COMMENT

The Aftermath Of *Silicon Graphics:* Pleading Scienter In Securities Fraud Litigation

TABLE OF CONTENTS

INTRODUCTION

The Securities Exchange Act of 1934 (the "Exchange Act"), and federal rules promulgated under the Exchange Act, regulate the purchase or sale of securities.[1] Specifically, Rule 10b-5 prohibits fraud or deception in connection with the purchase or sale of securities.[2] Either the Securities and Exchange Commission (the "SEC"), or private litigants can bring a suit against a company, alleging securities fraud under Rule 10b-5.[3] Historically, pleading securities fraud required the plaintiff to prove the defendant acted with scienter.[4] Scienter is a mental state that connotes the intent to deceive, manipulate, or defraud.[5]

Since Congress enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA"), several federal circuit courts of appeals have disagreed over the defendant's required mental state in a securities fraud action.[6] In enacting the PSLRA, Congress purported to heighten the pleading standard for causes of action under securities fraud.[7] The PSLRA requires plaintiffs alleging securities fraud to plead facts demonstrating that the defendant acted with the required state of mind.[8] However, the

---

[1] *See* Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1994) (effective Oct.1, 1934); *see also* 17 C.F.R. § 240.10b-5 (Supp. 1999).

[2] *See* 17 C.F.R. § 240.10b-5.

[3] *See* 15 U.S.C. § 78u(d) (giving SEC power to bring injunction proceedings); § 78u-3 (allowing SEC to bring administrative proceedings for securities fraud); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) (stating that there is private cause of action for Rule 10b-5 violations).

[4] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (holding that 10(b) action will not survive dismissal without showing scienter).

[5] *See id.* at 193 & n.12; *see also* BLACK'S LAW DICTIONARY 1345 (6th ed. 1990) (defining scienter as term used to signify defendant's guilty knowledge or misrepresentation with intent to deceive).

[6] *Compare In re* Silicon Graphics, 183 F.3d 970, 980 (9th Cir. 1999) (holding that plaintiff must plead defendant acted with deliberate recklessness), *with In re* Comshare, Inc., 183 F.3d 542, 549 (6th Cir. 1999) (holding that recklessness is sufficient to plead securities fraud, but pleading defendant had motive and opportunity to commit fraud is not sufficient), *and* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (holding that plaintiff only has to plead ordinary recklessness to satisfy scienter and that pleading defendant had motive and opportunity to commit fraud will also satisfy pleading requirement).

[7] *See* H.R. CONF. REP. NO. 104-369, at 41 (1995) (labeling section "Heightened Pleading Standard" and stating congressional intent to strengthen pre-existing pleading standard of Second Circuit).

[8] *See* 15 U.S.C. § 78u-4(b)(2). The statute reads:

> 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.

PSLRA fails to define the required state of mind.[9]

Prior to the enactment of the PSLRA, the Supreme Court declined to state whether recklessness was sufficient to plead scienter.[10] However, every federal circuit that encountered the issue held that recklessness was sufficient to satisfy scienter.[11] The purported heightened pleading standard under the PSLRA created a three-way split of authority among federal circuit courts regarding whether recklessness was still sufficient to satisfy the scienter requirement.[12] This split of authority has resulted in confusion over what a plaintiff must plead when alleging securities fraud.[13]

Id.

[9] *See id.* § 78u-4. Nowhere in the text of the PSLRA does it specifically define or state what is the required state of mind. *See id.*

[10] *See Hochfelder*, 425 U.S. at 193 & n.12. The Supreme Court stated, "In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under §10(b) or Rule 10b-5." *Id.*

[11] *See, e.g.*, Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569-70 (9th Cir. 1990) (adopting Seventh Circuit's definition of recklessness to plead scienter); *In re* Phillips Petroleum Sec. Litig., 881 F.2d 1236, 1244 (3d Cir. 1989) (recognizing that recklessness meets scienter requirement of section 10(b)); Van Dyke v. Coburn Enter., 873 F.2d 1094, 1100 (8th Cir. 1989) (agreeing with majority of circuits that Congress intended recklessness to satisfy scienter); McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989) (stating that showing of severe recklessness is sufficient to satisfy scienter); Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982) (holding that recklessness satisfies scienter requirement); Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961-62 (5th Cir. 1981) (holding that in private action for securities fraud, recklessness satisfies scienter requirement); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023-24 (6th Cir. 1979) (agreeing with majority of circuits that held recklessness is sufficient to plead scienter); Cook v. Avien, Inc., 573 F.2d 685, 692 (1st Cir. 1978) (implying that plaintiff may plead recklessness); Rolf v. Blyth, Eastman Dillion & Co., 570 F.2d 38, 47 (2d Cir. 1978) (finding that reckless misstatement is sufficient to plead securities fraud); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044 (7th Cir. 1977) (holding that reckless omission is actionable under section 10(b)).

[12] *See* Gregory A. Markel & Francis S. Chlapowski, *Life After Silicon Graphics: Will The PSLRA Be Enforced?*, 1151 PLI/CORP 809, 812 (1999) (recognizing three-way split of authority over pleading scienter in securities fraud). The most stringent view is that recklessness only satisfies the scienter requirement if it is deliberate recklessness. *See In re* Silicon Graphics, 183 F.3d 970, 980 (9th Cir. 1999). A second view is the pre-PSLRA standard, which allows recklessness or facts showing the defendant had a motive and opportunity to commit fraud to satisfy scienter. *See In re* Advanta Corp., 180 F.3d 525, 534-35 (3d Cir. 1999); Press v. Chem. Inv. Servs. Corp. 166 F.3d 529, 538 (2d Cir. 1999). The third view permits recklessness to satisfy scienter, but holds that motive and opportunity to commit fraud is insufficient to satisfy scienter. *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1286-87 (11th Cir. 1999); *In re* Comshare, 183 F.3d 542, 551 (6th Cir. 1999).

[13] *See* William H. Kuehnle, *Commentary: On Scienter, Knowledge, and Recklessness under the Federal Securities Laws*, 34 HOUS. L. REV. 121, 122 (1997) (stating that there is uncertainty

For example, if Plaintiff Doe pleads that ACME Inc.'s CEO, Johnson, recklessly misrepresented the corporation's profits with a motive to commit fraud, each circuit would handle the case differently.[14] The Ninth Circuit would dismiss the case because Plaintiff Doe failed to plead that Johnson acted with deliberate recklessness.[15] In the Second or Third Circuit, Plaintiff Doe would have a better case because in these circuits a motive and opportunity to commit fraud is sufficient to plead scienter.[16] Furthermore, Plaintiff Doe's allegation of recklessness would also satisfy the scienter requirement in these circuits.[17]

In the Sixth and Eleventh Circuits, Plaintiff Doe's allegations of motive and opportunity to commit fraud would not satisfy the scienter requirement.[18] However, allegations that Johnson acted recklessly would satisfy scienter.[19] Thus, if Plaintiff Doe shows Johnson acted recklessly when misrepresenting the corporation's profits, Plaintiff Doe's complaint would satisfy the pleading requirement in the Sixth and Eleventh Circuits.[20]

---

as to whether recklessness satisfies scienter in securities fraud context). For example, if a plaintiff files a securities fraud suit in one of the circuits that has not addressed this issue, it is unclear what the plaintiff must plead to satisfy scienter. *See id.*

[14] *See supra* note 6 and accompanying text (listing different pleading standards for scienter). This hypothetical will be used throughout the Comment to illustrate the differences in the circuits' standards.

[15] *See Silicon Graphics*, 183 F.3d at 979 (requiring plaintiff to show defendant acted with deliberate recklessness to satisfy scienter). In the example, the plaintiff has only plead facts showing the defendant acted with recklessness. Under the Ninth Circuit standard set in *Silicon Graphics*, the plaintiff must plead the defendant acted with deliberate recklessness. *See id.*

[16] *See Advanta*, 180 F.3d at 534-35 (finding motive and opportunity to commit fraud sufficient to plead scienter); *Press*, 166 F.3d at 537-38 (holding that motive and opportunity to commit fraud is sufficient to satisfy scienter). In the example, the plaintiff has pled facts showing the CEO had an improper motive for misrepresenting the corporation's profits. Pleading facts that show an improper motive is sufficient to satisfy scienter under the Second and Third Circuits' standard. *See Advanta*, 180 F.3d at 534-35; *Press*, 166 F.3d at 537-38.

[17] *See Advanta*, 180 F.3d at 534-35 (finding that recklessness is sufficient to plead scienter); *Press*, 166 F.3d at 537-38 (holding that recklessness satisfies scienter requirement).

[18] *See* Bryant v. Avado Brands, 187 F.3d 1271, 1285-86 (11th Cir. 1999) (refusing to allow motive and opportunity to commit fraud to satisfy scienter); *In re* Comshare, 183 F.3d 542, 551 (6th Cir. 1999) (holding that motive and opportunity test is insufficient to plead scienter).

[19] *See Bryant*, 187 F.3d at 1285-86 (holding that recklessness is sufficient to satisfy scienter); *Comshare*, 183 F.3d at 551 (holding that plaintiff need only plead facts giving rise to inference of recklessness).

[20] *See Bryant*, 187 F.3d at 1285-86 (holding that recklessness is sufficient to satisfy scienter); *Comshare*, 183 F.3d at 551 (holding that plaintiff only need plead facts giving rise to inference of recklessness). In the example, the plaintiff pled facts showing the CEO acted

This Comment attempts to resolve the disagreement in pleading securities fraud. Part I provides a general discussion of the requirements for pleading scienter in securities fraud litigation, and Part II analyzes the three-way split of authority. Part III shows the weaknesses and strengths of the two methods of statutory interpretation that the circuits used to interpret the PSLRA.[21] Part III argues that the PSLRA mandates an intentional form of conduct, albeit a heightened form of recklessness, as the required state of mind for pleading securities fraud. Finally, Part III concludes that the Ninth Circuit has come closest to this standard by requiring deliberate recklessness.[22]

I. BACKGROUND

The prohibition against securities fraud originated in the Exchange Act.[23] In 1976, the United States Supreme Court interpreted the Exchange Act to require intentional conduct to plead securities fraud, but left open the question whether recklessness was a form of intentional conduct.[24] For approximately the next twenty years, every federal court of appeals that addressed the issue held that recklessness satisfied the scienter requirement in securities fraud.[25]

---

with recklessness when the CEO misrepresented the corporation's profits. Pleading facts that demonstrate the defendant acted with recklessness is sufficient to satisfy scienter in the Sixth and Eleventh Circuits. *See Bryant*, 187 F.3d at 1285-86; *Comshare*, 183 F.3d at 551.

[21] *See Bryant*, 187 F.3d at 1284 (adopting contemporary legal context approach to interpret PSLRA); *In re* Silicon Graphics, 183 F.3d 970, 975-79 (9th Cir. 1999) (using plain language and legislative history approach to interpreting PSLRA); *Comshare*, 183 F.3d at 549-50 (using contemporary legal context approach to interpret PSLRA); *Advanta*, 180 F.3d at 534 (using plain language and legislative history analysis to adopt Second Circuit standard); *Press*, 166 F.3d at 537-38 (concluding that PSLRA adopted Second Circuit standard without giving any justification for that conclusion).

[22] *See Silicon Graphics*, 183 F.3d at 979 (requiring deliberate recklessness to satisfy scienter in Ninth Circuit).

[23] Securities Exchange Act of 1934, 15 U.S.C. § 78j(b)(1994) (effective Oct. 1, 1934).

[24] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976) (requiring intentional conduct to satisfy Exchange Act). The Court stated that recklessness is intentional conduct in some areas of law, but it failed to settle whether recklessness is intentional conduct in the securities fraud context. *See id.* at 193 & n.12.

[25] *See, e.g.*, Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569-70 (9th Cir. 1990) (adopting Seventh Circuit's definition of recklessness to plead scienter); *In re* Phillips Petroleum Sec. Litig., 881 F.2d 1236, 1244 (3d Cir. 1989) (recognizing that recklessness meets scienter requirement of section 10(b)); Van Dyke v. Coburn Enter., 873 F.2d 1094, 1100 (8th Cir. 1989) (agreeing with majority of circuits that Congress intended recklessness to satisfy scienter); McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989) (stating that showing of severe recklessness is sufficient to satisfy scienter); Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982) (holding that recklessness satisfies scienter requirement); Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961-62 (5th Cir. 1981) (holding

In 1995, Congress enacted the PSLRA, which stated that plaintiffs must plead facts showing that the defendant acted with the required state of mind.[26] However, Congress failed to describe the required state of mind.[27] In 1999, the Ninth Circuit changed its position on the scope of scienter, ruling that the PSLRA requires a showing of deliberate recklessness, a form of intentional conduct, to plead securities fraud.[28] Other circuits retained the recklessness standard, but disagreed on whether showing that the defendant had the motive and opportunity to commit fraud satisfied the state of mind requirement.[29] A general understanding of the scienter requirement's history in securities fraud litigation is necessary to comprehend the current split of authority.

A. The Prohibition of Securities Fraud: Section 10(b) and Rule 10b-5

Section 10(b) of the Exchange Act prohibits securities fraud.[30] Specifically, section 10(b) outlaws the use of any fraudulent scheme relating to the sale or purchase of securities.[31] The Exchange Act gave the

---

that in private action for securities fraud, recklessness satisfies scienter requirement); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023-24 (6th Cir. 1979) (agreeing with majority of circuits that held recklessness is sufficient to plead scienter); Cook v. Avien, Inc., 573 F.2d 685, 692 (1st Cir. 1978) (implying that plaintiff may plead recklessness); Rolf v. Blyth, Eastman Dillion & Co., 570 F.2d 38, 47 (2d Cir. 1978) (finding that reckless misstatement is sufficient to plead securities fraud); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044 (7th Cir. 1977) (holding that reckless omission is actionable under section 10(b)).

[26] 15 U.S.C. § 78u-4(b)(2) (Supp. IV 1998).

[27] *See generally id.* § 78u-4 (showing that PSLRA fails to mention what required state of mind is for securities fraud).

[28] *Compare In re* Silicon Graphics, 183 F.3d 970, 977 (9th Cir. 1999) (requiring plaintiff to plead facts that demonstrate defendant acted with deliberate recklessness), *with Hollinger*, 914 F.2d at 1569-70 (stating that mere recklessness is sufficient to plead scienter in securities fraud litigation).

