

## Second Circuit: When Plaintiffs Allege Securities Fraud Based on the Nondisclosure of Illegal Activity, Plaintiffs Must Plead the Alleged Illegal Acts With Particularity

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On December 10, 2019, the Second Circuit affirmed the dismissal with prejudice of a securities fraud action alleging that a poultry company failed to disclose an antitrust conspiracy to inflate chicken prices. *Gamm v. Sanderson Farms*, 944 F.3d 455 (2d Cir. 2019) (Winter, C.J.). The court held that “when a complaint claims that statements were rendered false or misleading through the nondisclosure of illegal activity, the facts of those underlying illegal acts must also be pleaded with particularity.”

The Second Circuit rejected plaintiffs’ contention that “there is no public policy reason supporting the use of a heightened pleading standard for allegations of anticompetitive conduct simply because they underpin a securities fraud class action.” The court explained that the Private Securities Litigation Reform Act (“PSLRA”) “requires that a securities fraud claim based on information and belief must ‘state with particularity *all facts* on which that belief is formed.’” *Id.* (quoting 15 U.S.C. § 78u-4(b)(1)). The court observed that “[i]n this case, appellants’ nondisclosure and material omission claims are entirely dependent upon the predicate allegation that [the company] participated in a collusive antitrust conspiracy.” The court found that “[i]n order to properly provide ‘all facts’ upon which their securities fraud claim is based, their allegations must also provide particularized facts about the underlying conspiracy.” The court reasoned that such particularized allegations are necessary to “explain[] what rendered the statements materially false or misleading.”

The Second Circuit explained that its decision “comports with the stated intent and public policy rationale of the PSLRA.” The court noted that “[a] stock-issuing company . . . cannot be required, whenever accused of illegal activity, to simultaneously defend itself in an accompanying securities fraud suit based on facts not alleged with the level of particularity required by the statute.” The court observed that “[s]uch a reality would harm the company’s stock and contravene the purpose of the securities laws—to protect shareholders’ interests.”

The Second Circuit noted that in order to plead an antitrust conspiracy, plaintiffs must allege “(1) a contract, combination, or conspiracy; (2) in restraint of trade; (3) affecting interstate commerce.” The court recognized that “an agreement may be alleged through conscious parallelism together with plus factors,” such as “a common motive to conspire, evidence that shows that the parallel acts were against the apparent individual economic self-interest of the alleged conspirators, and evidence of a high level of interfirm communications.” The court found that

plaintiffs “allege[d] mere parallel conduct, and lack[ed] indicia of mutuality or otherwise interdependent action.” The court noted that plaintiffs “could have alleged *when* [the company] decided on its course of supply reduction, *which* industry peers were a part of that decision, *how* specific supply reductions were performed by each of the different poultry producers, *what* information [the company] knew about its peers’ supply reductions, if any, and—perhaps most basic of all—whether [the company] *actually reduced* chicken supply, and if so, by what volume.” The court emphasized that plaintiffs “provided none of these facts.” The court concluded that plaintiffs “failed to plead the first element of antitrust conspiracy at even a basic level, much less with particularity.” The court also found the complaint “entirely silent” on whether the company’s actions “unreasonably restrained trade, and whether that restraint affected interstate commerce.” The court therefore concluded that plaintiffs’ complaint was “deficient.”

Authors and  
Contacts

Paul Gluckow  
Partner and General Counsel  
[pgluckow@stblaw.com](mailto:pgluckow@stblaw.com)  
[+1-212-455-2653](tel:+12124552653)

Linton Mann III  
Partner  
[lmann@stblaw.com](mailto:lmann@stblaw.com)  
[+1-212-455-2654](tel:+12124552654)

