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Vagaries of Particularity: New York CPLR 3016(b)

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Few tools are as handy to civil defense counsel as pleading rules imposing a particularity obligation. Absent such rules, participants in unprofitable ventures would find it all too easy to assert fraud against counterparties. In federal practice, the familiar FRCP 9(b) provides a reliable bulwark against the "in terrorem or stigmatizing effect on defendants and their reputations" of loosely pleaded fraud claims.[1] Federal courts emphasize that Rule 9(b) guards against strike suits—actions of dubious merit designed to extract a settlement through plaintiff's threatened access to the instruments of discovery.[2] For these reasons, the federal bench usually enforces strictly the heightened pleading standard requiring a claimant to specify the "who, what, when, where and how" of an alleged fraud.[3]

But in state court practice, CPLR 3016(b), the counterpart to FRCP 9(b), has been applied inconsistently, and some leading commentators have even questioned the viability of a heightened pleading standard on fraud claims. This article reviews the interpretation of CPLR 3016(b) in New York courts, and comments on the role of a heightened pleading standard for fraud claims in state practice.

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Initial Restricted Reading

On its face, the text of CPLR 3016(b) is actually more sweeping than FRCP 9(b). CPLR 3016(b) provides that "where a cause of action or defense is based upon misrepresentation, fraud, mistake, willful default, breach of trust or undue influence, the circumstances constituting the wrong shall be stated in detail." In contrast, FRCP 9(b) provides only that "a party must state with particularity the circumstances constituting fraud or mistake." And CPLR 3016(b) does not have language analogous to the caveat in FRCP 9(b) that "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally."

Despite the broad language of CPLR 3016(b), the inaugural First Department decision construing the pleading rule nearly read it out of existence. In *Foley v. D'Agostino*,[4] the First Department noted the "objective of greater liberality in pleading" that emerged from the adoption of the CPLR in 1962, and found that "the sufficiency of a pleading statement primarily depends upon compliance with CPLR §3013." Akin to FRCP 8, CPLR 3013 merely requires that a pleading give "notice of the transactions or occurrences…to be proved." The Foley court thus concluded that CPLR 3016(b) required no more than "adequate notice" of the "'transactions and occurrences' constituting the 'wrong.'"

On this basis, the court declined to dismiss claims for breach of fiduciary duty by one faction of the famed Manhattan grocer family, D'Agostino, against another, despite the complaint's failure to show "how and to what extent the family corporations have been or will be damaged by the acts of the individual defendants." And the court issued a virtual edict against motions to dismiss based on particularity deficiencies in pleadings, admonishing defendants that rather than addressing "a mere pleading error," a party who believed a claim lacked substance "would be better advised to proceed under Rules 3211 or 3212 upon affidavits or other proofs to secure an immediate determination upon the merits."[5]

The motif of liberal pleading that emerged in *D'Agostino* dominated the case law on CPLR 3016(b) for many years. In 1968, the Court of Appeals reinstated an admittedly unparticularized defense of fraudulent procurement on the ground that "[i]t is almost impossible to state in detail the circumstances constituting a fraud…[that] are peculiarly within the

knowledge of the party against whom the defense is being asserted."[6]

This reasoning was reiterated a decade later in *Lanzi v. Brooks*,[7] where the Court of Appeals affirmed dismissal of a fraud claim that omitted any allegation of fraudulent intent, but went to pains to clarify that its holding, unlike that of the Appellate Division, was not based in any part on CPLR 3016(b). CPLR 3016(b), the court emphasized, merely requires that defendant be "clearly inform[ed]" of the "incidents complained of." In view of cases like *Lanzi* and *D'Agostino*, some commentators have opined that, at a minimum, CPLR 3016(b) is "not popular with the courts,"[8] and perhaps has been outright "subordinated" to CPLR 3013.[9]

More Expansive Readings

A pleading standard for fraud claims that merely required the "incidents complained of" to be stated would be little different than CPLR 3013, which establishes the minimal threshold of "transactions and occurrences" as the general pleading standard. Either standard would seemingly permit plaintiffs to allege fraud in commercial transactions based on a mere suspicion that a counterparty misrepresented the value or utility of an item transferred, or misstated a material point in negotiations, without identifying any objective fact suggesting that defendant knowingly misled plaintiff. It would be sufficient to identify the parties and nature of the transaction, add a time frame, and then allege, upon information and belief, that defendant's communications were false and intended to, and did, induce plaintiff's reliance, to its detriment—a perfect palliative for a business struck with buyer's remorse.

But pronouncements since 2008 from the Court of Appeals may portend a tightening of the pleading standard for fraud and make clear—as is obvious from its text—that something more is required by CPLR 3016(b) than CPLR 3013. In *Pludeman v. Northern Leasing Systems*,[10] the Court of Appeals addressed the sufficiency under CPLR 3016(b) of plaintiffs' allegation that defendant Northern Leasing and its senior officers committed fraud by misleading lessees of small business equipment into ignoring the final three pages of a four-page lease form.

