Comments

The PSLRA's Heightened Pleading Standard: Does Severe Recklessness Constitute Sciente?

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In an effort to curtail abusive securities litigation, Congress passed the Private Securities Litigation Reform Act of 19951 ("PSLRA"). In essence, the PSLRA creates a heightened pleading standard requiring a stronger showing of fraudulent intent in order to bring a securities fraud lawsuit.2 By creating this heightened pleading standard, Congress attempted to deter frivolous securities fraud lawsuits brought by private plaintiffs,3 "to protect investors and to maintain confidence in the securities markets."4 The purpose of the PSLRA, was to restrict abusive practices such as: (1) filing lawsuits against issuers of securities in response to any significant change in stock price, independent of the defendant's culpability; (2) targeting "deep pocket" defendants; and (3) abusing the discovery process to induce settlements.5

This Comment analyzes the definition of scienter6 for securities fraud claims and the development of the various pleading standards

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* Class of 2001. The author wishes to thank his loving family for their constant and unyielding support during the last three years.

2. See Novak v. Kasaks, 216 F.3d 300, 310 (2d Cir. 2000) (concluding that the PSLRA effectively raised the nationwide pleading standard), cert. denied, 121 S. Ct. 567 (2000).
4. Id. at 31.
5. See id.
6. Scienter is defined as a term used in pleading to signify an allegation... setting out the defendant's previous knowledge of the cause which led to the injury complained of, or rather his previous knowledge of a state of facts which it was his duty to guard against, and his omission to do which has led to the injury complained of.
for securities fraud under the PSLRA. Part I of this Comment describes the pleading standard prior to the enactment of the PSLRA and the subsequent development of a heightened pleading standard. Part II outlines the discrepancy among the circuit courts following the adoption of the PSLRA. Part III analyzes the statutory language, legislative history, and subsequent legislation attempting to define the heightened pleading requirement. Finally, Part IV demonstrates that the Eleventh Circuit has correctly defined the heightened pleading standard and suggests the uniform adoption of the Eleventh Circuit's interpretation of the PSLRA.

I. Background

Plaintiffs may bring federal securities fraud actions under Section 10(b)\(^7\) of the Securities Exchange Act of 1934\(^8\) ("SEA") and the Securities and Exchange Commission's ("SEC") Rule 10b-5.\(^9\) Section 10(b) of the SEA makes it unlawful for a person "[t]o 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 as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors."\(^10\) Rule 10b-5 makes it unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security."\(^11\)

The required elements of a private securities claim under Section 10(b) are: "1) a misstatement or omission, 2) of a material fact, 3) made with scienter, 4) on which plaintiff relied, 5) that proximately caused his injury."\(^12\) In order to survive a Federal Rule of Civil Procedure 12(b)(6) motion to dismiss for "failure to state a claim upon which relief can be granted,"\(^13\) allegations of securities fraud must satisfy the pleading requirements of Federal Rule of Civil Procedure 9(b).\(^14\) Rule 9(b) provides that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with

\(^12\) Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1281 (11th Cir. 1999).
\(^13\) FED. R. CIV. P. 12(b)(6).
\(^14\) FED. R. CIV. P. 9(b).
particularity."15 Rule 9(b) further states that "[m]alice, intent, knowledge and other condition of mind of a person may be averred generally."16 Despite this "particularity" requirement, prior to the PSLRA, private litigants were able to abuse the securities laws.17 Some circuits interpreted Rule 9(b) broadly, allowing plaintiffs to plead the scienter element of securities fraud actions with mere conclusory allegations.18 However, other circuits required plaintiffs to plead specific facts sufficient to establish a "strong inference" of scienter.19 In response to these continued abuses and in an effort to establish a national standard, in 1995, Congress adopted the PSLRA to curb non-meritorious claims brought under federal securities laws.20 The PSLRA no longer allows plaintiffs to aver scienter merely with conclusory allegations.21 The new pleading standard created by the PSLRA requires that claimants "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."22 However, this new standard fails to define the requisite state of mind and fails to describe what is necessary to give "rise to a strong inference" of culpability.23

A. Defining Scienter Prior to the PSLRA

In *Ernst & Ernst v. Hochfelder*,24 the United States Supreme Court defined scienter as a "mental state embracing intent to deceive, manipulate, or defraud."25 In *Hochfelder*, a brokerage firm, First Securities Company of Chicago ("First Securities"), retained an accounting firm, Ernst & Ernst, to periodically audit the brokerage firm’s records and to prepare documents to be filed with the Securities and Exchange Commission.26 Customers of First Securities inadvertently invested in a fraudulent investment scheme promoted by the brokerage firm’s

15. *Id.*
16. *Id.*
18. *See* In re *GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1547-49 (9th Cir. 1994).
20. *See* sources cited *supra* notes 3-5.
22. *Id.*
23. *Id.*
25. *Id.* at 194 n.12.
26. *See* id. at 188.
president. In addition to filing an action for damages against the president, the customers filed an action claiming that Ernst & Ernst aided and abetted First Securities in a fraudulent scheme to the customers' detriment. The customers argued that Ernst & Ernst's failure to conduct a proper audit and the failure to discover the internal practices and the fraudulent investment scheme of First Securities constituted negligent nonfeasance. The Supreme Court ruled that negligent conduct is insufficient to satisfy the scienter requirement for a Section 10(b) fraud action. Therefore, absent an allegation of intent to defraud, manipulate, or deceive, the Supreme Court clearly stated that a cause of action under Section 10(b) of the SEA cannot be sustained.

In *Hochfelder*, the Court held that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that Section 10(b) was intended to proscribe knowing or intentional misconduct." The Supreme Court did not decide whether reckless behavior is sufficient to satisfy the scienter requirement under Section 10(b), but in a footnote stated that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act." In response to the Court's ruling in *Hochfelder*, every circuit court began holding that recklessness did fall within the scope of scienter for Section 10(b) purposes and was sufficient to impose liability for securities fraud. The circuits generally defined reckless conduct as:

a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of mis-

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27. See id. at 189.
28. See id. at 190.
29. See id. Nonfeasence is defined as "[t]he failure to act when a duty to act existed." *Black's Law Dictionary* 1076 (7th ed. 1999).
31. See id.
32. Id. at 197 (citing SEC v. Texas Gulf Sulfur, Co., 401 F.2d 838, 868 (2d Cir. 1968)).
33. Id. at 194 n.12 (emphasis added).
34. See Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1284 (11th Cir. 1999); see also Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990); *In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236, 1244 (3d Cir. 1989); Van Dyke v. Coburn Enter., Inc., 873 F.2d 1094, 1100 (8th Cir. 1989); Hackbart v. Holmes, 675 F.2d 1114, 1117–18 (10th Cir. 1982); Cook v. Avien, Inc., 573 F.2d 685, 692 (1st Cir. 1978); Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 47 (2d Cir. 1978).
leading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.\textsuperscript{35}

However, the enactment of the PSLRA has caused some disagreement among the circuits over whether reckless behavior still satisfies the substantive scienter requirement for the imposition of liability for securities fraud under Section 10(b).\textsuperscript{36} Additionally, the circuits are divided as to what facts must be alleged to satisfy the procedural requirements of averring scienter.\textsuperscript{37} The substantive requirement of securities fraud actions refers to the requisite condition of the mind of the defendant, while the procedural requirement refers to the level of facts that must be pled to meet this substantive requirement.