[29] *Compare In re* Advanta Corp., 180 F.3d 525, 534-35 (3d Cir. 1999) (holding that plaintiff must plead defendant acted with reckless behavior or had motive and opportunity to commit fraud), *and* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (holding motive and opportunity to commit fraud and reckless behavior sufficient to plead securities fraud), *with* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1286-87 (11th Cir. 1999) (holding recklessness standard sufficient to plead scienter, but motive and opportunity to commit fraud insufficient), *and In re* Comshare, Inc., 183 F.3d 542, 551 (6th Cir. 1999) (holding that plaintiff must plead that defendant acted with recklessness, but pleading motive and opportunity to commit fraud is not sufficient).

[30] Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1994) (effective Oct. 1, 1934).

[31] *Id.* Section 10(b) prohibits one "to use or employ, in connection with the purchase or sale of any security. . .any manipulative or deceptive device or contrivance in contravention of such rules and regulations." *Id.*

SEC power to promulgate rules to enforce the Exchange Act.[32] Exercising this power, the SEC created Rule 10b-5 to enforce section 10(b).[33] Rule 10b-5 forbids any act that would operate as fraud or deceit upon a person in the securities market.[34]

To state a claim under section 10(b) and Rule 10b-5, a plaintiff must allege four things.[35] First, the plaintiff must allege the defendant made a false material misrepresentation or omitted material information in connection with the purchase or sale of securities.[36] Second, the plaintiff must show justifiable reliance upon the misrepresentation or omission.[37] Third, the plaintiff must plead that the misrepresentation or omission proximately caused the plaintiff's injury.[38] Finally, the plaintiff must plead that the defendant acted with the required state of mind.[39] Neither section 10(b) nor Rule 10b-5 specifically states the required state of mind needed to commit securities fraud.[40] The Supreme Court was thus left to determine the required state of mind in *Ernst & Ernst v. Hochfelder*.[41]

---

[32] *See id.* § 23 (1994) (granting power to SEC to make rules to enforce Exchange Act).

[33] *See* 17 C.F.R. § 240.10b-5 (Supp. 1999).

[34] *See id.* (making it unlawful to defraud, make any untrue statement of material fact, or engage in any practice that operates as fraud or deceit upon person in connection with exchange of securities).

[35] *See In re* Comshare, Inc., 183 F.3d 542, 548 (6th Cir. 1999) (listing the requirements to state a claim under section 10(b) and Rule 10b-5); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 534 (2d Cir. 1999) (explaining the requirements for pleading securities fraud under section 10(b) and Rule 10b-5); *In re Time Warner Inc.*, 9 F.3d 259, 264 (2d Cir. 1993) (listing requirements for alleging securities fraud).

[36] *See* 17 C.F.R. § 240.10b-5; *see also Comshare*, 183 F.3d at 548 (listing misrepresentation or omission of material fact as requirement); *Press*, 166 F.3d at 534 (requiring material misrepresentation or omission of material fact); *Time Warner*, 9 F.3d at 264 (listing material misrepresentation or omission as requirement under section 10(b) and Rule 10b-5).

[37] *See Comshare*, 183 F.3d at 548 (listing reliance requirement for securities fraud); *Press*, 166 F.3d at 534 (requiring reliance to allege securities fraud); *Time Warner*, 9 F.3d at 264 (listing reliance as requirement under section 10(b) and Rule 10b-5).

[38] *See Comshare*, 183 F.3d at 548 (listing proximate cause as requirement for securities fraud); *Press*, 166 F.3d at 534 (requiring proximate cause to allege securities fraud); *Time Warner*, 9 F.3d at 264 (listing proximate cause as requirement under section 10(b) and Rule 10b-5).

[39] *See Comshare*, 183 F.3d at 548 (listing scienter as required state of mind for securities fraud); *Press*, 166 F.3d at 534 (requiring scienter to allege securities fraud); *Time Warner*, 9 F.3d at 264 (listing scienter as required state of mind under section 10(b) and Rule 10b-5).

[40] Securities Exchange Act of 1934, 15 U.S.C. § 78j (1994) (effective Oct. 1, 1934); 17 C.F.R. § 240.10b-5.

[41] 425 U.S. 185 (1976).

B. Ernst & Ernst v. Hochfelder

In 1976, the United States Supreme Court decided whether section 10(b) required intentional conduct or negligence.[42] In *Hochfelder*, customers of a brokerage firm that embezzled its clients' investments sued the brokerage firm's accountants.[43] Ernst & Ernst, the defendant accounting firm, audited the brokerage firm's books and records.[44] The plaintiffs alleged that Ernst & Ernst assisted in the brokerage firm's violation of section 10(b) and Rule 10b-5 by failing to conduct proper audits of the brokerage firm.[45] The plaintiffs acknowledged that Ernst & Ernst did not intentionally defraud them, but argued that they committed negligence by failing to conduct proper audits.[46]

Ernst & Ernst moved for summary judgment, and the district court granted the motion.[47] The district court found that there was no genuine issue of material fact with respect to how the defendant had conducted its audits.[48] However, the district court rejected the defendant's argument that allegations of negligence cannot support a section 10(b) action.[49] The Seventh Circuit reversed, holding that one who negligently breached a duty of inquiry or disclosure to a third party could be liable for the third party's violation of section 10(b) and Rule 10b-5.[50] The Supreme Court granted certiorari to determine whether a private cause of action under section 10(b) and Rule 10b-5 could survive summary judgment absent an allegation of scienter.[51]

The Court recognized that to establish liability under section 10(b), the plaintiff must demonstrate the defendant acted with the required state of mind.[52] The Court decided the required state of mind was scienter,

---

[42] *See id.* at 197 (ruling that section 10(b) intended to proscribe intentional conduct).

[43] *See id.* at 189. The president of the brokerage firm induced plaintiffs to invest funds in escrow accounts that did not exist, instead the president converted the funds to his own personal use. *See id.*

[44] *Id.* at 188.

[45] *Id.* at 190.

[46] *Id.* The plaintiffs' complaint admitted that the defendant did not intentionally commit fraud. *Id.* The plaintiffs based their cause of action on negligence theory. *Id.*

[47] *Id.* at 191.

[48] *Id.* The district court dismissed, finding no genuine issue of material fact regarding whether the defendant conducted its audits in accordance with generally accepted accounting principles. *Id.*

[49] *Id.*

[50] Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1118 (7th Cir. 1974).

[51] *See Hochfelder*, 425 U.S. 185, 194 (1976). Scienter refers to the mental state embracing intent to deceive, manipulate, or defraud. *Id.* at 193 n.12.

[52] *Id.* at 193.

which connoted intentional conduct.[53] The Court explained that the section 10(b) words "manipulative" and "deceptive" used in connection with the terms "device" or "contrivance" suggested that section 10(b) required knowing or intentional conduct.[54] The *Hochfelder* Court also stated that Congress intended the Exchange Act to proscribe a type of conduct quite different from negligence.[55] The Court concluded that to successfully bring a securities fraud action a plaintiff must plead that a defendant acted with scienter, a form of intentional conduct.[56] In *Hochfelder*, the plaintiffs admitted the defendant did not act intentionally.[57] Therefore, the Court found that the defendant had not acted with scienter and held the defendant was not liable.[58]

Although negligence was insufficient, the Court noted that recklessness may be a sufficient form of intentional conduct in securities fraud litigation.[59] It recognized that reckless behavior was a form of intentional conduct in certain areas of the law.[60] But the Court left open

---

[53] *Id.* The Court held that a plaintiff must plead facts that demonstrate the defendant acted with scienter. *Id.* Scienter is a form of intentional conduct. *Id.* at 201.

[54] *Id.* at 197. The Court stated that the language of section 10(b) "clearly connotes intentional misconduct." *Id.* at 201.

[55] *Id.* at 199. Several other federal courts and distinguished commentators also agree that the securities fraud provision of the Exchange Act does not encompass negligence. *See, e.g.*, SEC v. Steadman, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (stating that recklessness must be more than heightened form of negligence in section 10(b) action); Clegg v. Conk, 507 F.2d 1351, 1361-62 (10th Cir. 1974) (requiring scienter or conscious fault for section 10(b) action); Lanza v. Drexel & Co., 479 F.2d 579, 606 (2d Cir. 1973) (holding that negligence is insufficient in securities fraud context); Kuehnle, *supra* note 13, at 124 (recognizing section 10(b) action as not encompassing negligence); Recent Case, *Securities Acts-Federal Securities Exchange Act*, 82 HARV. L. REV. 938, 947 (1969) (implying that section 10(b) requires scienter, and negligence is insufficient).

[56] *Hochfelder*, 425 U.S. at 193 n.12.

[57] *Id.* at 190.

[58] *Id.* at 215.

[59] *Id.* The Supreme Court stated:

> In this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud. In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under section 10(b) and Rule 10b-5.

Id.

[60] *Id.* Recklessness may consist of two different types of conduct: 1) where the actor knows the risk and deliberately proceeds to act, and 2) where the actor does not realize the degree of risk but proceeds to act negligently. *See* RESTATEMENT (SECOND) OF TORTS § 500 cmt. a (1965); *see also* W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS § 8, at 36 (5th ed. 1984) (stating that difference between intentional recklessness and negligent

the question of whether reckless behavior gives rise to a cause of action in securities fraud litigation.[61]

For the next twenty years, federal courts tried to answer the question of whether recklessness was sufficient to plead scienter in securities fraud litigation.[62] All of the circuits that addressed this question answered in the affirmative.[63] From 1976 to 1995, reckless behavior was sufficient to bring a private cause of action for securities fraud.[64] In 1995, however, Congress enacted the PSLRA, which purported to heighten the existing pleading standard.[65]

---

recklessness is matter of degree).

[61] *See Hochfelder*, 425 U.S. at 193 n.12 (declining to answer if recklessness is form of intentional conduct in securities fraud).

[62] *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1284 (11th Cir. 1999) (recognizing that majority of circuits have faced question whether recklessness satisfies scienter). After the *Hochfelder* decision, up until the PSLRA, the majority of circuits had to decide whether recklessness satisfied the scienter requirement. *See, e.g.*, Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569-70 (9th Cir. 1990); *In re* Phillips Petroleum Sec. Litig., 881 F.2d 1236, 1244 (3d Cir. 1989); Van Dyke v. Coburn Enter., 873 F.2d 1094, 1100 (8th Cir. 1989); McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989); Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982); Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961-62 (5th Cir. 1981); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023-24 (6th Cir. 1979); Cook v. Avien, Inc., 573 F.2d 685, 692 (1st Cir. 1978); Rolf v. Blyth, Eastman Dillion & Co., 570 F.2d 38, 47 (2d Cir. 1978); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044 (7th Cir. 1977).

[63] *See, e.g., Hollinger*, 914 F.2d at 1569-70 (adopting Seventh Circuit's definition of recklessness to plead scienter); *Phillips Petroleum*, 881 F.2d at 1244 (recognizing that recklessness meets scienter requirement of section 10(b)); *Van Dyke*, 873 F.2d at 1100 (agreeing with majority of circuits that Congress intended recklessness to satisfy scienter); *McDonald*, 863 F.2d at 814 (stating that showing of severe recklessness is sufficient to satisfy scienter); *Hackbart*, 675 F.2d at 1117 (holding that recklessness satisfies scienter requirement); *Broad*, 642 F.2d at 961-62 (holding that in private action for securities fraud, recklessness satisfies scienter requirement); *Mansbach*, 598 F.2d at 1023-24 (agreeing with majority of circuits that held recklessness is sufficient to plead scienter); *Cook*, 573 F.2d at 692 (implying that plaintiff may plead recklessness); *Rolf*, 570 F.2d at 47 (finding that reckless misstatement is sufficient to plead securities fraud); *Sundstrand*, 553 F.2d at 1044 (holding that reckless omission is actionable under section 10(b)).

[64] *See Bryant*, 187 F.3d at 1284 (stating that every circuit to address issue before PSLRA decided that recklessness satisfied scienter); *see also supra* note 11 and accompanying text (listing decisions between 1976 and 1995 holding that recklessness was sufficient to plead scienter).

[65] *See* 15 U.S.C. § 78u-4 (Supp. IV 1998); *see also* H.R. CONF. REP. NO. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740 (stating in section "Heightened Pleading Standard" that Conference Committee intended to strengthen pleading standard above that of Second Circuit's, which then was most stringent standard).

C. The Private Securities Litigation Reform Act of 1995

Congress enacted the PSLRA to curb abuses in securities fraud litigation.[66] One of the PSLRA's primary purposes was to curtail frivolous lawsuits.[67] To achieve this end, Congress sought to heighten the pleading requirement for securities fraud actions.[68] Although Congress's objective appeared concrete, courts have interpreted the PSLRA inconsistently.[69]

1. The PSLRA's Statutory Language

The PSLRA outlines the requirements for securities fraud actions.[70] Among other things, the PSLRA requires that a defendant act with the required state of mind.[71] Like the Exchange Act, however, the PSLRA does not indicate what the required state of mind is.[72] The PSLRA only states that the defendant have the required state of mind, and that the plaintiff plead facts that show the defendant acted with that state of mind.[73]

Unlike the section outlining the requirements for securities fraud, the PSLRA's safe harbor provision expressly defines the required state of

---

[66] *See* H.R. CONF. REP. NO. 104-369, at 32, (stating that PSLRA protects investors from abusive securities litigation).

[67] *Id.*

[68] *See id.* at 41 (implying that Congress intended to heighten pre-existing recklessness standard).

[69] *See, e.g., Bryant*, 187 F.3d at 1286-87 (holding plaintiff may plead reckless behavior, but motive and opportunity to commit fraud is insufficient); *In re* Silicon Graphics, 183 F.3d 970, 979 (9th Cir. 1999) (requiring plaintiff to plead facts giving rise to deliberate or conscious recklessness); *In re* Comshare, Inc., 183 F.3d 542, 551 (6th Cir. 1999) (holding that plaintiffs need only plead recklessness to satisfy scienter, but pleading defendant had motive and opportunity to commit fraud is insufficient); *In re* Advanta Corp., 180 F.3d 525, 534-35 (3d Cir. 1999) (holding that recklessness and motive and opportunity to commit fraud sufficient to plead scienter); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (stating that both recklessness and motive and opportunity to commit fraud is sufficient to plead scienter).

[70] *See* 15 U.S.C. § 78u-4(b). The requirements for securities fraud include (1) misleading statements and omissions, (2) required state of mind, and (3) causation. *Id.*

[71] *See id.* § 78u-4(b)(2). The statute states that the plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Id.*

[72] *Id.* § 78u-4. Nowhere in the text of the PSLRA does it specifically define or state what is the required state of mind. *See id.; see also* Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1994) (effective Oct. 1, 1934) (lacking definition of what is required state of mind in securities fraud).