Plaintiffs asserted that, in a "nationwide scheme that took place over a number of years," sales representatives presented the form on a clipboard that made it appear as a single page document, although the final three pages were in fact part of the lease and contained the more onerous terms. But the complaint contained no allegations suggesting that the individual defendants had knowledge of the supposed scheme.

In state court practice, CPLR 3016(b), the counterpart to FRCP 9(b), has been applied inconsistently.

In finding the pleading sufficient against all defendants, the majority decision in *Pludeman* agreed with the dissent that CPLR 3016(b) "'must require more than 'notice pleading' applicable in other [non-fraud] cases.'"[11] But the majority held that the additional component "may be met when the facts are sufficient to permit a *reasonable inference* of the alleged conduct" said to constitute fraud.[12]

The dissent in *Pludeman,* by Judge Robert Smith, a commercial litigator for many years before joining the Court of Appeals, noted that CPLR 3016(b) "has received surprisingly little attention from our court." Smith mused that the "reasonable inference" standard adopted by the majority "does not differ greatly" from the U.S. Court of Appeals for the Second Circuit's test under FRCP 9(b) requiring "particularized facts" sufficient to support a "strong inference" of fraud.[13]

Examining the appellate record in *Northern Leasing*, Smith could find no allegations sufficient to support a reasonable inference that the individual defendants knew of the supposed fraud. He noted that the sales personnel were not employees of Northern Leasing, that the front of the lease legibly stated "Page 1 of 4," and that the lease was presented in a "booklet form." Smith found these facts incompatible with a reasonable inference that the individual defendants intended to mislead the plaintiffs, and suggested the case would be better analyzed under unconscionability standards.

A year later, the Court of Appeals provided further guidance on the "reasonable inference" standard enunciated in *Pludeman* as the key to application of CPLR 3016(b). In *Eurycleia Partners v. Seward & Kissel,*[14] a hedge fund had agreed to limit its holding of any individual security to no more than 10 percent of fund assets. In violation of that limitation, the principal of the fund invested 65 percent of its assets in a technology stock that later collapsed. The principal eventually pleaded guilty to securities fraud for falsifying reports to investors about the fund's holdings, and investors sued the fund's outside counsel on the ground that the law firm had participated in the fraud by facilitating the issuance of false reports.

The Court of Appeals affirmed a decision of the Appellate Division dismissing the fraud claim against outside counsel, and explained that

> [A]lthough we are mindful that a plaintiff need not produce absolute proof of fraud and there may be cases in which particular facts are within a defendant's possession, it is also true that the strength of the requisite inference of fraud will vary based on the facts and context of each case.[15]

The "context" in *Eurycleia* was that the defendant asserted, and plaintiffs did not dispute, that plaintiffs had "secured [the convicted principal's] assistance in drafting the amended complaint." In view of this access to information about

the fund's conduct, the failure to allege specific facts concerning outside counsel's knowledge of the false statements on investment diversification doomed the complaint under CPLR 3016(b).

Lower Court Cases

Lower courts applying CPLR 3016(b) following *Pludeman* and *Eurycleia* have emphasized the need to evaluate the "surrounding circumstances" in assessing whether a fraud claim is properly stated.[16] One surrounding circumstance that has weighed in favor of permitting a fraud claim is a defendant's knowledge of falsity or misconduct in a part of a scheme, even though there is no relationship to the alleged misrepresentation that supposedly triggered plaintiff's loss. For example, in *Oster v. Kirschner*, the defendant law firm that prepared a private placement memorandum moved for dismissal under CPLR 3016(b) on the ground that it was not alleged to have actual knowledge that the investment was a Ponzi scheme. 905 N.Y.S.2d at 56.

The First Department rejected this argument and reinstated a claim for aiding and abetting fraud because the firm was alleged to have known of, but failed to disclose, the criminal background of the issuer's principals. In other words, in view of defendants' alleged knowledge of background facts raising a red flag, it was reasonable to infer knowledge of the alleged false statements about the investment. Similarly, in *Lawati v. Montague Morgan State*,[17] the First Department found that an individual defendant's description of operations in a New York office with which he said he was communicating to resolve issues about the redemption of investments, when no such office existed, supported a reasonable inference that he knew statements about the redemption were false.

Other lower court decisions in the wake of *Pludeman* reflect an increased willingness by state judges to apply a level of scrutiny to fraud claims approaching that used by their colleagues on the federal bench. While acknowledging that the Pludeman standard "is a more lenient test than the Second Circuit's 'strong inference of fraud' test,"[18] Commercial Division justices have emphasized that "when a plaintiff seeks to extend an alleged fraud beyond the principal actors, the requirements of CPLR 3016(b) must be 'strictly adhered' to because 'the alleged aider and abetter, by hypothesis, has not made any fraudulent misrepresentation.'"[19] Indeed, Commercial Division justices have not hesitated to cite Rule 9(b) cases in deciding a motion under CPLR 3016(b).[20]

Recent pronouncements from the Court of Appeals may portend a tightening of the pleading standard for fraud and make clear—as is obvious from its text—that something more is required by CPLR 3016(b) than CPLR 3013.

