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Erin Brady

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# Determining the Proper Pleading Standard Under the Private Securities Litigation Reform Act of 1995 After *In re Silicon Graphics*

## I. INTRODUCTION

Allegations of securities fraud tend to take a common form, and the allegations made by Deanna Brody in *In re Silicon Graphics*<sup>1</sup> are fairly typical of those made by similarly situated plaintiffs. Brody filed a securities fraud class action in the Northern District of California, alleging that six top officers of Silicon Graphics, Inc. ("SGI") made misleading statements about the success of the company while at the same time engaging in mass insider trading.<sup>2</sup> Subsequent to this trading, the stock price dropped significantly, and investors like Brody lost substantial amounts of money.<sup>3</sup> In support of her allegations, Brody offered internal reports of SGI showing that the officers of SGI had knowledge that the company was not going to reach its predicted revenue growth for Fiscal Year 1996, as well as evidence showing that six officers of SGI engaged in massive insider trading during that same time period.<sup>4</sup> Together, this evidence established a "reasonable inference of deliberate recklessness"; however, Brody's claim was dismissed by the district court.<sup>5</sup> The district court's decision was affirmed by the Court of Appeals for the Ninth Circuit.<sup>6</sup> The Ninth Circuit held that Brody failed to meet the new heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA") because she failed to state particular facts giving rise to a "strong inference of deliberate recklessness."<sup>7</sup>

One would think that if the substance of securities fraud allegations were common, the relief afforded to them under the laws would be common as well. However, this is not the case. The circuits have recently split in their interpretations of the substantive and procedural pleading requirements under the PSLRA.<sup>8</sup>

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1. *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970 (9th Cir. 1999).

2. *Id.* at 980.

3. *Id.* at 981.

4. *Id.* at 982, 984.

5. *Id.*

6. *Id.*

7. *Id.* (emphasis omitted).

8. *See id.* at 974; *see also In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 549 (6th Cir. 1999) (holding that plaintiffs may plead scienter "by alleging facts giving rise to a strong inference of recklessness"); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534-35 (3d Cir. 1999) (holding that under the PSLRA "plaintiffs [may] plead scienter by alleging facts 'establishing a motive and an opportunity to

Unfortunately, Brody had no way of knowing when she decided to file her suit against SGI in the Ninth Circuit that her ability to enter the courthouse gate and recover for losses could be limited by the court's interpretation of the pleading requirements under the PSLRA.<sup>9</sup>

To recover for losses resulting from securities fraud, plaintiffs may seek a private cause of action under Section 10(b)<sup>10</sup> and Rule 10b-5<sup>11</sup> of the Securities Exchange Act of 1934.<sup>12</sup> Historically, pleading securities fraud under this Act required a higher standard of pleading than that required for most other actions.<sup>13</sup> In order to state a claim upon which relief may be granted under Rule 10b-5 of the Securities Exchange Act of 1934, a plaintiff must allege "reliance on material misstatements or omissions which were made [by the defendants] with scienter in connection with the purchase or sale of a security."<sup>14</sup> The interpretation of this heightened pleading requirement can be separated into two basic questions: the substantive question, regarding what constitutes an actionable state of mind in securities fraud cases, and the procedural question, regarding the means plaintiffs

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commit fraud, or by setting forth facts that constitute circumstantial evidence and either reckless or conscious behavior"); *Press v. Chem. Inv. Serv. Corp.*, 166 F.3d 529, 537-38 (2d Cir. 1999) (holding that "a plaintiff is required to prove that the defendant . . . acted with scienter and the scienter, needed to prove securities fraud is intent to deceive, manipulate or defraud, or knowing misconduct"); *Bryant v. Avado Brands, Inc.* 187 F.3d 1271, 1283, 1285 (11th Cir. 1999) (holding that the PSLRA "does not prohibit the practice of alleging scienter by pleading facts that denote severe recklessness" but that "allegations of motive and opportunity to commit fraud, standing alone, are [not] sufficient to establish scienter").

9. *In re Silicon Graphics*, 183 F.3d at 979.

10. Section 10(b) of the Securities Exchange Act of 1934 prohibits the "use or employ[ment], 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 [Securities and Exchange] Commission may prescribe." 15 U.S.C. § 78j (1994). The elements a plaintiff must establish to make a Section 10(b) claim are: "(1) a false statement or an omission that rendered another statement misleading; (2) materiality; (3) scienter; (4) loss causation; and (5) damages." *Zeid v. Kimberly*, 973 F. Supp. 910, 913 (N.D. Cal. 1997).

11. Rule 10b-5 makes it illegal "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in light of the circumstances under which they were made, not misleading . . . in connection with the sale or purchase of a security." 17 C.F.R. § 240.10b-5 (2000).

12. See Laura R. Smith, Comment, *The Battle Between Plain Meaning and Legislative History: Which Will Decide The Standard For Pleading Scienter After The Private Securities Litigation Reform Act Of 1995?*, 39 SANTA CLARA L. REV. 577, 580 (1999); see also Ryan G. Miest, Note, *Would the Real Scienter Please Stand Up: The Effect of the Private Securities Litigation Reform Act of 1995 on Pleading Securities Fraud*, 82 MINN. L. REV. 1103, 1108 (1998); Richard W. Walker & J. Gordon Seymour, Symposium, *Recent Judicial and Legislative Developments Affecting the Private Securities Fraud Class Action*, 40 ARIZ. L. REV. 1003, 1003 (1998).

13. See FED. R. CIV. P. 9(b). Rule 9(b) of the Federal Rules of Civil Procedure requires that all averments of fraud or mistake, such as those brought under Rule 10b-5, must state "circumstances constituting fraud or mistake. . . . with particularity. Malice, intent, knowledge, and other conditions of mind of a person may be averred generally." *Id.*

14. Miest, *supra* note 12, at 1108; see also *Luce v. Edelstein*, 802 F.2d 49, 55 (2d Cir. 1986) (holding that "a claim under section 10(b) . . . must allege material misstatements or omissions indicating an intent to deceive or defraud in connection with the purchase or sale of a security").

may utilize in pleading this state of mind.<sup>15</sup>

Prior to the passage of the PSLRA, circuit courts had adopted different interpretations of the level of pleading required by Section 10(b) and Rule 10b-5 of the Securities Exchange Act.<sup>16</sup> While all circuits agreed that plaintiffs could establish the element of scienter by pleading either intent or recklessness,<sup>17</sup> due to the ambiguity of Rule 10b-5, the circuits split on the specificity of facts required to make an adequate showing of scienter.<sup>18</sup> In determining the procedural pleading requirement, both the Second and Ninth Circuits turned to Rule 9(b) of the Federal Rules of Civil Procedure.<sup>19</sup> In doing so, however, the two circuits reached drastically different conclusions.<sup>20</sup> The Ninth Circuit concluded that facts demonstrating scienter could be plead in either a general or conclusory manner.<sup>21</sup> The Second Circuit, on the other hand, found that while the rule allowed general pleading as to state of mind, it did not condone conclusory pleading.<sup>22</sup> Thus, the Second Circuit adopted a heightened pleading requirement in Rule 10b-5 securities fraud actions, thereby requiring plaintiffs to make a showing of motive and intent or circumstantial evidence of recklessness.<sup>23</sup> Acknowledging this split in the circuits, Congress sought to create a uniform pleading standard when it enacted the PSLRA.<sup>24</sup>

Unfortunately, the drafters of the PSLRA did not specifically state their intent

15. See Miest, *supra* note 12, at 1109; see also Richard L. Jacobson & Joshua R. Martin, *The Private Securities Litigation Reform Act of 1995: A Survey of the First Three Years*, SD79 ALI-ABA 861, 864 (1999).

16. See Smith, *supra* note 12, at 580-81.

17. See Miest, *supra* note 12, at 1109; see also *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569-70 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991) (accord); *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809, 814 (11th Cir. 1989) (accord); *In re Phillips Sec. Litig.*, 881 F.2d 1236, 1244 (3d Cir. 1989) (accord); *Hackbart v. Holmes*, 675 F.2d 1114, 1117-18 (10th Cir. 1982) (accord); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir. 1981) (en banc), *cert. denied*, 454 U.S. 965 (1981) (accord); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1023-24 (6th Cir. 1979) (accord); *Cook v. Avien, Inc.*, 573 F.2d 685, 692 (1st Cir. 1978) (holding that recklessness is an acceptable state of mind to impose liability in securities fraud actions); *Rolf v. Byth Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir. 1977), *cert. denied*, 424 U.S. 875 (1977) (accord). The Fourth Circuit is the only circuit that had not considered the adequacy of recklessness in establishing scienter in its appellate courts, however, district courts in the Fourth Circuit had uniformly held prior to the enactment of the PSLRA that allegations of recklessness were adequate to state a valid cause of action in securities fraud actions. Smith, *supra* note 12, at 585 n.76.

18. Miest, *supra* note 12, at 1110.

19. See FED. R. CIV. P. 9(b).

20. See *In re GlenFed Inc. Sec. Litig.*, 42 F.3d 1541, 1545 (9th Cir. 1994) (en banc); see also *In re Time Warner Inc. Sec. Litig.* 9 F.3d 259, 268-69 (2d Cir. 1993).

21. Smith, *supra* note 12, at 587; see also Miest, *supra* note 12, at 1111; *In re GlenFed Inc.*, 42 F.3d at 1545.

22. Smith, *supra* note 12, at 586; see also Miest, *supra* note 12, at 1111-12.

23. *In re Time Warner Inc.*, 9 F.3d at 268-69.

24. H.R. CONF. REP. NO. 104-360, at 36 (1995), reprinted in 1995 U.S.C.C.A.N. 679.

for pleading requirements when drafting the language of the PSLRA. As a result, the language of the statute is somewhat ambiguous in regard to what a plaintiff must show to make an adequate showing of scienter, and the circuit courts have again splintered in their interpretations of the pleading requirements for securities fraud.<sup>25</sup> Thus, depending on the circuit in which an action is filed, private plaintiffs' claims will be more or less likely to survive a motion to dismiss.<sup>26</sup>

This Comment argues that the interpretation given to the PSLRA's heightened pleading requirements by the Ninth Circuit in *In re Silicon Graphics* contradicts both the plain language and the legislative history of the PSLRA, and therefore congressional reform or Supreme Court interpretation of the Act is necessary to allow the Act to have its intended impact. Part II discusses the difference between the substantive and procedural pleading requirements under Rule 10b-5 of the Securities Exchange Act and the interpretation of these requirements by the federal circuit courts prior to the enactment of the PSLRA.<sup>27</sup> Part III discusses the legislative history of the PSLRA.<sup>28</sup> Part IV discusses the split between the federal circuits in their interpretations of the PSLRA.<sup>29</sup> Part V discusses the impact of the recent decisions interpreting the PSLRA, in particular the *In re Silicon Graphics* decision, on private plaintiffs, the capital markets, and the federal courts in general.<sup>30</sup> Finally, Part VI argues that a case similar to *In re Silicon Graphics* will be accepted by the Supreme Court for certiorari, and that upon review the Court will take a plain language approach to interpreting the PSLRA and hold that while recklessness survives as an adequate state of mind for the imposition of liability under the PSLRA, mere allegations of motive and opportunity will no longer suffice to meet the procedural requirements of Rule 10b-5 securities fraud actions.<sup>31</sup>

## II. SUBSTANTIVE AND PROCEDURAL PLEADING REQUIREMENTS FOR ALLEGATIONS OF SECURITIES FRAUD UNDER RULE 10B-5

### A. *Substantive Requirement of Scienter under Rule 10b-5*

Prior to the passage of the PSLRA, courts found themselves in the position of having to determine whether intent, recklessness, or negligence sufficed as an adequate showing of scienter, because Rule 10b-5 failed to explicitly specify the

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25. See *In re Silicon Graphics*, 183 F.3d 970 (9th Cir. 1999); see also *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542 (6th Cir. 1999); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525 (3d Cir. 1999); *Press v. Chem. Inv. Serv. Corp.*, 166 F.3d 529 (2d Cir. 1999); *Bryant v. Avado Brands, Inc.* 187 F.3d 1271 (11th Cir. 1999).

26. See *supra* note 25.

27. See *infra* notes 32-57 and accompanying text.

28. See *infra* notes 58-96 and accompanying text.

29. See *infra* notes 97-291 and accompanying text.

30. See *infra* notes 292-327 and accompanying text.

31. See *infra* notes 328-351 and accompanying text.

state of mind a defendant must have possessed to be found liable for fraudulent misrepresentation.<sup>32</sup> The Supreme Court weighed in on this issue in the seminal case of *Ernst & Ernst v. Hochfelder*.<sup>33</sup> In this case, the Court held that, while intent would always be sufficient to satisfy the scienter requirement of Rule 10b-5, a mere showing of negligence could never be sufficient to satisfy the scienter requirement.<sup>34</sup> However, while the Court gave guidance to the circuit courts as to the adequacy of intent and negligence in *Hochfelder*, it failed to make a specific holding as to the adequacy of recklessness.<sup>35</sup> Thus, circuit courts were left to determine the adequacy of pleading recklessness under Rule 10b-5.<sup>36</sup>

Subsequently, the circuit courts uniformly held that recklessness was sufficient to satisfy the scienter requirement of Rule 10b-5.<sup>37</sup> The most commonly adopted definition of recklessness was promulgated by the Seventh Circuit in *Sunstrand Corp. v. Sun Chemical Corp.*<sup>38</sup> The *Sunstrand* court defined recklessness as

a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.<sup>39</sup>

Under this definition, a defendant could be found reckless when the defendant knew that there was a "substantial possibility" that a statement made by the defendant was untrue, or that a statement made by the defendant was not made with a solid basis for determining its truthfulness.<sup>40</sup> Thus, recklessness, along with intent, was accepted as a sufficient basis for pleading scienter in securities fraud cases in all circuits prior to the enactment of the PSLRA.<sup>41</sup>

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32. Meist, *supra* note 12, at 1109.

33. *Id.*; see also *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 (1976).

34. *Hochfelder*, 425 U.S. at 193-94.

35. See *id.* at 193-94 n.12.

36. Meist, *supra* note 12, at 1109-10.

37. See *supra* note 17 (providing a sample of cases holding that recklessness is an adequate level of scienter for alleging securities fraud).

38. 553 F.2d 1033, 1044-45 (7th Cir. 1977).

39. *Id.* at 1045.

40. Meist, *supra* note 12, at 1109-10; see also William H. Kuehnle, *On Scienter, Knowledge, and Recklessness Under the Federal Securities Laws*, 34 Hous. L. Rev. 121, 169 (1997).