[73] 15 U.S.C. § 78u-4(b)(2).

mind necessary to avoid securities fraud liability.[74] The safe harbor provision protects defendants from liability for alleged misrepresentations or omissions of material facts.[75] The safe harbor protects defendants from liability when the plaintiff fails to prove the individual making the statement made it with actual knowledge that the statement was false or misleading.[76] Therefore, unlike the PSLRA's pleading requirements, the PSLRA's safe harbor provision expressly states that "actual knowledge" is the state of mind necessary to defeat the safe harbor protection.[77] Congress designed the safe harbor, along with the actual knowledge requirement, to curtail abusive securities fraud litigation.[78]

2. Policy Against Abusive Securities Fraud Litigation

Abusive securities fraud litigation led Congress to enact the PSLRA.[79] Abusive practices in private securities litigation include suing when there is a change in stock price, targeting wealthy defendants for lawsuits, and abusing the discovery process.[80] Plaintiffs file hundreds of private class action suits annually alleging securities fraud violations, and have recovered billions of dollars from these claims.[81] Defendant

---

[74] *Compare id.* § 78u-4(b) (showing requirements of pleading securities fraud, yet lacking definition for required state of mind), *with id.* § 78u-5(c) (declaring that defendant can invoke safe harbor if plaintiff fails to prove defendant acted with actual knowledge).

[75] *See* 15 U.S.C. § 78u-5(c).

[76] *See id.* § 78u-5(c)(1)(B)(i).

[77] *See id.* § 78u-4(b) (stating that requirements of pleading securities fraud include pleading facts that imply defendant acted with required state of mind, yet lacking definition for required state of mind); *see also id.* § 78u-5(c) (declaring that defendant can invoke safe harbor if plaintiff fails to prove defendant acted with actual knowledge).

[78] See H.R. CONF. REP. NO. 104-369, at 32 (1995) (stating Congressional objective to curtail abusive securities fraud litigation).

[79] *See id.* (stating congressional intent to curtail existing abusive securities fraud litigation).

[80] *See id.* at 31 (listing several types of evidence of abuse in securities fraud litigation); *see also* 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*, 39 SANTA CLARA L. REV. 577, 577-78 (listing reasons why securities fraud is abusive).

[81] *See* Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 963, 963 (1994) (examining volume of securities fraud lawsuits and settlements that occurred). In 1992, plaintiffs filed 268 securities fraud class actions and over 642 cases were still pending. *See* Administrative Office of the United States Courts, Annual Report of the Director, tbls. X-4, X-5, at 365-66 (1992). A study of 80 settlements reached between July 1991 and June 1992 totaled 846.7 million dollars in recoveries, an average of 10.58 million dollars per case. *See* John C. Coffee, Jr., *New Myths and Old Realities: The American Law Institute Faces the Derivative Action*, 48 BUS. LAW. 1407, 1438 n.123 (1993).

corporations have complained to the courts and Congress that they have been victims of an epidemic of frivolous lawsuits.[82] They complain that plaintiffs confuse securities fraud with stock market volatility, equating sharp drops in the price of their securities with securities fraud.[83]

When it enacted the PSLRA, Congress relied upon an article by Professor Janet Cooper Alexander on securities class actions.[84] Alexander's study found that plaintiffs filed lawsuits against every company in the high technology industry whose stock declined significantly in 1983.[85] Alexander further found that almost every one of these suits settled, and that the suits settled for approximately twenty-five percent of the damage exposure.[86] She concluded that these lawsuits forced corporations to settle because they were unwilling to take the risk a jury could find them fully liable.[87]

Courts have listened and reacted to corporations' complaints of frivolous lawsuits.[88] Congress is also highly sensitive to the defendants'

---

[82] *See* Grundfest, *supra* note 81, at 972 (stating that plaintiffs often file abusive lawsuits because of change in stock prices); *see also Securities Fraud Hearings Before the Subcomm. of the Senate Comm. on Banking, Housing & Urban Affairs* 103rd Cong. 5 (1993) [hereinafter *Securities Fraud Hearings*] (statements of Sen. John G. Adler, Sen. Edward R. McCracken, Sen. Richard J. Egan & Sen. F. Thomas Dunlop, Jr.) (calling for better filters that would reduce meritless litigation and facilitate dismissing baseless claims earlier in litigation process).

[83] *See* John C. Coffee, Jr., *The "New Learning" on Securities Litigation*, N.Y. L.J., Mar. 25, 1993, at 5 (noting that empirical studies show that sharp decline in securities translates into securities fraud allegations); Grundfest, *supra* note 81, at 972 (stating that plaintiffs often think that stock market changes result from securities fraud); *Senate Panel Hears Views on Reducing Number of Frivolous Rule 10b-5 Actions*, 25 SEC. REG. & L. REP. (BNA) 847, 847 (June 18, 1993) (noting that plaintiffs often file securities fraud suits after 10 percent drop in value of securities prices).

[84] *See* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 497 (1991); *see also* S. REP. NO. 104-98, at 8 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 687 (relying on Alexander's study); H.R. REP. NO. 104-50, at 1 (1995) (recognizing Alexander's findings); William S. Lerach, *The Implications of the Private Securities Litigation Reform Act*, 76 WASH. U.L.Q. 597, 598 (1998) (claiming that proponents of curtailing abusive securities litigation relied heavily upon Alexander's article).

[85] *See* Alexander, *supra* note 84, at 500 (claiming that plaintiffs filed lawsuits against every company in technology industry whose stock declined significantly following its initial stock offering).

[86] *Id.*

[87] *Id.* at 530; *see also Securities Fraud Hearings*, *supra* note 82, at 6-7 (finding that one-eighth of all firms listed on NYSE have been sued in preceding five years, although it is unlikely that so many American companies engage in fraud).

[88] *See, e.g.*, Cent. Bank of Denver v. First Interstate Bank, 511 U.S. 164, 175 (1994) (holding that private plaintiff may not maintain "aiding-and-abetting" claim under section 10(b)); Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 359-62 (1991) (imposing shorter statute of limitations on filing securities fraud lawsuits); Ernst & Ernst v.

arguments that courts and Congress need to control the abusive litigation.[89] The policy against frivolous securities litigation and Alexander's study were the primary influences behind the PSLRA.[90] One of the ways Congress sought to achieve this policy objective was through a heightened pleading standard.[91]

3. The PSLRA's Legislative History

The PSLRA's legislative history indicates that Congress intended to heighten the current pleading standard to curtail frivolous securities fraud litigation.[92] However, the PSLRA's legislative history, like the PSLRA's statutory language, does not specifically define the required state of mind.[93] The only evidence of a definition of the required state of mind is found in Congress's stated objective in the legislative history of the PSLRA.[94] The objective provides that Congress intended to produce a stricter standard for pleading securities fraud than that of the Second Circuit.[95]

When it adopted the PSLRA, Congress recognized that the Second Circuit standard was the strictest standard among the federal circuits.[96] However, Congress declined to codify the Second Circuit standard.[97] In

---

Hochfelder, 425 U.S. 185, 193 (1976) (requiring scienter to plead securities fraud); *see also* Grundfest, *supra* note 81, at 991-94 (stating that courts have reacted to defendant's complaints of frivolous lawsuits).

[89] *See* H.R. CONF. REP. NO. 104-369, at 32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 731 (showing congressional intent to curtail abusive securities fraud litigation).

[90] *See* S. REP. NO. 104-98, at 8 (1995), *reprinted in* 1995 U.S.C.C.A.N. 979, 987 (mentioning reliance on Alexander's article); H.R. REP. NO. 104-50, at 1 (1995) (stating reliance on Alexander's study); H.R. CONF. REP. NO. 104-369, at 32 (showing congressional intent to curtail abusive and frivolous securities litigation); Lerach, *supra* note 84, at 598 (claiming that proponents of curtailing abusive securities litigation relied heavily upon Alexander's article).

[91] *Compare* H.R. CONF. REP. NO. 104-369, at 32 (stating objective to curtail abusive securities practices), *with id.* at 41 (stating congressional intent to heightened pleading standard).

[92] *See* H.R. CONF. REP. NO. 104-369, at 41, (labeling section "Heightened Pleading Standard" and stating congressional intent to strengthen pre-existing pleading standard of Second Circuit).

[93] *See generally id., reprinted in* 1995 U.S.C.C.A.N. 730 (lacking definition of "required state of mind"); S. REP. NO. 104-98 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679 (giving no definition for "required state of mind").

[94] *See* H.R. CONF. REP. NO. 104-369, at 41 (stating intention to strengthen existing pleading requirements above that of Second Circuit standard).

[95] *See id.*

[96] *See id.*

[97] *See id.*

a Conference Report, Congress expressed its intent to raise the pleading standard above the Second Circuit standard.[98] Congress stated that they chose not to use the Second Circuit standard, in the PSLRA, because Congress intended to heighten the pleading standard above the Second Circuit standard.[99]

President Clinton recognized the congressional intent to heighten the pleading standard and vetoed the PSLRA.[100] In vetoing the PSLRA, President Clinton stated that he disagreed with the PSLRA because it raised the pleading standard above that of the Second Circuit standard.[101] Congress subsequently overrode President Clinton's veto and enacted the PSLRA.[102]

Another important piece of legislative history concerning the PSLRA surfaced in the Securities Litigation Uniform Standards Act of 1998 ("Standards Act").[103] Congress enacted the Standards Act in response to a dramatic shift of securities fraud lawsuits from federal courts to state courts, after Congress enacted the PSLRA.[104] Congress was concerned that plaintiffs were avoiding the PSLRA's heightened pleading standard by filing in state courts.[105] Therefore, the Standards Act made any class action brought in state court removable to federal court.[106] In response to

---

[98] *See id.*

[99] *See id.* at 41 n.23. Congress stated that it intended to heighten the standard above the Second Circuit standard, and "for this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness." *Id.*

[100] *See* 141 CONG. REC. H15,214 (daily ed. Dec. 20, 1999) (showing President Clinton's recognition of PSLRA's heightened pleading standard above that of Second Circuit when he vetoed PSLRA).

[101] *See id.*

[102] *See* Robert J. Giuffra, Jr., *CEOs Beware: The Strict Suit Lives*, WALL ST. J., Sept. 13, 1999, at A45 (stating that Congress overrode President Clinton's veto of PSLRA); *see also* 15 U.S.C. § 78u-4 (Supp. IV 1998) (enacting PSLRA).

[103] *See* Pub. L. No. 105-353, 112 Stat. 3227 (1998); *see also* S. REP. NO. 105-182, at 5-6 (1998) (showing legislative history concerning PSLRA in Standards Act's legislative history); H.R. CONF. REP. NO. 105-803, at 2 (1998) (stating congressional concern about PSLRA).

[104] *See* S. REP. NO. 105-182, at 3 (describing Congressional awareness of noticeable shift in class action litigation from federal courts to state courts); H.R. CONF. REP. NO. 105-803, at 1 (taking notice of dramatic shift of securities litigation from federal court to state court since Congress enacted PSLRA).

[105] *See* S. REP. NO. 105-182, at 3-5 (expressing concern that having different standards in federal and state courts allows plaintiffs to circumvent federal standards by suing in state courts); H.R. CONF. REP. NO. 105-803, at 1-2 (stating concern for ease of avoiding PSLRA by filing in state court).

[106] *See* 112 Stat. 3227, § 16(c). Section 16(c) states, "Any covered class action brought in any state court involving a covered security. . .shall be removable to the Federal district court for the district in which the action is pending." *Id.*

plaintiffs' purported circumvention of the PSLRA's stricter scienter requirement, Congress stated in the Standards Act's legislative history, that the PSLRA did not abandon the Second Circuit standard.[107] The Standard Act's legislative history indicates that, under the PSLRA, Congress did not intend to heighten the pleading standard above the Second Circuit standard.[108] The lack of congressional clarity regarding the required scienter for securities fraud in the PSLRA's plain meaning and legislative history, led to the current three-way split of authority.[109]

II. STATE OF THE LAW: THREE-WAY SPLIT OF AUTHORITY

Since Congress enacted the PSLRA, federal courts have tried to determine the PSLRA's effect on the scienter requirement.[110] The circuit courts have failed to agree, however, on whether recklessness constitutes scienter under the PSLRA.[111] Consequently, a three-way split of authority has formed over the PSLRA's effect on the scienter requirement.[112]

---

[107] *See* S. REP. NO. 105-182, at 5-6.

[108] *See id.*

[109] *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282-83 (11th Cir. 1999) (addressing difference in opinion over interpretation of PSLRA); *In re* Silicon Graphics, Inc. 183 F.3d 970, 974-75 (9th Cir. 1999) (blaming lack of consistent interpretation of PSLRA for conflict amongst circuit courts about scienter requirement).

[110] *See, e.g., Bryant*, 187 F.3d at 1282-86 (evaluating effect PSLRA had on scienter requirement); *Silicon Graphics*, 183 F.3d at 974-79 (examining effect of PSLRA on scienter requirement); *In re* Comshare, Inc., 183 F.3d 542, 548-51 (6th Cir. 1999) (examining effect of PSLRA on scienter requirement in securities fraud); *In re* Advanta Corp., 180 F.3d 525, 530-35 (3d Cir. 1999) (evaluating effect of PSLRA on scienter in section 10(b) actions); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 537-38 (2d Cir. 1999) (determining effect of PSLRA on scienter requirement in securities fraud).

[111] *Compare Silicon Graphics*, 183 F.3d at 980 (holding that plaintiff must plead defendant acted with deliberate recklessness), *with Comshare*, 183 F.3d at 549 (holding that recklessness is sufficient to plead securities fraud, but pleading defendant had motive and opportunity to commit fraud is not sufficient), *and Press*, 166 F.3d at 538 (holding that plaintiff only has to plead ordinary recklessness to satisfy scienter and that pleading defendant had motive and opportunity to commit fraud will also satisfy pleading requirement).

[112] *See* Markel & Chlapowski, *supra* note 12, at 812 (recognizing three-way split of authority over pleading scienter in securities fraud). The most stringent view is that recklessness satisfies the scienter requirement only if it is deliberate recklessness. *See Silicon Graphics*, 183 F.3d at 980. A second view is the pre-PSLRA standard, which allows recklessness or facts showing the defendant had a motive and opportunity to commit fraud to satisfy scienter. *See Advanta*, 180 F.3d at 534-35; *Press*, 166 F.3d at 538. The third view permits recklessness to satisfy scienter, but holds that motive and opportunity to commit fraud is insufficient to satisfy scienter. *See Bryant*, 187 F.3d at 1286-87; *Comshare*, 183 F.3d at 551.

