2004

Comfort with the Majority: The Eighth Circuit Weighs in on the Proper Pleading Test for a Securities Fraud Claim in Florida State Board of Administration v. Green Tree Financial Corporation, 270 F.3d 645 (8th Cir. 2001)

Erin M. O’Gara
University of Nebraska College of Law, erin.ogara@kutakrock.com

Follow this and additional works at: https://digitalcommons.unl.edu/nlr

Recommended Citation
Available at: https://digitalcommons.unl.edu/nlr/vol82/iss4/7

This Article is brought to you for free and open access by the Law, College of at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in Nebraska Law Review by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.
Comfort with the Majority: The Eighth Circuit Weighs in on the Proper Pleading Test for a Securities Fraud Claim in *Florida State Board of Administration v. Green Tree Financial Corporation*, 270 F.3d 645 (8th Cir. 2001)

TABLE OF CONTENTS

I. Introduction ............................................. 1277
II. Background ............................................. 1281
   A. The Pre-Reform Act Pleading Standard ............... 1281
   B. The Reform Act and Its Legislative History .......... 1282
   C. The Reform Act's Interpretation by the Courts and the Resulting Circuit Court Split ............... 1284
      1. The Second Circuit Standard: The Motive-and-Opportunity Test .................................. 1284
      2. The Ninth Circuit Standard: Allegations of Motive and Opportunity Are Never Sufficient to Plead Sciener ........................................ 1285
      3. The Middle Ground: Allegations of Motive and Opportunity May Not Necessarily be Sufficient to Plead Sciener .................................. 1286
   D. *Green Tree* ........................................... 1287
      1. Facts .............................................. 1287
      2. Holding ........................................... 1290
III. Analysis ................................................ 1292

© Copyright held by the *Nebraska Law Review*
A. The Plain Language, Legislative History, and Policies Underlying the Reform Act Indicate that Congress Neither Codified Nor Rejected the Second Circuit's Motive-and-Opportunity Test 1293

1. The Reform Act's Plain Language Indicates That Congress Neither Codified, Nor Rejected the Second Circuit's Motive-and-Opportunity Test 1293

2. The Reform Act's Legislative History Indicates That Congress Did Not Explicitly Reject the Motive-and-Opportunity Test 1294

B. The Eighth Circuit Should Adopt the Motive-and-Opportunity Pleading Test 1298

1. The Motive-and-Opportunity Test, Along with the Second Circuit Case Law, Raises the Procedural Pleading Requirement, Thus Deterring Meritless Strike Suits 1300

2. The Motive-and-Opportunity Test Best Protects Investors in the Securities Market 1302

3. The Adoption of the Motive-and-Opportunity Test, Along with the Second Circuit Case Law, Establishes a Uniform Pleading System Throughout the Circuits 1304

C. Some Guidance for Securities Fraud Plaintiffs in the Eighth Circuit 1305

IV. Conclusion and Future of the Reform Act 1307

I. INTRODUCTION

In this age of corporate scandals it is unlikely that one would view large profitable corporations such as Enron, WorldCom, and Global Crossing, as victimized, "deep-pocket" defendants—the unfair targets of frivolous shareholder lawsuits.1 However, it was exactly this concern that motivated Congress to pass the Private Securities Litigation Reform Act of 1995 (the "Reform Act").2 The Reform Act, which amended the Securities and Exchange Act of 1934, strengthened a variety of securities laws in favor of corporate defendants. In part, the Reform Act increased the minimum showing of scienter,3 an essential element of both a section 10(b) claim of the Securities and Exchange


2. See infra notes 128-35 and accompanying text.

3. Scienter is "a degree of knowledge that makes a person legally responsible for the consequences of his or her act or omission." BLACK'S LAW DICTIONARY 1347 (7th ed. 1999).
Act of 1934 ("section 10(b) claim") and a Securities and Exchange Commission Rule 10b-5 claim ("Rule 10b-5 claim"), necessary to survive a motion to dismiss.6