41. See *Bryant v. Avado Brands, Inc.* 187 F.3d 1271, 1284 (11th Cir. 1999); see also *supra* note 17.

## B. Procedural Pleading Requirement for Establishing Scienter under Rule 10b-5

Just as Rule 10b-5 failed to indicate the level of scienter needed to satisfy the substantive state of mind requirement, Rule 10b-5 also failed to indicate the specificity of facts needed to satisfy the procedural pleading requirement.<sup>42</sup> Prior to the enactment of the PSLRA, the circuit courts were split as to the specificity of facts required to satisfy the procedural pleading requirement.<sup>43</sup> In seeking to interpret the meaning of Rule 10b-5, the courts looked to Rule 9(b) of the Federal Rules of Civil Procedure, which states that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity[;] [m]alice, intent, knowledge, and other condition of mind of a person may be averred generally."<sup>44</sup> However, the Second and Ninth Circuits gave different interpretations of this rule, and as a result, a split occurred between the circuits as to the level of specificity needed to aver securities fraud.<sup>45</sup>

The Ninth Circuit interpreted Rule 9(b) as allowing for general and conclusory pleading as to the defendant's state of mind.<sup>46</sup> The Ninth Circuit considered the meaning of Rule 9(b) in *In re Glenfed* and determined that, under Rule 9(b), when an allegation of malice, intent, knowledge, or other condition of mind is material to a claim, it is sufficient "to allege the same as a fact without setting out the circumstances from which the same is to be inferred."<sup>47</sup> The court found that the rule promulgated by the Second Circuit, which required a pleading of facts showing motive and opportunity to commit fraud or a strong inference of circumstantial evidence of recklessness, conflicted with both the plain meaning of Rule 9(b) and with Ninth Circuit authority.<sup>48</sup> The court further reasoned that however beneficial it may be to adopt a higher standard of pleading, courts "are not permitted to add new requirements to Rule 9(b) simply because [the courts] like the effects of doing so."<sup>49</sup> The court recognized that amending or otherwise altering the interpretation of a rule is not a task for the courts, but is rather a task for the appropriate rule-making body.<sup>50</sup> Thus, prior to the enactment of the PSLRA, it was sufficient to make general and conclusory statements when averring scienter in securities fraud cases in the Ninth Circuit.<sup>51</sup>

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42. See Miest, *supra* note 12, at 1110.

43. *Id.*; see also Bryant, 187 F.3d at 1282.

44. FED. R. CIV. P. 9(b); see also Miest, *supra* note 12, at 1110; Smith, *supra* note 12, at 580-81.

45. Smith, *supra* note 12, at 581; see also Miest, *supra* note 12, at 1110.

46. Smith, *supra* note 12, at 587-88; see also Miest, *supra* note 12, at 1111.

47. *In re Glenfed*, Inc. Sec. Litig., 42 F.3d 1541, 1545 (9th Cir. 1994) (en banc).

48. *Id.* at 1545-46.

49. *Id.* at 1546.

50. *Id.*

51. See *id.* at 1546-47; see also Wool v. Tandem Computers, Inc., 818 F.2d 1433, 1440 (9th Cir. 1987) (holding that a complaint is sufficient to survive a motion to dismiss when the complaint specified "the manner in which representations [at issue] were false and misleading").

The Second Circuit, however, adopted a much higher pleading standard than that adopted by the Ninth Circuit.<sup>52</sup> The Second Circuit, concluding that general, *but not conclusory*, pleading was sufficient under Rule 9(b), created a two prong test, which it outlined in *In re Time Warner*.<sup>53</sup> The court explained that it had recognized two distinct ways by which a plaintiff could adequately plead specific facts giving rise to a "'strong inference' of fraudulent intent," or scienter.<sup>54</sup> The first means of pleading scienter was by showing both motive and opportunity for the defendant to commit fraud.<sup>55</sup> The alternative means of pleading scienter was to "allege facts constituting circumstantial evidence of either recklessness or conscious behavior" on the part of the defendant.<sup>56</sup> Prior to the enactment of the PSLRA, the Second Circuit pleading standard was the most rigorous of all the circuit courts'.<sup>57</sup>

### III. ENACTMENT OF THE PSLRA

As a result of the ongoing concern of the business community, the legal community, and the public in general, Congress enacted the PSLRA to "protect investors, issuers, and all who are associated with [the] capital markets from abusive securities litigation."<sup>58</sup> One means Congress attempted to utilize to protect those involved in the capital markets from this abusive litigation was the adoption of heightened pleading requirements for private securities fraud cases.<sup>59</sup> In creating a heightened pleading requirement, Congress sought to resolve the split between the Second and Ninth Circuits regarding the specificity of facts required to adequately allege "state of mind," or scienter.<sup>60</sup> The most controversial issue that Congress faced when drafting the PSLRA was the level of specificity with which it would require plaintiffs to plead in order to survive a motion to dismiss.<sup>61</sup> An examination of the legislative history of the PSLRA gives useful insight into the intent of Congress in the legislation of this controver-

52. Smith, *supra* note 12, at 586-87; *see also* Miest, *supra* note 12, at 1111-12.

53. *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268-69 (2d Cir. 1993).

54. *Id.* at 268.

55. *Id.* at 269.

56. *Id.*

57. *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534 (3d Cir. 1999) (noting that the Second Circuit standard was the most stringent pleading standard prior to the enactment of the PSLRA); *see also* Smith, *supra* note 12, at 586.

58. H.R. CONF. REP. NO. 104-369, at 32 (1995), *reprinted in* U.S.C.C.A.N. 679, 731.

59. *Id.*; *see also* William S. Lerach & Eric Alan Isaacson, *Pleading Scienter Under Section 21D(B)(2) of the Securities Exchange Act of 1934: Motive, Opportunity, Recklessness, and the Private Securities Litigation Reform Act of 1995*, 33 SAN DIEGO L. REV. 893, 931 (explaining the state of mind pleading standard under proposed section 10A(a)); Miest, *supra* note 12, at 1114-15.

60. *See* Miest, *supra* note 12, at 1112.

61. *See id.*



sial measure.

### A. House Deliberations

Interestingly, the most controversial issue faced in the initial House deliberations concerned not the procedural question of the proper standard of pleading for securities fraud actions, but rather the substantive question of the level of scienter required to impose liability on a defendant for securities fraud.<sup>62</sup> In fact, the original House bill, H.R. 10, required plaintiffs to plead direct evidence of scienter and eliminated liability for recklessness.<sup>63</sup> However, after considerable lobbying by the Securities Exchange Commission ("SEC"),<sup>64</sup> the

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62. See *id.* at 1113; see also Lerach & Isaacson, *supra* note 59, at 930-37 (explaining proposals for eliminating reckless misconduct liability).

63. See H.R. 10, 104th Cong., (1st Sess. 1995). This proposed bill would have added a new section 10A which would have read:

SEC. 10A. REQUIREMENTS FOR SECURITIES FRAUD ACTIONS.

1. SCIENTER.—In any action under section 10(b), a defendant may be held liable for money damages only on proof—

a. that the defendant made an untrue statement of a material fact, or omitted to state a material fact necessary in order to make the statements, made, in light of the circumstances in which they were made, not misleading; and

b. that the defendant knew the statement was misleading at the time it was made, or intentionally omitted to state a fact knowing that such omission would render misleading the statements made at the time they were made.

2. REQUIREMENT FOR EXPLICIT PLEADING AND PROOF OF SCIENTER.—In any action under section 10(b) in which it is alleged that the defendant—

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 allege specific facts demonstrating the state of mind of each defendant at the time the alleged violation occurred. The complaint shall also specify each statement or omission alleged to have been misleading and the reasons the statement or omission is misleading. If an allegation regarding the statement or omission is made on information and belief, the complaint shall set forth with specificity all information on which that belief is formed. Failure to comply fully with this requirement shall result in dismissal of the complaint for failure to state a cause of action.

*Id.*

64. SEC Chairman Arthur Levitt expressed his disapproval of H.R. 10 when testifying before the Subcommittee on Telecommunications and Finance of the House Committee on Commerce. See Hearings Before the Subcomm. on Telecomm. and Finance of the House Comm. On Commerce, 104th Cong., 1st Sess. 191-221 (1995). In this statement, Chairman Levitt expressed the SEC's fears that the elimination liability for reckless misconduct was a threat to the integrity of private investors. *Id.* Chairman Levitt explained:

[W]e really want corporations—we want executives of corporations—to worry about the accuracy of their disclosures. It is the best way I know to assure the markets of a continuous stream of reliable, accurate information. Any higher scienter standard threatens the process that has made our markets what they are. Indeed, an actual knowledge standard could create a legal incentive to ignore indications of fraud.

*Id.* at 194-95. Chairman Levitt went on to urge:

[T]he Commission has consistently supported a recklessness standard because such a standard is needed to protect the integrity of the disclosure process. The law should sanction corporations and individuals who act recklessly when making disclosures, because that is the only way to assure the markets of a continuous stream of accurate information. Any higher scienter standard would lessen the incentives for corporations and other issuers to conduct a full inquiry into areas

House committee passed a final version of the bill that had reinstated liability for recklessness.<sup>65</sup> This proposed House version of the bill was ultimately rejected by the Conference Committee in favor of the Senate version of the bill.<sup>66</sup>

### B. Senate Deliberations

During the Senate deliberations, the procedural question regarding the specificity of facts necessary to plead allegations of scienter in securities fraud actions fully emerged.<sup>67</sup> Both the White House and the SEC lobbied the Senate Banking Committee to formulate a bill adopting the Second Circuit pleading standard.<sup>68</sup> The bill developed by the Senate Banking Committee, S. 240,<sup>69</sup> contained language adopting the "strong inference" language of the Second Circuit, but failed to explicitly adopt the Second Circuit's interpretation of this

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of potential exposure, and thus threaten the process that has made our markets a model for nations around the world.

*Id.* at 202.

65. See 141 CONG. REC. H2862-64 (daily ed. Mar. 8, 1995). The bill passed by a vote of 325 to 99. See *id.* The final version of the bill adopted the *Sundstrand* standard of recklessness, showing the clear intent of the House of Representatives to retain recklessness as adequate for proof of scienter. Lerach & Isaacson, *supra* note 59, at 938-39.

66. Miest, *supra* note 12, at 1113.

67. Lerach & Isaacson, *supra* note 59, at 940-42. The procedural pleading issue was addressed by the House as well. However there was far less controversy on the House floor regarding the pleading requirement than there was on the Senate floor. *Id.* The SEC, however, did object to the House version of the pleading requirement as well, noting that it felt that it would be "beneficial" to resolve the split between the circuits regarding the pleading requirement by enacting a pleading requirement no more stringent than that of the Second Circuit. *Id.* at 938.

68. Lerach & Isaacson, *supra* note 59, at 944.

69. See S. 240, 104th Cong. (1995). The text of the bill that came out of the Senate Banking Committee was as follows:

**SEC. 36. REQUIREMENTS FOR SECURITIES FRAUD ACTIONS**

a. MISLEADING STATEMENTS AND OMISSIONS. In any private action arising under this title in which the plaintiff alleges that the defendant:

1. made an untrue statement of a material fact; or

2. 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 plaintiff shall set forth all information on which that belief is formed.

b. REQUIRED STATE OF MIND.—In any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the plaintiff's complaint shall, with respect to each act or omission alleged to violate this title, specifically allege facts giving rise to a strong inference that the defendant acted with the required state of mind.

*Id.*

strong inference standard.<sup>70</sup> However, because the report accompanying the Senate Banking Committee's version of the bill demonstrated that the "strong inference of scienter" language was indeed modeled after the Second Circuit standard,<sup>71</sup> both the White House<sup>72</sup> and the SEC<sup>73</sup> voiced approval for the Senate Banking Committee's version of the bill.<sup>74</sup>

The Senate sought to make its adoption of the Second Circuit Standard more explicit by its adoption of the Specter Amendment.<sup>75</sup> During the Senate debate on S. 240, Senator Arlen Specter introduced an amendment proposing to fully adopt the Second Circuit test and case law into the proposed bill.<sup>76</sup> The amendment was passed by the full Senate by a vote of 57 to 42,<sup>77</sup> and it seemed that the Senate felt it had resolved the question of the level of specificity needed to allege scienter once and for all in its final version of the bill.<sup>78</sup>

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70. See S. REP. NO. 104-98, at 15, *reprinted in* 1995 U.S.C.C.A.N. 679, 694. The Senate Banking Committee stated:

[T]he Committee does not adopt a new and untested pleading standard that would generate additional litigation. Instead, the Committee chose a uniform standard modeled upon the pleading standard of the Second Circuit. Regarded as the most stringent pleading standard, the Second Circuit requires that the plaintiff plead facts that give rise to a "strong inference" of defendant's fraudulent intent. The Committee does not intend to codify the Second Circuit's case law interpreting this pleading standard, although courts may find this body of law instructive.

*Id.*

71. *Id.*; see also Lerach & Isaacson, *supra* note 59, at 944.

72. See Executive Office of the President, Office of Management and Budget, Statement of Administration Policy on S. 240—Private Securities Litigation Reform Act of 1995 (June 23, 1995). The White House announced that "S. 240 is now a substantial improvement on H.R. 1058, which the Administration could not support. . . . [S. 240] adopts several sensible provisions, including a workable pleading standard taken from the Second Circuit." *Id.*

73. The SEC statement indicated that "[t]he Commission supports, or does not oppose, the measures set forth in Section 104, 'Requirements for Securities Fraud Actions.'" Lerach & Isaacson, *supra* note 59, at 944 n.283, quoted in SEC Response to OMB Request for Views of the Securities And Exchange Commission Regarding S. 240, "Private Securities Litigation Reform Act of 1995" 1 (June 21, 1995).

74. See *id.* at 944.

75. Miest, *supra* note 12, at 1114.

76. 141 CONG. REC. S9170 (daily ed. June 27, 1995). The proposed text read as follows:

[A] strong inference that the defendant acted with the required state of mind may be established either—

A. by alleging facts to show that the defendant had both motive and opportunity to commit fraud; or

B. by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness by the defendant.

*Id.* The text of this proposed amendment was based on the language of the Second Circuit case *Beck v. Mfrs. Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987). See Miest, *supra* note 12, at 1114.

77. See 141 CONG. REC. S9201 (daily ed. June 28, 1995).

78. The Senate had adopted an established standard of pleading scienter, as the level adopted in the Specter amendment codified the pleading requirement already in place in the Second Circuit; thus there can be little doubt that the Senate believed that this pleading requirement would not require additional interpretation. See Miest, *supra* note 12, at 1114; see also *Beck v. Mfrs. Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987).

### C. Conference Committee

However, the resolution of the issue was short-lived. Although the general language of the Senate version of the bill was adopted by the Conference Committee, the Conference Committee replaced language of the Specter amendment with the less clear "strong inference" language contained in the Senate Banking Committee's version of the bill.<sup>79</sup> However, the Conference Committee arguably gave the courts some guidance as to its intent in enacting the "strong inference" standard in its Statement of Managers.<sup>80</sup> In this Statement, the Committee explained that "[b]ecause 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."<sup>81</sup> The Committee also stated, in reference to Senator Specter's proposed amendment codifying the Second Circuit test, that the Committee "chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness."<sup>82</sup> However, because no explanation was given as to either the stringency of the pleading requirements that Congress intended to impose or the reasons for omitting language concerning motive, opportunity, and recklessness, courts have been left to wonder about the intent of the Committee in removing the Specter Amendment.<sup>83</sup>

### D. Presidential Veto and Subsequent Override

A statement made by President Clinton in vetoing the bill and Congress' subsequent override of the President's veto added further confusion to the interpretation of this PSLRA section.<sup>84</sup> The President noted an objection to the language of the Statement of Managers when citing his reasons for vetoing the bill.<sup>85</sup> The President indicated both that deletion of the Specter Amendment, resulting in the omission of the Second Circuit standard from the language of the PSLRA, and the language in the Statement of Managers, indicating that the

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79. See H.R. REP. NO. 104-369, at 41 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 740.