B. Development of the Heightened Pleading Standard

Prior to the enactment of the PSLRA, the circuits were split as to the requisite pleading standards under Rule 9(b) in securities fraud cases.\textsuperscript{38} The following cases illustrate the pre-PSLRA differences in the pleading standards among the federal circuits.

In \textit{In re Time Warner Inc. Securities Litigation},\textsuperscript{39} the Second Circuit ruled that facts alleged in a securities fraud complaint must "give rise to a 'strong inference' of fraudulent intent."\textsuperscript{40} In \textit{Time Warner}, the defendant, Time, Inc. ("Time"), agreed to merge with Warner Communications ("Warner") by acquiring all of Warner's outstanding stock.\textsuperscript{41} This acquisition caused Time to incur a debt of over $10 billion and forced the company to raise capital through a new stock offering.\textsuperscript{42} Announcement of the new offering caused a decline in the price of stock from $117 per share to $89.75 per share.\textsuperscript{43} The new shareholders brought a securities fraud claim alleging that a series of statements made by company officials during the new offering period materially

\textsuperscript{35} Sunstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044–45 (7th Cir. 1977). \textit{See also} Bryant, 187 F.3d at 1284; \textit{In re Silicon Graphics Inc. Sec. Litig.}, 183 F.3d 970, 976–77 (9th Cir. 1999), \textit{reh’g denied}, 195 F.3d 521 (9th Cir. 1999).

\textsuperscript{36} \textit{See In re Advanta Corp. Sec. Litig.}, 180 F.3d 525, 531 n.6 (3d Cir. 1999); \textit{Bryant}, 187 F.3d at 1284 n.21; \textit{Silicon Graphics}, 183 F.3d at 976–77; \textit{see also} discussion \textit{infra} Part II.

\textsuperscript{37} \textit{See Silicon Graphics}, 183 F.3d at 978–79.

\textsuperscript{38} \textit{See In re GlenFed, Inc. Sec. Litig.}, 42 F.3d 1541 (9th Cir. 1994); \textit{In re Time Warner Inc. Sec. Litig.}, 9 F.3d 259 (2d Cir. 1993).

\textsuperscript{39} 9 F.3d 259 (2d Cir. 1993).

\textsuperscript{40} \textit{Id.} at 268 (alteration in original) (quoting \textit{O’Brien v. Nat’l Prop. Analysts Partners}, 936 F.2d 674, 676 (2d Cir. 1991)).

\textsuperscript{41} \textit{See id.} at 262.

\textsuperscript{42} \textit{See id.}

\textsuperscript{43} \textit{See id.}
mislled investors by misrepresenting the status of the strategic partnership.\textsuperscript{44}

In order to satisfy the requirement that the complaint give rise to a strong inference of fraudulent intent, the Second Circuit recognized two distinct ways in which a plaintiff may plead scienter.\textsuperscript{45} A plaintiff must either (1) allege facts establishing a motive and opportunity to commit fraud, or (2) "allege facts constituting circumstantial evidence of either reckless or conscious behavior."\textsuperscript{46} The Time Warner court reversed the district court's dismissal of the complaint and remanded the case for a determination consistent with its interpretation of the procedural rules.\textsuperscript{47} By allowing plaintiffs to allege facts constituting motive and opportunity, the Second Circuit created the potential for pleading reckless conduct that cannot be distinguished from negligent conduct. However, according to the Hochfelder Court, such a showing is insufficient to establish scienter under Section 10(b).\textsuperscript{48} At that time, the Second Circuit's pleading requirement was regarded as the most stringent pleading standard of any circuit because it required that fraudulent intent be \textit{specifically} pled, rather than generally pled.\textsuperscript{49} But the facts that must be specifically pled to establish scienter could include facts constituting simply motive and opportunity.\textsuperscript{50}

At the other end of the spectrum, the Ninth Circuit failed to adopt the Second Circuit's view that plaintiffs must plead facts giving rise to a "strong inference of fraudulent intent."\textsuperscript{51} Rather, the Ninth Circuit, in \textit{In re GlenFed, Inc. Securities Litigation},\textsuperscript{52} determined that Rule 9(b) does not require "'any particularity in connection with an averment of intent, knowledge or condition of the mind.'"\textsuperscript{53} In GlenFed, investors appealed the district court's dismissal of their complaint for failing to plead fraud with particularity.\textsuperscript{54} The shareholders alleged that corporate officers concealed the company's deteriorating financial condition, lack of adequate internal controls, and declining

\begin{itemize}
\item \textsuperscript{44} See id.
\item \textsuperscript{45} See id. at 268–69.
\item \textsuperscript{46} Id. at 269.
\item \textsuperscript{47} See id. at 272.
\item \textsuperscript{48} See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 210 (1976).
\item \textsuperscript{49} See \textit{In re Advanta Corp. Sec. Litig.}, 180 F.3d 525, 534 (3d Cir. 1999).
\item \textsuperscript{50} See \textit{In re Time Warner Inc. Sec. Litig.}, 9 F.3d 259, 269 (2d Cir. 1993).
\item \textsuperscript{51} See \textit{In re GlenFed, Inc. Sec. Litig.}, 42 F.3d 1541, 1546–49 (9th Cir. 1994).
\item \textsuperscript{52} 42 F.3d 1541 (9th Cir. 1994).
\item \textsuperscript{53} Id. at 1545 (alteration in original) (quoting Walling v. Beverly Enters., 476 F.2d 393, 397 (9th Cir. 1973)).
\item \textsuperscript{54} See id. at 1543.
\end{itemize}
market value.\textsuperscript{55} The Ninth Circuit ultimately determined that the pleading met the broad requirement of pleading scienter under Rule 9(b) and vacated the dismissal.\textsuperscript{56} The court concluded that the second provision of Rule 9(b) is clear in that conditions of the mind may be averred generally.\textsuperscript{57} The court stated that "it shall be sufficient to allege [scienter] without setting out the circumstances from which the same is to be inferred."\textsuperscript{58} In effect, the Ninth Circuit allowed plaintiffs to assert scienter generally by alleging that scienter existed, so long as the plaintiff pled with particularity the "circumstances constituting fraud."\textsuperscript{59} Since this pleading standard allowed conclusory allegations of scienter, the standard was viewed as far less stringent than the Second Circuit pleading standard.\textsuperscript{60}

In an attempt to reconcile the conflicting pleading standards, Congress enacted the PSLRA.\textsuperscript{61} The PSLRA requires that a plaintiff, "with respect to each act or omission alleged . . . , state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."\textsuperscript{62} The language of this new pleading standard parallels the Second Circuit's standard.\textsuperscript{63} Clearly, scienter can no longer be averred generally as it could under the Ninth Circuit test enunciated in GlenFed.\textsuperscript{64} The statutory language of the PSLRA, however, does not define the term "strong inference" nor does it provide guidance on what a plaintiff must plead in order to establish this "strong inference."\textsuperscript{65} Consequently, the circuits are divided in their interpretations of this new pleading standard.\textsuperscript{66}