A split has developed among the circuit courts concerning which pleading requirement Congress adopted, if any, to satisfy the strong-inference-of-scienter requirement mandated by the Reform Act. At one end of the spectrum, the Second and Third Circuits have adopted the "motive-and-opportunity" test, which finds that pleading facts demonstrating motive and opportunity is sufficient to give rise to a strong inference of scienter.7 At the other end of the spectrum, the Ninth Circuit has held that Congress raised the pleading standard beyond that of "motive and opportunity," meaning that pleading facts detailing motive and opportunity will never satisfy the strong-inference-of-scienter requirement.8 In the middle of the spectrum are the First, Fourth, Fifth, Sixth, Tenth, and Eleventh Circuits, holding that while pleading facts detailing motive and opportunity are important in pleading a securities fraud claim, ultimately the court must engage in a factual determination on a case-by-case basis to determine whether the strong-inference-of-scienter requirement has been met.9

The circuits are in agreement that the Reform Act does not alter the substantive requirement of scienter, which is recklessness, for a

---

4. Section 10(b) states, in relevant part:
   It shall be unlawful for any person, directly or indirectly, by the use . . . of any facility of any national securities exchange . . . [to] use or employ, in connection with the purchase or sale of any security registered on a national securities . . . , and manipulative or deceptive device or contrivance in contravention or such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

5. Rule 10b-5 provides that it is unlawful to use any facility of the national securities exchange "[t]o employ any device, scheme, or artifice to defraud." 17 C.F.R. § 240.10b-5(a) (2001).

6. The Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 (2001). The elements of a section 10(b) and Rule 10b-5 claim are: (1) misrepresentations or omissions of material fact or acts that operated as a fraud or deceit in violation of the rule; (2) causation, often analyzed in terms of materiality and reliance; (3) scienter on the part of the defendants; and (4) economic harm caused by the fraudulent activity occurring in connection with the purchase and sale of a security." In re K-tel Int'l., Inc. Sec. Litig., 300 F.3d 881, 888 (8th Cir. 2002).


section 10(b) and a Rule 10b-5 claim. Although the substantive scienter requirement is not the focus of this Note, it is important to understand that by increasing the minimum showing of scienter necessary to survive a motion to dismiss, "Congress has effectively, for policy reasons, made it substantively harder for plaintiffs to bring securities fraud cases." Under the Reform Act, once a motion to dismiss is filed, all discovery, with certain narrow exceptions, is stayed while the motion to dismiss is pending. Clearly, determining the proper pleading test that satisfies the strong-inference-of-scienter requirement has far reaching implications. The adoption of a lenient pleading test will fail to screen out frivolous securities fraud claims and will subject corporations to costly and time-consuming "strike suits." Conversely, the adoption of an overly strict pleading test may deny securities fraud litigants with meritorious claims their day in court.

Interestingly, in the seven years since the passage of the Reform Act, it is not clear that the heightened pleading standards have decreased the number of strike suits. Initially, the passage of the Re-

10. The Eighth Circuit has adopted the Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977), definition of recklessness:

[Recklessness is] limited to those highly unreasonable omissions or misrepresentations that involve not merely simply 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.

The following Circuits have adopted a similar definition of recklessness for a section 10(b) and a Rule 10(b)(5) claim: Greebel v. FTP Software, Inc., 194 F.3d 185, 198-201 (1st Cir. 1999); Press v. Chemical Inv. Serv. Corp. 166 F.3d 529, 537-38 (2d Cir. 1999); In re Advanta Corp. Sec. Litig., 180 F.3d 525, 534 (3d Cir. 1999); Phillips v. LCI Int'l., Inc., 190 F.3d 609, 620 (4th Cir. 1999); Nathenson v. Zonagen Inc., 267 F.3d 400, 409 (5th Cir. 2001); Hoffman v. Comshare, Inc., 183 F.3d 542, 548-49 (6th Cir. 1999); City of Philadelphia v. Fleming Cos., 264 F.3d 1245, 1258-60 (10th Cir. 2001); Bryant v. Avado Brands Inc., 187 F.3d 1271, 1283-84 (11th Cir. 1999). In In re Silicon Graphics Sec. Litig., 183 F.3d 970, 977 (9th Cir. 1999), the Ninth Circuit initially stated that the Reform Act adopted a heightened substantive standard for scienter, that of deliberate recklessness which was "some degree of intentional or conscious misconduct." However, one year later, the same court held that the Reform Act "did not alter the substantive requirements for scienter under § 10(b)." Howard v. Everex Sys., Inc., 228 F.3d 1057, 1064 (9th Cir. 2000).