80. See *id.*

81. *Id.* (emphasis added).

82. *Id.* at 41 n.23.

83. Miest, *supra* note 12, at 1115. The omission of the Specter amendment has subsequently been interpreted as both a complete rejection of the legal doctrines encompassed in the Second Circuit standard and as a mere unwillingness to codify the language and case law as interpreted and applied by the Second Circuit. *Id.* at 1115-20.

84. See President's Message to the House of Representatives Returning Without Approval the Private Securities Litigation Reform Act of 1995, 31 WEEKLY COMP. PRES. DOC. 2210 (Dec. 19, 1995).

85. *Id.*

Committee wished to "strengthen" the existing pleading requirement, led the President to believe that the intent of Congress in passing the bill was to create a higher pleading standard than that already in existence in the Second Circuit.<sup>86</sup> Subsequent to President Clinton's statement regarding the interpretation of Congress' intent in omitting the Specter Amendment, Congress debated the bill once more<sup>87</sup> and voted to override the President's veto.<sup>88</sup> The bill, as revised by the Conference Committee without the Specter Amendment, became law on December 22, 1995.<sup>89</sup>

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86. *Id.* at 2211. Further, in his message to the House, President Clinton stated: "I will support a bill that submits all plaintiffs to the tough pleading standards of the Second Circuit, but I am not prepared to go beyond that." *Id.*

87. Although the President interpreted the omission of the Specter Amendment as an intent to raise the pleading requirement to one more stringent than that of the Second Circuit, the debate in Congress prior to the override vote indicated that Congress did not intend to raise the pleading requirements above those in the Second Circuit in its enactment of the PSLRA. *See Lerach & Isaacson, supra* note 59, at 957. Senator Domenici entered into the Congressional Record his interpretation of the pleading standard adopted in the PSLRA:

Second [C]ircuit pleading standard becomes the uniform rule.—Same as Senate-passed bill; Senator Specter's amendment deleted from conference report.

The objective: . . . To codify the requirements in the [Second] Circuit. A complaint should outline the facts supporting the lawsuit . . . . Under the Conference Agreement, the complaint must set forth the facts supporting each of the alleged misstatements or omissions and must include facts that give rise to a "strong inference" of scienter or intent. . . . This is a codification of the [Second] Circuit rule.

141 CONG. REC. S19151 (daily ed. Dec. 22, 1995); *see also generally* 141 CONG. REC. H15218 (daily ed. Dec. 20, 1995) (noting various groups that agreed with the President); 141 CONG. REC. S19050 (daily ed. Dec. 21, 1995) (noting the difference between the Senate Banking Committee standard and the administration endorsed standard).

88. The House vote was 319 to 100; the Senate vote was 68-30. John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Reform Act of 1995*, 51 BUS. LAW. 335, 353 (1996); *see also* Miest, *supra* note 12, at 1115.

89. Avery, *supra* note 88, at 353; *see also* Miest, *supra* note 12, at 1115. The final version of the PSLRA reads as follows:

(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:

(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 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. 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.

15 U.S.C. § 78u-4 (a)(9)(b).

### E. Legislative History of the Uniform Standards Act of 1998

Adding even more confusion to the array of legislative history surrounding the enactment of the PSLRA, the legislative history of the Uniform Standards Act of 1998 (*hereinafter* "Uniform Standards Act") again made reference to Congress' intent in enacting the PSLRA.<sup>90</sup> After several courts found that the PSLRA eliminated recklessness as an adequate level of scienter to impose liability on a defendant, the SEC began substantial lobbying to "clarify" Congress' intent in enacting the PSLRA.<sup>91</sup> In a compromise between the SEC and Congress, the SEC agreed to support the Uniform Standards Act of the 105th Congress if that Congress would include language in its legislative history of the Uniform Standards Act indicating that the 104th Congress did not intend to abolish recklessness as an adequate level of scienter for imposing liability on civil defendants when drafting and enacting the PSLRA.<sup>92</sup> However, even the adoption

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90. See Smith, *supra* note 12, at 582-83.

91. See Jacobson & Martin, *supra* note 15, at 875.

92. See *id.* The Uniform Standards Act designates federal courts as the sole venue for securities fraud class actions so as to deter litigants from filing their cases in state courts to avoid the demands of the PSLRA. *Id.* at 890; see also Jeffrey A. Parness, Amy M. Leonetti, and Austin W. Bartlett, *The Substantive Elements In The New Special Pleading Laws*, 78 NEB. L. REV. 412, 412-415 (1999). The pertinent language of the legislative history seeking to clarify Congress' intent in drafting and enacting the PSLRA reads:

[I]t is the clear understanding of the managers that Congress did not, in adopting the [PSLRA], intend to alter the standards of liability under the Exchange Act.

The managers understand, however, that certain federal district courts have interpreted the [PSLRA] as having altered the scienter requirement. In that regard, the managers again emphasize that the clear intent in 1995 and our continuing intent in this legislation is that neither the Reform Act nor [the Uniform Standards Act] in any way alters the scienter standard in federal securities fraud suits.

Additionally, it was the intent of Congress, as was expressly stated during the legislative debate on the Reform Act, and particularly during the debate on overriding the President's veto, that the Reform Act establish a heightened uniform federal standard on pleading requirements based upon the pleading standard applied by the Second Circuit Court of Appeals. Indeed, the express language of the Reform Act itself carefully provides that plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." The managers emphasize that neither the Reform Act nor [the Uniform Standards Act] makes any attempt to define that state of mind.

The managers note that in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Supreme Court left open the question of whether conduct that was not intentional was sufficient for liability under the federal securities laws. The Supreme Court has never answered that question. The Court expressly reserved the question of whether reckless behavior is sufficient for civil liability under Section 10(b) and Rule 10b-5 in a subsequent case, *Herman & Maclean v. Huddleston*, 459 U.S. 375 (1983), where it stated, "We have explicitly left open the question of whether recklessness satisfies the scienter requirement."

H.R. Conf. Rep. No. 105-803, Joint Explanatory Statement, at 15 (Oct. 9, 1998).

of this language did not fully clarify intent of Congress in enacting the PSLRA.<sup>93</sup> First, members of 105th Congress were far from unanimous in their interpretations of the PSLRA; there was debate on both the House and Senate floor concerning whether or not the PSLRA actually codified the Second Circuit standard.<sup>94</sup> Additionally, because the Supreme Court has held that “the interpretation given by one . . . Congress to an earlier statute is of little assistance in discerning the meaning of that statute,” courts must only use this legislative history as persuasive evidence of Congress’ intent rather than actual evidence of that intent.<sup>95</sup> Therefore, rather than clarifying Congress’ intent in enacting the PSLRA, the legislative history accompanying the Uniform Standards Act did no more than give the courts another piece of history to interpret and, inevitably, upon which to disagree.<sup>96</sup>

#### IV. FEDERAL COURT INTERPRETATIONS OF THE PSLRA

As a result of the ambiguous language and legislative history of the PSLRA, federal courts have applied varying interpretations of the PSLRA.<sup>97</sup> The courts have basically formulated three different interpretations of the pleading requirement promulgated by the PSLRA:<sup>98</sup> that the PSLRA is a de facto codification of Second Circuit case law;<sup>99</sup> that the PSLRA did not raise the standard of scienter above that of recklessness but did raise the level of specificity needed to plead scienter beyond that developed in Second Circuit case law;<sup>100</sup> and that the PSLRA raised both the standard of scienter and the standard of pleading scienter beyond those promulgated by Second Circuit case law.<sup>101</sup> A discussion of the three interpretations and the rationale behind them is essential to a full understanding of the impact of the PSLRA.<sup>102</sup>

##### A. *De Facto Codification of Second Circuit Case Law*

###### 1. Substantive Requirement of Scienter

Many of the district courts’ initial interpretations of the PSLRA found that the Act merely codified the test already in place in the Second Circuit prior to the

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93. Jacobson & Martin, *supra* note 15, at 878; *see also* Smith, *supra* note 12, at 606-07.

94. 1844 Fed. Sec. L. Rep. (CCH) 2 (Nov. 11, 1998).

95. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 185 (1993).

96. *See* 1844 Federal Sec. L. Rep. (CCH) 2 (Nov. 11, 1998); *see also* Smith, *supra* note 12, at 606; *In re Advanta*, 180 F.3d 525, 533 (3d Cir. 1999).

97. *See* Miest, *supra* note 12, at 1116.

98. Smith, *supra* note 12, at 578-79; *see also* Miest, *supra* note 12, at 1116.

99. *See infra* notes 103-136 and accompanying text.

100. *See infra* notes 137-184 and accompanying text.

101. *See infra* notes 185-252 and accompanying text.

102. *See* Smith, *supra* note 12, at 579.

enactment of the PSLRA.<sup>103</sup> Thus, these courts held that recklessness remained an adequate level of scienter for pleading securities fraud under the PSLRA.<sup>104</sup> District courts advancing this argument did so on four major grounds.<sup>105</sup>

The first ground advanced by courts for the determination that recklessness remained sufficient for pleading scienter was that, because recklessness was so widely accepted as an adequate level of scienter in the circuit courts prior to the enactment of the PSLRA, absent a direct legislative decree, the standard should remain unchanged subsequent to the enactment of the PSLRA.<sup>106</sup>

Another ground advanced by such courts was that Congress' stated intention to raise the procedural pleading requirements for scienter did not automatically translate into an implicit intention to raise the substantive requirement of scienter needed to impose liability upon a defendant for securities fraud.<sup>107</sup>

A third ground commonly advanced by district courts was that, while in some sections of the PSLRA Congress explicitly raised the scienter requirement to one of "actual knowledge," Congress failed to do so in Section 10(b) of the PSLRA.<sup>108</sup> Thus, these courts found that Congress' failure to explicitly raise the scienter requirement exhibited a lack of intent by Congress to do so.<sup>109</sup>

A final argument advanced by these courts for their determination that recklessness remained sufficient to plead scienter under the PSLRA was that, despite the fact that the plain language and the legislative history of the PSLRA are somewhat ambiguous, legislative silence "does not give the Court grounds to conclude that recklessness is no longer an adequate basis to establish scienter."<sup>110</sup>

103. *Id.* at 588; *see also* Miest, *supra* note 12, at 1117-19; *see also generally* Rehm v. Eagle Fin. Corp., 954 F. Supp. 1246 (N.D. Ill. 1997); Fugman v. Arogenex, Inc., 961 F. Supp. 1190 (N.D. Ill. 1997); Zeid v. Kimberly, 973 F. Supp. 910 (N.D. Cal. 1997), *vacated*, 201 F.3d 446 (9th Cir. 1999); Marksman Partners L.P. v. Chantal Pharm. Corp., 927 F. Supp. 1297 (C.D. Cal. 1996); *In re* Health Mgmt. Inc. Sec. Litig., 970 F. Supp. 192 (E.D.N.Y. 1997).

104. *Marksman*, 927 F. Supp. at 1309 (quoting *In re* Software Toolworks, Inc., 50 F.3d 615, 626 (9th Cir. 1994) (holding that recklessness can constitute scienter under Rule 10b-5 if the recklessness "involves not merely simple or inexcusable negligence, but an 'extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it'")); *see also* Health Mgmt., Inc. Sec. Litig., 970 F. Supp. at 201 (holding that "reckless is sufficient to plead a strong inference of fraudulent intent under the PSLRA"); *Fugman*, 691 F. Supp. at 1195 (holding that a plaintiff's complaint must provide sufficient facts to create a "strong inference" of knowledge or recklessness regarding a statement's falsity); Rehm, 954 F. Supp. at 1252 (holding that the PSLRA adopted the Second Circuit pleading standard, thereby making a showing of recklessness adequate in establishing scienter, but did not adopt the Second Circuit case law interpreting this standard).

105. Smith, *supra* note 12, at 589; *see also* *Marksman*, 927 F. Supp. at 1309.

106. Smith, *supra* note 12, at 589.

107. *Id.*; *see also* *Marksman*, 927 F. Supp. at 1309.

108. *Id.*

109. *See id.*

110. *Id.*



Thus, this first group of district courts concluded that the PSLRA did not eliminate recklessness as a means of establishing scienter in securities fraud actions.<sup>111</sup>

## 2. Procedural Requirement of Establishing Scienter

In addition to finding that recklessness survives as an adequate level of scienter for securities fraud actions, the district courts that first held that the PSLRA was a de facto codification of the Second Circuit standard found that plaintiffs could make an adequate showing of scienter to survive a motion to dismiss by alleging facts demonstrating either (1) motive and opportunity to commit fraud,<sup>112</sup> or (2) circumstantial evidence showing recklessness in making questionable statements.<sup>113</sup> The district courts making the determination that the PSLRA codified the Second Circuit standard reasoned that the plain language of the PSLRA alone must be used to determine the intent of Congress in drafting and enacting the statute.<sup>114</sup> The District Court for the Central District of California, in *Marksman Partners L.P. v. Chantal Pharmaceutical Corp.* was one such district court.<sup>115</sup> The *Marksman* court held that the motive and opportunity test survived the passage and enactment of the PSLRA.<sup>116</sup> The court reasoned that the motive and opportunity test did not conflict in any way with Congress' stated intention to strengthen the pleading requirements because, prior to the passage of the PSLRA, the motive and opportunity test was part of the most stringent pleading requirement among those used throughout the federal circuits.<sup>117</sup> Further, the court reasoned that the motive and opportunity test was consistent with Congress' intent to require plaintiffs to show a "strong inference" of fraud, because application of the motive and opportunity test prior to the enactment of the PSLRA required that "plaintiff's [sic] allegations . . . yield a 'strong' inference of fraudulent intent . . . ."<sup>118</sup> The court also noted that it was highly suggestive of Congress' intent to adopt the Second Circuit's test when Congress used the

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111. See *id.*; see also Smith, *supra* note 12, at 588-90.

112. The motive and opportunity test requires a showing that the defendants had a motive and the opportunity to commit fraud. *Marksman*, 927 F. Supp. at 1310. The Second Circuit defines motive as "concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged," and opportunity as "the means and likely prospect of achieving concrete benefits by the means alleged." *Shields v. Citytrust Bancorp., Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994).

113. See *e.g.*, *Marksman*, 927 F. Supp. 1297 (C.D. Cal. 1996).

114. Smith, *supra* note 12, at 589.

115. *Marksman*, 927 F. Supp. 1297 (C.D. Cal. 1996).