\textsuperscript{55} See id.
\textsuperscript{56} See id. at 1554.
\textsuperscript{57} See id. at 1545.
\textsuperscript{58} Id. (alterations in original) (citation omitted).
\textsuperscript{59} Id. at 1547 (emphasis omitted).
\textsuperscript{61} See Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282 (11th Cir. 1999).
\textsuperscript{64} Compare 15 U.S.C. § 78u-4(b)(2) with GlenFed, 42 F.3d at 1545; see also Bryant, 187 F.3d at 1282 (discussing the differences between the PSLRA and the Second and Ninth Circuit standards).
\textsuperscript{65} See In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 977 (9th Cir. 1999), reh'g denied, 195 F.3d 521 (9th Cir. 1999).
\textsuperscript{66} See Bryant, 187 F.3d at 1282; Press, 166 F.3d at 538; Silicon Graphics, 183 F.3d at 970.
II. The Problem: Confusion Among Federal Circuit Courts Following the Adoption of the PSLRA

Two issues have arisen among the circuit courts as a result of the 1995 enactment of the PSLRA. First, the circuits are divided as to whether recklessness constitutes the requisite mental state needed to satisfy the substantive element of scienter as defined by the PSLRA for purposes of Section 10(b) securities fraud claims. Second, there is ambiguity as to what a plaintiff must allege in order to satisfy the procedural requirement of stating facts which give rise to a "strong inference" of the requisite state of mind.

A. What Mental State Is Sufficient to Satisfy Scienter Under Section 10(b)?

1. Simple Recklessness

Following the adoption of the PSLRA, most circuits concluded that some form of recklessness satisfies the scienter element of Section 10(b). However, the circuits have differed in the degree of recklessness required to establish scienter. In Press v. Chemical Investment Services Corp., the Second Circuit ruled that facts alleged in a securities fraud complaint must give rise to a "strong inference" of fraudulent intent. In Press, the Second Circuit determined that simple recklessness satisfied the scienter requirement. The Second Circuit's test explicitly states that a plaintiff may "allege facts that 'constitute strong circumstantial evidence of conscious misbehavior or recklessness.'"

In Press, the individual plaintiff had purchased a United States Treasury bill through a registered securities broker-dealer. The plaintiff maintained that the defendants committed fraud by failing to disclose that the funds, at maturity, would not be immediately availa-

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67. See Bryant, 187 F.3d at 1282.


69. See In re Advanta Corp. Sec. Litig., 180 F.3d 525, 534 (3d Cir. 1999); Bryant, 187 F.3d at 1282; In re Comshare, Inc. Sec. Litig., 189 F.3d 542, 552-53 (6th Cir. 1999); Press, 166 F.3d at 538.

70. See generally Bryant, 187 F.3d 1271; Press, 166 F.3d 529; Silicon Graphics, 183 F.3d 970.

71. 166 F.3d 529 (2d Cir. 1999).

72. See id. at 538 (quoting 15 U.S.C. § 78u-4(b)(2) (Supp. IV 1998)).

73. See id.

74. Id. (emphasis added) (quoting Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1128 (2d Cir. 1994)).

75. See id. at 532.
ble because of the delay caused by the United States Postal Service. Since "the period over which the yield [on the Treasury bill] should have been calculated was longer than [the defendant] represented . . . [the plaintiff claimed] the yield advertised was . . . fraudulently inaccurate." The plaintiff filed suit under Section 10(b).

The Second Circuit concluded that the plaintiff had sufficiently alleged facts establishing that the defendants had an intent to keep possession of the investor's proceeds and had the opportunity to do so since the proceeds at maturity were in their control. However, the court failed to explain how motive and opportunity in this case established reckless conduct.

The Third and Sixth Circuits have also adopted the simple recklessness standard. The Third Circuit, in In re Advanta Corp. Securities Litigation, held that all allegations of scienter must be supported with facts stated with particularity and must give rise to a strong inference of scienter. The Third Circuit reiterated its previous holding that reckless conduct, as well as intentional or conscious behavior, remains a sufficient basis for liability under Section 10(b).

In Advanta, the shareholders alleged that Advanta's corporate officers made false and misleading statements and material omissions regarding the earning potential and value of the company stock. The Third Circuit determined that the PSLRA establishes a safe harbor provision protecting "forward-looking statements" from Rule 10b-5 liability, unless the plaintiff proves that the statements were made with actual knowledge that the statements were false or misleading. Therefore, under this provision, plaintiffs cannot allege reckless behavior when the claim of fraud relates to forward-looking statements. The Third Circuit concluded that the complaint did not state

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76. See id. at 533.
77. Id.
78. See id.
79. See id. at 538.
80. See In re Advanta Corp. Sec. Litig., 180 F.3d 525, 555 (3d Cir. 1999); In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 552–53 (6th Cir. 1999).
81. 180 F.3d 525 (3d Cir. 1999).
82. See id. at 535 (paraphrasing 15 U.S.C. § 78u-4(b)(2) (Supp. IV 1998)).
83. See id.
84. See id. at 528.
85. Id. at 535 (quoting 15 U.S.C. § 78u-5 (Supp. IV 1998)).
87. See id. A statement is forward looking if it is "a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items." Id. § 78u-5(i)(1)(A).
any specific facts to support an inference that any company officer had actual knowledge of the falsity of the statements and therefore affirmed the district court’s motion to dismiss.\textsuperscript{88}

In \textit{In re Comshare Inc. Securities Litigation},\textsuperscript{89} the Sixth Circuit also determined that “plaintiffs may plead scienter in Section 10(b) . . . cases by alleging facts giving rise to a strong inference of recklessness.”\textsuperscript{90} The Sixth Circuit noted that “the PSLRA did not change the scienter that a plaintiff must prove to prevail in a securities fraud case but instead changed what a plaintiff must plead in his complaint in order to survive a motion to dismiss.”\textsuperscript{91} Therefore, according to the Sixth Circuit, the substantive scienter requirement of recklessness remained the same, but the procedural standards for pleading recklessness changed.

In \textit{Comshare}, shareholders sued a computer software developer alleging that corporate officers knowingly or recklessly disregarded acknowledged errors in revenue recognition and that, through public misrepresentations about company revenue, the officers fraudulently induced the plaintiffs to purchase Comshare stock at artificially inflated prices.\textsuperscript{92} The Sixth Circuit recognized that the officers had a motive and opportunity to receive greater compensation if Comshare’s stock prices increased.\textsuperscript{93} However, the court held that “motive and opportunity do not, without more, suffice to give rise to a ‘strong inference’ of scienter.”\textsuperscript{94} The Second and Third Circuits are of the view that pleading facts showing motive and opportunity is sufficient to plead recklessness, while the Sixth Circuit contends that pleading facts illustrating motive and opportunity alone is insufficient.\textsuperscript{95} Despite this difference, the circuits agree that the substantive standard of recklessness remains unchanged.\textsuperscript{96}

2. \textbf{Severe Recklessness}

In order to satisfy the scienter requirement of Section 10(b), the Eleventh Circuit interprets the PSLRA to require a high degree of
recklessness. In a pre-PSLRA decision, the Eleventh Circuit characterized its severe recklessness standard as follows:

Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.