13. A strike suit is defined as "[a] suit brought against a corporation by a shareholder who owns a small amount of that corporation's shares. Such suits are most often brought with the sole intention of forcing the corporation to privately settle the suit, rather than spend a large sum of money to defend." GILBERT'S LAW DICTIONARY 318 (1997).
form Act caused a significant drop in shareholder lawsuits,\textsuperscript{14} but shareholder lawsuits quickly climbed back to previous levels, with a record number of suits filed in 2001.\textsuperscript{15} One possible explanation is that the decline and subsequent rise in shareholder lawsuits had little to do with the heightened pleading standards and instead are attributable to the rise and fall of the stock market.\textsuperscript{16} In a rising stock market, corporate directors and officers are less likely to manipulate their numbers or hide bad news, because investors are more likely to ignore this information.\textsuperscript{17} In a down market, investors are more likely to act on this information, giving corporate directors and officers an incentive to try to hide the bad news from investors by manipulating the numbers reported to shareholders. Others argue, however, that because of the falling stock market, the number of suits filed in 2001 would have likely been higher without the heightened Reform Act pleading standards.\textsuperscript{18}

This Note argues that the Reform Act neither codified nor rejected the Second Circuit’s motive-and-opportunity pleading test and accompanying case law, instead leaving the matter to the courts. Left with this flexibility, the Eighth Circuit should have adopted the Second Circuit’s motive-and-opportunity test and the accompanying Second Circuit case law. The motive-and-opportunity test, and the accompanying Second Circuit case law, best furthers the policies and considerations underlying the Reform Act, namely the deterrence of meritless strike suits, the protection of investors in the securities market, and the establishment of a uniform pleading system for securities fraud claims. The pleading test adopted by the Eighth Circuit, the case-by-case factual determination test, adds little to the deterrence of strike suits, fails to provide securities plaintiffs with guidance on how to satisfy the increased pleading requirements, and injects judicial flexibility into a situation where Congress clearly wanted it limited.

Section II of the Note examines (1) the pleading standard for scienter prior to the Reform Act; (2) the Reform Act’s text and legislative history; and (3) the resulting circuit court split that has developed concerning the test for pleading scienter under the Reform Act. Section II also discusses the factual background and procedural history of \textit{Florida State Board of Administration v. Green Tree Financial Corpora-}

\textsuperscript{14} Jonathan Krim, \textit{Shareholder Suits Possible Early Warning Sign of Accounting Ills}, \textit{Chicago Tribune}, Aug. 18, 2002, at C3. The number of shareholder suits in 1995 was 188; there were 109 in 1996 (giving figures from the Stanford Law School Securities Class Action Clearing House).

\textsuperscript{15} \textit{Id.} The number of lawsuits in 2001 was 485.


\textsuperscript{17} \textit{Id.}

tion ("Green Tree"), the case in which the Eighth Circuit weighed in on the appropriate pleading test under the Reform Act. Section III argues that the legislative history and plain text of the Reform Act indicate that Congress neither codified nor rejected the Second Circuit's motive-and-opportunity test, and instead, left the matter to judicial determination. Section III also examines the policies and considerations underlying the Reform Act and concludes that to best further these policies and considerations, the Eighth Circuit should have adopted the motive-and-opportunity test and the accompanying Second Circuit case law.