A. Deliberate Recklessness: A Form of Intentional Conduct

In the summer of 1999, the Ninth Circuit held that a plaintiff must establish that the defendant acted with deliberate recklessness.[113] Deliberate recklessness differs from mere recklessness in that deliberate recklessness calls for some type of conscious or intentional conduct.[114] In *In re Silicon Graphics, Inc.*, the Ninth Circuit held that pleading the defendant acted with recklessness is only sufficient in a section 10(b) action if the alleged recklessness involves some form of intentional or conscious misconduct.[115] The test is whether the defendant acted with a degree of recklessness that strongly suggests actual intent to commit fraud.[116] The Ninth Circuit thus retreated from its post-*Hochfelder* view that mere recklessness was sufficient.[117] The Ninth Circuit is the first circuit to interpret the PSLRA to require a heightened pleading standard that is beyond mere recklessness.[118]

Silicon Graphics involved a private cause of action for securities fraud against Silicon Graphics, Inc. ("SGI").[119] A SGI stockholder alleged that SGI misrepresented its growth to inflate its stock, and that six of SGI's top officers engaged in insider trading.[120] The district court dismissed

---

[113] *See Silicon Graphics*, 183 F.3d at 977 (becoming first circuit to require heightened pleading standard in form of intentional conduct – deliberate recklessness).

[114] *Compare Silicon Graphics*, 183 F.3d at 977 (stating that deliberate recklessness is form of intentional or conscious conduct), *with* Press, 166 F.3d at 538 (holding that recklessness is sufficient to plead scienter, but refusing to base pleading standard on intent). *Press* implies that recklessness is not a form of intentional conduct. *Press*, 166. F.3d at 538.

[115] *Silicon Graphics*, 183 F.3d at 977.

[116] *See id.* at 979. The court stated that plaintiffs "must state specific facts indicating no less than a degree of recklessness that strongly suggests actual intent." *Id.*

[117] *Compare* Hollinger v. Titan Capital Corp. 914 F.2d 1564, 1569-70 (9th Cir. 1990) (stating that Ninth Circuit continues to adhere to view that recklessness is sufficient to satisfy scienter and recognizing that court at times has articulated recklessness as form of negligence), *with Silicon Graphics*, 183 F.3d at 977 (stating that deliberate recklessness, form of intentional conduct, is required to satisfy scienter).

[118] *See Silicon Graphics*, 183 F.3d at 974-75 (recognizing that all other circuits' interpretations of PSLRA's heightened pleading standard are less stringent than Ninth Circuit's deliberate recklessness standard).

[119] *Id.* at 980.

[120] *Id.* SGI is a corporation that manufactures desktop graphic workstations and software. *Id.* The stockholder alleged that SGI assured investors that Indigo2, a new graphic design computer, would sustain a 40% growth rate and exceed one billion dollars in sales. *Id.* The stockholder alleged that SGI had quality control problems with the Indigo2, but continued making misrepresentations that everything was going along as planned with its production. *Id.* at 980-81. The quality control problem caused a shortage of Indigo2's which resulted in lower sales. *Id.* at 981. SGI continued to downplay SGI's problems. *Id.* The price of the stock started at $31 per share, rose to $38 dollars under the misrepresentation, and ended up falling to $21 per share. *Id.* at 981-82. The stockholder

the complaint because the plaintiff failed to make a pre-suit settlement demand the Federal Rules of Civil Procedure require.[121] Thereafter, the plaintiff appealed to the Ninth Circuit.[122] Before the Ninth Circuit discussed the merits of the case, the court spent a considerable amount of time discussing the PSLRA's scienter requirement.[123] To determine the scienter requirement under the PSLRA, the Ninth Circuit performed a plain meaning and legislative history analysis of the PSLRA.[124]

The Ninth Circuit acknowledged that the PSLRA's plain language failed to define the required state of mind for pleading securities fraud.[125] Accordingly, the Ninth Circuit relied on the Supreme Court's decision in *Hochfelder* to define the required state of mind.[126] Focusing on language in *Hochfelder* regarding recklessness, the Ninth Circuit stressed that recklessness only satisfies the scienter requirement if it is a form of intentional conduct - not merely negligent conduct.[127] Therefore, a plaintiff pleading securities fraud must, at a minimum, demonstrate that the defendant acted with conscious or deliberate recklessness.[128]

The Ninth Circuit further supported its intentional conduct requirement by looking to the PSLRA's legislative history.[129] The Ninth Circuit found the legislative history indicated that Congress intended to heighten the pleading standard above the Second Circuit standard to avoid abusive securities fraud litigation.[130] To support that conclusion, the Ninth Circuit made three crucial findings concerning the PSLRA's legislative history.[131] First, Congress declined to adopt a specific

---

also claimed that six SGI officers engaged in insider trading by taking advantage of the high $38 price and selling large amounts of stock at that price. *Id.* at 982.

[121] *Id.* at 980. Federal Rule of Civil Procedure 23.1 requires plaintiff to allege in the complaint any efforts made to obtain the action the plaintiff desires from the defendant. FED. R. CIV. P. 23.1.

[122] *Silicon Graphics*, 183 F.3d at 980.

[123] *See id.* at 974-79 (discussing various interpretations of scienter, examining PSLRA's plain language and legislative history, and concluding that precedent in *Hochfelder* requires intentional or conscious misconduct to satisfy scienter).

[124] *See id.* at 975-79.

[125] See *id.* at 975; *see also* 15 U.S.C. § 78u-4(b)(2) (Supp. IV 1998) (lacking definition of required state of mind).

[126] *See Silicon Graphics*, 183 F.3d at 975-76.

[127] *Id.*; *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976) (stating that required state of mind in securities fraud is form of intentional conduct).

[128] *Silicon Graphics*, 183 F.3d at 980.

[129] *Id.* at 977-79.

[130] *Id.*

[131] *Id.* at 977-78.

amendment that would have codified the Second Circuit standard.[132] Second, the Conference Committee stated that it intended to strengthen existing pleading requirements and did not intend to codify the Second Circuit's interpretation of the pleading standard.[133] Third, Congress overrode President Clinton's veto of the PSLRA.[134] President Clinton vetoed the PSLRA because he thought it was an unacceptable procedural hurdle that raised the Second Circuit standard.[135]

Relying on both the PSLRA's legislative history and the *Hochfelder* standard, the Ninth Circuit concluded that, at a minimum, the PSLRA requires deliberate recklessness to satisfy scienter.[136] Recklessness that is a form of negligent conduct is insufficient.[137] Accordingly, the Ninth Circuit held the plaintiff's allegations that SGI misrepresented its growth and that its officers traded illegally did not create a strong inference of deliberate recklessness.[138] In addition, the Ninth Circuit suggested that the recklessness standard adopted by federal courts, in the wake of *Hochfelder*, had strayed from the Supreme Court's requirement of intentional conduct.[139] Several of the other circuits have disagreed with the Ninth Circuit's conclusion that the PSLRA requires deliberate recklessness.[140]

---

[132] *See* H.R. CONF. REP. NO. 104-369, at 41 (1995) (refusing to adopt Second Circuit case law); *see also* Gulf Oil Corp. v. Copp Paving Co., 419 U.S. 186, 200 (1974) (holding that where Conference Committee has declined to adopt proposed statutory language, that action strongly suggests that Congress did not intend result that it expressly declined to state).

[133] *See Silicon Graphics*, 183 F.3d at 978 (recognizing congressional intent to raise pleading standard); *see also* H.R. CONF. REP. NO. 104-369, at 41 & n.23 (determining Second Circuit standard as most stringent, but intending to adopt more stringent standards than Second Circuit).

[134] *See Silicon Graphics*, 183 F.3d at 979 (recognizing that Congress overrode President Clinton's veto of PSLRA). *Compare* 15 U.S.C. § 78u-4 (Supp. IV 1998) (overriding presidential veto by enacting PSLRA), *with* 141 CONG. REC. H15,214 (daily ed. Dec. 10, 1995) (vetoing PSLRA).

[135] *See* 141 CONG. REC. H15,214 (vetoing PSLRA and stating that PSLRA is unnecessary heightened procedural hurdle and that Second Circuit standard is sufficient); *see also Silicon Graphics*, 183 F.3d at 979 (recognizing that overriding President Clinton's veto is evidence that Congress intended to heighten pleading standard).

[136] *Silicon Graphics*, 183 F.3d at 976, 979.

[137] *See id.* at 976 (stating that Supreme Court in *Hochfelder* decided that negligent conduct was insufficient to plead securities fraud).

[138] *Id.* at 988.

[139] *See id.* at 974-75, 979 (recognizing that all circuits have approved recklessness as sufficient to plead scienter, but have not defined recklessness as conscious or intentional conduct).

[140] *Compare id.* at 980 (holding that plaintiff must plead that defendant acted with deliberate recklessness), *with In re* Comshare, Inc., 183 F.3d 542, 549 (6th Cir. 1999) (holding

B. Second Circuit Standard: Recklessness or Motive and Opportunity Test

The Second and Third Circuits have retained the pre-PSLRA, Second Circuit standard.[141] The Second Circuit standard requires, at a minimum, that the plaintiff plead reckless behavior or a motive and opportunity to commit fraud.[142] In securities fraud litigation, the Second and Third Circuits found that the PSLRA did not change the scienter requirement, but codified the Second Circuit standard.[143] The Second and Third Circuits also determined that the Ninth Circuit had gone too far by requiring deliberate or conscious recklessness.[144]

The Second Circuit standard only requires that a plaintiff show the defendant acted recklessly or had a motive and opportunity to commit fraud.[145] Applying the Second Circuit standard to the ACME Inc. hypothetical from the introduction, Plaintiff Doe could satisfy the scienter requirement in two different ways.[146] First, Plaintiff Doe could plead facts that give rise to an inference that ACME Inc.'s CEO, Johnson, recklessly misrepresented corporate profits.[147] Alternatively, Plaintiff

---

that recklessness is sufficient to plead securities fraud, but pleading that defendant had motive and opportunity to commit fraud is insufficient), *and* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (holding that plaintiff may plead either ordinary recklessness or motive and opportunity to commit fraud).

[141] *See In re* Advanta Corp., 180 F.3d 525, 534-35 (3d Cir. 1999) (retaining pre-PSLRA Second Circuit standard of recklessness or motive and opportunity to commit fraud test); *Press*, 166 F.3d at 538 (requiring plaintiff to allege facts showing recklessness or that defendant had motive and opportunity to commit fraud); *see also* Shields v. Citytrust Bancorp., Inc., 25 F.3d 1124, 1128 (2d Cir. 1994) (showing that, before enactment of PSLRA, Second Circuit required showing of recklessness or motive and opportunity to commit fraud).

[142] *See* Chill v. Gen. Elec. Co., 101 F.3d 263, 267 (2d Cir. 1996) (requiring plaintiff to allege that defendant had motive and opportunity to commit fraud or that defendant acted recklessly); *Shields*, 25 F.3d at 1128 (requiring allegation that defendant had motive and opportunity to commit fraud or that defendant acted recklessly); *In re* Time Warner Inc., 9 F.3d 259, 269 (2d Cir. 1993) (stating that two ways to plead scienter are to allege defendant had motive and opportunity to commit fraud or that defendant acted recklessly).

[143] *See Advanta*, 180 F.3d at 534-35 (holding that use of Second Circuit language in PLSRA implies that Congress adopted Second Circuit standard); *Press*, 166 F.3d at 537-38 (claiming that PSLRA heightened pleading requirement to that of Second Circuit standard).

[144] *See Advanta*, 180 F.3d at 530, 534-35 (recognizing Ninth Circuit's deliberate recklessness standard, but adhering to Second Circuit standard of recklessness or motive and opportunity to commit fraud); *Press*, 166 F.3d at 538 (refusing to adopt intentional pleading standard).

[145] *See Advanta*, 180 F.3d at 534-35 (requiring plaintiff to plead defendant acted recklessly or had motive and opportunity to commit fraud); *Chill*, 101 F.3d at 267 (requiring plaintiff to allege that defendant had motive and opportunity to commit fraud or that defendant acted recklessly).

[146] *See Advanta*, 180 F.3d at 534-35; *Chill*, 101 F.3d at 267.

[147] *See, e.g., Advanta*, 180 F.3d at 534-35 (requiring plaintiff to plead defendant acted

Doe could plead that Johnson had a motive and opportunity to commit fraud.[148] Either of these two pleadings would be sufficient to satisfy scienter in the Second and Third Circuits.[149]

The Second and Third Circuits concluded that the PSLRA adopted the pre-PSLRA Second Circuit standard because of the similarity of language between the two standards.[150] The pre-PSLRA Second Circuit standard required plaintiffs to allege facts giving rise to a "strong inference" that a defendant acted with recklessness or had a motive and opportunity to commit fraud.[151] The PSLRA requires plaintiffs to state facts that give rise to a "strong inference" that the defendant had the required state of mind.[152] The Second Circuit held that the PSLRA codified their pre-PSLRA standard without giving any justification besides illustrating the similarity of language between the two standards.[153] The Second Circuit did not perform an analysis of the PSLRA's legislative history.[154]

In adopting the pre-PSLRA Second Circuit standard, the Third Circuit performed a plain meaning and legislative history analysis of the PSLRA.[155] Accordingly, the Third Circuit held that Congress's use of the Second Circuit's "strong inference" language is substantial evidence the PSLRA codified the Second Circuit pleading standard.[156] Furthermore, Congress's intent to heighten the pleading standard is consistent with adoption of the Second Circuit standard because it was the most stringent at the time Congress enacted the PSLRA.[157] The Sixth and

---

recklessly); *Chill*, 101 F.3d at 267 (requiring plaintiff to allege that defendant acted recklessly).

[148] *See, e.g., Advanta*, 180 F.3d at 534-35 (allowing plaintiff to plead defendant had motive and opportunity to commit fraud to satisfy scienter); *Chill*, 101 F.3d at 267 (requiring plaintiff to allege that defendant had motive and opportunity to commit fraud).

[149] *See Advanta*, 180 F.3d at 534-35; *Chill*, 101 F.3d at 267.

