particularity (1) a material misrepresentation, (2) actual and
8 reasonable reliance, and (3) causation, which are the essential elements of a claim of negligent
9 misrepresentation. Defendants argue that plaintiffs cannot amend their complaint to cure this
10 pleading defect because plaintiffs cannot establish the element of reasonable reliance due to the
11 explicit cautionary disclaimers that accompany the defendants’ ratings, including their ratings of
12 Lehman Brothers and its bonds.

13 Defendant Moody’s argues that plaintiffs’ fraud claim fails as a matter of law
14 because plaintiffs have failed to allege with the required particularity not only (1) a material
15 misrepresentation, (2) actual and reasonable reliance, and (3) causation, but also (4) scienter,
16 which is an element of a fraud claim.

17 Finally, defendants argue that both of plaintiffs’ claims fail as a matter of law
18 because credit rating opinions published by rating agencies have been consistently held to be
19 protected under the First Amendment in two ways. Defendants assert first that, as expressions of
20 protected opinion rather than fact, credit ratings cannot be proven false and are not actionable as
21 false “statements.” Defendants assert second that, as protected speech on matters of public
22 concern, credit ratings cannot give rise to liability absent pleading and proof of “actual malice.”

23 In opposition to defendants’ motions, plaintiffs argue that their complaint was
24 properly drafted under California law on state-approved forms. However, plaintiffs request leave
25 to amend if more detailed pleadings are required. Plaintiffs claim that they can and will re-plead
26 their claims for relief more specifically.

1 Plaintiffs’ insistence that they can and will re-plead more specifically is cast into
2 doubt, however, by plaintiffs assertion that they cannot plead their claims with specificity until
3 discovery has been completed. Plaintiffs indicate that if they are required to file an amended
4 pleading alleging actual facts, they will need to (1) take the depositions of the defendants’ CEO’s
5 and the analysts who reviewed the information available on the bonds purchased by plaintiffs, (2)
6 propound interrogatories, and (3) request production of extensive records. Toward that end,
7 plaintiffs request an order permitting them to conduct at least limited discovery.

8 Returning to their argument that their complaint is sufficient under California law,
9 plaintiffs argue that they should not be required to change their claims or how their claims are
10 pled just because this court has determined that their state claims will be heard in federal court.
11 Plaintiffs contend that their common law negligence and fraud claims have not been preempted
12 by federal law and that they have pled sufficient facts to apprise defendants of the specific
13 negligence and fraud at issue, when it occurred, and what the result was.

14 On the subject of defendants’ duty of care, plaintiffs contend that California law
15 should be applied, and once again they argue that they can and will amend their complaint to
16 allege the relationship required under California law in order to establish defendants’ duty to
17 plaintiffs. Plaintiffs contend that the investing public is a “limited group,” thereby establishing
18 the required privity, and that plaintiffs are third party beneficiaries or intended beneficiaries or at
19 least foreseeable recipients of the companies’ ratings. Plaintiffs reiterate that if required to
20 replead their state court causes of action to conform to federal rules, they can and will comply.

21 Plaintiffs conclude by disputing defendants’ arguments regarding First
22 Amendment protection for credit rating companies. Plaintiffs do not view defendants’ ratings as
23 protected opinions but as provably false statements. Plaintiffs also assert that they can amend
24 their complaint to allege malice or reckless disregard to meet the standard described by

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1 defendants.¹

2 In their replies, defendants note that plaintiffs repeatedly claim that they can plead
3 facts but do not identify any of those facts, thus failing to show that they can state any cognizable
4 claim under New York or California law. Defendant Moody's asserts that plaintiffs have in fact
5 admitted they had no relationship with Moody's other than being members of the entire
6 "investing public." Defendant Moody's cites federal court decisions dismissing negligent
7 misrepresentation claims brought by members of the "general investing public." (Def't Moody's
8 Reply filed July 16, 2009, at 4 n.3.) Defendant McGraw-Hill also cites cases rejecting the
9 argument that the limited group requirement actually encompasses all members of the investing
10 public. (Def't McGraw-Hill's Reply filed July 16, 2009, at 4-5.) All defendants argue that
11 plaintiffs have failed to rebut any of defendants' arguments in support of dismissal, that the court
12 should deny plaintiffs' unsupported requests for leave to amend and to conduct discovery, and
13 that defendants' motions to dismiss should be granted with prejudice.

14 II. Discussion

15 Once a case has been removed from state court, it is subject to the Federal Rules
16 of Civil Procedure, and those rules govern procedure after removal. Fed. R. Civ. P. 81(c)(1)
17 ("These rules apply to a civil action after it is removed from a state court."). The United States
18 Supreme Court has determined that the "expansive language" of Rule 81(c) "contains no express
19 exceptions and indicates a clear intent to have the Rules . . . apply to all district court civil
20 proceedings." Willy v. Coastal Corp., 503 U.S. 131, 134-35 (1992).

21 Rule 81(c) establishes the general rule that, "[a]fter removal, repleading is
22 unnecessary unless the court orders it." Fed. R. Civ. P. 81(c)(2). However, federal pleading

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24 ¹ In support of their opposition to the pending motions to dismiss, plaintiffs request that
25 the court take judicial notice of documents attached to the declaration of plaintiff Ronald Grassi.
26 No documents were attached to the declaration as filed with the court. The undersigned has
reviewed plaintiffs' list of exhibits and finds that it consists of excerpts of congressional
testimony, transcripts of hearings, and emails, none of which appear to be documents properly
subject to judicial notice.