II. BACKGROUND

A. The Pre-Reform Act Pleading Standard

Prior to the passage of the Reform Act, the pleading standard for a section 10(b) and a Rule 10b-5 claim was governed under Rule 9(b) of the Federal Rules of Civil Procedure ("Rule 9(b)"), which provided that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." The Eighth Circuit interpreted Rule 9(b) as requiring the plaintiff to plead circumstances such as "the time, place, and contents of false representations, as well as the identity of the person making the misrepresentation and what was obtained or given up thereby." The Eighth Circuit has held that "conclusory allegations that a defendant's conduct was fraudulent and deceptive are not sufficient to satisfy [Rule 9(b)]." Members of Congress and the leadership of many large corporations recognized the importance of the pleading standard for section 10(b) and Rule 10(b)(5) claims and the role an increased pleading standard could play in deterring securities fraud litigation. In his Congressional testimony, former Securities and Exchange Commission Chairman Arthur Levitt stated that "[o]ne of the most critical aspects of a fair and efficient litigation system is the ability to identify meritless cases early in the process, before the costs associated with protracted litigation are incurred." Both political parties felt that the current Rule 9(b) pleading requirements were too lenient, and failed to "screen out" meritless securities litigation. Also, the varying interpretations of Rule 9(b) requirements led to different pleading

20. FED. R. CIV. P. 9(b).
standards for securities fraud claims throughout the Circuits. Consequently, federal legislation was drafted that would create a uniform pleading standard for securities fraud claims and that would deter frivolous securities fraud litigation at the pleading stage.

B. The Reform Act and Its Legislative History

A substantial portion of the Congressional debate concerning the Reform Act pleading standards focused on whether the Second Circuit's pre-Reform Act pleading standard and test showing how to meet that standard should be adopted. Prior to the passage of the Reform Act, the Second Circuit applied a heightened pleading standard for securities fraud claims. This heightened pleading standard required plaintiffs to "allege facts giving rise to a strong inference of fraudulent intent." The Second Circuit has held that the "strong inference of fraudulent intent" pleading standard may be satisfied by pleading facts that show that the (1) defendant had motive and opportunity to commit fraud, or (2) circumstantial evidence of conscious misbehavior or recklessness. This became known as the Second Circuit's motive-and-opportunity pleading test.

Initially, the House Bill adopted a stricter pleading standard that required the pleader to "make specific allegations which, if true, would be sufficient to establish scienter as to each defendant at the time the alleged violation occurred." The House subsequently rejected several Amendments that would have weakened this pleading standard. In contrast, the Senate Bill adopted the Second Circuit's strong-inference-of-scienter pleading standard. The Senate Committee stated that it did not "intend to codify the Second Circuit case law interpreting the pleading standard, although courts might find this body of law instructive." The Senate Committee further recognized that this pleading standard was not "a new and untested pleading standard that would generate additional litigation." During subsequent floor debate, the Senate considered and adopted an amendment offered by Senator Arlen Specter that would have codified the Second Circuit pleading standard and case law, including the motive-and-opportunity pleading test. Senator Specter reasoned that

28. Id.
31. Id
33. Id.
34. 141 CONG. REC. S9170 (daily edition June 27, 1995). The amendment stated: [A] strong inference that the defendant acted with the required state of mind may be established either —
the amendment was necessary because the strong-inference-of-scienter standard posed an impossible task to plaintiffs—to get into the defendant’s head in order to plead that the defendant acted with the required state of mind.\textsuperscript{35}

Notably, the Conference Committee failed to adopt the Specter Amendment, which included the motive-and-opportunity test. The Conference Report stated 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.”\textsuperscript{36} The Conference Report clearly stated, “[f]or this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness.”\textsuperscript{37}

The Reform Act’s current language is the result of the Conference Committee’s reconciliation of the House and Senate Bills. The Reform Act’s language is based on the Second Circuit’s pleading standard and Federal Rule 9(b)’s requirement that the pleadings be made “with particularity.”\textsuperscript{38} The Reform Act first requires that a plaintiff specify each false statement or misleading omission and explain why the statement or omission was misleading.\textsuperscript{39} The Reform Act then states:

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.\textsuperscript{40}

There was much confusion among members of Congress during the debates, with some members arguing that the Reform Act adopted the Second Circuit’s motive-and-opportunity pleading test, despite the fact that the Specter Amendment was explicitly rejected by the Conference Committee.\textsuperscript{41} Others, however, argued that the Reform Act

\begin{itemize}
\item[(A)] by alleging facts to show that the defendant had both motive and opportunity to commit fraud;
\item[(B)] by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness by the defendant.
\end{itemize}


\textsuperscript{35} \textit{141 Cong. Rec.} 17424 (1995).
\textsuperscript{36} \textit{Id.}
\textsuperscript{37} \textit{Id.}
failed to adopt the motive-and-opportunity test. Further complicating matters, President Clinton vetoed the Reform Act on the grounds that the pleading standard was too stringent. The President stated 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." The President further remarked that he would support the Second Circuit's pleading standard, but that "the conferees made crystal clear in the Statement of Managers their intent to raise the standard even beyond that level. I am not prepared to accept that." Congress eventually overrode the President's veto and enacted the Reform Act.