[150] *See Advanta*, 180 F.3d at 534 (stating that Congress's use of Second Circuit's language compels conclusion that PSLRA adopted Second Circuit standard); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 537-38 (2d Cir. 1999) (comparing language of PSLRA with Second Circuit standard).

[151] *See* Acito v. IMCERA Group, Inc., 47 F.3d 47, 53 (2d Cir. 1995) (holding that either recklessness or motive and opportunity to commit fraud satisfied scienter requirement in Ninth Circuit before PSLRA).

[152] 15 U.S.C. 78u-4b(2) (Supp. IV 1998). The statute provides that plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Id.*

[153] *Press*, 166 F.3d at 537-38.

[154] *Id.*

[155] *Advanta*, 180 F.3d at 531-34.

[156] *Id.* at 534.

[157] *See id.* (stating that Congress's intent of heightened pleading standard is consistent with PSLRA's adoption of Second Circuit standard).

Eleventh Circuits have also agreed with the Second Circuit standard on the issue of recklessness, but disagree about the motive and opportunity test.[158]

C. Recklessness Standard Without Motive and Opportunity Test

The Sixth and Eleventh Circuits have taken a middle ground between the Ninth Circuit's deliberate recklessness standard and the Second Circuit standard.[159] The Sixth and Eleventh Circuits adopted the part of the Second Circuit's test that says reckless behavior is sufficient to plead scienter.[160] The Sixth and Eleventh Circuits disagree, however, that the PSLRA codified the Second Circuit's motive and opportunity test.[161]

Applying the Sixth and Eleventh Circuit standard to the ACME Inc. hypothetical, Plaintiff Doe could satisfy the scienter requirement by pleading facts that give rise to an inference of reckless behavior.[162] However, pleading that CEO Johnson had a motive and opportunity to commit fraud would be insufficient to satisfy scienter.[163] This example illustrates that the Sixth and Eleventh Circuit standard is a higher

---

[158] *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1287 (11th Cir. 1999) (holding that recklessness is sufficient to satisfy scienter requirement, but also holding that motive and opportunity test is not sufficient to satisfy scienter); *In re* Comshare, Inc., 183 F.3d 542, 551 (6th Cir. 1999) (stating that recklessness is sufficient to satisfy scienter, but that claiming defendant had motive and opportunity to commit fraud is insufficient).

[159] *Compare Bryant*, 187 F.3d at 1287 (holding that pleading recklessness is sufficient, but pleading motive and opportunity to commit fraud is insufficient), *and Comshare*, 183 F.3d at 551 (holding that recklessness is sufficient to plead securities fraud, but pleading defendant had motive and opportunity to commit fraud is not sufficient), *with In re* Silicon Graphics, 183 F.3d 970, 980 (9th Cir. 1999) (holding that plaintiff must plead that defendant acted with deliberate recklessness), *and Press*, 166 F.3d at 538 (holding that plaintiff can plead recklessness or that defendant had motive and opportunity to commit fraud).

[160] *See Bryant*, 187 F.3d at 1287 (holding that pleading facts implying defendant acted with recklessness is sufficient); *Comshare*, 183 F.3d at 551 (holding that pleading facts that imply defendant acted with recklessness is sufficient to plead scienter).

[161] *See Bryant*, 187 F.3d at 1287 (holding that pleading facts under Second Circuit's motive and opportunity to commit fraud test is insufficient to plead scienter under PSLRA's new heightened pleading standards); *Comshare*, 183 F.3d at 551 (holding that pleading that defendant had motive and opportunity to commit fraud is insufficient to plead scienter).

[162] *See, e.g., Bryant*, 187 F.3d at 1287 (holding that pleading facts implying defendant acted with recklessness is sufficient); *Comshare*, 183 F.3d at 551 (holding that pleading facts that imply defendant acted with recklessness is sufficient to plead scienter).

[163] *See Bryant*, 187 F.3d at 1287 (holding that pleading facts under Second Circuit's motive and opportunity to commit fraud test is insufficient to plead scienter under PSLRA's new heightened pleading standards); *Comshare*, 183 F.3d at 551 (holding that pleading that defendant had motive and opportunity to commit fraud is insufficient to plead scienter).

standard than that of the Second Circuit.[164] The Sixth and Eleventh Circuit standard only allows for one of the two alternative tests under the Second Circuit standard to satisfy the pleading requirement.[165]

In deciding only to adopt the first part of Second Circuit standard, the recklessness test, the Sixth and Eleventh Circuits applied the contemporary legal context theory.[166] The contemporary legal context theory is a doctrine adopted by the U.S. Supreme Court to aid in interpreting a statute that is reenacted with prior interpretative case law.[167] Under this theory, when courts adopt a particular statutory interpretation, and Congress leaves that interpretation undisturbed in a subsequent reenactment of the statute, a court must presume that Congress intended to codify the prior interpretation.[168]

The Sixth and Eleventh Circuits determined that the PSLRA is a reenactment of the Exchange Act's general prohibition against securities fraud.[169] Because the PSLRA requires the plaintiff to plead scienter, without providing a new definition for scienter, the courts presume Congress codified the current legal definition of scienter at the time of the PSLRA's enactment.[170] When Congress reenacted the prohibition

---

[164] *Compare Bryant*, 187 F.3d at 1285-86 (holding that plaintiff must plead facts giving rise to strong inference of scienter, and pleading motive and opportunity to commit fraud alone does not rise to level of strong inference), *and Comshare*, 183 F.3d at 551 (stating that showing motive and opportunity to commit fraud is not sufficient alone to show strong inference of scienter), *with Press*, 166 F.3d at 538 (holding that plaintiff can plead recklessness or that defendant had motive and opportunity to commit fraud).

[165] *See Bryant*, 187 F.3d at 1285-86; *Comshare*, 183 F.3d at 551; *Press*, 166 F.3d at 538.

[166] *See Bryant*, 187 F.3d at 1284 (stating that Congress applied contemporary legal doctrine in enacting PSLRA); *Comshare*, 183 F.3d at 550 (determining that Congress adopted contemporary legal doctrine).

[167] *See* Cottage Sav. Ass'n v. Comm., 499 U.S. 554, 561-62 (1991) (stating that Court will interpret reenactment under contemporary legal context theory); Pierce v. Underwood, 487 U.S. 552, 567 (1988) (stating that Court will presume Congress codified contemporary legal doctrine in subsequent reenactment if it did not change contemporary legal doctrine); Cannon v. Univ. of Chi., 441 U.S. 667, 698-99 (1979) (using contemporary legal doctrine to interpret reenacted statute).

[168] *See Cottage Savings*, 499 U.S. at 561-62 (stating that court will interpret reenactment as adopting contemporary legal doctrine if reenactment does not purport to change contemporary legal doctrine); *Pierce*, 487 U.S. at 567 (stating that court will presume Congress codified contemporary legal doctrine because Congress did not change contemporary legal doctrine); *Cannon*, 441 U.S. at 698-99 (stating that Court will presume Congress intended to codify contemporary legal doctrine if Congress did not change it when reenacting statute).

[169] *See Bryant*, 187 F.3d at 1284 (implying that PSLRA is subsequent reenactment of Exchange Act); *Comshare*, 183 F.3d at 549-50 (finding that *Hochfelder's* interpretation of "required state of mind" under Exchange Act is same as "required state of mind" under PSLRA).

[170] *See Bryant*, 187 F.3d at 1284 (finding that PSLRA adopts contemporary scienter

against securities fraud in the PSLRA, recklessness satisfied the scienter requirement.[171] Therefore, the Sixth and Eleventh Circuits concluded that the PSLRA codified the then current standard permitting recklessness to satisfy the scienter requirement.[172]

Although the Sixth and Eleventh Circuits accepted the Second Circuit's recklessness test, they did not accept the Second Circuit's motive and opportunity test.[173] These two circuits concluded that pleading facts alleging a motive and opportunity to commit fraud does not satisfy the scienter requirement.[174] More specifically, the Eleventh Circuit held that the motive and opportunity test lowered the bar for securities fraud cases below the *Hochfelder* standard.[175] The Eleventh Circuit observed that, before Congress enacted the PSLRA, only the Second and Ninth

---

standard); *Comshare*, 183 F.3d at 550 (stating that Congress intended to adopt recklessness standard under contemporary legal context theory).

[171] *See* Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569-70 (9th Cir. 1990) (adopting Seventh Circuit's definition of recklessness to plead scienter); *In re* Phillips Petroleum Sec. Litig., 881 F.2d 1236, 1244 (3d Cir. 1989) (recognizing that recklessness meets scienter requirement of section 10(b)); Van Dyke v. Coburn Enter., 873 F.2d 1094, 1100 (8th Cir. 1989) (agreeing with majority of circuits that Congress intended recklessness to satisfy scienter); McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989) (stating that showing of severe recklessness is sufficient to satisfy scienter); Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982) (expressly holding that recklessness satisfies scienter requirement); Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961-62 (5th Cir. 1981) (en banc) (holding that recklessness satisfies scienter requirement in private action for securities fraud); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023-24 (6th Cir. 1979) (agreeing with majority of circuits that recklessness is sufficient to plead scienter); Cook v. Avien, Inc., 573 F.2d 685, 692 (1st Cir. 1978) (finding that because defendant did not act recklessly, plaintiff may satisfy scienter requirement by pleading recklessness); Rolf v. Blyth, Eastman Dillion & Co., 570 F.2d 38, 47 (2d Cir. 1978) (claiming that reckless misstatement is sufficient to plead securities fraud); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044 (7th Cir. 1977) (holding that reckless omission is actionable under section 10(b)).

[172] *See Bryant*, 187 F.3d at 1284 (implying that PSLRA adopted contemporary recklessness standard); *Comshare*, 183 F.3d at 550 (stating that Congress intended to adopt recklessness standard under contemporary legal context theory).

[173] *See Bryant*, 187 F.3d at 1287 (holding that pleading facts under Second Circuit's motive and opportunity to commit fraud test is insufficient to plead scienter under new heightened pleading standards); *Comshare*, 183 F.3d at 551 (holding that pleading facts that show defendant had motive and opportunity to commit fraud is insufficient to plead scienter).

[174] *See Bryant*, 187 F.3d at 1285-86 (holding that plaintiff must plead facts giving rise to strong inference of scienter, and pleading motive and opportunity to commit fraud alone does not rise to level of strong inference); *Comshare*, 183 F.3d at 551 (stating that showing motive and opportunity to commit fraud is not sufficient alone to give strong inference of scienter).

[175] *See Bryant*, 187 F.3d at 1285-86 (quoting Carley Capital Group v. Deloitte & Touche, L.L.P., 27 F. Supp. 2d 1324, 1339 (N.D. Ga. 1998), which stated that motive and opportunity test lowers standard for securities fraud below *Hochfelder* standard).

Circuits had used the motive and opportunity test.[176] Applying the contemporary legal context theory, the Eleventh Circuit held the motive and opportunity test was not a contemporary legal doctrine at the time Congress passed the PSLRA.[177] The Eleventh Circuit thus concluded that the PSLRA heightened the pleading standard by eliminating the motive and opportunity test, while retaining the recklessness standard for scienter.[178]

Based on the above, any remaining jurisdictions that have not confronted this issue can choose among three different standards when attempting to determine the scienter requirement under the PSLRA.[179] These jurisdictions can choose from a deliberate recklessness standard, a mere recklessness standard, or a mere reckless standard combined with the motive and opportunity to commit fraud test.[180] Analyzing the two different methods of statutory interpretation that the circuits used to develop these standards will help the other jurisdictions decide which standard they should adopt.[181]

---

[176] *Bryant*, 187 F.3d at 1286; *see also In re* Wells Fargo Sec. Litig., 12 F.3d 922, 931 (9th Cir. 1993) (recognizing motive and opportunity test as sufficient to plead scienter); *In re* Time Warner Inc., 9 F.3d 259, 270 (2d Cir. 1993) (holding that motive and opportunity to commit fraud is sufficient to plead securities fraud).

[177] *See Bryant*, 187 F.3d at 1286-87 (implying that because only two circuits followed motive and opportunity test it is not contemporary legal doctrine).

[178] *See id.* at 1286 (declaring clear purpose of PSLRA was to heighten pleading standard, which calls for elimination of motive and opportunity test); *see also Comshare*, 183 F.3d at 550-51 (determining that motive and opportunity test does not comply with heightened pleading standard).

[179] *See* Markel & Chlapowski, *supra* note 12, at 812 (recognizing three-way split of authority over pleading scienter in securities fraud). The strictest view is that recklessness only satisfies the scienter requirement if it is deliberate recklessness. *See In re* Silicon Graphics, 183 F.3d 970, 980 (9th Cir. 1999). A second view is the pre-PSLRA standard, which allows recklessness or facts showing the defendant had a motive and opportunity to commit fraud to satisfy scienter. *See In re* Advanta Corp., 180 F.3d 525, 534-35 (3d Cir. 1999); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999). The third view permits recklessness to satisfy scienter, but holds that motive and opportunity to commit fraud is insufficient to satisfy scienter. *See Bryant*, 187 F.3d at 1286-87; *Comshare*, 183 F.3d at 551.

[180] *See Bryant*, 187 F.3d at 1286-87 (allowing for recklessness to satisfy scienter, but not motive and opportunity to commit fraud); *Silicon Graphics*, 183 F.3d at 980 (requiring deliberate recklessness to satisfy scienter); *Press*, 166 F.3d at 538 (permitting either recklessness or motive and opportunity to commit fraud to satisfy scienter).

[181] *See Bryant*, 187 F.3d at 1284 (adopting contemporary legal context approach); *Comshare*, 183 F.3d at 549-50 (using contemporary legal context approach); *Silicon Graphics*, 183 F.3d at 975-79 (using plain language and legislative history approach to interpret PSLRA); *Advanta*, 180 F.3d at 534 (using plain language and legislative history analysis to adopt Second Circuit standard); *Press*, 166 F.3d at 537-38 (claiming PSLRA adopted Second Circuit standard without giving any real justification besides illustrating similarity of language).