116. *Id.* at 1311-12. Although the court in *Marksman* failed to make an explicit finding as to whether the "circumstantial evidence of recklessness" prong of the Second Circuit test survived the enactment of the PSLRA, subsequent courts explaining the *Marksman* holding have found that the holding did conclude that the "circumstantial evidence of recklessness" prong survived the enactment of the PSLRA. Zeid, 973 F. Supp. at 917, *vacated* 201 F.3d 446 (9th Cir. 1999) (explaining that the *Marksman* court "applied the Second Circuit's two-prong inquiry allowing allegations of either 'motive and an opportunity' or 'conscious behavior or recklessness' in its analysis of the case").

117. *Marksman*, 927 F. Supp. at 1310.

118. *Id.* at 1311.

language "strong inference," language already used by the Second Circuit in the application of its test, to describe the heightened scienter pleading standard.<sup>119</sup> Finally, the court noted that Congress did not expressly reject the motive and opportunity test anywhere in the language of the PSLRA or in the legislative history of the statute, and the court recognized that absent an express abrogation of the prior test, courts should not assume an implicit intent on the part of Congress to abrogate it.<sup>120</sup> Thus, the court in *Marksman* found that the PSLRA was a de facto codification of the Second Circuit pleading standard.<sup>121</sup>

### 3. The Court of Appeals for the Second, Third, and Fifth Circuits Respond to the Second Circuit Standard

Recently, the Second, Third, and Fifth Circuits adopted the view of many district courts when they held that the PSLRA was a de facto codification of the Second Circuit pleading standard.<sup>122</sup> The Second and Fifth Circuits both concluded that the PSLRA was a codification of the Second Circuit standard without analysis.<sup>123</sup> However, the Third Circuit, in *In re Advanta Corp. Securities Litigation*, presented an extensive argument for its adoption of the Second Circuit pleading standard.<sup>124</sup>

After dismissing the complicated and conflicting legislative history of the PSLRA,<sup>125</sup> the *Advanta* court turned to the plain language of the statute.<sup>126</sup> Noting that the language used in the PSLRA mirrors the language used by the Second Circuit in employing its pleading standard,<sup>127</sup> the *Advanta* court concluded that the PSLRA established a pleading standard with a pleading requirement similar to that of the Second Circuit standard.<sup>128</sup> The court also recognized that Congress' adoption of the Second Circuit pleading standard was consistent with Congress'

119. *Id.* at 1310.

120. *Id.* at 1311-12.

121. *Id.* at 1312.

122. Walker & Seymour, *supra* note 12, at 1024 n.124.

123. See *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d at 537-38 (interpreting the PSLRA standard is the same as the Second Circuit standard and applying this standard in a non-demanding manner); see also *Williams v. WMX Techs., Inc.*, 112 F.3d at 177-78.

124. See *Advanta*, 180 F.3d 525, 530-35 (3d Cir. 1999).

125. *Id.* at 533. The *Advanta* court maintained that "there [was] little to gain in attempting to reconcile the conflicting expressions of legislative intent," and therefore the court "direct[ed] [its] attention to the Reform Act's plain language, . . . the customary starting point in statutory interpretation." *Id.*; see also *supra* notes 58-96 and accompanying text.

126. *Advanta*, 180 F.3d at 533.

127. See *id.* at 534. The court noted that both the plain language of the PSLRA and the Second Circuit test require that plaintiffs allege facts supporting a "strong inference of scienter." *Id.*

128. *Id.*

intent to create heightened pleading requirements for securities actions.<sup>129</sup> The court reasoned that, because the Second Circuit standard was historically the most stringent standard prior to the enactment of the PSLRA, the adoption of the Second Circuit standard would effectively heighten the pleading requirements in many jurisdictions.<sup>130</sup> The court further reasoned that the PSLRA's additional requirement that plaintiffs plead facts demonstrating scienter "with particularity" would serve to heighten the standard even in circuits already employing the Second Circuit standard.<sup>131</sup>

The court in *Advanta* also noted that even though the PSLRA created a heightened procedural pleading requirement, it did not in any way alter the substantive requirement of scienter.<sup>132</sup> The court concluded that nowhere in the plain language or legislative history of the PSLRA did Congress show intent to eliminate recklessness as an adequate state of mind to impose liability on a defendant for securities fraud.<sup>133</sup> In fact, the court acknowledged that the retention of the recklessness standard of scienter serves the policy objective of "discouraging deliberate ignorance and preventing defendants from escaping liability solely because of the difficulty of proving conscious intent to commit fraud."<sup>134</sup> Thus, the *Advanta* court interpreted the PSLRA as a de facto codification of the Second Circuit standard and held that the PSLRA both codified the procedural requirements of the Second Circuit for pleading scienter and retained recklessness<sup>135</sup> as an adequate level of scienter for imposing liability in securities actions.<sup>136</sup>

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129. *Id.* at 534.

130. *Id.*

131. *Id.* at 534.

132. *Id.*

133. *Id.*

134. *Id.* The court also noted that the elimination of recklessness as an adequate level of scienter would thwart the purpose of the procedural language of the PSLRA, allowing a showing of facts constituting circumstantial evidence of recklessness or intent to satisfy the pleading requirement. *Id.* The court also noted that the language used by the managers in the conference committee report on the PSLRA, stating that Congress did not intend to codify the case law of the Second Circuit (referring to the deletion of the Specter Amendment from the final version of the bill), and "for this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness," was not dispositive of an intent to eliminate recklessness as an adequate level of scienter or as a means to plead scienter in securities fraud actions. *Id.* The court explained that, if Congress intended to eliminate recklessness as a means for pleading scienter, it could have done so explicitly in the statute. *Id.* Thus, the *Advanta* court reasoned that this language is suggestive of a Congressional intent to leave the matter open for judicial interpretation. *Id.*

135. The *Advanta* court adopted the definition of recklessness devised by the Seventh Circuit in *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033 (7th Cir. 1977). *Id.*

136. *Id.*

## B. The PSLRA as Containing more Stringent Pleading Requirements but a Similar Scierter Requirement

### 1. Substantive Requirement of Scierter

Subsequent to the enactment of the PSLRA, a second group of courts interpreting the statute found that even though the PSLRA raised the pleading requirement beyond the Second Circuit standard, the statute did not eliminate recklessness as an adequate level of scierter in securities fraud actions.<sup>137</sup> In interpreting the substantive element of the pleading requirement, these courts applied the same reasoning as the courts that interpreted the PSLRA as a de facto codification of the Second Circuit standard.<sup>138</sup> For example, the Southern District of New York, in *In re Baesa Securities Litigation*,<sup>139</sup> agreed with courts such as *Marksman* by holding that the PSLRA did not overrule the uniform conclusion of the circuit courts finding recklessness to be an adequate state of mind to impose liability upon a defendant for securities fraud.<sup>140</sup> However, the court in *Baesa* expanded on the *Marksman* court by interpreting recklessness to be a "lesser form of intent" rather than a "greater degree of negligence" and by finding that courts do not disturb the intent standard mandated by *Hochfelder* by allowing acts of recklessness to be sufficient to impose liability upon a defendant for securities fraud.<sup>141</sup> The *Baesa* court also reiterated that nothing in the plain language of the PSLRA purported to overrule the uniform holding of the circuit courts that a showing of recklessness satisfied the scierter requirement in the averment of securities fraud.<sup>142</sup> Therefore, the court reasoned that, because the plain language of the statutory text is unambiguous regarding Congress' intent, resort to the legislative history of the PSLRA is unnecessary.<sup>143</sup> Thus, courts such as *Baesa* held that the substantive requirement of pleading securities fraud remained unchanged following the enactment of the PSLRA.<sup>144</sup>

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137. Miest, *supra* note 12, at 1120; *see also* Smith, *supra* note 12, at 593.

138. *See id.* at 593-95.

139. 969 F. Supp. 238 (S.D.N.Y. 1997).

140. *Id.* at 241; *see also* Smith, *supra* note 12, at 594.

141. *Baesa*, 969 F. Supp. at 241.

142. *See id.*

143. *Id.*

144. *See id.*

## 2. Procedural Requirement of Establishing Scierter

Although courts such as *Baesa* found that the substantive requirement remained unchanged by the PSLRA, district courts following the *Baesa* line of reasoning did not find that the procedural requirement remained unchanged as well.<sup>145</sup> Courts coming to this conclusion looked to the plain language of the PSLRA, requiring a plaintiff to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," and concluded that while Congress expressly adopted the "strong inference" standard, it did not adopt the motive and opportunity standard as historically used by the Second Circuit.<sup>146</sup> Thus, because Congress did not expressly adopt the Second Circuit standard in the plain language of the statute, these courts determined that Congress did not intend that a showing of motive and opportunity would automatically raise a "strong inference" of scierter.<sup>147</sup>

However, courts such as *Baesa* that followed this reasoning left open the possibility that facts showing motive and opportunity may be relevant and useful in establishing a "strong inference" of scierter.<sup>148</sup> Interestingly, the court in *Baesa* did not even eliminate the possibility that a strong showing of motive and opportunity could, by itself, establish a "strong inference" of scierter sufficient to satisfy the heightened pleading requirement.<sup>149</sup> At the same time, *Baesa*, like other courts holding that the PSLRA is not a de facto codification of the Second Circuit pleading requirement, recognized that the facts giving rise to a "strong inference" of scierter, whatever they may be, must be pled with particularity.<sup>150</sup> Thus, if motive and opportunity were to give rise to a "strong inference" of scierter, motive and opportunity would have to be pled with particularity—as required by the plain language of the PSLRA.<sup>151</sup>

Other district courts followed the basic reasoning of *Baesa* and found that this reasoning was consistent with the legislative history of the PSLRA, as well as its plain language.<sup>152</sup> The court in *Carley Capital Group v. Deloitte & Touche, L.L.P.*<sup>153</sup> found that the *Baesa* approach was consistent with the intent exhibited by Congress in the Conference Committee Report to the PSLRA and the Joint Explanatory Statement of the Committee of Conference Regarding S. 1260.<sup>154</sup> The court in *Carley Capital Group* also noted that the legislative history of the

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145. See Smith, *supra* note 12, at 594.

146. *Baesa*, 969 F. Supp. at 242; see also Miest, *supra* note 12, at 1120.

147. *Baesa*, 969 F. Supp. at 242; see also Smith, *supra* note 12, at 594.

148. *Baesa*, 969 F. Supp. at 242.

149. *Id.*

150. *Id.*

151. *Id.*; see also Smith, *supra* note 12, at 595.

152. Smith, *supra* note 12, at 595.

153. 27 F. Supp. 2d 1324 (N.D. Ga. 1998).

154. *Id.* at 1338.

Uniform Standards Act did not establish that the Second Circuit pleading standard was either adopted or refuted by the PSLRA.<sup>155</sup> Thus, subsequent courts found that the *Baesa* interpretation of the PSLRA's procedural requirement, while based solely on the plain language of the statute, was also consistent with the legislative history of the PSLRA.<sup>156</sup>

### 3. The Sixth and Eleventh Circuits: more Stringent Pleading Requirements but a Similar Scierter Requirement

Recently, the Eleventh Circuit handed down its decision in *Bryant v. Avado Brands, Inc.*,<sup>157</sup> in which it held that while the PSLRA did not alter the substantive standard that was in place prior to its enactment, it did alter the procedural pleading standard to one above any standard in place prior to its enactment.<sup>158</sup> *Bryant* was the second federal circuit court decision to interpret the PSLRA as adopting the pre-PSLRA substantive standard of recklessness while rejecting the Second Circuit's motive and opportunity test.<sup>159</sup>

The court in *Bryant* first concluded that recklessness survived as an adequate level of scierter to impose liability for securities fraud after the adoption of the PSLRA.<sup>160</sup> In doing so, the *Bryant* court adopted the reasoning of many district courts.<sup>161</sup> *Bryant*, like *Baesa*,<sup>162</sup> acknowledged that it is unnecessary, and even improper, to look to the legislative history for guidance when the plain language of the statute is unambiguous as to the drafters' intent.<sup>163</sup> Therefore, the court relied on the plain language of the statute in making its determination as to the sufficiency of recklessness in proving state of mind.<sup>164</sup> *Bryant* reasoned that the

155. See *id.* at 1338-39. The interpretation given to a statute by a subsequent Congress is of little assistance in determining the intent of the Congress that enacted the statute. See *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 185-86 (1994).

156. See *Carley Capital Group*, 27 F. Supp. 2d at 1338; see also *Smith*, *supra* note 12, at 595.

157. 187 F.3d 1271 (11th Cir. 1999).

158. See *id.* at 1286-87.

159. See *id.* The Sixth Circuit has also held that the PSLRA did not change the substantive law as to what constitutes scierter and did not change the Sixth Circuit's pre-PSLRA holding that motive and opportunity are not the equivalent of intent and therefore cannot create a strong inference of scierter. See *In re Comshare, Inc.*, 183 F.3d 542, 548-54 (6th Cir. 1999). The Second, Third, and Fifth Circuits have held that the PSLRA was a de facto codification of the Second Circuit pleading standard. See *supra* notes 122-136 and accompanying text. The Ninth Circuit has held that the PSLRA eliminated mere reckless as a standard for liability and the motive and opportunity test as a means for pleading scierter. See *infra* notes 216-252 and accompanying text.

160. *Bryant*, 187 F.3d at 1286.

161. See e.g. *Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1310-12 (C.D. Ca. 1996); see also *Baesa*, 969 F. Supp. at 241.

162. See *id.*

163. *Bryant*, 187 F.3d at 1283.

164. *Id.* at 1284.

plain language of the statute was unambiguous as to the required state of mind because the plain language of the PSLRA failed to require "actual knowledge" as the standard for scienter.<sup>165</sup> The court in *Bryant* also reasoned that, because Congress was aware that the federal circuits had uniformly found recklessness to be sufficient to show that the defendant possessed the "required state of mind" in securities fraud actions, if Congress had intended to alter the scienter requirement, it would not have referred to the "required state of mind"<sup>166</sup> in the plain language of the statute.<sup>167</sup> Thus, *Bryant* found that recklessness survived as an adequate level of scienter under the PSLRA.<sup>168</sup>

However, *Bryant* did not find that the motive and opportunity test developed by the Second Circuit survived the enactment of the PSLRA.<sup>169</sup> The court came to this conclusion after closely scrutinizing of the language of the statute.<sup>170</sup> *Bryant* notes that the PSLRA requires plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."<sup>171</sup> The "required state of mind" in the Eleventh Circuit is, at a minimum, severe recklessness.<sup>172</sup> The *Bryant* court then reasoned that because "required state of mind" is clearly a substantive standard, motive and opportunity, a procedural standard, can never suffice to plead "state of mind," or scienter.<sup>173</sup> The court concluded that motive and opportunity is merely a specific kind of evidence that can be utilized to plead the "required state of mind."<sup>174</sup> Thus, while facts pleading motive and opportunity can serve as evidence to show that the defendant possessed the "required state of mind," motive and opportunity cannot alone serve as an adequate basis for establishing state of mind.<sup>175</sup>

The *Bryant* court also reasoned that because the motive and opportunity test was not well established throughout the circuits, this test could not have been codified *sub silentio* by the legislature.<sup>176</sup> While the recklessness standard was uniform throughout the federal circuits, the motive and opportunity test was

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165. *Id.* Another section in the PSLRA, the safe harbor provision, explicitly provides that the safe harbor provision applies only to statements that the defendant made with less than "actual knowledge" of their falsity or misleading nature. See 15 U.S.C. s. 78u-5(c)(1)(B).