Conclusion

CPLR 3016(b) has been interpreted and applied unevenly by New York courts, and is a less potent weapon in the hands of defense counsel facing fraud claims than FRCP 9(b). Nonetheless, it is now firmly established that claims for "misrepresentation, fraud, mistake, willful default, breach of trust or undue influence" require a pleading with details significantly exceeding the minimal notice standards of CPLR 3013 in order to avoid dismissal. *Pludeman's* embrace of a "reasonable inference" standard invites lower courts to evaluate the circumstances surrounding a defendant's relationship to an alleged fraud, and suggests that in doing so a judge is not strictly limited to the face of the complaint.

Rather, in reaching a judgment about whether a reasonable inference of fraud may be drawn against the defendant, the court is free to consider facts brought to its attention—perhaps by means of documentary evidence presented under CPLR 3211(a)(1)—about the access of both plaintiff and defendant to information regarding a supposed fraud, and defendant's relationship to it. Where some record of the surrounding circumstances already exists and would be available to a plaintiff exercising reasonable diligence, then the threshold for particular allegations linking a defendant to the alleged misconduct should rise.

Where a plaintiff can legitimately assert the inaccessibility of relevant facts and defendant is chargeable with knowledge of some aspect of an alleged scheme, then the threshold for satisfaction of CPLR 3016(b) need not be as demanding. But in all events the court should engage in a critical analysis—informed by its experience and judgment—to determine whether the pleaded facts support a "reasonable inference" of fraud as to each defendant.

1. Baicker-McKee, Federal Civil Rules Handbook, (19th ed. 2013); *ATSI Commc'ns v. Shaar Fund*, 493 F.3d 87, 101 (2d Cir. 2007).
2. *DiVittorio v. Equidyne Extractive Indus.*, 822 F.2d 1242, 1247 (2d Cir. 1987).
3. *Keystone Global v. Decor Essentials*, 12 Civ. 9077, 2014 WL 888336, at *1 (SDNY March 6, 2014) (citing *Exergen Corp. v. Wal-Mart*, 575 F.3d 1312, 1327 (Fed. Cir. 2009)).
4. 248 N.Y.S.2d 121, 126 (1st Dept. 1964).
5. Id. at 128.
6. *Jered Contracting Corp. v. N.Y.C Transit Auth.*, 292 N.Y.S.2d 98, 104 (1968).
7. 402 N.Y.S.2d 384 (1977).
8. Patrick Connors, Practice Commentaries (McKinney's Con. Laws of NY, Book 7B, C:3016:3).
9. Siegel, New York Practice §216 (3d ed. 1999) §216.
10. 860 N.Y.S.2d 422 (2008).
11. Id. at 425, n.3 (majority opinion quoting dissent).
12. Id. at 425 (emphasis added).
13. Id. at 427, quoting *Eternity Global Master Fund v. Morgan Guar. Trust*, 375 F.3d 168, 187 (2d Cir. 2004) and *Shields v. Citytrust Bancorp*, 25 F.3d 1124, 1129 (2d Cir. 1994).
14. 883 N.Y.S.2d 147 (2009).
15. Id. at 151.
16. E.g., *Oster v. Kirschner*, 905 N.Y.S.2d 69, 72 (1st Dept. 2010).
17. 961 N.Y.S.2d 5, 8 (1st Dept. 2013).
18. *HSH Nordbank AG v. Goldman Sachs Group, Inc.*, 992 N.Y.S.2d 158 at *6 (N.Y. Sup. Ct. N.Y. Co. 2013).
19. *Chambers v. Weinstein*, No. 157781/2013, 2014 WL 4276910, at *5 (N.Y. Sup. Ct. Aug. 22, 2014) (quoting the First Department decision in *National Westminister Bank v. Weksel*).
20. E.g., *Northern Valley Partners v. Jenkins*, 885 N.Y.S.2d 712, at *6 (N.Y. Sup. Ct. N.Y. Co. 2009), citing *Hughes v. BCI Int'l Holdings*, 452 F.Supp.2d 290, 312-33 (S.D.N.Y. 2006); *NRAM PLC v. Societe Generale Corporate & Inv. Banking*, No. 652033/2013, 2014 WL 3924619, at *9 (N.Y. Sup. Ct. N.Y. Co. Aug. 5, 2014); *Phoenix Light SF v. Ace Sec. Corp.*, (N.Y. Sup. Ct. N.Y. Co. 2013).