III. ANALYSIS

The current split of authority is essentially a dispute over the difficulty of bringing a cause of action for securities fraud.[182] The Ninth Circuit has the most stringent standard - deliberate recklessness.[183] The Second and Third Circuits have the lowest standard - reckless conduct or the motive and opportunity test.[184] The Sixth and Eleventh Circuits take a middle ground in allowing reckless behavior, but do not use the motive and opportunity test.[185]

The circuit courts involved in the three-way split of authority based their decisions on two different methods of statutory interpretation.[186] The two methods the courts used are (1) an approach drawing on plain meaning and legislative history; and (2) the contemporary legal context approach.[187] These methods of interpretation have led to three different results.[188] However, the circuits' analyses under both methods of interpretation are flawed.[189] As such, the Ninth Circuit was the only circuit to correctly hold that the PSLRA required some form of

---

[182] *See Bryant*, 187 F.3d at 1283 (recognizing that *Silicon Graphics* heightened pleading standard, but declining to follow *Silicon Graphics*); *Silicon Graphics*, 183 F.3d at 974 (stating that Congress intended to elevate pleading standard when it enacted PSLRA).

[183] *See Silicon Graphics*, 183 F.3d at 979 (requiring deliberate recklessness standard, which strongly suggests actual intent).

[184] *See Advanta*, 180 F.3d at 534-35 (allowing plaintiffs to plead recklessness or motive and opportunity test); *Press*, 166 F.3d at 538 (allowing recklessness or motive and opportunity to commit fraud to plead scienter).

[185] *See Bryant*, 183 F.3d at 1287 (holding recklessness sufficient to plead scienter, but motive and opportunity to commit fraud as insufficient); *Comshare*, 183 F.3d at 551 (allowing allegation of recklessness to satisfy scienter, but finding motive and opportunity test insufficient).

[186] *See Comshare*, 183 F.3d at 549-50 (using contemporary legal context approach); *Silicon Graphics*, 183 F.3d at 975-79 (using plain language and legislative history approach to interpreting PSLRA); *Advanta*, 180 F.3d at 534 (using plain language and legislative history analysis to adopt Second Circuit standard); *Bryant*, 187 F.3d at 1284 (adopting contemporary legal context approach); *Press*, 166 F.3d at 537-38 (stating that PSLRA adopted Second Circuit standard without giving justification for that conclusion).

[187] *See; Bryant*, 187 F.3d at 1284 (adopting contemporary legal context approach); *Comshare*, 183 F.3d at 549-50 (using contemporary legal context approach); *Silicon Graphics*, 183 F.3d at 975-79 (using plain language and legislative history approach to interpreting PSLRA); *Advanta*, 180 F.3d at 534 (using plain language and legislative history analysis to adopt Second Circuit standard); *Press*, 166 F.3d at 537-38 (failing to justify conclusion that PSLRA adopted Second Circuit standard); *see also* Cottage Sav. Ass'n v. Comm., 499 U.S. 554, 561-62 (1991) (finding that contemporary legal doctrine theory applies when case law interprets statute, Congress subsequently amends statute, and statute does not alter original statute regarding interpretation).

[188] *See Bryant*, 187 F.3d at 1287; *Comshare*, 183 F.3d at 551; *Silicon Graphics*, 183 F.3d at 980; *Advanta*, 180 F.3d at 534-35; *Press*, 166 F.3d at 538.

[189] *See infra* Parts III.A-B.

intentional conduct to successfully plead securities fraud.[190]

A. Plain Meaning and Legislative History Analysis of the PSLRA

One of the methods the circuits courts employed to interpret the PSLRA was a plain meaning and legislative history approach.[191] A statute's plain language is the customary starting point for its interpretation.[192] However, courts may resort to legislative history when the plain language of the statute is unclear.[193] The plain language of the PSLRA does not specifically state whether intent, reckless behavior, or motive and opportunity to commit fraud are sufficient to satisfy the required state of mind.[194] Thus, it is appropriate to turn to legislative history to look at congressional intent.[195]

Despite the absence of language defining the required state of mind, the Second and Third Circuits concluded that the PSLRA adopted the Second Circuit standard.[196] The Second Circuit concluded that the PSLRA adopted their pre-PSLRA standard without justification or analyzing the PSLRA's legislative history.[197] The Third Circuit found that the use of the Second Circuit's strong inference language in the PSLRA signified that Congress had implemented a standard identical to the Second Circuit standard.[198] Despite the Second and Third Circuit's conclusions, the plain language of the PSLRA does not support the

---

[190] *Silicon Graphics*, 183 F.3d at 980.

[191] *See, e.g., Silicon Graphics*, 183 F.3d at 975-79 (using plain language and legislative history approach to interpreting PSLRA); *Advanta*, 180 F.3d at 534 (using plain language analysis to adopt contemporary legal doctrine); *Press*, 166 F.3d at 537-38 (using plain language and legislative history analysis, but considering contemporary legal context theory).

[192] *See* Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980) (stating courts should first look to plain language of statute); N.W. Forest Res. v. Glickman, 82 F.3d 825, 831 (9th Cir. 1996) (holding that plain language is starting point for interpretation).

[193] *See GTE Sylvania*, 447 U.S. at 108; *Glickman*, 82 F.3d at 831.

[194] 15 U.S.C. § 78u-4 (Supp. IV 1998).

[195] *See GTE Sylvania*, 447 U.S. at 108; *Glickman*, 82 F.3d at 831.

[196] *See Advanta*, 180 F.3d at 534 (stating that Congress's use of Second Circuit language signifies adoption of equivalent standard); *Press*, 166 F.3d 529, 537-38 (2d Cir. 1999) (concluding that PSLRA heightened pleading standard to Second Circuit standard without examining legislative history).

[197] *See Press*, 166 F.3d at 537-38.

[198] *See Advanta*, 180 F.3d at 533-34 (emphasizing that use of similar language between PSLRA and Second Circuit indicates that PSLRA requires standard equivalent to Second Circuit's).

Second Circuit standard.[199] Both the recklessness and motive and opportunity tests are simply not in the plain language of the PSLRA.[200] Absent a definition of the required state of mind, the PSLRA's plain language is unclear and an analysis of the legislative history was appropriate.[201]

The Conference Report concerning the PSLRA contradicts the argument that the PSLRA adopted the Second Circuit standard.[202] Two of the PSLRA's objectives were to protect against abusive securities litigation and to discourage frivolous lawsuits.[203] One of the ways Congress set out to deter these abusive practices was to heighten the pleading standard for securities fraud litigation.[204]

Congress intended to draft a pleading standard more stringent than the Second Circuit standard.[205] Congress recognized the Second Circuit's strong inference standard as the most rigid pleading standard observed at that time.[206] However, Congress stated that it intended to strengthen existing pleading requirements to deter frivolous lawsuits, and therefore did not intend to codify the Second Circuit standard.[207] For this reason, Congress left out language of recklessness, motive, and opportunity from the PSLRA.[208]

President Clinton's veto of the PSLRA supports the position that the PSLRA raised the pleading standard above the Second Circuit

---

[199] *See generally* 15 U.S.C. § 78u-4 (lacking any support that it adopts Second Circuit standard).

[200] *See generally id.* (showing absence of any language of Second Circuit's recklessness or motive and opportunity test).

[201] *See id.* (lacking definition of required state of mind); *see also* Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980) (finding that when plain language is not clear, courts may look to legislative history to interpret statute); N.W. Forest Res. v. Glickman, 82 F.3d at 825, 831 (9th Cir. 1996) (allowing courts to look at legislative history of statute if plain language is unclear).

[202] *See* H.R. CONF. REP. NO. 104-369, at 32, 41 (1995), *reprinted in* 1995 U.C.C.A.N. 730, 740 (stating that Congress desired to curtail existing abusive securities litigation, stop frivolous lawsuits, and raise pleading standard above that of Second Circuit).

[203] *Id.* at 32.

[204] *See id.* at 31-32 (stating objective to curtail abusive securities fraud litigation).

[205] *See id.* at 41 (stating that Congress declined to adopt Second Circuit case law with intent to strengthen existing pleading standard).

[206] *Id.*

[207] *See id.* (showing congressional intent not to adopt Second Circuit standard with intention of creating more stringent standard).

[208] *See id.* at 41 n.23 (stating that Congress did not include language relating to recklessness, motive and opportunity because they did not intend to codify Second Circuit standard).

standard.[209] In vetoing the PSLRA, President Clinton stated that he disagreed with Congress's action to raise the pleading standard above that of the Second Circuit standard.[210] Overriding President Clinton's veto demonstrates Congress's intent to raise the pleading standard above that of the Second Circuit.[211] Therefore, it is clear from both the legislative history and President Clinton's veto that Congress did not intend to codify the Second Circuit standard.[212] As such, the Second Circuit standard is inconsistent with the PSLRA.[213] Although the Second and Third Circuit failed to rely on the PSLRA's legislative history, the Ninth Circuit did just that when developing its standard.[214]

In adopting the deliberate recklessness standard, the Ninth Circuit recognized that the plain language of the PSLRA is unclear and that the legislative history called for a heightened pleading standard.[215]

---

[209] *See* 141 CONG. REC. H15,214 (daily ed. Dec. 20, 1995) (stating in veto that Second Circuit standard is sufficient and Congress should not attempt to raise it); *see also In re* Silicon Graphics, Inc., 183 F.3d 970, 979 (9th Cir. 1999) (noting that overriding of presidential veto is strong evidence that Congress did not intend to codify Second Circuit standard); Smith, *supra* note 80, at 605 (recognizing that presidential veto is important piece of legislative history when interpreting PSLRA).

[210] *See* 141 CONG. REC. H15,214. President Clinton stated upon vetoing the PSLRA:

> 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 standard 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 Managers their intent to raise the standard even beyond that level. I am not prepared to accept that.

Id.

[211] *See Silicon Graphics*, 183 F.3d at 979 (claiming that overriding President Clinton's veto of PSLRA is evidence of congressional intent to raise pleading standard). Congress still enacted the PSLRA after President Clinton claimed that the new pleading standard under the PSLRA is too high and that the Second Circuit standard is sufficient. *See* 15 U.S.C. § 78u-4 (Supp. IV 1998); 141 CONG. REC. H15,214 (daily ed. Dec. 20, 1995).

[212] *See Silicon Graphics*, 183 F.3d at 979 (finding that overriding President Clinton's veto of PSLRA is substantial evidence of congressional intent to raise pleading standard above Second Circuit standard); H.R. CONF. REP. NO. 104-369, at 41 (1995) (stating that Congress declined to adopt Second Circuit case law with intent to strengthen existing pleading standard).

[213] *Compare In re* Advanta, Corp., 180 F.3d 525, 534 (3d Cir. 1999) (stating that Congress's use of Second Circuit language signifies adoption of equivalent standard) *and* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 537-38 (2d Cir. 1999) (concluding that PSLRA heightened pleading standard to Second Circuit standard), *with* H.R. CONF. REP. NO. 104-369 at 41 (stating that Congress declined to adopt Second Circuit case law with intent to strengthen existing pleading standard).

[214] *See Silicon Graphics*, 183 F.3d at 977-79 (examining PSLRA's legislative history).

[215] *See id.* (recognizing that PSLRA's plain language does not define required state of

However, critics argue that the PSLRA's legislative history does not support a deliberate recklessness standard.[216] Proponents of the Second Circuit standard contend that the PSLRA's legislative history shows that Congress intended to adopt the Second Circuit standard.[217] The Second Circuit proponents assert that the Standards Act's legislative history supports this argument.[218] The Standards Act placed limitations on plaintiffs who avoided the PSLRA's requirements by filing in state court.[219] In the Conference Report of the Standards Act, Congress stated that it had never abandoned the Second Circuit standard for pleading scienter.[220]

The problem with this argument is that, strictly speaking, the Standards Act's legislative history does not apply to the PSLRA.[221] Congress enacted the Standards Act over two years after Congress enacted the PSLRA.[222] The Supreme Court has held that the

---

mind but legislative history requires heightened pleading standard).

[216] *See Advanta*, 180 F.3d at 533 (stating that Standards Act's legislative history shows that Congress did not intend to raise pleading standard above Second Circuit standard); *Press*, 166 F.3d at 538 (stating unwillingness to adopt any type of standard that connotes intent).

[217] *See Advanta*, 180 F.3d at 534 (stating that PSLRA requires standard equivalent to Second Circuit); *Press*, 166 F.3d at 537-38 (claiming PSLRA adopted Second Circuit standard).

[218] *See Advanta*, 180 F.3d at 533 (stating that Standards Act's legislative history shows that Congress did not intend to raise pleading standard above Second Circuit standard); Richard H. Walker & J. Gordon Seymour, *Recent Judicial and Legislative Developments Affecting the Private Securities Fraud Class Action*, 40 ARIZ. L. REV. 1003, 1033-34 (1998) (stating that Second Circuit proponents believe that Standards Act's legislative history supports argument that PSLRA adopted Second Circuit standard).

[219] *See* Securities Litigation Uniform Standards Act, Pub. L. No. 105-353, 112 Stat. 3227 (1998). Section 16(c) provides that plaintiffs can remove claims to federal court from state court when they are seeking to avoid PSLRA's regulations. *Id.*

[220] *See* S. REP. NO. 105-182, at 5-6 (1998). The Conference Report states:

> In that regard, the Committee emphasizes that the clear intent in 1995 and our continuing intent in this legislation is that neither the PSLRA nor S. 1260 in any way alters the scienter standard in federal securities fraud suits. It was the intent of Congress, as we expressly stated during the legislative debate on the PSLRA, and particularly during the debate on overriding the President's veto, that the PSLRA establish a uniform federal standard on pleading requirements by adopting the pleading standard applied by the Second Circuit.

Id.

[221] *Compare* H.R. CONF. REP. NO. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740 (stating congressional intent to raise pleading standard above that of Second Circuit), *with* S. REP. NO. 105-182, at 5-6 (stating that congressional intent was not to raise pleading standard of PSLRA above that of Second Circuit).

[222] *See* Smith, *supra* note 80, at 606 (stating that Standard Act's Legislative History came more than two years after PSLRA). Congress wrote the Standard Act's legislative history in

interpretation of an earlier statute by a later Congress does not help to discern the meaning of the earlier statute.[223] Thus, the Standard Act's legislative history is irrelevant when defining the required state of mind under the PSLRA.[224] Therefore, standing alone, the PSLRA's legislative history provides that the Second Circuit standard is insufficient to plead scienter under the PSLRA.[225]

Under the plain meaning and legislative history method for interpretation, the PSLRA requires something greater than mere recklessness or motive and opportunity to commit fraud.[226] The Second and Third Circuits were therefore wrong to adopt the pre-PSLRA Second Circuit standard.