1 rules apply regardless of whether the substantive law at issue is state or federal. Kearns v. Ford
2 Motor Co., 567 F.3d 1120, 1125 (9th Cir. 2009).² A pleading removed from state court is
3 therefore subject to dismissal pursuant to Rule 8(a)(2) of the Federal Rules of Civil Procedure if
4 the pleading does not contain a short and plain statement of the claim showing that the pleader is
5 entitled to relief.

6 When fraud is alleged in a pleading removed from state court, the pleading is
7 subject to dismissal pursuant to Rule 9(b), which requires that “a party must state with
8 particularity the circumstances constituting fraud.” Kearns, 567 F.3d at 1124. The
9 circumstances constituting the alleged fraud must be specific enough to give each defendant
10 notice of its particular misconduct so that the defendant can defend against the charge. Id. (citing
11 Bly-Magee, 236 F.3d at 1019). Where fraud is not an essential element of all claims alleged in a
12 pleading, only the claims that allege fraud are subject to the heightened pleading standard of Rule
13 9(b). Kearns, 567 F.3d at 1124. To satisfy that standard, a plaintiff alleging fraud must set forth
14 more than the neutral facts necessary to identify the transaction at issue. Id. (citing In re
15 GlenFed, Inc., 42 F.3d at 1548).

16 In the present case, the court finds plaintiffs’ pleading deficient under both Rules
17 8 and 9. The fact that the form complaint was adequate for purposes of proceedings in state
18 court is irrelevant. For federal court proceedings, plaintiffs’ complaint, while undeniably short,
19 is not a plain statement of claims showing that plaintiffs are entitled to relief on their claims of
20 negligent misrepresentation and fraud. The allegations of the pleading are not specific enough to
21 give each defendant notice of its particular misconduct, it does not allege facts that establish each
22 element of the two claims, and it falls far short of stating a plausible, cognizable claim against
23 any defendant.

24
25 ² In diversity cases, “substantive” issues are governed by state law under the Erie
26 doctrine, but all “procedural” issues are governed by the Federal Rules of Civil Procedure and
applicable federal statutes.

1 While the undersigned finds it unlikely that plaintiffs can file an amended
2 complaint that will meet federal pleading standards and state a cognizable claim, it is not possible
3 to conclude that they cannot do so. Accordingly, defendants' motion to dismiss will be granted,
4 but dismissal of the complaint originally filed in state court by plaintiffs will be without prejudice
5 to the filing of an amended complaint. See Smith v. Local Union No. 110, Int'l Brotherhood of
6 Elec. Workers, ___ F. Supp. 3d ___, ___, Civil No. 09-2528 (DWF/SRN), 2010 WL 173797, at
7 *9 (D. Minn. Jan. 13, 2010) (finding no basis to dismiss the state court pleading with prejudice
8 and therefore dismissing the complaint with leave to file an amended complaint that conforms to
9 the applicable federal rules); Rockwood Retaining Walls, Inc. v. Patterson, Thuente, Skaar &
10 Christensen, P.A., Civil No. 09-2493 (DWF/FLN), 2009 WL 5185770, at *6 (D. Minn. Dec. 22,
11 2009) (dismissing the complaint without prejudice upon finding that "the threadbare, conclusory
12 allegations" in the pleading removed from state court failed to meet the federal pleading standard
13 as defined by the United States Supreme Court in recent cases).

14 Plaintiffs are cautioned that the amended complaint must comply with the
15 requirements of Rules 8 and 9 to allege facts that establish all elements of the claims alleged and
16 must provide the specificity required for the fraud claim under Rule 9.

17 In this regard, plaintiffs are advised that Rule 9(b) serves three purposes. First, a
18 plaintiff's compliance with the rule provides defendants with adequate notice to allow them to
19 defend the charge and deters plaintiffs from filing complaints "as a pretext for the discovery of
20 unknown wrongs"; second, a plaintiff's compliance with the rule protects those whose reputation
21 would be harmed as a result of being subject to fraud charges; third, compliance with the rule
22 prohibits plaintiffs from "unilaterally imposing upon the court, the parties and society enormous
23 social and economic costs absent some factual basis. Kearns, 567 F.3d at 1125. Plaintiffs'
24 request for leave to conduct discovery is denied because permitting discovery before the
25 plaintiffs have filed an adequate pleading that states claims upon which relief may be granted
26 would violate all three of these purposes of Rule 9(b).

1 CONCLUSION

2 Accordingly, IT IS HEREBY ORDERED that:

3 1. Defendants' motions to dismiss filed June 15, 2009 (Doc. Nos. 44, 47, and 52)
4 are granted;

5 2. Plaintiffs' July 2, 2009 request for limited discovery (Doc. No. 55) is denied;
6 and

7 3. Plaintiffs are granted thirty days to file an amended complaint that complies
8 with this order, the Local Rules of Practice, and the Federal Rules of Civil Procedure; plaintiffs'
9 amended complaint must bear the case number assigned to this case, must be titled "Amended
10 Complaint," and must comply with the requirements of the Federal Rules of Civil Procedure, the
11 Local Rules of Practice, and this order.

12 DATED: March 26, 2010.

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15 DALE A. DROZD
16 UNITED STATES MAGISTRATE JUDGE

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