In Bryant v. Avado Brands, Inc., the Eleventh Circuit addressed the issue of whether, under the PSLRA, allegations of recklessness can still meet the requisite state of mind under Section 10(b). In Bryant, the shareholders of Avado Brands, Inc. alleged that the chief executive officer and chief financial officer made false and misleading statements and material omissions regarding the company's expansion strategy and profit margins in order to inflate the value of the company's stock.

The Eleventh Circuit interpreted the scienter requirement of Section 10(b) to mean that a "plaintiff must plead with particularity facts which give rise to a strong inference that the defendant acted in a severely reckless fashion." The Eleventh Circuit also held that although allegations of motive and opportunity to commit fraud may, under certain circumstances, contribute to an inference of severe recklessness, such allegations, without more, are not sufficient to demonstrate scienter. The court in Bryant remanded the case to the district court for proceedings consistent with the severe recklessness standard and its ruling regarding motive and opportunity. The use of the language "severe recklessness" indicates that the Eleventh Circuit intended the proof requirement to be more stringent than those circuits allowing simple recklessness to be alleged with facts of motive and opportunity.

98. See McDonald v. Alan Bush Brokerage Co., 863 F.2d 809 (11th Cir. 1989).
99. Id. at 814 (quoting Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961–62 (5th Cir. 1981)).
100. 187 F.3d 1271 (11th Cir. 1999).
101. See id. at 1283–84.
102. See id. at 1274.
103. Id. at 1285 (emphasis added).
104. See id. at 1285–86.
105. See id. at 1287. On remand, the defendants' renewed motion to dismiss was granted. See Bryant v. Avado Brands, Inc., 100 F. Supp. 2d 1368, 1385 (M.D. Ga. 2000).
3. Deliberate Recklessness

The Ninth Circuit has adopted a standard that is the "most defense-friendly" interpretation of scienter under the PSLRA.\textsuperscript{106} In other words, this standard requires the greatest showing of scienter. The Ninth Circuit held, in \textit{In re Silicon Graphics Securities Litigation},\textsuperscript{107} that a plaintiff "must plead, in great detail, facts that constitute strong circumstantial evidence of \textit{deliberately reckless} or conscious misconduct."\textsuperscript{108} As a result, the court held that although facts showing \textit{mere recklessness} or a motive and opportunity to commit fraud provide some reasonable inference of intent, these facts, standing alone, fail to establish deliberate or conscious misconduct.\textsuperscript{109} In order to demonstrate a strong inference of deliberate recklessness, "plaintiffs must state facts that come closer to demonstrating intent, as opposed to mere motive and opportunity."\textsuperscript{110}

In \textit{Silicon Graphics}, an investor filed a Section 10(b) securities fraud class action against corporate officers alleging that the officers made misleading statements regarding production and sales of the company in an effort to inflate the value of the company's stock.\textsuperscript{111} These officers were alleged to have been engaged in insider trading\textsuperscript{112} by selling their stock at these inflated prices.\textsuperscript{113} The court determined that the plaintiff's allegations were insufficient to create a strong inference that the officers acted with deliberate recklessness.\textsuperscript{114} The court reasoned that the allegations were too generic and contained little more than evidence of mere motive and opportunity.\textsuperscript{115}

The court further noted that "Congress intended to elevate the pleading requirement above the Second Circuit standard requiring plaintiffs merely to provide facts showing simple recklessness."\textsuperscript{116} According to the court, Congress intended to require something closer to actual intent as well as to eliminate the motive and opportunity

\textsuperscript{107} 183 F.3d 970 (9th Cir. 1999), \textit{reh’g denied}, 195 F.3d 521 (9th Cir. 1999).
\textsuperscript{108} \textit{Id.} at 974 (emphasis added).
\textsuperscript{109} \textit{See id.}
\textsuperscript{110} \textit{Id.}
\textsuperscript{111} \textit{See id.} at 984.
\textsuperscript{112} The term "insider trading" refers to "[t]he use of material, nonpublic information in trading the shares of a company by a corporate insider or other person who owns a fiduciary duty to the company." \textit{BLACK'S LAW DICTIONARY} 798 (7th ed. 1999).
\textsuperscript{113} \textit{See Silicon Graphics}, 183 F.3d at 984.
\textsuperscript{114} \textit{See id.} at 988.
\textsuperscript{115} \textit{See id.}
\textsuperscript{116} \textit{Id.} at 974.
presumption. The Ninth Circuit explained that allegations contained in the pleading must create an inference of a deliberate or knowing misrepresentation in order to be distinguishable from "fishing expeditions," where opportunistic plaintiffs target corporate officers selling a significant quantity of shares prior to the company taking an unforeseeable turn for the worse. The Ninth Circuit does not presume that scienter is established merely by pleading facts constituting a motive and opportunity to commit fraud.

A panel of Ninth Circuit judges recently denied a petition for a rehearing of the Silicon Graphics decision, and a majority of the non-recused active judges failed to grant a petition for rehearing en banc. However, a group of dissenting judges, in response to the petition for rehearing, expressed their strong belief that the Ninth Circuit's deliberate recklessness standard, a change in the substantive scienter requirement, is contrary to the "plain directives of Congress" and "creates a striking conflict with our fellow circuits."

B. What Must a Plaintiff Plead in Order to Satisfy the Pleading Requirement of Rule 10(b)?

1. Establishing Motive and Opportunity Creates a Presumption of Reckless Behavior

Following the adoption of the PSLRA, several circuits have concluded that satisfaction of either of the Second Circuit's pre-PSLRA tests is sufficient to establish the required strong inference of fraudulent intent. In order to satisfy this requirement, the Second Circuit determined that "a plaintiff must either (a) allege facts to show that 'defendants had both motive and opportunity to commit fraud' or (b)"

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117. See id; see also Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1284 n.21 (11th Cir. 1999) (describing the Ninth Circuit's holding in Silicon Graphics). The Eleventh Circuit in Bryant was "satisfied that Congress intended to codify the well-established law that some form of recklessness was included" within the substantive requirements, while only changing the procedural standard. See Bryant, 187 F.3d at 1284 n.21; see also In re Advanta Corp. Sec. Litig., 180 F.3d 525, 534 n.8 (3d Cir. 1999); Phillips v. LCJ Int'l, Inc., 190 F.3d 609, 620 (4th Cir. 1999) (holding that the PSLRA did not change the substantive requirements that a plaintiff prove the defendant acted intentionally, which may be shown by recklessness, but did heighten the standard for pleading scienter).

118. Silicon Graphics, 183 F.3d at 988.

119. See id. at 974.

120. See In re Silicon Graphics Inc. Sec. Litig., 195 F.3d 521, 522 (9th Cir. 1999) (denying rehearing).

121. Id. (Reinhardt, J., dissenting).

122. See generally In re Advanta Corp. Sec. Litig., 180 F.3d 525 (3d Cir. 1999); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529 (2d Cir. 1999).
allege facts that 'constitute strong circumstantial evidence of conscious misbehavior or recklessness.'”

The Second Circuit reasoned that “[t]o require more in pleading of motive ... would make virtually impossible a plaintiff’s ability to plead scienter in a financial transaction involving a corporation, institution, bank or the like that did not involve specifically greedy comments from an authorized corporate individual.”

The Second Circuit itself continues to follow its pre-PSLRA test that motive and opportunity are sufficient to establish a strong inference of fraudulent intent. The Second Circuit seems to lose sight of Congress’ clear intention to deter frivolous lawsuits.