B. Contemporary Legal Context Theory Analysis of the PSLRA

The Sixth and Eleventh Circuits utilized a different method than the Second and Third Circuits to interpret the PSLRA - the contemporary legal context theory.[227] The contemporary legal context approach to statutory interpretation is the process of applying the contemporary legal doctrine when a reenacted statute's plain language does not purport to change the law.[228] The Sixth and Eleventh Circuits acknowledged that the PSLRA's plain language states only that a plaintiff must plead that a

---

1998, while Congress passed the PSLRA in 1995. *See* 15 U.S.C. § 78u-4 (Supp. IV 1998); S. REP. NO. 105-182, at 5-6.

[223] *See* Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 185 (1994) (holding that congressional interpretation of statute that it did not enact is of little assistance).

[224] *See id.* (holding that congressional interpretation of statute that it did not enact is of little assistance).

[225] *See supra* notes 191-226 and accompanying text (discussing plain language and legislative history interpretation method for PSLRA).

[226] *See* 15 U.S.C. § 78u-4 (lacking statutory definition of required state of mind); H.R. CONF. REP. NO. 104-369, at 41, (labeling section "Heightened Pleading Standard" and stating congressional intent to strengthen pre-existing pleading standard of Second Circuit of recklessness).

[227] *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1284 (11th Cir. 1999) (stating that Congress was applying contemporary legal doctrine in PSLRA); *In re* Comshare, Inc., 183 F.3d 542, 550 (6th Cir. 1999) (stating that Congress adopted contemporary legal doctrine).

[228] *See* Cottage Sav. Ass'n v. Comm., 499 U.S. 554, 561-62 (1991) (holding that contemporary legal doctrine remains valid when Congress left undisturbed principles established by contemporary legal doctrine in reenacted statute); Pierce v. Underwood, 487 U.S. 552, 567 (1988) (stating that reenactment of statute incorporates settled judicial interpretation when statute does not purport to change interpretation); Cannon v. Univ. of Chicago, 441 U.S. 677, 698-99 (1979) (stating that Court's interpretation of congressional action must take into account its contemporary legal context).

defendant acted with the required state of mind.[229] Because the statute's plain language does not purport to change the law, these two circuits have determined that the required state of mind at the time Congress enacted the PSLRA remained the same after Congress enacted the PSLRA.[230] Before the PSLRA, the U.S. Supreme Court had ruled that scienter was the required state of mind.[231] Subsequently, every circuit court prior to the PSLRA had ruled that recklessness satisfied that scienter requirement.[232] Therefore, the Sixth and Eleventh Circuits concluded that mere recklessness is sufficient to satisfy scienter under the PSLRA.[233]

The Ninth Circuit disagreed with the Sixth and Eleventh Circuits over the validity of the contemporary standard for pleading scienter when Congress enacted the PSLRA.[234] Between the time of *Hochfelder* and the

---

[229] *See Bryant*, 187 F.3d at 1284 (declaring that PSLRA does not define required state of mind); *Comshare*, 183 F.3d at 549-50 (stating that PSLRA gives no provision defining required state of mind). *See generally* 15 U.S.C. § 78u-4 (showing absence of definition of required state of mind).

[230] *See Bryant*, 187 F.3d at 1284 (finding that Congress codified established law that recklessness satisfies scienter requirement); *Comshare*, 183 F.3d at 549-550 (applying contemporary legal context theory to conclude that recklessness satisfies scienter requirement).

[231] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (holding that securities fraud cause of action requires defendant to act with scienter).

[232] *See, e.g.*, Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569-70 (9th Cir. 1990) (adopting Seventh Circuit's definition of recklessness to plead scienter); *In re* Phillips Petroleum Sec. Litig., 881 F.2d 1236, 1244 (3d Cir. 1989) (recognizing that recklessness meets scienter requirement of section 10(b)); Van Dyke v. Coburn Enter., 873 F.2d 1094, 1100 (8th Cir. 1989) (agreeing with majority of circuits that Congress intended recklessness to satisfy scienter); McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989) (stating that showing of severe recklessness is sufficient to satisfy scienter); Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982) (holding that recklessness satisfies scienter requirement); Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961-62 (5th Cir. 1981) (holding that in private action for securities fraud, recklessness satisfies scienter requirement); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023-24 (6th Cir. 1979) (agreeing with majority of circuits that held recklessness is sufficient to plead scienter); Cook v. Avien, Inc., 573 F.2d 685, 692 (1st Cir. 1978) (implying that plaintiff may plead recklessness); Rolf v. Blyth, Eastman Dillion & Co., 570 F.2d 38, 47 (2d Cir. 1978) (finding that reckless misstatement is sufficient to plead securities fraud); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044 (7th Cir. 1977) (holding that reckless omission is actionable under section 10(b)).

[233] *See Bryant*, 187 F.3d at 1283-84 (holding that recklessness is still sufficient to satisfy scienter); *Comshare*, 183 F.3d at 550-51 (holding that recklessness is still sufficient to plead scienter).

[234] *Compare In re* Silicon Graphics, Inc., 183 F.3d 970, 977 (9th Cir. 1999) (holding that plaintiff must plead intentional or conscious recklessness according to *Hochfelder*), *with Bryant*, 187 F.3d at 1284 (holding that plaintiff need only plead reckless behavior to satisfy scienter), *and*

PSLRA's enactment, every circuit had ruled that mere recklessness satisfied the scienter requirement.[235] However, in *Silicon Graphics*, the Ninth Circuit found that the purported contemporary standard, mere recklessness, was inconsistent with *Hochfelder*'s intentional conduct standard.[236] Therefore, the Sixth and Eleventh Circuits misinterpreted the contemporary legal standard by ignoring the *Hochfelder* precedent.[237] After examining the PSLRA's legislative history, the Ninth Circuit properly concluded that the PSLRA heightened the pleading standard to deliberate recklessness to comport with the *Hochfelder* intentional conduct standard.[238]

The Sixth and Eleventh Circuits disagree with the Ninth Circuit's position that the PSLRA's legislative history required a deliberate recklessness standard.[239] The PSLRA's safe harbor provision supports the Sixth and Eleventh Circuits' contemporary legal standard analysis.[240] Congress expressly stated in the safe harbor provision that if a plaintiff

---

Comshare, 183 F.3d at 550-51 (finding that recklessness is sufficient to satisfy scienter).

[235] *See, e.g., Hollinger*, 914 F.2d at 1569-70 (adopting Seventh Circuit's definition of recklessness to plead scienter); *In re Phillips Petroleum*, 881 F.2d at 1244 (3d Cir. 1989) (recognizing that recklessness meets scienter requirement of section 10(b)); *Van Dyke*, 873 F.2d at 1100 (agreeing with majority of circuits that Congress intended recklessness to satisfy scienter); *McDonald*, 863 F.2d at 814 (stating that showing of severe recklessness is sufficient to satisfy scienter); *Hackbart*, 675 F.2d at 1117 (holding that recklessness satisfies scienter requirement); *Broad*, 642 F.2d at 961-62 (holding that in private action for securities fraud, recklessness satisfies scienter requirement); *Mansbach*, 598 F.2d at 1023-24 (agreeing with majority of circuits that held recklessness is sufficient to plead scienter); *Cook*, 573 F.2d at 692 (implying that plaintiff may plead recklessness); *Rolf*, 570 F.2d at 47 (finding that reckless misstatement is sufficient to plead securities fraud); *Sundstrand*, 553 F.2d at 1044 (holding that reckless omission is actionable under section 10(b)).

[236] *Silicon Graphics*, 183 F.3d at 975-77.

[237] *Compare Bryant*, 187 F.3d at 1284 (finding that Congress codified established law that recklessness satisfies scienter requirement) *and Comshare*, 183 F.3d at 549-550 (applying contemporary legal context theory to conclude that recklessness satisfies scienter requirement), *with* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (requiring that securities fraud cause of action requires defendant to act with scienter, form of intentional conduct); *see also Silicon Graphics*, 183 F.3d at 975-77 (concluding that other circuit's reliance on recklessness was insufficient to satisfy scienter because *Hochfelder* required a form of intentional conduct).

[238] *See Silicon Graphics*, 183 F.3d at 975-76, 979 (holding that plaintiff must plead facts that imply defendant acted with deliberate recklessness to satisfy scienter requirement under *Hochfelder* and PSLRA).

[239] *See Bryant*, 187 F.3d at 1283 (stating disagreement with Ninth Circuit opinion in *Silicon Graphics*, which required raised pleading standard); *Comshare*, 183 F.3d at 550-51 (acknowledging more stringent approach of intentional conduct, but holding that recklessness is sufficient to plead scienter).

[240] *See Bryant*, 187 F.3d at 1284 (stating that evidence of Congress expressly stating required scienter for safe harbor provision and failing to do so with respect to scienter requirement in section 78u-4(b)(2) supports Sixth and Eleventh Circuit positions).

failed to show that a defendant acted with "actual knowledge," the defendant escapes liability.[241] If Congress wanted to replace the contemporary legal standard of recklessness with some type of intentional conduct, Congress could have done so with express language, as it did in the safe harbor provision.[242] The Sixth and Eleventh Circuits thus held that the contemporary standard of mere recklessness is sufficient to plead scienter, as it had been since the *Hochfelder* decision.[243]

However, both the Sixth and Eleventh Circuits refused to analyze the PSLRA's legislative history.[244] The Ninth Circuit disagreed with the Sixth and Eleventh Circuits, holding that mere recklessness does not satisfy the scienter requirement.[245] The Ninth Circuit held that *Hochfelder* and the PSLRA's legislative history requires deliberate recklessness, despite the prevalent legal standard among the circuit courts of mere recklessness.[246] When other circuits are faced with deciding between the mere recklessness and deliberate recklessness standards, the circuits must make two determinations. They must determine if there is a difference between mere and deliberate recklessness, and if so, whether the PSLRA requires deliberate recklessness.[247]

---

[241] *See* 15 U.S.C. § 78u-5(c)(1)(B)(i) (Supp. IV 1998) (stating that defendant is not liable if plaintiff fails to plead defendant had actual knowledge that statement was false).

[242] *Compare id.* § 78u-4(b)(2) (requiring plaintiff to plead facts giving rise to strong inference that defendant acted with required state of mind), *with id.* § 78u-5(c)(1)(B)(i) (stating that defendant can invoke safe harbor protection if plaintiff fails to prove that defendant made statement with actual knowledge that statement was false). If Congress intended to raise the pleading standard above a recklessness standard they would have expressly done so like they did when they raised the required state of mind to "actual knowledge" under the safe harbor provision. *See Bryant*, 187 F.3d at 1284.

[243] *See Bryant*, 187 F.3d at 1283-84 (acknowledging that every circuit to address this issue has held that recklessness was sufficient to allege scienter and holding that recklessness is still sufficient); *Comshare*, 183 F.3d at 550-51 (recognizing that all circuits that considered issue have decided that recklessness was sufficient to plead scienter and holding that recklessness is still sufficient to plead scienter).

[244] *See Bryant*, 187 F.3d at 1284 (determining that an analysis of PSLRA's legislative history was unnecessary); *Comshare*, 183 F.3d at 552 (concluding that lower court was incorrect to analyze PSLRA's legislative history).

[245] *See In re* Silicon Graphics, 183 F.3d 970, 979 (9th Cir. 1999) (stating that plaintiff can no longer aver intent by pleading recklessness, but that pleading deliberate recklessness is necessary).

[246] *See id.* at 976-79 (finding that PSLRA's legislative history, combined with *Hochfelder* precedent, required intentional form of conduct to plead scienter, despite that recklessness had been sufficient to plead scienter prior to PSLRA).

[247] *See Bryant*, 187 F.3d at 1283 (disagreeing with Ninth Circuit's standard claiming it raised pleading standard, and holding recklessness to remain sufficient to plead securities fraud); *Comshare*, 183 F.3d at 552 (disagreeing with district court's decision that plaintiff

1. The Difference Between Mere and Deliberate Recklessness

The issue whether the contemporary legal standard of mere recklessness satisfies scienter under the PSLRA involves two specific questions. First, is the question of whether there is a difference between mere recklessness and deliberate recklessness.[248] The second question asks which form of recklessness is sufficient to plead scienter in the securities fraud context.[249]

In *Hochfelder*, the Supreme Court noted that certain areas of the law consider recklessness a form of intentional conduct.[250] The differences between negligence and recklessness, and between recklessness and intent are just a matter of degree.[251] At its very foundation, the law considers recklessness to be negligence - albeit an aggravated form of negligence.[252] However, William Prosser, a highly-regarded tort theorist, suggests that if a reckless act is egregious, the law will treat the reckless act as if the actor intended it.[253] In this sense, the legal commentators

---

must plead facts giving rise to intentional conduct and holding that mere recklessness is sufficient); *Silicon Graphics*, 183 F.3d at 974 (observing split of authority on whether deliberate recklessness or simple recklessness is necessary to satisfy scienter).

[248] *See Bryant*, 187 F.3d at 1283 (implying difference between deliberate and mere recklessness by holding deliberate recklessness unnecessary and mere recklessness sufficient); *Silicon Graphics*, 183 F.3d at 979 (arguing that there is difference between deliberate recklessness and mere recklessness because only deliberate recklessness satisfies scienter).

[249] *Compare Silicon Graphics*, 183 F.3d at 979 (arguing that if recklessness satisfies scienter it has to be deliberate recklessness), *with Bryant*, 187 F.3d at 1283 (disagreeing with Ninth Circuit's deliberate recklessness standard, and stating that reckless is sufficient).

[250] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976) (stating that scienter requires intentional mental state and that in some areas of law recklessness is considered form of intentional conduct).

[251] *See* KEETON, *supra* note 60, at 36 (stating that difference between intentional recklessness and negligent recklessness is just matter of degree); *id.* at 212-13 (explaining that recklessness lies closely between intent and negligence).

[252] *See* Hackbart v. Cincinnati Bengals, Inc., 601 F.2d 516, 525 (10th Cir. 1979) (stating that football player that struck another football player did it recklessly, and was thus negligent); Matheson v. Pearson, 619 P.2d 321, 322 (Utah 1980) (stating that intent is absent from recklessness and is form of negligent conduct); Stockman v. Marlowe, 247 S.E.2d 340, 342 (S.C. 1978) (declaring that recklessness is extension of law of negligence); *see also* KEETON, *supra* note 60, at 212-13 (stating that recklessness is at its essence negligent conduct).