166. "Required state of mind" had been defined in the circuits as intent or recklessness. *Bryant*, 187 F.3d at 1284.

167. *Id.*

168. *Id.*

169. *Id.* at 1285.

170. *See id.*

171. *Id.*

172. *See id.* (quoting *Carley Capital Group*, 27 F. Supp. 2d at 1339).

173. *Id.* at 1285-86.

174. *Id.*

175. *See id.* This is distinguishable from the reasoning in *Baesa*, where the court reasoned in dicta that it may be possible for motive and opportunity alone to serve as adequate evidence of scienter. *See Baesa*, 969 F. Supp. at 242; *see also supra* note 150 and accompanying text.

176. *Bryant*, 187 F.3d at 1286.

employed only by two circuits.<sup>177</sup> Therefore, while the *Bryant* court was willing to interpret the absence of language defining the "required state of mind" as adopting the uniform requirement of recklessness, it was not willing to interpret the absence of language adopting the motive and opportunity test as adopting the "lesser-known, lesser-accepted, and certainly not well-established notion that allegations of motive and opportunity to commit fraud are sufficient to show scienter."<sup>178</sup> Thus, the *Bryant* court rejects the motive and opportunity test based on the court's reading of the plain language of the PSLRA.<sup>179</sup>

In addition to its argument rejecting the motive and opportunity test based upon the plain language of the PSLRA, *Bryant* also offered a policy argument for rejecting the motive and opportunity test of the Second Circuit.<sup>180</sup> Adopting the rationale of Judge Thrash in *Carley Capital Group*,<sup>181</sup> the court argued that the motive and opportunity standard may in fact lower the standard of pleading scienter for securities cases below the level required by the Supreme Court in *Hochfelder*.<sup>182</sup> The court argued that because the motive and opportunity standard would serve to lessen the pleading requirements rather than heighten them, this standard would not serve to adequately curb securities litigation abuse—a primary goal of Congress in drafting and enacting the PSLRA.<sup>183</sup> Thus, the *Bryant* court held that the plain language of the statute compels the retention of the recklessness standard, and that both the plain language of the statute and underlying policy concerns compel the rejection of the Second Circuit's motive and opportunity test.<sup>184</sup>

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177. See *id.* Prior to the enactment of the PSLRA, only the Second and Ninth Circuits had employed the motive and opportunity standard for pleading scienter. See *id.*

178. *Id.*

179. *Id.* at 1286-87.

180. See *id.* at 1286.

181. *Id.* Judge Thrash stated:

The Eleventh Circuit has never adopted a scienter standard that follows the "motive and opportunity" analysis of the Second Circuit. A good argument can be made that the "motive and opportunity" standard lowers the bar for securities fraud cases below that mandated by the Supreme Court in *Hochfelder*. Greed is a ubiquitous motive, and corporate insiders and upper management always have opportunity to lie and manipulate. Furthermore, allowing private securities class actions to proceed to discovery upon bare allegations of motive and opportunity would upset the delicate balance of providing a remedy for genuine fraud while preventing abusive strike suits that the Reform Act sought to achieve. Motive and opportunity will ordinarily be relevant, and often highly relevant . . . [but] a showing of motive and opportunity standing alone [is] insufficient to allege securities fraud under the "severe recklessness" standard established by the Eleventh Circuit.

*Id.* (quoting *Carley Capital Group*, 27 F. Supp. 2d at 1339).

182. *Id.*

183. *Id.*

184. *Id.* at 1286-87.



### C. The PSLRA: more Stringent Scierter and Pleading Requirements than the Second Circuit

#### 1. Substantive Requirement for Scierter

Still a third group of courts has held that the enactment of the PSLRA heightened both the substantive and procedural requirements for pleading securities fraud.<sup>185</sup> These courts have held that a showing of simple recklessness, as opposed to deliberate recklessness, is no longer adequate to establish scierter in securities fraud cases.<sup>186</sup> Courts making this determination have reasoned that Congress' stated intent to both strengthen the pleading requirements that existed prior to the enactment of the PSLRA and eliminate frivolous litigation indicates that Congress meant to eliminate liability for simple recklessness.<sup>187</sup>

One of the first district courts to make this ruling was the Northern District of California in *In re Silicon Graphics*.<sup>188</sup> The court in *In re Silicon Graphics* held that "[a] plaintiff must allege specific facts that constitute circumstantial evidence of conscious behavior by defendants."<sup>189</sup> The court looked to the legislative history of the PSLRA in determining that Congress intended to heighten the scierter requirement in securities fraud actions to one above that in place prior to the enactment of the PSLRA.<sup>190</sup> The court argued that Congress showed a definite intent to strengthen both substantive and procedural pleading requirements in securities fraud cases by its omission of the Second Circuit's language regarding motive, opportunity, and recklessness, its rejection of the Specter Amendment, its Conference Committee statement indicating that the Committee intended to "strengthen existing pleading requirements," and its override of President Clinton's veto.<sup>191</sup> Thus, the court concluded that a reading of the legislative history of the PSLRA shows that Congress intended to raise both the substantive and procedural pleading standard beyond that of the Second Circuit when

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185. See Miest, *supra* note 12, at 1116-17; see also *Voit v. Wonderware Corp.*, 977 F. Supp. 363, 373-74 (E.D. Pa. 1997) (holding that the PSLRA eliminates both recklessness and the motive and opportunity standard as adequate evidence of scierter for imposing liability for securities fraud); *Norwood Venture Corp. v. Converse Inc.*, 959 F. Supp. 205, 208-09 (S.D.N.Y. 1997) (accord); *Friedberg v. Discreet Logic, Inc.*, 959 F. Supp. 42, 45-50 (D. Mass. 1997).

186. See Smith, *supra* note 12, at 590-99; see also Miest, *supra* note 12, at 1116-17 (explaining the heightened pleading and liability standards of section 21D(8)(2)); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 974-75 (noting that the PSLRA's purpose is best served by the "deliberate recklessness" standard).

187. Miest, *supra* note 12, at 1117.

188. *In re Silicon Graphics, Inc. Sec. Litig.*, No. C96-0393, 1996 WL 664639 (N.D. Cal. 1996).

189. *Id.* at \*6.

190. *Id.* at \*5. The district court in *In re Silicon Graphics* did not distinguish between the substantive and procedural pleading requirements under the PSLRA, and therefore its analysis of the substantive pleading requirement is based largely on congressional language relating to the procedural pleading requirements. Miest, *supra* note 12, at 1117.

191. *In re Silicon Graphics*, 1996 WL 664639, at \*5-6.

enacting the PSLRA.<sup>192</sup>

The plaintiffs in *In re Silicon Graphics* presented two arguments previously accepted by other federal courts when arguing that simple recklessness remained an adequate state of mind to impose liability subsequent to the enactment of the PSLRA.<sup>193</sup> The district court dispensed with both arguments.<sup>194</sup> The plaintiffs first argued that several legislators made statements in the course of debating the bill indicating that they felt that the bill was adopting the Second Circuit pleading standard.<sup>195</sup> The court attacked this argument by contending that the statements cited by the plaintiffs were made by only a few members of Congress prior to the President's veto message and the veto's subsequent override.<sup>196</sup> The court further argued that it is proper to look at a committee report as a whole, rather than at the comments of individual legislators, when determining Congress' intent in enacting a bill.<sup>197</sup>

The plaintiffs also argued that because section 210(g)(2)(A) made a distinction between "knowing and non-knowing" violators, liability for recklessness was possible under the PSLRA.<sup>198</sup> The plaintiffs argued that, while section 210(g)(2)(A) explicitly states that non-knowing persons could not be found liable for securities fraud violations, section 78u-4 does not make a distinction between knowing and non-knowing persons, and, therefore, both may be found liable.<sup>199</sup> The court rejected this argument as well.<sup>200</sup> Arguing that it is necessary to consider policy objectives when interpreting congressional intent, the court pointed out that it was because Congress sought to protect those associated with the capital markets from abusive securities litigation that it enacted heightened pleading requirements in the PSLRA.<sup>201</sup> Thus, in order to curb the number of frivolous suits, Congress intended to raise the scienter requirement beyond that

192. *Id.*

193. *See id.* at \*6-7. In fact, the arguments cited to by the plaintiffs were previously advanced in and accepted by other federal district courts within the Ninth Circuit. *See e.g.*, *Marksman Partners L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1310-13 (C.D. Cal. 1996); *Zeid v. Kimberly*, 973 F. Supp. 910, 91618 (N.D. Cal. 1997), *vacated by*, 201 F.3d 446 (9th Cir. 1999).

194. *In re Silicon Graphics*, 1996 WL 664639, at \*6-7.

195. *Id.* Examples of these statements included those made by Representative Bliley, 141 CONG. REC. H14,040 (daily ed. Dec. 6, 1995) and Senator Moseley-Braun, 141 CONG. REC. S17,983 (daily ed. Dec. 5, 1995).

196. *In re Silicon Graphics*, 1996 WL 664639, at \*6.

197. *Id.* *But see In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 992-93 (9th Cir. 1999) (Browning, J., concurring and dissenting) (remarking that by looking at the legislative history of the PSLRA as a whole, the proper conclusion to be drawn is that Congress adopted simple recklessness as an adequate state of mind for the imposition of liability under the PSLRA).

198. *In re Silicon Graphics*, 1996 WL 664639, at \*7.

199. *Id.*

200. *Id.*

201. *Id.*

of simple recklessness.<sup>202</sup> Therefore, the district court in *In re Silicon Graphics* held that a showing of simple recklessness was not sufficient to make an adequate showing of scienter subsequent to the enactment of the PSLRA.<sup>203</sup>

## 2. Procedural Requirement of Establishing Scienter

Courts holding that the PSLRA rejects recklessness as adequate to impose liability upon a defendant for securities fraud also reject the motive and opportunity test as a means for establishing scienter.<sup>204</sup> Courts rejecting the motive and opportunity test argue that the legislative history of the PSLRA shows the clear intent of Congress to raise the pleading requirements for securities fraud actions and, thus, to adopt a pleading standard higher than that of the Second Circuit.<sup>205</sup> The *In Re Silicon Graphics* court advanced this same argument for eliminating the motive and opportunity test—that Congress' stated intent to strengthen existing pleading requirements and to curb frivolous litigation required the rejection of the motive and opportunity test.<sup>206</sup> Thus, the *In re Silicon Graphics* court held that in order to satisfy the pleading requirement of the PSLRA, plaintiffs had to allege facts that created a "strong inference" that the defendant possessed the required state of mind.<sup>207</sup>

Other district courts have advanced arguments specifically directed toward the rejection of the procedural pleading requirement of motive and opportunity.<sup>208</sup> The United States District Court for the District of Massachusetts, in *Friedberg v. Discreet Logic Inc.*,<sup>209</sup> held that the PSLRA rejected the motive and opportunity standard of the Second Circuit while retaining the Second Circuit's circumstantial evidence of conscious behavior standard.<sup>210</sup> The court reasoned that Congress failed to codify the Second Circuit's case law regarding the pleading of motive, opportunity, and recklessness "because these approaches . . . were not sufficiently stringent."<sup>211</sup> However, the court did accept the circumstantial evidence of

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202. *Id.*

203. *Id.*

204. *Voit v. Wonderwave Corp.*, 977 F. Supp. 363, 373-77 (E.D. Pa. 1997) (holding that the PSLRA eliminates both recklessness and the motive and opportunity standards as adequate evidence of scienter for imposing liability for securities fraud); *Norwood Venture Corp. v. Converse Inc.*, 959 F. Supp. 205, 208-09 (S.D.N.Y. 1997) (accord); *Friedberg v. Discreet Logic, Inc.*, 959 F. Supp. 42, 45-50 (D. Mass. 1997) (accord).

205. *See In re Silicon Graphics*, 1996 WL 664639, at \*5-6; *see also Friedberg*, 959 F. Supp. at 48-50.

206. *In re Silicon Graphics*, 1996 WL 664639, at \*5-6; *see also Miest, supra* note 12, at 1117 (noting that the *In re Silicon Graphics* court "did not distinguish between the substantive concept of scienter and the procedural pleading tests").

207. *In re Silicon Graphics*, 1996 WL 664639, at \*7.

208. *See, e.g., Friedberg*, 959 F. Supp. at 48-50.

209. 959 F. Supp. 42 (D. Mass. 1997).

210. *Id.* at 49.

211. *Id.*

conscious behavior standard,<sup>212</sup> finding it more stringent, because under this standard plaintiffs had to support their allegations with 'strong' circumstantial evidence.<sup>213</sup> Thus, courts such as *Friedberg* and *In re Silicon Graphics* have found that the PSLRA eliminated both liability for recklessness and the motive and opportunity standard for pleading scienter.<sup>214</sup>

### 3. The Ninth Circuit: The PSLRA has Heightened both the Substantive and Procedural Requirements for Pleading Securities Fraud.

The plaintiffs in *In re Silicon Graphics* appealed the district court's dismissal of their claim to the Ninth Circuit.<sup>215</sup> The opinion handed down in this case has been very controversial, as its holding is contrary to that of other circuit courts which have considered the interpretation of the pleading requirements of the PSLRA, and is likely to spawn debate until Congress or the Supreme Court attempts to again create uniformity among the circuits.<sup>216</sup> Therefore, the majority, concurring, and dissenting opinions of the *In re Silicon Graphics* decision will be discussed in detail in the remainder of this Comment, along with the likely effect that these opinions will have on the federal courts, private plaintiffs, and the capital markets.

#### a. Majority Opinion

The majority opinion in *In re Silicon Graphics* is structured in a manner that effectively underscores the court's intent to clarify the standard of pleading

212. *Id.* The court noted that there is a distinction between conscious behavior and recklessness. *Id.* at 49 n.2. This distinction was blurred in the Second Circuit as both were allowed under the prior pleading standard. *See id.* However, because the court held that the PSLRA eliminated liability for recklessness, conscious behavior can now only refer to "intent to defraud [or] knowledge of the falsity [of a statement]." *Id.*

213. *Id.* at 49.

214. *Id.*; *see also In re Silicon Graphics*, 1996 WL 664639, at \*5-7.

215. *See In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970 (9th Cir. 1999), *reh'g denied*, 195 F.3d 521 (9th Cir. 1999).