In order to satisfy the scienter requirement, the Third Circuit also allows a plaintiff to either allege facts showing either: (1) the defendant had both motive and opportunity to commit fraud or (2) allege facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness. The Second and Third Circuits have concluded that the motive and opportunity test suffices to presumptively raise a strong inference of the requisite scienter.

However, a recent Second Circuit case, Novak v. Kasaks, seems to cast doubt on the motive and opportunity prong of establishing recklessness. The court in Novak explicitly stated that it “believe[d] that Congress’s failure to include language about motive and opportunity suggests that [courts] need not be wedded to these concepts in articulating the prevailing standard.” Although the Novak court did not reject its previous ruling in Press, the court, at a minimum, recognized the conflict and alternative approaches in other circuits. The Second Circuit seemed to disfavor the presumption that alleging motive and opportunity by itself constitutes a showing of reckless behavior, but the motive and opportunity analysis was important to a finding of reckless conduct. The court stated that “litigants and lower courts need and should not employ or rely on magic words such as ‘motive and opportunity,’ we believe that our prior case law may be

123. Press, 166 F.3d at 538 (emphasis added) (quoting Shields v. Citytrust Bancorp., Inc., 25 F.3d 1124, 1128 (2d Cir. 1999)).
124. Id.
125. See id.
126. See Advanta, 180 F.3d at 534–35.
128. 216 F.3d 300 (2d Cir. 2000), cert. denied, 121 S. Ct. 567 (2000).
129. See id. at 310.
130. Id.
helpful in providing guidance as to how the 'strong inference' standard may be met." On November 27, 2000, the United States Supreme Court denied Kasaks's petition for writ of certiorari to resolve the issue.

2. Motive and Opportunity Does Not Presumptively Raise a Strong Inference of Reckless Behavior

In contrast, the Sixth and Eleventh circuits have concluded that the motive and opportunity test no longer suffices to presumptively raise a strong inference of scienter. In Comshare, the Sixth Circuit held that "plaintiffs may plead scienter . . . by alleging facts giving rise to a strong inference of recklessness, but not by alleging facts merely establishing that a defendant had the motive and opportunity to commit securities fraud." Consequently, plaintiffs may allege facts showing motive and opportunity to support a finding of scienter, but these facts alone are insufficient to establish scienter.

In Bryant, the Eleventh Circuit similarly held that plaintiffs must plead facts giving rise to a strong inference of scienter. The court held that allegations of motive and opportunity may be relevant to a showing of severe recklessness, but such allegations, without more, are insufficient to demonstrate the requisite scienter.

3. Merely Showing Motive and Opportunity Is Insufficient to Establish Deliberate Recklessness

In Silicon Graphics, the Ninth Circuit rejected the Second Circuit's interpretation of the PSLRA. The Ninth Circuit does not allow plaintiffs to plead scienter by simply alleging facts establishing that the defendant had both a motive and the opportunity to commit securities fraud. The Ninth Circuit requires plaintiffs to alleging facts giving rise to a strong inference of conscious misconduct or deliberate recklessness. The Ninth Circuit views the PSLRA as Congress' attempt

131. Id. at 311.
133. See Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1285–86 (11th Cir. 1999); In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 549 (6th Cir. 1999).
134. Comshare, 183 F.3d at 549 (emphasis added).
135. See id.
136. See Bryant, 187 F.3d at 1285.
137. See id.
138. See In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 974 (9th Cir. 1999).
139. See id.
140. See id.
to elevate the pleading requirement above the Second Circuit standard.\textsuperscript{141} Therefore, the Ninth Circuit requires pleading facts evidencing a state of mind resembling intent as opposed to pleading a mere motive and opportunity establishing simple recklessness.\textsuperscript{142}

The Ninth Circuit interpreted the Supreme Court's decision in Hochfelder as elevating the requisite mental state to deliberate recklessness.\textsuperscript{143} The Ninth Circuit viewed recklessness as a lesser form of intentional conduct rather than a greater degree of negligence.\textsuperscript{144} Consequently, it found that the PSLRA altered the substantive requirements as well as the procedural requirement of pleading facts constituting deliberate recklessness.\textsuperscript{145} The Ninth Circuit concluded that plaintiffs can no longer aver scienter in terms of recklessness but must state specific facts indicating no less than a degree of recklessness that strongly suggests actual intent.\textsuperscript{146}

III. Analysis

It is critical to reconcile the inconsistent interpretations of the PSLRA by the various circuits. The PSLRA must be applied uniformly in securities fraud actions in order to effectuate Congress' intent to curtail frivolous and abusive litigation.\textsuperscript{147} Our securities markets include corporations that are located in many states and that conduct business across the nation. Issuers of securities should not be subject to varying pleading standards depending on the circuit in which a particular plaintiff chooses to bring suit.\textsuperscript{148}

After a careful analysis of the statutory language, the congressional intent, and the congressional history of the PSLRA, it becomes clear that the Eleventh Circuit provided the most accurate interpretation of the PSLRA in Bryant.

A. Statutory Language

In order to resolve the conflict among the circuits regarding the proper pleading requirements and the substantive definition of scien-

\textsuperscript{141} See id.
\textsuperscript{142} See id. at 976–77.
\textsuperscript{143} See id. at 977.
\textsuperscript{144} See id.
\textsuperscript{145} See id.
\textsuperscript{146} See id.
\textsuperscript{147} See supra sources cited and text accompanying notes 3–5.
\textsuperscript{148} See sources cited supra notes 2–5.
ter, an analysis of the language found in text of the PSLRA is the most appropriate starting point. The PSLRA provides, in pertinent part:

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. 149

The statutory language of the PSLRA clearly requires plaintiffs to plead fraudulent intent with particularity. 150 The language obviously rejects the Ninth Circuit's pre-1995 standard to plead fraudulent intent generally. 151 However, the potential ambiguity with regard to what facts are sufficient to give rise to a strong inference of the requisite mental state creates a problem. 152 The Third Circuit reasoned that the PSLRA's close resemblance to the Second Circuit's "strong inference" language demonstrates that Congress also intended to completely adopt all of the pleading requirements outlined by the Second Circuit. 153 The Second and Third Circuits' approach adopts the view that pleading facts alleging a motive and opportunity to commit fraud presumptively establishes the required element of scienter. 154

The Third Circuit concluded that Congress enacted the PSLRA to establish a uniform pleading standard equal to the most stringent prevailing standard of the Second Circuit while leaving the substantive requirement of scienter unchanged. 155 In other words, recklessness remains sufficient to establish scienter, but this substantive standard must be pled with particularity. The question remains whether pleading facts which allege motive and opportunity are sufficient to establish recklessness.

Another interpretation of the language of the PSLRA is that Congress intended to heighten the pleading standard to require allegations of scienter to be pled with particular facts giving rise to a strong inference, while also intending to reject the motive and opportunity presumption. 156 In Comshare, the Sixth Circuit noted that the PSLRA

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150. See id.
154. See id. at 534–35; Press, 166 F.3d at 538.
155. See Advanta, 180 F.3d at 534.
156. See In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 549 (6th Cir. 1999).
allows plaintiffs to plead facts that give rise to a strong inference of recklessness, but not by simply alleging facts of motive and opportunity. The Sixth Circuit noted that the PSLRA did not change the substantive scienter requirement that a plaintiff must prove, but instead only changed the pleading requirements sufficient to sustain a motion to dismiss.