[253] *See* KEETON, *supra* note 60, at 213 (explaining that law treats reckless conduct as if it were intended because it is so far from proper state of mind). For example, at times reckless conduct can result in punitive damages, which are normally reserved for intentional conduct. *See* Dorsey v. Honda Motor Co., 655 F.2d 650, 652 (5th Cir. 1981) (granting plaintiff five million dollars in punitive damages against defendant car manufacturer for reckless conduct); Taylor v. Superior Court, 24 Cal.3d 890, 598 P.2d 854 (1979) (granting punitive damages for drunk driving); *see also* RESTATEMENT (SECOND) OF

refer to recklessness as quasi-intent.[254]

Therefore, recklessness can take two forms.[255] First, at its most basic level, recklessness is simply a form of aggravated negligence.[256] But if the conduct is so unreasonable as to make the consequences of the action highly foreseeable, recklessness takes on a form of intentional conduct.[257] This second, heightened form of recklessness is what the Ninth Circuit calls deliberate recklessness, a form of intentional conduct.[258]

The dividing line between mere recklessness and deliberate recklessness is difficult to define.[259] The Ninth Circuit defines deliberate recklessness as conduct that reflects some degree of intentional, knowing, or conscious misconduct.[260] The existence of two types of recklessness is made apparent by the Sixth, Eleventh, Second, and Third Circuits' refusal to accept the Ninth Circuit's deliberate recklessness standard.[261] These other four circuits deem the Ninth Circuit standard as

---

TORTS, § 908(b) (1965) (stating that punitive damages are awarded for conduct that is result of defendant's reckless indifference).

[254] *See* KEETON, *supra* note 60, at 212 (stating that recklessness is considered quasi-intent). *See generally* James B. Brady, *Recklessness, Negligence, Indifference, and Awareness*, 43 MOD. L. REV. 381, 398 (1980) (arguing that reckless conduct is as voluntary as intentional conduct and therefore recklessness is degree of intentional conduct); Sheldon D. Elliot, *Degrees of Negligence*, 6 S. CAL. L. REV. 91, 143 (1933) (stating that recklessness can take form of intentional conduct).

[255] *See* KEETON, *supra* note 60, at 212-13 (finding that recklessness can either be form of intentional conduct or form of negligent conduct); RESTATEMENT (SECOND) OF TORTS, *supra* note 253 at § 908(b)(stating that recklessness may consist of two different types of conduct: 1) where actor knows risk and deliberately proceeds to act, or 2) where actor does not realize degree of risk but acts negligently).

[256] *See Matheson*, 619 P.2d at 322 (stating that intent is absent from recklessness, which is negligent form of conduct); *Hackbart*, 601 F.2d at 525 (stating that because there was no absence to do harm, football player that struck another football player did it recklessly); *Stockman*, 247 S.E.2d at 342 (declaring that recklessness is extension of law of negligence); *see also* KEETON, *supra* note 60, at 212-13 (stating that recklessness is at its essence negligent conduct).

[257] *See* KEETON, *supra* note 60, at 36 (stating that when known danger of action becomes highly foreseeable, recklessness takes form of intentional conduct); RESTATEMENT (SECOND) OF TORTS, *supra* note 253 at § 908(b) (stating that when actor knows or has reason to know of risk and deliberately proceeds, that is one form of reckless conduct).

[258] *See In re* Silicon Graphics, 183 F.3d 970, 976-79 (9th Cir. 1999) (reasoning that there are two forms of recklessness, intentional form and negligent form, and concluding that intentional form is necessary to satisfy scienter).

[259] *See* KEETON, *supra* note 60, at 36 (stating that difference between intentional recklessness and negligent recklessness is just matter of degree); *id.* at 212-13 (explaining that recklessness lies closely between intent and negligence).

[260] *See Silicon Graphics*, 183 F.3d at 977, 979 (stating that deliberate recklessness is necessary to plead scienter and that deliberate recklessness entails intentional, knowing, or conscious misconduct).

[261] *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282-83 (11th Cir. 1999) (failing to

an unnecessarily heightened pleading standard.[262]

2. The Contemporary Legal Standard of Mere Recklessness is Not Sufficient to Plead Scienter Under the PSLRA

The Supreme Court stated in *Hochfelder* that recklessness could be sufficient to plead scienter for securities fraud if recklessness is a form of intentional conduct in the section 10(b) context.[263] Recklessness, therefore, is sufficient as a form of intentional conduct, not as a form of negligent conduct.[264] The Ninth Circuit adopted the standard of deliberate recklessness, a form of intentional conduct, to plead scienter.[265] The other circuits that have decided this issue have wrongly held that mere recklessness is sufficient to plead scienter, and that deliberate recklessness is unnecessary.[266]

All circuits have recognized that negligence is not enough to plead scienter.[267] The Ninth Circuit is the only circuit, however, that has held

---

adopt Ninth Circuit deliberate recklessness standard, but finding that recklessness is sufficient to plead scienter under PSLRA); *In re* Comshare, Inc., 183 F.3d 542, 551-52 (6th Cir. 1999) (stating that recklessness is sufficient to plead scienter, but disagreeing with district court that PSLRA raised standard to intentional conduct); *In re* Advanta Corp., 180 F.3d 525, 531, 534 (3d Cir. 1999) (recognizing Ninth Circuit standard in *Silicon Graphics*, but declining to adopt it in place of Second Circuit recklessness standard); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 537-38 (2d Cir. 1999) (retaining recklessness standard to plead scienter, but claiming Second Circuit will not raise pleading standard to level of intent).

[262] *See Bryant*, 187 F.3d at 1284 (claiming that Ninth Circuit standard intends to raise pleading standard); *Comshare*, 183 F.3d at 552 (disagreeing with district court's analysis that PSLRA requires intentional conduct); *Advanta*, 180 F.3d at 534 & n.8 (stating that Congress did not intend to heighten pleading standard to *Silicon Graphics's* standard); *Press*, 166 F.3d at 538 (stating that intentional pleading requirement is impossible).

[263] Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976).

[264] *See id.* (reasoning that because scienter is intent to deceive, manipulate, or defraud, recklessness must be form of intentional conduct to satisfy scienter).

[265] *See Silicon Graphics*, 183 F.3d 977-79 (adopting standard of deliberate recklessness, intentional form of conduct).

[266] *See, e.g., Bryant*, 187 F.3d at 1286-87 (allowing recklessness standard, but holding that pleading defendant had motive and opportunity to commit fraud is insufficient); *Comshare*, 183 F.3d at 551 (allowing recklessness standard, but holding that pleading defendant had motive and opportunity to commit fraud is insufficient); *Advanta*, 180 F.3d at 534-35 (following Second Circuit standard of recklessness and motive and opportunity); *Press*, 166 F.3d at 538 (allowing recklessness and motive and opportunity to commit fraud sufficient to plead scienter).

[267] *See* Phillips v. LCI Int'l, Inc., 190 F.3d 609, 621 (4th Cir. 1999) (stating that negligence is not sufficient to support liability under section 10(b)); Provenz v. Miller, 102 F.3d 1478, 1490 (9th Cir. 1996) (stating that mere or inexcusable negligence is insufficient to plead scienter); Alpern v. Utilicorp United, Inc., 84 F.3d 1525, 1534 (8th Cir. 1996) (stating that negligence is not sufficient); Donohoe v. Consolidated Operating & Prod. Corp., 30 F.3d 907, 912 (7th Cir. 1994) (stating that negligence is insufficient for securities fraud);

that *Hochfelder* requires deliberate recklessness to trigger securities fraud liability.[268] As the Ninth Circuit explained, the *Hochfelder* standard requires recklessness to be a form of intentional conduct.[269] Deliberate recklessness is an intentional form of conduct, not a negligent form of conduct.[270] In this sense, the Ninth Circuit has complied with the precedent set in *Hochfelder* that requires intentional conduct.[271] The circuits that disagree with the Ninth Circuit's heightened standard are disregarding Supreme Court precedent.[272]

Three important conclusions can be drawn from analyzing the two methods of statutory interpretation the circuits used to interpret the

---

Shushany v. Allwaste, Inc., 992 F.2d 517, 521 (5th Cir. 1993) (stating that scienter does not include simple or even inexcusable negligence); SEC v. Steadman, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (stating that recklessness must be more than heightened form of negligence in section 10(b) action); Bd. of County Comm'rs v. Liberty Group, 965 F.2d 879, 883 (10th Cir. 1992) (stating that 10b-5 liability requires much more than negligence); Platsis v. E.F. Hutton & Co., 946 F.2d 38, 40 (6th Cir. 1991) (finding that negligence is insufficient to plead scienter); McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989) (requiring recklessness to be more than negligent conduct); Wechsler v. Steinberg, 733, F.2d 1054, 1058 (2d Cir. 1984) (stating negligence is insufficient to plead scienter); Heales v. Catalyst Recovery of Penn., Inc., 616 F.2d 641, 649 (3d Cir. 1980) (claiming negligence is not enough to establish scienter); Hoffman v. Estabrook & Co., 587 F.2d 509, 516 & n.10 (1st Cir. 1978) (rejecting recklessness as mere negligence).

[268] *Compare Silicon Graphics*, 183 F.3d at 979 (requiring deliberate recklessness, intentional form of conduct, to plead scienter), *with Bryant*, 187 F.3d at 1286-87 (allowing recklessness standard, but holding that pleading defendant had motive and opportunity to commit fraud is insufficient), *and Comshare*, 183 F.3d at 551 (allowing recklessness standard, but holding that pleading defendant had motive and opportunity to commit fraud is insufficient), *and Advanta*, 180 F.3d at 534-35 (following Second Circuit standard of recklessness and motive and opportunity to commit fraud), *and Press*, 166 F.3d at 538 (allowing recklessness and motive and opportunity to commit fraud sufficient to plead scienter).

[269] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); *Silicon Graphics*, 183 F.3d at 979.

[270] *See Silicon Graphics*, 183 F.3d at 976, 979 (stating that pleading deliberate recklessness is degree of recklessness that suggests actual intent and that negligence is insufficient to plead scienter under *Hochfelder*).

[271] *Compare Silicon Graphics*, 183 F.3d at 979 (requiring intentional form of conduct to plead scienter – deliberate recklessness), *with Hochfelder*, 425 U.S. at 197 (requiring plaintiff to show defendant acted with intent or knowledge in securities fraud action).

[272] *Compare Hochfelder*, 425 U.S. at 197 (requiring form on intentional conduct to satisfy scienter), *with Bryant*, 187 F.3d at 1283 (disagreeing with Ninth Circuit's deliberate recklessness test because it heightens pleading standard), *and Comshare*, 183 F.3d at 550-51 (recognizing that recklessness can take on form of intentional conduct or negligent conduct, but failing to adopt deliberate recklessness standard that includes intentional conduct), *and Advanta*, 180 F.3d at 531 & n.6, 534-35 (realizing that Congress defined recklessness as some type of deliberate conduct, but failing to modify its adoption of Second Circuit standard), *and Press*, 166 F.3d at 538 (stating expressly that Second Circuit is not inclined to create pleading standard where intent is involved).

PSLRA. First, under the plain language and legislative history method for interpretation, Congress intended to heighten the pleading standard above the Second Circuit standard of recklessness.[273] Second, the PSLRA's legislative history clearly dictates that the Second Circuit's motive and opportunity test is insufficient to plead scienter.[274] Third, the contemporary legal standard, mere recklessness, is inconsistent with the *Hochfelder* precedent.[275] The only approach to the scienter requirement in securities fraud litigation consistent with these three conclusions is the Ninth Circuit's approach: deliberate recklessness, a form of intentional conduct.

Policy considerations also support the deliberate recklessness standard.[276] There is an underlying public policy against abusive securities fraud litigation.[277] Aware of this policy, Congress decided that the pleading standard must be more stringent than the Second Circuit standard.[278] With the PSLRA, Congress sought to end the extraordinary amount of frivolous lawsuits filed under section 10(b).[279] The Ninth Circuit's deliberate recklessness test complies with these expectations.[280]

CONCLUSION

Reckless behavior, as a form of intentional conduct, satisfies the scienter requirement in a private cause of action for securities fraud.[281] The Ninth Circuit has come closest to this standard by requiring deliberate recklessness.[282] The deliberate recklessness standard raises the

---

[273] *See* H.R. CONF. REP. NO. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740 (requiring more stringent standard than Second Circuit standard).

[274] *See supra* notes 174-208, 219-22 and accompanying text.

[275] *See supra* notes 245-54 and accompanying text.

[276] *See Silicon Graphics*, 183 F.3d at 974 (holding that Congress intended to evaluate pleading standard to avoid abusive securities fraud litigation); *see also* H.R. CONF. REP. NO. 104-369, at 32 (stating policy against abusive securities fraud litigation helped to enact PSLRA).

[277] *See* H.R. CONF. REP. NO. 104-369, at 32 (describing underlying policy against frivolous securities fraud litigation).

[278] *Id.* at 41.

[279] *See id.* at 32 (stating that purpose of PSLRA was to end frivolous securities fraud litigation).

[280] *Compare id.* (describing policy against abusive securities fraud litigation), *with Silicon Graphics*, 183 F.3d at 974, 979 (holding that Congress intended to evaluate pleading standard to deliberate recklessness to avoid abusive securities fraud litigation).

[281] *See supra* notes 245-54 and accompanying text (showing that reckless behavior only satisfies scienter as form of intentional conduct, not as form of negligent conduct).

[282] *See Silicon Graphics*, 183 F.3d at 979 (requiring plaintiffs to plead facts that demonstrate defendant acted with deliberate recklessness to satisfy scienter); *see also supra*

hurdle to bringing a cause of action for securities fraud.[283] With the intent of closing the door to thousands of private litigants, the Ninth Circuit's deliberate recklessness standard is supported by case law, legislative history, and public policy considerations.[284] Absent any future congressional action, other circuits should allow recklessness as a form of intentional conduct to satisfy scienter in a section 10(b) action.

Aron Hansen[*]

---

notes 245-54 and accompanying text (arguing that Ninth Circuit standard is more consistent with *Hochfelder* and PSLRA than other circuit's standards).

[283] *See* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1283 (11th Cir. 1999) (stating that Ninth Circuit standard raises required level of scienter); *Silicon Graphics*, 183 F.3d at 974 (stating that holding raises pleading standard above that of Second Circuit standard).

[284] *See supra* notes 245-54 and accompanying text (arguing that Ninth Circuit standard is most supported by *Hochfelder*, PSLRA's legislative history, and public policy considerations against frivolous lawsuits).

[*] I would like to thank my wife Patty for all her support and Professor Raymond Christensen, the one and only college professor that taught me the importance of good writing skills.