216. *See In re Comshare Inc.*, 183 F.3d 542, 550 (6th Cir. 1999) (holding that a "plaintiff may survive a motion to dismiss by pleading facts that give rise to a 'strong inference' of recklessness"); *see also In re Advanta Corp.*, 180 F.3d 525, 535 (3rd Cir. 1999) (holding that it "remains sufficient for plaintiffs [to] plead [sic] scienter by alleging facts 'establishing a motive and an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior'"); *Press v. Chem. Inv. Serv. Corp.*, 166 F.3d 529, 538 (2nd Cir. 1999) (holding that a plaintiff may either allege facts of motive and opportunity to commit fraud or facts that "constitute strong circumstantial evidence of conscious misbehavior or recklessness") (quoting *Shields v. Citytrust Bancorp. Inc.*, 25 F.3d 1124, 1128 (2nd Cir. 1996)); *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1285-86 (11th Cir. 1999) (holding that recklessness is an adequate level of scienter for purposes of liability but allegations of motive and opportunity are not sufficient to establish scienter).

required in the Ninth Circuit.<sup>217</sup> The court began by enunciating the proper standard of pleading under the PSLRA and then applied that standard to the facts of the case.<sup>218</sup> The court first addressed the scienter requirement of the PSLRA, holding that recklessness, in the Section 10(b) context, is "a form of intentional conduct," and, therefore, evidence pleading recklessness must give rise to a strong inference of deliberate recklessness.<sup>219</sup> The court came to this conclusion after recounting the development of the recklessness standard in the Ninth Circuit.<sup>220</sup> The court first considered its interpretation of the United States Supreme Court's decision in *Hochfelder*.<sup>221</sup> The court recalled that in *Nelson v. Serwold*,<sup>222</sup> it accepted recklessness as sufficient for civil liability under section 10(b) and Rule 10b-5.<sup>223</sup> The court then continued to trace the history of recklessness in the circuit, noting that, in *Hollinger v. Titan Capital Corp.*,<sup>224</sup> it adopted the *Sunstrand* definition of recklessness.<sup>225</sup> The court reasoned that both of these cases demonstrated that the Ninth Circuit viewed recklessness as "intentional or knowing misconduct" even prior to the enactment of the PSLRA.<sup>226</sup> Thus, the Ninth Circuit extended its previous interpretation of recklessness to its interpretation of the PSLRA.<sup>227</sup>

Next, the court turned to its interpretation of the procedural requirements for pleading securities fraud under the PSLRA.<sup>228</sup> The court noted that the plain language of the PSLRA does not establish whether motive and opportunity or circumstantial evidence of simple recklessness suffice to raise a "strong inference" of deliberate recklessness.<sup>229</sup> Thus, the court turned to the legislative history of the Act.<sup>230</sup>

The court first acknowledged that the most reliable source of legislative intent, other than the plain language of the statute itself, is the Conference Report.<sup>231</sup> After examining the Conference Report, the court concluded that, by enacting the PSLRA, Congress intended to raise the pleading standard for

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217. See *In re Silicon Graphics*, 183 F.3d at 973-74.

218. *Id.*

219. *Id.* at 976-77.

220. *Id.* at 975-77.

221. *Id.* at 975.

222. 576 F.2d 1332, 1337 (9th Cir. 1978).

223. *In re Silicon Graphics*, 183 F.3d at 976.

224. 914 F.2d 1564 (9th Cir. 1990) (en banc).

225. *In re Silicon Graphics*, 183 F.3d at 976; see also *supra* notes 38-39 and accompanying text (recounting the *Sunstrand* definition of recklessness).

226. *In re Silicon Graphics*, 183 F.3d at 977.

227. See *id.* (holding that "recklessness in the § 10(b) context is, in the words of the Supreme Court, a form of intentional conduct").

228. See *id.*

229. *Id.*

230. See *id.* But see *In re Advanta*, 180 F.3d 525, 535 (3rd Cir. 1995) (observing that, because the legislative history is as unhelpful as it is confusing and contradictory, the legislative history should be disregarded and interpretation should be limited to the plain language of the statute).

231. *In re Silicon Graphics*, 183 F.3d at 977.

securities fraud actions in an attempt to curb frivolous securities litigation.<sup>232</sup> The court reasoned that Congress intended to raise the pleading requirement for securities fraud actions because Congress' purpose in enacting the PSLRA was to "deter non-meritorious lawsuits by creating procedural barriers such as heightened pleading standards."<sup>233</sup> Thus, the court held that the PSLRA raised pleading standards to discourage abusive securities litigation.<sup>234</sup>

The *In re Silicon Graphics* court further held that Congress intended to heighten pleading standards beyond those of the Second Circuit.<sup>235</sup> The court pointed to three pieces of legislative history in making this determination: the rejection of the Specter Amendment, the rejection of the Second Circuit's two-prong standard in favor of the more stringent "strong inference" standard, and President Clinton's veto and Congress' subsequent vote to override his veto.<sup>236</sup> Looking first at the rejection of the Specter Amendment, the court concluded that, had Congress wanted to codify the Second Circuit test, it would not have discarded the Specter Amendment.<sup>237</sup> Instead, the court concluded that Congress implicitly rejected the Second Circuit's two-pronged standard when it declined to incorporate the Specter Amendment into the final version of the bill.<sup>238</sup> The court then focused its analysis on the Conference Committee's express rejection of the Second Circuit's two-prong standard in favor of the more stringent "strong inference" standard, citing the following language of the Conference Committee:

The Conference Committee language is based in part on the pleading standard of the Second Circuit. . . . 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.<sup>239</sup>

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232. *Id.* at 977-78.

233. *Id.* at 978. The court cited to the language of the Statement of Managers to argue that Congress intended to prevent frivolous securities litigation by enacting the PSLRA. *Id.* at 977-78. Citing to this language, the court explained that Congress intended to protect investors and the capital markets from losses caused from frivolous litigation by instituting heightened pleading requirements. *Id.* at 978.

234. *Id.*

235. *Id.*

236. *Id.* at 978-79. For a discussion of President Clinton's veto of the PSLRA, see *infra* note 246 and accompanying text.

237. *Id.* at 978.

238. *Id.*

239. *Id.* (citing H.R. Conf. Rep. 104-369, at 41 n.23) (emphasis omitted).

The court explained that, although Congress incorporated the Second Circuit's strong inference standard into the PSLRA, it did not incorporate the less stringent Second Circuit case law that interpreted this standard.<sup>240</sup> The court also explained that Congress' adoption of the "strong inference" standard of the Second Circuit is not indicative of Congressional intent to adopt the underlying two-prong standard.<sup>241</sup> The court was of the view that the "strong inference" standard was adopted by Congress in drafting the PSLRA "only because it was facially more stringent than the 'reasonable inference' standard" that was in place in most jurisdictions at the time the PSLRA was drafted.<sup>242</sup> Thus, although Congress accepted the Second Circuit standard of pleading itself, it expressly rejected the methods approved by the Second Circuit for meeting this standard.<sup>243</sup>

The court finally determined that the presidential veto and subsequent congressional override showed that Congress intended to enact a pleading standard more stringent than that of the Second Circuit when enacting the PSLRA.<sup>244</sup> In his message to Congress, President Clinton stated:

I believe that the pleading requirements of the Conference Report with regard to a defendant's state of mind impose an unacceptable procedural hurdle to meritorious claims being heard in Federal courts. I am prepared to support the high pleading standards of the U.S. Court of Appeals for the Second Circuit—the highest pleading standard of any Federal circuit court. But the conferees make crystal clear in the Statement of the Managers their intent to raise the standard even beyond that level. I am not prepared to accept that.<sup>245</sup>

The court argued that because Congress voted to override the President's veto and to enact the version of the bill adopted by the Conference Committee, Congress intended to elevate the pleading standard beyond that of the Second Circuit.<sup>246</sup> Hence, because Congress could have altered the bill to address the concerns voiced by the President but chose not to do so, the court felt it was evident that Congress intended to elevate the pleading standard beyond that of the Second Circuit.<sup>247</sup>

Thus, after examining the legislative history, the *In re Silicon Graphics* court held the pleading standard under the PSLRA to be more stringent than that of the

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240. *Id.* at 978-79.

241. *Id.* at 979.

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.* (citing 141 CONG. REC. H15,214 (daily ed. Dec. 10, 1995)).

246. *Id.* *But see infra* text accompanying notes 269-71.

247. *In re Silicon Graphics*, 187 F.3d at 979 (noting that "because the joint committee expressly rejected the 'motive and opportunity' and 'reckless' tests when raising the standard, Congress must have intended a standard that lies beyond the Second Circuit standard").

Second Circuit.<sup>248</sup> Therefore, plaintiffs in the Ninth Circuit making claims under the PSLRA must plead "particular facts giving rise to a strong inference of deliberate recklessness. . . ." <sup>249</sup> The *In re Silicon Graphics* court concluded that the "deliberate recklessness" standard adopted by the court properly reconciled Congress' adoption of the "strong inference" standard with Congress' refusal to codify the Second Circuit's two-prong "motive and opportunity" and "recklessness" test.<sup>250</sup> Thus, the Ninth Circuit in *In re Silicon Graphics* adopted the most stringent interpretation of the PSLRA to date.<sup>251</sup>

*b. Concurring and Dissenting Opinion*

Judge Browning dissented to the majority's interpretation of the PSLRA and its dismissal of Brody's complaint.<sup>252</sup> Judge Browning first addressed the majority's interpretation of the procedural pleading requirements.<sup>253</sup> Judge Browning took a textualist approach to the statute and concluded that, because the PSLRA does not mention motive, opportunity, or recklessness, there is no basis for courts to conclude that proof of motive and opportunity or recklessness are not sufficient to establish a "strong inference" of deliberate recklessness.<sup>254</sup> Judge Browning felt that a plain language reading of the statute was all that was needed to interpret the statute and admonished the majority for turning to legislative history in its interpretation.<sup>255</sup> Judge Browning then argued that, even if a reading of the legislative history was necessary for interpretation of the PSLRA, the

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248. *Id.*

249. *Id.*

250. *Id.* The court then applied its interpretation of the PSLRA to the facts of *In re Silicon Graphics*. *Id.* at 979-88. In its application, the court determined that the plaintiff, Brody, failed to "state with particularity" the facts upon which Brody's allegations were made because Brody failed to provide corroborating details concerning Brody's sources of information for the suspect reports, the author or authors of the suspect reports, the recipients of the suspect reports, and the contents of the suspect reports. *Id.* at 985. The court further reasoned that, without these facts, it was not possible for the court to determine whether the defendant's level of scienter reached that of deliberate recklessness, and without this showing the claim had to be dismissed. *Id.* The court also examined Brody's allegations regarding insider trading and determined that none of the officers in question had engaged in the type of stock sales that gave rise to a "strong inference of deliberate recklessness." *Id.* at 985-88. Thus, the court concluded that the generic allegations set forth by Brody in this case amounted to no more than the type of "fishing expedition" that the PSLRA was enacted to deter. *Id.* at 988.

251. *See id.* at 979.

252. *Id.* at 991-1003 (Browning, J., concurring and dissenting).

253. *Id.* at 991-94 (Browning, J., concurring and dissenting).

254. *Id.* at 992 (Browning, J., concurring and dissenting).

255. *Id.* at 992-93 (Browning, J., concurring and dissenting).



majority's interpretation of the relevant legislative history was erroneous.<sup>256</sup> In making this argument, Judge Browning rebuked the majority for its arguments relating to the rejection of the Specter Amendment, the rejection of the Second Circuit's two-prong standard in the Conference Committee report, and the Presidential veto and subsequent Congressional override vote.<sup>257</sup>

Judge Browning began by dismissing the majority's argument that the rejection of the Specter Amendment was an implicit rejection of the Second Circuit pleading standard.<sup>258</sup> Judge Browning pointed out that, while Congress did reject the Specter Amendment, the legislative history of the PSLRA suggests that this language was rejected because it was "an incomplete and inaccurate codification" of the Second Circuit case law and not because Congress intended to reject "motive and opportunity" or "recklessness" as adequate to plead scienter under the PSLRA.<sup>259</sup> Judge Browning further acknowledged that Congress expressly stated that courts may find the Second Circuit "body of law" instructive, again giving rise to the interpretation that Congress did not intend to reject the Second Circuit pleading standard.<sup>260</sup> Finally, Judge Browning acknowledged that an express codification of the Second Circuit case law, allowing recklessness to suffice for pleading scienter in *all* cases, including cases involving forward-looking statements, would be inconsistent with the safe harbor's express requirement of "actual knowledge" for forward-looking statements.<sup>261</sup> Thus, Judge Browning reasoned that it was a practical consideration of Congress that compelled it to reject the Specter Amendment, rather than an express rejection of the body of law the Specter Amendment incorporated.<sup>262</sup>

Judge Browning next addressed the majority's argument that a statement made in the Conference Report, which indicated that Congress chose not to include language relating to motive, opportunity, or recklessness because the Conference Committee intended to strengthen the pleading requirements in place prior to the enactment of the PSLRA, showed the express intention of Congress to enact a more stringent pleading requirement than that of the Second Circuit.<sup>263</sup> Judge Browning argued that it is more probable that Congress chose not to use language pertaining to opportunity, motive, or recklessness because Congress "was concerned only with adopting the Second Circuit's pleading standard, not with adopting (or rejecting) particular factual patterns that might satisfy that

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256. *Id.* (Browning, J., concurring and dissenting). Judge Browning argued that legislative history must be interpreted as a whole, and when considered as a whole the legislative history of the PSLRA does not reject the Second Circuit pleading standard. *Id.* (Browning, J., concurring and dissenting).

257. *Id.* at 993-94 (Browning, J., concurring and dissenting).

258. *Id.* at 993 (Browning, J., concurring and dissenting).

259. *Id.* (Browning, J., concurring and dissenting) (quoting 141 CONG. REC. S19067 (daily ed. Dec. 21, 1995) (Sen. Dodd quoting memorandum of Prof. Grundfest)).

260. *Id.* (Browning, J., concurring and dissenting).

261. *Id.* (Browning, J., concurring and dissenting).

262. *Id.* (Browning, J., concurring and dissenting).