In Bryant, the Eleventh Circuit pointed out that the PSLRA “makes no express mention of the motive and opportunity test developed in the Second Circuit, and certainly does not expressly codify it.” Additionally, the Eleventh Circuit stated that the term “required state of mind” clearly refers to a substantive standard, such as negligent, reckless, or intentional, and not a specific kind of evidence, such as facts alleging a motive and opportunity. As a result, allegations of motive and opportunity may be relevant, but such allegations, without more, are insufficient to demonstrate the requisite mental state. While the Sixth Circuit in Comshare maintained a simple recklessness scienter requirement, the Eleventh Circuit in Bryant seemingly elevated the substantive requirements from a simple recklessness standard to a severe recklessness standard. This is supported by the fact that the Bryant court expressly changed the language from recklessness to severe recklessness. At the time of the Bryant opinion, the Second, Third, and Sixth Circuits handed down opinions with the reckless language and, instead of adopting this language, the Bryant court presumably elevated the form of recklessness. The Eleventh Circuit's view is consistent with the intent of Congress in enacting the PSLRA to deter frivolous lawsuits.

Given the recent case of Novak, the Sixth and Eleventh Circuits' interpretation of the statutory language is more accurate regarding the sufficiency of pleading motive and opportunity. The Second Circuit appears to acknowledge that its view of recklessness is difficult to distinguish from higher levels of negligence. However, the Sixth Circuit has not elevated the substantive scienter requirement to severe recklessness. In light of Congress' policy of deterring frivolous law-

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157. See id.
158. See id. at 548–49.
160. See id. at 1286.
161. See id.
162. See id.
163. See id.
164. See In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 549 (6th Cir. 1999).
suits, a severely reckless standard, as adopted by the Eleventh Circuit in \textit{Bryant}, seems more consistent with the language of the PSLRA.

A third interpretation of the language of the PSLRA is that Congress intended to alter \textit{both} the procedural and substantive requirements.\footnote{See Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1283–84 (11th Cir. 1999); \textit{In re} Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 979 (9th Cir. 1999), \textit{rehg} denied, 195 F.3d 521 (9th Cir. 1999).} The Ninth Circuit adopted such a view in \textit{Silicon Graphics},\footnote{See \textit{Silicon Graphics}, 183 F.3d at 979.} in which it rejected the approach of inferring scienter simply from allegations showing a motive and opportunity.\footnote{See \textit{id. at 974.}} The court also elevated the substantive scienter requirement from a simple recklessness standard to a deliberate recklessness standard—a standard very similar to intentional conduct.\footnote{See \textit{id.}} Given the language and the views of all the other circuits, the Ninth Circuit’s decision to change the substantive requirement is unfounded. In the recent case denying a rehearing, dissenting Judge Reinhardt stated that the Ninth Circuit “was the first to arrive at the remarkable conclusion that proving recklessness is no longer sufficient” and that “[w]e did not start a trend.”\footnote{\textit{In re} Silicon Graphics Inc. Sec. Litig., 195 F.3d 521, 523 (Reinhardt, J., dissenting).} He also stated that “every other circuit to have interpreted the PSLRA’s pleading requirement had concluded that the statute did not overturn the well-established, preexisting law governing the mental state required to establish securities fraud.”\footnote{See \textit{Advanta Corp. Sec. Litig.}, 180 F.3d 525, 531 (3d Cir. 1999).}

Although the language of the PSLRA parallels the Second Circuit pleading standard with respect to pleading facts constituting fraudulent intent with particularity, the extent to which Congress intended to completely adopt the Second Circuit standard becomes clear when looking at the legislative intent.\footnote{See, e.g., \textit{Silicon Graphics}, 183 F.3d at 977 (noting that in the absence of a clear command in the text the court must turn to legislative history for guidance).}

\section*{B. Legislative History and the Securities Litigation Uniform Standards Act of 1998}

Since the statutory language is silent as to what facts constitute a strong inference of scienter and what the definition of scienter encompasses, the legislative history provides additional guidance.\footnote{See \textit{id.}} The legislative history demonstrates that the \textit{Bryant} interpretation of the

\begin{footnotesize}
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\item 165. See Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1283–84 (11th Cir. 1999); \textit{In re} Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 979 (9th Cir. 1999), \textit{rehg} denied, 195 F.3d 521 (9th Cir. 1999).
\item 166. See \textit{Silicon Graphics}, 183 F.3d at 979.
\item 167. See \textit{id. at 974.}
\item 168. See \textit{id.}
\item 170. \textit{id. at} 522 (Reinhardt, J., dissenting).
\item 171. See \textit{In re} Advanta Corp. Sec. Litig., 180 F.3d 525, 531 (3d Cir. 1999).
\item 172. See, e.g., \textit{Silicon Graphics}, 183 F.3d at 977 (noting that in the absence of a clear command in the text the court must turn to legislative history for guidance).
\end{itemize}
\end{footnotesize}
PSLRA is most accurate—alleging a motive and opportunity to commit securities fraud does not alone establish a strong inference of scienter.\textsuperscript{173} The \textit{Bryant} court also correctly interpreted the substantive requirements of scienter to include recklessness although its view encompassed a more stringent severely reckless standard than the Second Circuit standard.\textsuperscript{174}

\section{The House of Representatives}

An initial version of the Securities Litigation Reform Bill\textsuperscript{175} ("Reform Bill"), House Bill 10, was proposed in the House of Representatives to restrict abuses in securities class actions.\textsuperscript{176} It would have changed both the substantive and procedural requirements of the scienter element of Section 10(b) claims.\textsuperscript{177} This bill would have required that a complaint alleging securities fraud contain "specific facts" establishing that the defendant acted with the requisite scienter.\textsuperscript{178} In addition, this bill would have eliminated recklessness as a basis for liability under the scienter element.\textsuperscript{179} Limiting the scienter to intent would drastically reduce the number of securities fraud cases brought in federal court.

However, after hearings by the House Subcommittee on Telecommunications and Finance, the bill was revised.\textsuperscript{180} The revised bill, House Bill 1058,\textsuperscript{181} reinstated recklessness as a basis for liability and required the complaint to "make specific allegations, which, if true would be sufficient to establish scienter as to each defendant at the time the alleged violation occurred."\textsuperscript{182} House Bill 1058 defined recklessness as follows:

\begin{quote}
[A] defendant makes a fraudulent statement recklessly if the defendant, in making such statement, is guilty of highly unreasonable conduct that (A) involves not merely simple or even gross negligence, but an extreme departure from standards of ordinary care, and (B) presents a danger of misleading buyers, sellers or security holders that was either known to the defendant or so obvious that the defendant must have been aware of it. Deliberately refraining from taking steps to discover whether one's statements are false or
\end{quote}

\begin{thebibliography}{99}
\bibitem{}\textsuperscript{173} See discussion \textit{infra} Part III.B.1–3.
\bibitem{}\textsuperscript{174} See \textit{Bryant v. Avado Brands, Inc.}, 187 F.3d 1271, 1285 (11th Cir. 1999).
\bibitem{}\textsuperscript{175} H.R. 10, 104th Cong. (1st Sess. 1995).
\bibitem{}\textsuperscript{176} See id. \textsuperscript{177} \textsuperscript{178} id.
\bibitem{}\textsuperscript{177} See id.
\bibitem{}\textsuperscript{178} See id.
\bibitem{}\textsuperscript{179} See id.
\bibitem{}\textsuperscript{180} See \textit{H.R. 1058}, 104th Cong. \textsuperscript{181} \textsuperscript{182} (1995).
\bibitem{}\textsuperscript{181} H.R. 1058, 104th Cong. \textsuperscript{182} (1995).
\end{thebibliography}
misleading constitutes recklessness, but if the failure to investigate was not deliberate, such conduct shall not be considered to be reckless.\footnote{Id.}

The House of Representatives passed House Bill 1058\footnote{See 141 CONG. REC. H2863 (daily ed. Mar. 8, 1995).} in March of 1995 by a vote of 325 to 99.\footnote{See id.}

2. The Senate

The Senate also passed a version of the Reform Bill, which required plaintiffs to allege "specific facts demonstrating the state of mind of each defendant at the time the alleged violation occurred."\footnote{S. 240, 104th Cong. § 104 (1995).} In a report to the full Senate, the Senate Committee on Banking, Housing, and Urban Affairs stated that "[t]he Committee does not adopt a new and untested pleading standard that would generate additional litigation. Instead, the Committee chose a uniform standard modeled upon the pleading standard of the Second Circuit."\footnote{S. REP. No. 104-98, at 15 (1995).} The Committee added that the Second Circuit pleading standard, which requires the plaintiff to plead facts that give rise to a "strong inference" of defendant's fraudulent intent, is "[r]egarded as the most stringent pleading standard."\footnote{Id.} The Committee stated that it "does not intend to codify the Second Circuit's case law interpreting this pleading standard, although courts may find this body of law instructive."\footnote{Id.} This means that the Second Circuit's motive and opportunity prong showing recklessness was not adopted by Congress, but may be relevant in the analysis of the sufficiency of the pleading.

During the Senate debate of the Senate version of the Reform Bill, Senator Arlen Specter (R-PA) proposed an amendment ("Specter Amendment") that codified both the Second Circuit's strong inference standard as well as the two alternative tests for establishing a strong inference of scienter.\footnote{See 141 CONG. REC. S9170 (daily ed. June 27, 1995).} The amendment provided:

[A] strong inference that the defendant acted with the required state of mind may be established either—(A) by alleging facts to show that the defendant had both motive and opportunity to commit fraud; or (B) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness by the defendant.\footnote{Id.}
The Senate Bill, absent the Specter Amendment, passed on June 28, 1995 by a vote of 70 to 29.192

3. House Committee of Conference: Statement of the Managers

The House Committee of Conference resolved the differences between the House and Senate versions of the Reform Bill.193 The Conference Committee drafted the final version of the Reform Bill utilizing part of the pleading standard of the Second Circuit and also Federal Rule of Civil Procedure 9(b).194 Since the Second Circuit pleading requirement was regarded as the most stringent, the Committee adopted the Second Circuit requirement that the plaintiff state with particularity facts that give rise to a "strong inference" of the defendant's fraudulent intent.195 However, the Committee commented that "[b]ecause the Conference Committee intends to strengthen existing pleading requirements, it does not intend to codify the Second Circuit's case law interpreting this pleading standard."196 This means that Congress did not codify the motive and opportunity prong. In an accompanying footnote, the Committee expressly rejected the Second Circuit case law interpreting the pleading standard by stating that "the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness."197

Concerned that the Conference Committee pleading standard created a stricter standard than the Second Circuit, President Clinton vetoed the Reform Bill.198 President Clinton expressed his concerns regarding the new pleading standard in a message to the House of Representatives.199 In this message President Clinton stated:

I believe that the pleading requirements of the Conference Report with regard to a defendant's state of mind impose an unacceptable procedural hurdle to meritorious claims being heard in Federal courts. I am prepared to support the high pleading 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

194. See id. at 41.
195. See id.
196. Id.
197. Id.
199. See id.
President Clinton did state that he would sign the bill if Congress would “adopt the Second Circuit pleading standards and reinsert the Specter amendment.” By reinserting the Specter Amendment, it would have become easier for plaintiffs to plead securities fraud. Despite the President’s disapproval, both the Senate and the House of Representatives overrode the President’s veto and enacted the House Committee version of the PSLRA into law in December of 1995, without changes.

4. Securities Litigation Uniform Standards Act of 1998 Reinforces the Previous Purposes for Passing the PSLRA

Section 78u-4 specifically provides that the PSLRA’s provisions “shall apply in each private action arising under this chapter that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure.” Since the PSLRA only applies to actions filed in federal courts, plaintiffs in securities fraud class actions avoided the new pleading requirements by filing lawsuits in state courts under state law. As a result, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”). SLUSA requires plaintiffs to file in federal court those securities class actions which involve nationally traded securities and which are based on similar allegations of Section 10(b).

Congress, in its Conference Report on the SLUSA, commented on the adoption of the PSLRA. This Conference Report states that “[i]t is the clear understanding of the [Conference Committee] managers that Congress did not, in adopting the [PSLRA], intend to alter the standards of liability under the [SEA].” In a similar Senate Report, the managers emphasized that Congress clearly did not intend to alter the scienter standard in federal securities fraud suits. The Senate Report reiterated that the

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200. Id. at H15215.
201. Id.
204. See Daniel J. Kramer, Reforming the Securities Reform Act with National Pleading Standards, N.Y.L.J., July 22, 1999, at 1 (1999) (pointing out plaintiff’s ability to avoid the PSLRA by filing class actions in state court).
206. See id.
208. Id.
PSLRA establishes a heightened uniform federal standard of pleading requirements based in part upon Second Circuit’s holding in *Press*.210

The Third Circuit has held that the PSLRA completely adopts the Second Circuit pleading standards, while not imposing a more stringent scienter requirement beyond that enunciated in the Second Circuit—simple recklessness.211 Since the legislative history is contradictory and inconclusive, these circuits focus on the plain language of the PSLRA.212 Courts adopting this view reason that since the language of the PSLRA mirrors the language used in the Second Circuit, Congress intended to establish standards equal in stringency to that of the Second Circuit.213 Thus, by refusing to expressly reject the Second Circuit motive and opportunity presumption and simple recklessness substantive standard, Congress implicitly accepted these approaches.