263. *Id.* at 993-94 (Browning, J., concurring and dissenting).

standard."<sup>264</sup> Judge Browning also noted an inconsistency in the majority's reasoning by pointing out that the majority interpreted an absence of language concerning motive, opportunity, or recklessness as a rejection of these standards of pleading, while interpreting an absence of language concerning conscious misbehavior as an adoption of that standard of pleading.<sup>265</sup> Thus, according to Judge Browning, it is likely that the absence of language concerning motive, opportunity, or recklessness was not meant to eliminate them as adequate standards of pleading.<sup>266</sup>

Judge Browning finally addressed the majority's argument that Congress demonstrated its intent to heighten the pleading requirement when it overrode the President's veto of the PSLRA.<sup>267</sup> Judge Browning argued that the majority's argument relied on the assumption that Congress agreed with the President's interpretation that the PSLRA heightened the pleading standard beyond that of the Second Circuit.<sup>268</sup> However, Judge Browning noted that during the Senate's override debate, the sponsors of the bill explicitly disagreed with the President's interpretation of the bill and stated that the PSLRA's pleading standard was "faithful to the Second Circuit's test."<sup>269</sup> Thus, Judge Browning concluded that the majority's argument regarding the veto override failed to concede that Congress did not necessarily have to agree with the President's interpretation of the bill, which resulted in his decision to veto, in order to override his veto.<sup>270</sup>

Following his discussion of the shortcomings of the majority's interpretation of the procedural pleading requirements of the PSLRA, Judge Browning went on to criticize the majority's holding that the PSLRA altered the substantive requirement for establishing scienter and eliminated "mere recklessness as a basis of liability."<sup>271</sup> Judge Browning first recognized that prior to the enactment of the PSLRA, the circuits had uniformly held that recklessness sufficed to satisfy section 10(b)'s scienter requirement.<sup>272</sup> He further noted that when Congress intended to eliminate liability for recklessness in other parts of the PSLRA, Congress did so explicitly.<sup>273</sup> Judge Browning then argued that, because Congress

264. *Id.* (Browning, J., concurring and dissenting).

265. *Id.* at 994 (Browning, J., concurring and dissenting).

266. *Id.* (Browning, J., concurring and dissenting).

267. *Id.* (Browning, J., concurring and dissenting).

268. *Id.* (Browning, J., concurring and dissenting).

269. *Id.* (Browning, J., concurring and dissenting) (quoting 141 CONG. REC. S19067 (daily ed. Dec. 21, 1995) (Sen. Dodd quoting from memorandum of Prof. Grundfest)).

270. *See id.* (Browning, J., concurring and dissenting).

271. *Id.* at 994-95 (Browning, J., concurring and dissenting) (internal quotations omitted).

272. *Id.* at 995 (Browning, J., concurring and dissenting).

273. *Id.* (Browning, J., concurring and dissenting). Judge Browning explained that the standard of liability for "forward-looking" statements in the "safe harbor" provision of the PSLRA requires plaintiffs to allege that these "forward looking" statements were made with "actual knowledge" as to their falsity.

was aware of this interpretation and did not explicitly heighten the scienter requirement, Congress did not intend to eliminate recklessness as a sufficient level of scienter in cases of securities fraud.<sup>274</sup>

Judge Browning further noted that the SEC, the governing agency for securities fraud actions, often allows for use of the recklessness standard in its own cases.<sup>275</sup> The SEC argues that recklessness is "essential to the effective functioning of Section 10(b),' and 'necessary to protect investors and the integrity of the disclosure process.'<sup>276</sup> Thus, Judge Browning advocated consideration of SEC standards and policy goals when interpreting the scienter requirement under the PSLRA.<sup>277</sup>

Finally, Judge Browning noted that the Senate Report stated that the Conference Committee was not adopting a "new and untested . . . standard that would generate additional litigation."<sup>278</sup> However, Judge Browning explained that the pleading requirement formulated by the majority was indeed a new pleading standard, and, because of this novel interpretation, extensive litigation of this issue is likely in the future.<sup>279</sup> Judge Browning argued that this new pleading standard is "a formulation not found in the text of the statute, in the legislative history, or in any case heretofore litigated, and rejected by the responsible administrative agency . . . [and is thus] 'new,' 'untested,' and certain to 'generate additional litigation.'<sup>280</sup> Thus, upon finding that the PSLRA adopted the Second Circuit pleading standard, Judge Browning rejected the majority's view that the PSLRA heightened both the scienter and pleading requirements beyond those in place in the Second Circuit prior to the enactment of the PSLRA.<sup>281</sup>

### c. *Dissenting Opinion from Denial of Rehearing En Banc*

Subsequent to the court's ruling on this case, the plaintiffs filed petitions for

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*Id.* (Browning, J., concurring and dissenting). Judge Browning further explained that the PSLRA imposes joint and several liability only if the defendant "knowingly committed a violation of the securities laws." *Id.* (Browning, J., concurring and dissenting) (quoting 15 U.S.C. § 78u-8(g)(10)(B)). Thus, he concluded that because the court did not explicitly require that the plaintiff show that the defendant had actual knowledge and intent, a showing of recklessness is adequate to meet the liability standard. *Id.* at 995-96 (Browning, J., concurring and dissenting).

274. *Id.* (Browning, J., concurring and dissenting).

275. *Id.* (Browning, J., concurring and dissenting).

276. *Id.* (Browning, J., concurring and dissenting) (quoting Brief of Amicus SEC at 17, 20).

277. *Id.* at 995-96 (Browning, J., concurring and dissenting).

278. *Id.* at 996 (Browning, J., concurring and dissenting).

279. *Id.* (Browning, J., concurring and dissenting).

280. *Id.* (Browning, J., concurring and dissenting).

281. *See id.* (Browning, J., concurring and dissenting). In making this finding, Judge Browning determined that Brody's complaint satisfied the pleading requirement of the PSLRA by providing adequate detail as to the factual basis giving rise to a strong inference that SGI and its officers knowingly or recklessly misrepresented the projected success of the company and, as shown by the officer's massive insider trading, had the motive and opportunity to defraud. *Id.* (Browning, J., concurring and dissenting). Thus, Judge Browning would not have dismissed Brody's claim. *Id.* (Browning, J., concurring and dissenting).

rehearing and rehearing en banc.<sup>282</sup> The Ninth Circuit denied both petitions.<sup>283</sup> Judge Reinhardt, along with Judges Pregerson, Tashima, Hawkins, and Graber, dissented from the denial of rehearing en banc, arguing that the court made an erroneous decision when it interpreted the pleading requirement under the PSLRA.<sup>284</sup> Judge Reinhardt, writing for the dissent, began by arguing that the court has a duty to rectify an opinion that "ignores the authority of Congress's words, the dictates of stare decisis, and the uniform conclusion of other circuit courts."<sup>285</sup> Judge Reinhardt then acknowledged that the Ninth Circuit is the only circuit to have "arrive[d] at the remarkable conclusion" that the PSLRA's pleading requirement eliminated recklessness as an adequate level of scienter to impose liability on a defendant.<sup>286</sup> Judge Reinhardt pointed to the Eleventh Circuit's decision in *Bryant v. Avado Brands, Inc.*,<sup>287</sup> which was decided after *In re Silicon Graphics* and explicitly rejected the reasoning of the Ninth Circuit in *In re Silicon Graphics*, to show that rather than setting a trend throughout the circuits by raising the level of scienter required to impose liability on a defendant, the Ninth Circuit had instead been "left [out] in the cold."<sup>288</sup> After questioning the logic of the court in altering the substantive standard of scienter and in replacing the old standard of recklessness with an entirely new and untested standard, Judge Reinhardt concluded by remarking on the newly formed standard of "deliberate recklessness."<sup>289</sup>

For all its ambiguity and peculiarity, however, two things are clear: (1) the "deliberate recklessness" standard is deliberately designed to make it more difficult for innocent persons injured by the reckless conduct of the issuers of securities to obtain recoveries, and (2) the substantive change in the law was made not by Congress but by a panel of [the Ninth Circuit] that substituted its own policy views for those of the legislative branch.<sup>290</sup>

Thus, even the Ninth Circuit is far from a consensus that the PSLRA heightened both the substantive and procedural pleading requirements for securities fraud actions.<sup>291</sup>

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282. *In re Silicon Graphics Inc. Sec. Litig.*, 195 F.3d 521, 522 (9th Cir. 1999).

283. *Id.*

284. *Id.* (Reinhardt, J., dissenting).

285. *Id.* (Reinhardt, J., dissenting).

286. *Id.* at 523 (Reinhardt, J., dissenting).

287. 187 F.3d 1271, 1283 (11th Cir. 1999).

288. *In re Silicon Graphics*, 195 F.3d at 523 (Reinhardt, J., dissenting).

289. *Id.*

290. *Id.*

291. *See id.*

## V. THE IMPACT OF *IN RE SILICON GRAPHICS*

The *In re Silicon Graphics* decision put the Ninth Circuit in conflict with every other circuit court in the country by holding that recklessness does not suffice for liability under the PSLRA.<sup>292</sup> It also placed the Ninth Circuit in the midst of a split in the federal circuits as to the proper interpretation of the pleading requirements under the PSLRA.<sup>293</sup> Because one of the predominant goals of the PSLRA was to create a uniform pleading standard, it is likely that either Congress or the Supreme Court will take action seeking to end the controversy once and for all.<sup>294</sup> In the meantime, however, the impact of this case on pending federal court cases, future plaintiffs, and corporate entities will be significant.<sup>295</sup>

### A. *Impact of In re Silicon Graphics On Pending Cases*

While the *In re Silicon Graphics* case was pending appeal in the Ninth Circuit, courts all over the country, particularly in the Ninth Circuit, delayed making decisions on motions to dismiss for securities fraud cases.<sup>296</sup> Now that *In re Silicon Graphics* has been decided, judges are likely to rule on these motions to dismiss.<sup>297</sup> Many cases that were pending appeal prior to the decision in *In re Silicon Graphics* are now being decided by the Ninth Circuit courts,<sup>298</sup> and as a result of the Ninth Circuit's stringent pleading requirement, appellate courts have

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292. *Id.* at 522 (Reinhardt, J., dissenting).

293. Howard Mintz, *Securities Fraud Just Got Harder To Prove*, THE SALT LAKE TRIB., July 8, 1999, at C7.

294. Edward Brodsky, *Circuits Split on Stock Fraud Scierter Pleading Standard*, N.Y.L.J., September 8, 1999, at 3 (recognizing that "[i]n light of the sharpness of division between the circuits in their interpretation of the Reform Act's scierter pleading standard, it is improbable that the circuits will agree on a consistent standard absent legislative or Supreme Court intervention").

295. See Davan Maharaj & Henry Weinstein, *Ruling Tightens Standard in Investors' Fraud Suits Courts: Shareholders Must Show Company Acted Deliberately, U.S. 9th Circuit Says in Decision Hailed By High-Tech Executives*, L.A. TIMES, July 3, 1999, at C1.

296. Paul Elias & Ellen Rosen, *Justices May Have To Decide What Scierter Applies In Reform Law*, NAT'L L.J., July 19, 1999, at B1 (noting that fewer than 100 of the 643 cases that the Stanford Law School Securities Clearinghouse tracks had been ruled on).

297. Paul Elias, *Shareholder Suits Handcuffed By Court*, ZDNET NEWS FROM ZDWIRE, July 6, 1999, available at 1999 WL 14537749 (noting that courts have been waiting for the circuit courts to hand down their decisions, and as these decisions start to come down many district judges, especially those in California, will rule on pending motions to dismiss).

298. *In re Fritz Co. Sec. Litig.*, No. 98-15558, 1999 WL 997291 (9th Cir. Nov. 2, 1999) (vacating the judgment of the district court finding that the plaintiff's pleading was sufficient and remanding the decision for further review in light of *In re Silicon Graphics*); *accord Zeid v. Kimberley*, No. 96-20136 SW, 1999 WL 993649 (9th Cir. Nov. 1, 1999); see also *Heliotrope Gen., Inc. v. Ford Motor Co.*, 189 F.3d 971 (9th Cir. 1999) (holding that claims based on a manufacturer's alleged failure to disclose information about a possible merger did not satisfy the scierter requirement of the PSLRA because the claims did not state particular information that the defendants should have made public or state particular facts that gave rise to a strong inference of "deliberate recklessness").

found that the plaintiffs in most of these cases have failed to satisfy the pleading standards of the PSLRA.<sup>299</sup>

Courts outside of the Ninth Circuit have awaited the *In re Silicon Graphics* decision before deciding pending cases.<sup>300</sup> The First Circuit recently decided *Greebel v. FTP Software*,<sup>301</sup> where it found that the PSLRA did not adopt or reject the motive and opportunity standard or the circumstantial evidence of recklessness standard or alter the First Circuit's prior law on this point, that the PSLRA did not impose more stringent particularity requirements than those in place in the First Circuit prior to its passage, that the PSLRA imposed the requirement that pleadings raise only a "reasonable" rather than "strong" inference of scienter, and that the PSLRA did not alter the circuit's previous definition of scienter, which included a recklessness standard that was a lesser form of intent.<sup>302</sup> Also recently, the Fourth Circuit, while declining to interpret the pleading requirements of the PSLRA as an interpretation not essential to the disposition of the case at bar, discussed the federal circuit court split as to the interpretation of the PSLRA in *Phillips v. LCI International Inc.*<sup>303</sup> In dicta, the *Phillips* court noted the disagreement among the circuits regarding the standard of pleading which best effectuates Congress' intent in enacting the PSLRA.<sup>304</sup> Several other circuits have yet to make explicit rulings interpreting the pleading and scienter requirements of the PSLRA, and even if they fail to hold in accord with the Ninth Circuit, the Ninth Circuit interpretation is likely to influence their analysis of the issue.<sup>305</sup> Thus, as additional courts interpret the PSLRA, the full effect of the Ninth Circuit ruling will become more apparent.<sup>306</sup>

### B. Impact on Future Plaintiffs

The *In re Silicon Graphics* decision will have a far-reaching impact on the ability of private plaintiffs to bring securities fraud actions against corporate

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299. Scott Thurm, *Technology, Appeals Court Sets High Standard For Shareholders in Stock-Fraud Suits*, WALL ST. J., July 6, 1999, at A23, available at 1999 WL-WSJ 5459113 (noting that plaintiffs' lawyers see the Ninth Circuit's heightened pleading requirement as unfair because prior to discovery plaintiffs are unlikely to have the evidence necessary to plead with particularity).

300. *Elias & Rosen*, *supra* note 296, at B1.

301. 194 F.3d 185 (1st Cir. 1999).

302. *Id.* at 188.

303. 190 F.3d 609, 621 (4th Cir. 1999).

304. *Id.*

305. See, e.g., *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271 (discussing the *In re Silicon Graphics* holding upon interpreting the PSLRA); accord *Greebel v. FTP Software*, 194 F.3d 185 (1st Cir. 1999).