The Senate Committee Report does state that courts may find the Second Circuit case law instructive when interpreting the PSLRA pleading standard.214 Furthermore, it is argued that the adoption of the Second Circuit test satisfies Congress' goal of curtailing abusive securities actions.215 In this context, "instructive" means that courts are free to consider facts alleging a motive and opportunity as a factor in determining whether the alleged facts give rise to a strong inference of intent.216 However, instructive does not mean that the courts are required to accept allegations of motive and opportunity as a presumptive showing of scienter.217

Some circuits disagree that the PSLRA completely adopts the Second Circuit pleading and substantive standards.218 Relying on the legislative history, these circuits argue that Congress implicitly rejected some Second Circuit standards and explicitly stated its intention to heighten the pleading standard above that of the Second Circuit.219 Consequently, Congress could not have completely adopted the Sec-

210. See id.
211. See In re Advanta Corp. Sec. Litig., 180 F.3d 525, 532–33 (3d Cir. 1999).
212. See id. at 533–34.
215. See Advanta, 180 F.3d at 534.
216. See, e.g., In re Comshare, Inc. Sec. Litig., 183 F.3d 542 (6th Cir. 1999).
217. See id. at 549.
218. See generally Bryant v. Avado Brands, Inc., 187 F.3d 1271 (11th Cir. 1999); In re Comshare, Inc. Sec. Litig., 183 F.3d 542 (6th Cir. 1999); In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999), reh’g denied, 195 F.3d 521 (9th Cir. 1999).
219. See 141 Cong. Rec. S9219 (daily ed. June 28, 1995); see also Comshare, 183 F.3d at 551; Silicon Graphics, 183 F.3d at 977–78.
ond Circuit standards. This view is supported by the Senate Committee Report, in which the Committee explicitly stated its intention not to codify the Second Circuit case law interpreting the pleading standard. The House Committee Report, which explicitly states its decision not to include certain language relating to motive, opportunity, or recklessness, also supports this interpretation.

Additionally, the Senate rejected the proposed Specter Amendment, which would have adopted the motive and opportunity presumption used in the Second Circuit. Finally, by overriding President Clinton's veto, Congress manifested its intention to heighten the pleading standard by rejecting the motive and opportunity presumption of the Second Circuit. It is apparent that Congress considered completely adopting the Second Circuit test, but clearly declined to do so by deleting such language from the final version of the bill.

IV. The Solution

Congress' attempt to reform securities litigation in 1995 has caused confusion among the circuits. Since the statutory language and the congressional history of the PSLRA are ambiguous, the federal circuit courts of appeal have interpreted the PSLRA in various ways. These various interpretations are contrary to the goal of establishing a uniform federal pleading standard that prevents abusive securities litigation. After analyzing the statutory language and legislative history, the Eleventh Circuit's interpretation of the PSLRA is most consistent with the language, history, and purpose of the PSLRA.

In Bryant v. Avado Brands, Inc., the Eleventh Circuit interpreted the PSLRA to incorporate heightened pleading requirements beyond that of the Second Circuit without altering the substantive requirements of scienter. The Eleventh Circuit implicitly rejected the mental state of simple recklessness by holding severe recklessness is required to satisfy the scienter element of the PSLRA. Requiring

223. See Comshare, 183 F.3d at 551–52; see also Silicon Graphics, 183 F.3d at 977-78.
224. See Comshare, 183 F.3d at 551.
225. See id.
226. 187 F.3d 1271 (11th Cir. 1999).
227. See id. at 1285–86.
228. See id. at 1284 n.21.
severe recklessness is most consistent with the definition of scienter outlined in the United States Supreme Court decision in *Hochfelder*.229

In *Hochfelder*, the Supreme Court held that negligence was an insufficient mental state to impose civil liability under Section 10(b) of the SEA.230 The Supreme Court did, however, leave open the question of whether recklessness is a sufficient mental state to establish scienter.231 The Supreme Court defined scienter as a "mental state embracing intent to deceive, manipulate, or defraud."232 The Supreme Court also added that "[i]n certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability."233

In *Bryant*, the Eleventh Circuit correctly held that under the PSLRA "a showing 'of severe recklessness' satisfies the scienter requirement."234 The court concluded that under the PSLRA the substantive requirements of scienter were unchanged since prior to the enactment of the PSLRA reckless conduct was sufficient to establish the requisite mental state.235 However, the Eleventh Circuit held that the requisite mental state must be at least severe recklessness, implicitly rejecting simple recklessness.236 The key inquiry is whether the conduct alleged is sufficiently greater than negligence. It is for this reason that the Second Circuit's view of recklessness is subject to abuse. Reckless conduct must be shown by facts amounting to more than gross negligence.

Moreover, given the broad policy goal of curtailing abusive lawsuits, it follows that Congress intended to raise the pleading standards uniformly. Presumably, Congress did not enact the PSLRA only to prevent abusive securities actions in the Ninth Circuit.237 Therefore, in order to curtail abusive suits nationally, the standard must have been heightened to a level beyond the most stringent existing standards. This means a scienter requirement of severe recklessness is what Congress intended with the PSLRA. Since the existing standard was a simple recklessness standard, a severe recklessness standard is the most

230. See id. at 193.
231. See id. at 194 n.12.
232. Id.
233. Id.
235. See id. at 1284.
236. See id. at 1286.
237. Although there is an argument that the PSLRA was a response to the Ninth Circuit's loose interpretation of Rule 9(b), the real issue is the appropriate level of fraudulent intent required to bring securities fraud actions.
appropriate interpretation consistent with effectuating the goal of ensuring that plaintiffs file only meritorious securities fraud suits.

The Eleventh Circuit also correctly held that the PSLRA did elevate the pleading standard beyond that adopted in the Second Circuit. Since the language of the PSLRA does not expressly mention the motive and opportunity test, the Eleventh Circuit rejected the notion that allegations of motive and opportunity alone are sufficient to establish scienter. The Conference Committee Report and the Senate Report, which explicitly fail to adopt the Second Circuit approach, support the Eleventh Circuit’s view. The Eleventh Circuit pointed out that the language of the PSLRA does not support a motive and opportunity test. The Eleventh Circuit correctly analyzed the term “mental state” as a substantive condition of the mind and found that the terms “motive and opportunity” indicate specific kinds of evidence and do not constitute a requisite condition of the mind. Additionally, the Eleventh Circuit rejected the motive and opportunity test for being too inclusive, as almost all corporate insiders have a motive and opportunity to increase one’s wealth through manipulation. Since Congress attempted to deter frivolous lawsuits nationally, the level of recklessness must be elevated beyond the most stringent existing standards. For this reason, the appropriate level is a severe recklessness standard, which cannot be alleged simply by showing motive and opportunity.

Conclusion

In 1995, Congress adopted the PSLRA to curb abusive securities litigation. Since its inception, courts have struggled with Congress’ explicit goal to heighten the pleading requirement in securities fraud cases. Some courts have determined that adopting the Second Circuit standard, the most stringent standard prevailing at the time, satisfied this goal. However, other courts have determined that Congress intended to elevate the pleading requirement beyond the Second Circuit standard. Based on the language and history of the PSLRA, a severely reckless level of scienter is most consistent with Congress’ directives.

238. See Bryant, 187 F.3d at 1283.
239. See id. at 1285.
241. See Bryant, 187 F.3d at 1285.
242. See id. at 1285–86.
243. See id. at 1286.
In order to effectuate the purpose of the PSLRA, the United States Supreme Court or Congress must resolve these issues and adopt a uniform federal pleading standard for securities fraud actions. Using the Eleventh Circuit as a model, a heightened pleading requirement can be attained, while retaining recklessness as the substantive scienter requirement. However, since plaintiffs must allege facts that are distinguishable from gross negligence, a greater showing of recklessness is in order. This is the dilemma that the Ninth Circuit attempted to resolve in *Silicon Graphics*. The circuit courts need assistance from the Supreme Court or Congress in defining the appropriate recklessness standard. Until these issues are resolved, our nation's securities markets are threatened by inconsistent court determinations.