306. As more cases are decided in the circuit courts, many feel that the likely impact of the unprecedented *In re Silicon Graphics* holding will be an appeal of a similar case to the Supreme Court. Robert J. Giuffra, Jr., *Pleading Scienter Under the PSLRA*, N.Y.L.J., July 22, 1999, at 5 (col. 1).

entities.<sup>307</sup> Plaintiffs' attorneys fear that if the *In re Silicon Graphics* decision stands, it will be extremely difficult for plaintiffs to meet the pleading standards that it imposes with the limited information that plaintiffs, as investors, possess.<sup>308</sup> Prior to *In re Silicon Graphics*, it was possible to bring forth evidence of massive insider trading to show fraudulent intent on behalf of corporate officers.<sup>309</sup> Much to the dismay of plaintiffs and plaintiffs' attorneys, in the Ninth Circuit, a showing of insider trading alone is no longer permissible evidence for securities fraud actions.<sup>310</sup> Plaintiffs must now evaluate the insider trading in a larger context, and this context is one that may not be fully apparent to plaintiffs in early stages of a case.<sup>311</sup>

Additionally, the SEC has expressed concern about the interpretation that the Ninth Circuit has given to the PSLRA.<sup>312</sup> In its amicus brief in the *In re Silicon Graphics* appeal, the SEC warned that "[p]roving a defendant's actual knowledge of fraud in a securities case can be a daunting task, particularly when the evidence is entirely circumstantial."<sup>313</sup> The SEC has also voiced concern regarding the Ninth Circuit holding that the scienter requirement was altered by the PSLRA.<sup>314</sup> While *In re Silicon Graphics* was pending on appeal, the SEC lobbied Congress to include language indicating Congressional intent to adopt the Second Circuit standards of scienter and pleading in the PSLRA in the newly legislated Uniform Standards Act.<sup>315</sup> Thus, there is active opposition to the Ninth Circuit interpretation of the pleading requirement by the SEC.<sup>316</sup>

### C. Impact on Corporate Entities

However, the business and technology industries laud the *In re Silicon Graphics* decision, as it makes it more difficult for plaintiffs to bring frivolous claims.<sup>317</sup> As the Ninth Circuit oversees more securities litigation than any other

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307. See Scott Thurm, *Global Corporate Report: U.S. Court Sets Stock-Fraud Suit Standard*, WALL ST. J. EUROPE, July 7, 1999, at 7.

308. See *id.*

309. Elias, *supra* note 297 (noting that "[i]nsider trading has long been the centerpiece of stock fraud class actions," with plaintiffs' lawyers often filing boilerplate language in their complaints); see also Paul Elias, *Securities Ruling Seen As Key For Defendants* N.Y.L.J., July 8, 1999, at 5 (noting that "[f]ully 60 percent of all securities class actions use insider trades as evidence of fraud").

310. Elias, *supra* note 309, at 5.

311. See *id.*

312. See Maharaj & Weinstein, *supra* note 295, at C1 (noting that subsequent to the *In re Silicon Graphics* ruling the SEC maintained that "the judge misinterpreted Congress' intent"). In fact, the SEC has filed amicus briefs in many cases interpreting the pleading requirement of the PSLRA that have gone up to the circuit court level in an effort to persuade these courts to interpret the PSLRA as adopting the Second Circuit pleading standard. Walker & Seymour, *supra* note 12, at 1027.

313. Walker & Seymour, *supra* note 12, at 1027.

314. See *id.* (noting that the SEC argues that recklessness should not be eliminated as a basis for liability).

315. *Id.*

316. See *id.*

317. See Maharaj & Weinstein, *supra* note 295, at C1; see also Elias, *supra* note 297.

federal circuit, the heightened pleading requirements will have a large impact on such litigation.<sup>318</sup> Joseph Grundfest, a securities law professor at Stanford Law School, commented that "[i]n the world of securities class-action legislation, this is big. It makes it harder to sue [corporations] and it gives them an additional measure of protection against litigation that they have viewed as harassing and frivolous."<sup>319</sup> Historically, corporations located in the Ninth Circuit have been especially vulnerable to allegations of securities fraud.<sup>320</sup> Many corporations based in the Ninth Circuit, particularly those located in California, are high-technology companies, and because the technology industry is so vulnerable to market forces, high-technology companies often experience plunging stock prices.<sup>321</sup> Prior to the Ninth Circuit ruling, these plunging prices alone were enough for plaintiffs to make allegations of securities fraud and mismanagement.<sup>322</sup> Companies were forced to either litigate, spending enormous amounts of money while plaintiffs dragged out the discovery process, or settle.<sup>323</sup> Most companies settled.<sup>324</sup> High-technology corporations were active proponents of the PSLRA, which they believed would raise the pleading requirements by requiring particular evidence of fraud, rather than general allegations, to be pled.<sup>325</sup> Therefore, these companies are quite pleased with the interpretation that has been given to the PSLRA by the Ninth Circuit in *In re Silicon Graphics*.<sup>326</sup> However, whether or not the standard as articulated by *In re Silicon Graphics* will survive congressional overhaul or Supreme Court review remains to be seen.<sup>327</sup>

## VI. THE FUTURE OF IN RE SILICON GRAPHICS

Although lawyers, judges, and corporate executives are split on whether the

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318. See Maharaj & Weinstein, *supra* note 295, at C1.

319. *Id.*

320. See *id.*; see also Elias, *supra* note 297.

321. See Maharaj & Weinstein, *supra* note 295, at C1; see also Elias, *supra* note 297.

322. See Elias, *supra* note 309, at 5.

323. Brodsky, *supra* note 294, at 3; see also Maharaj & Weinstein, *supra* note 295, at C1.

324. *Id.*; see also Miranda S. Schiller & Haron W. Murage, *The Circuit Courts Divide on Key Securities Litigation Reform Act Issue: Part II*, METRO. CORP. COUNS., January, 2000, at 1 (noting that in 1998 approximately 235 companies were named as defendants in federal securities fraud class action lawsuits, and that in 1998 the average settlement amount in such lawsuits was over \$10 million).

325. See Maharaj & Weinstein, *supra* note 295, at C1 (noting that executives from many high-tech California corporations joined "corporate America" in 1995 seeking to reform the nation's securities laws and lobbying Congress to override the Presidential veto pass the PSLRA).

326. See *id.* (quoting Bruce Vanyo, an attorney for *In re Silicon Graphics, Inc.*, as saying: "This is wonderful that after four years, we finally have a vindication. Companies that commit real fraud are going to get sued, . . . but companies that don't commit fraud and simply had a bad quarter or unexpected surprises aren't going to get sued").

327. See Elias, *supra* note 309, at 5 (noting that attorneys expect the case to be appealed to the Supreme Court).



Ninth Circuit's interpretation of the PSLRA in *In re Silicon Graphics* was true to congressional intent, one thing that they all agree on is that the pronounced split among the circuits will result in Supreme Court review being sought in a future case interpreting or applying an interpretation of the PSLRA.<sup>328</sup> In fact, Judge Sneed, in his majority opinion in *In re Silicon Graphics*, stated that "not all courts share our view," acknowledging that the issue is one ripe for Supreme Court review.<sup>329</sup> Further, lawyers on both sides of the *In re Silicon Graphics* case have been quoted as saying that they expect a similar case to be appealed to the Supreme Court.<sup>330</sup> It also seems likely that the Supreme Court will grant certiorari if such case is appealed.<sup>331</sup> According to Stanford Law Professor Joseph Grundfest, "[t]here is a clear split in the circuits now, and that is a key factor the Supreme Court looks at" when deciding whether or not to grant certiorari.<sup>332</sup> Thus, the question seems to be not so much whether the Supreme Court will consider the issue, but rather what standard the Supreme Court will adopt.<sup>333</sup>

The standard that the Supreme Court adopts will likely be a result of both a plain language approach to the PSLRA<sup>334</sup> and a consideration of the policy behind the enactment of the PSLRA.<sup>335</sup> The plain language approach to statutory construction has become the preferred method of judicial interpretation in recent years.<sup>336</sup> If the Court takes a plain language approach, it is unlikely that it will find that the PSLRA eliminated recklessness as a standard of liability, as all courts that have interpreted the PSLRA's scienter requirement using only its plain

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328. See Mintz, *supra* note 293, at C7 (noting that both William Lerach, the plaintiffs' attorney, and Bruce Vanyo, an attorney for *In re Silicon Graphics*, predict that the Supreme Court will likely have to define the pleading standards in securities fraud lawsuits).

329. *In re Silicon Graphics* Sec. Litig., 183 F.3d 970, 974 (9th Cir. 1999); see also Elias & Rosen, *supra* note 296, at B1.

330. See Mintz, *supra* note 293, at C7; see also Thurm, *supra* note 307, at 7 (stating that "[a]ttorneys on both sides of the *In re Silicon Graphics* case agreed that the U.S. Supreme Court probably will have to resolve the disputes").

331. See Mintz, *supra* note 293, at C7.

332. *Id.*

333. See Elias & Rosen, *supra* note 296, at B1 (noting that after a "spate" of contradictory circuit court decisions, the Supreme Court may have to determine the scienter standards that will control securities fraud litigation).

334. See Smith, *supra* note 12, at 611 (noting that the Supreme Court has recently begun to engage in a "pattern of statutory interpretation" that favors the use of plain language over legislative history); see also *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994) (reasoning that "[t]he starting point in every case involving [the] construction of a statute" is strict adherence to the plain language of the statute). Justice Scalia, for example, has openly voiced his belief that legislative history lacks legitimacy because it is not the law itself. See Smith, *supra* note 12, at 610. Justice Scalia advocates that courts should be cautious in using legislative history because it is possible that the court could "create an intent for the legislature where none truly existed." *Id.* Thus, Justice Scalia maintains that the only way to properly interpret the intent of a statute is by its plain language. See *id.*

335. Where the plain language of a statute is ambiguous, as in the area of the level of scienter to be pled under the PSLRA, the Court is likely to look to the policy aims of Congress, as evidenced in the Conference Report, in enacting the legislation. See *id.*

336. See *id.*; see also *Central Bank of Denver*, 511 U.S. at 173 (stating that, in determining the scope of section 10(h), the plain meaning of the statute must control).

language have found that the PSLRA did not eliminate liability for recklessness.<sup>337</sup> However, it is not as easy to predict the Supreme Court's plain language interpretation of the PSLRA's procedural pleading requirement because courts that have interpreted the pleading requirement using the plain language of the PSLRA have developed different interpretations of Congress' intent.<sup>338</sup> Because there is nothing in the statute itself that supports a finding that mere allegations of motive and opportunity, without other evidence, are sufficient to survive a motion to dismiss, it is unlikely that the Supreme Court will find the Second Circuit two-prong test sufficient for pleading scienter.<sup>339</sup> Thus, it is likely that the Supreme Court will rule that the PSLRA did not codify the Second Circuit standard of pleading scienter.<sup>340</sup>

As a result of the various interpretations that can be given to the plain language of the PSLRA, it is also likely that the Supreme Court will look to Congress' purpose in enacting the PSLRA and the policy behind it.<sup>341</sup> Because Congress intended to create more stringent pleading requirements in an attempt to deter and eliminate frivolous securities litigation in its enactment of the PSLRA, it is quite possible that the Supreme Court could adopt the Ninth Circuit interpretation of the heightened pleading standard, reasoning that the Second Circuit standard does not raise the bar high enough to serve the policy goals of the PSLRA.<sup>342</sup> Thus, the Supreme Court is likely to find that a plain language reading of the statute compels the retention of the *Sunstrand* recklessness standard and the rejection of the Second Circuit pleading standard, and the court is likely to adopt an interpretation of the statute much like that adopted by the Eleventh Circuit in *Bryant*.<sup>343</sup>

Until the Supreme Court reviews the PSLRA, however, courts and litigants alike will be left to grapple with the interpretation of perhaps one of the most controversial statutes in the area of securities litigation.<sup>344</sup> Indeed, it is likely that both district and appellate courts, even in circuits where an interpretation of the

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337. See, e.g., *Bryant*, 187 F.3d at 1286-87; *Advanta*, 180 F.3d at 533.

338. Compare *Bryant*, 187 F.3d at 1285 (finding that a proper reading of the plain language of the PSLRA demonstrates that Congress did not intend to adopt the Second Circuit standard); with *Advanta*, 180 F.3d at 534 (finding that a proper reading of the plain language of the PSLRA demonstrates that Congress intended to adopt the Second Circuit standard).

339. See *Bryant*, 187 F.3d at 1285; see also Giuffra, *supra* note 306, at 5 (stating that "[t]here is nothing in the PSLRA that supports the conclusion that allegations of motive and opportunity alone are sufficient to require a defendant to go to the enormous expense of defending a securities fraud case").

340. See *id.*

341. See *Bryant*, 187 F.3d at 1286 (holding that, "because the clear purpose of the Reform Act was to curb abusive securities litigation, and because [the court] believe[s] that the motive and opportunity analysis is inconsistent with that purpose, [the court] declines to adopt it").

342. See *id.*

343. See *id.* at 1284 n.21, 1286.

344. See *Elias & Rosen*, *supra* note 296, at B1.

PSLRA has already been adopted, will encounter a great number of opportunities to further refine their interpretations of the PSLRA.<sup>345</sup> Because each circuit court formulating an interpretation of the PSLRA has allowed a degree of latitude in the application of that interpretation, district courts will likely continue to have the ability to allow for consideration of the specific facts and circumstances in each particular case they decide.<sup>346</sup> Additionally, when district courts do grant motions to dismiss for failure to meet the pleading requirements of the PSLRA, appeals from these decisions will be reviewed de novo.<sup>347</sup> Thus, the appellate courts will have additional opportunities to refine their own interpretations of the PSLRA, possibly adapting them to the facts and circumstances of the particular case under consideration.<sup>348</sup> It is also possible that either the Second or Ninth Circuit will allow for consideration of the issue en banc.<sup>349</sup> If such consideration is given, it is possible that either circuit may adopt an interpretation that is very different than the one each now promulgates.<sup>350</sup> The dissenting opinion in the Ninth Circuit's denial of the petition to review the *In re Silicon Graphics* decision en banc is a sound example of the disagreement that exists regarding the interpretation of the PSLRA within that circuit alone, and if a fact pattern were to present itself that were more conducive to a finding for the plaintiffs, a review en banc may yield far different results than the interpretation given by the court in *In re Silicon Graphics*.<sup>351</sup> Thus, even as the circuits courts have begun to weigh in on the proper interpretation of the PSLRA, the issue is far from decided. The circuit courts, Congress, and the Supreme Court may all have an opportunity to devise the "proper" interpretation of the PSLRA. What that interpretation is remains to be seen.

ERIN BRADY<sup>352</sup>

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345. See HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, *EMERGING TRENDS IN SECURITIES LAW* § 2.10 (1999-2000 ed. 1999).

346. See *id.*; see also *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970 (9th Cir. 1999); *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542 (6th Cir. 1999); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525 (3d Cir. 1999); *Press v. Chem. Inv. Serv. Corp.*, 166 F.3d 529 (2d Cir. 1999); *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271 (11th Cir. 1999).

347. See BLOOMENTHAL AND WOLFF, *supra* note 345, at § 2.10.

348. See *id.*

349. See *id.*; see also Marc J. Sonnenfeld and Karen Pieslak Pohlmann, *The Continuing Evolution of the Standard for Pleading Scienter Under the Reform Act*, METRO. CORP. COUNS., November, 1999, at 6 (noting that "the plaintiffs' bar is likely to press for review of [the] issue, possibly by the Supreme Court").

350. See BLOOMENTHAL AND WOLFF, *supra* note 345, at § 2.10.

351. See *id.*; see also *In re Silicon Graphics Sec. Litig.*, 195 F.3d 521, 522-23 (9th Cir. 1999) (Reinhardt, J., dissenting).

352. J.D., Pepperdine University School of Law, 2001.