C. The Reform Act's Interpretation by the Courts and the Resulting Circuit Court Split

1. The Second Circuit Standard: The Motive-and-Opportunity Test

Both the Second and Third Circuits endorse the use of the motive-and-opportunity test and the Second Circuit case law to determine whether the plaintiff has satisfied the strong-inference-of-scienter requirement. Specifically, the Third Circuit held that it remained sufficient for a securities fraud plaintiff to plead motive and opportunity to satisfy the scienter requirement. The Third Circuit reasoned that had Congress wanted to foreclose the use of the motive-and-opportunity pleading test, which was the test used in the Circuit with the strictest pre-Reform Act pleading standard, it would have done so expressly in the Reform Act. The Third Circuit remarked that "the fact that Congress considered inserting language directly addressing [the motive-and-opportunity pleading test], but chose not to, suggests that it intended to leave the matter to judicial interpretation." The Third Circuit narrowed the motive-and-opportunity test by holding that blanket assertions of motive and opportunity will not be sufficient to satisfy the heightened standard. Specifically, the court commented that "catch-all allegations that defendants stood to benefit

---

44. Id.
45. Id.
48. Id. at 534 n.8.
49. Id.
50. Id. at 535.
from wrongdoing and had the opportunity to implement a fraudulent scheme" are not sufficiently pled because they do not state facts with particularity or satisfy the strong-inference-of-scienter requirement.51

The Second Circuit similarly held that the Reform Act failed to codify or explicitly reject the motive-and-opportunity test.52 The Second Circuit stated that while courts and litigants should not solely rely on the words “motive and opportunity” in pleading securities fraud claims, they should instead look to Second Circuit case law, which applies the motive-and-opportunity test, to determine how the strong-inference-of-scienter standard is satisfied.53 Specifically, Second Circuit case law suggests that the strong-inference-of-scienter requirement is met when the complaint alleges that the defendants “(1) benefited in a concrete and personal way from the purported fraud; (2) engaged in deliberately illegal behavior; (3) knew facts or had access to information suggesting that their public statements were not accurate; or (4) failed to check information that they had a duty to monitor.”54 In support of its interpretation, the Second Circuit relied on the Reform Act's adoption of the Second Circuit's pre-Reform Act pleading standard requiring that plaintiffs “allege facts that give rise to a strong inference of fraudulent intent.”55 The Second Circuit also narrowed the motive-and-opportunity test by not allowing plaintiffs to proceed on motives commonly held by all corporate insiders such as (1) the desire to maintain a high corporate credit rating or show the appearance of profitability or success and (2) the desire to maintain a high stock price to increase executive compensation or other benefits of holding corporate office.56

2. The Ninth Circuit Standard: Allegations of Motive and Opportunity Are Never Sufficient to Plead Scienter

The Ninth Circuit held that the Reform Act raised the pleading standard above that of the Second Circuit’s pre-Reform Act standard.57 In reaching this conclusion, the Ninth Circuit reasoned that the failure of the Conference Committee to adopt the Specter Amendment codifying the motive-and-opportunity test, coupled with the President’s veto of the Reform Act because it raised the pleading standard to a level above the Second Circuit’s standard, demonstrates that Congress intended to raise the pleading standard above that of the Second Circuit. Therefore, pleading motive and opportunity is never

51. Id.
53. Id.
54. Id. (internal citations omitted).
55. Id. at 306; Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1128 (2d Cir. 1994).
57. In re Silicon Graphic Inc. Sec. Litig., 183 F.3d 970, 978 (9th Cir. 1999).
sufficient to plead a strong-inference-of-scienter required by the Reform Act.\footnote{Id.} Instead, plaintiffs must "state specific facts indicating no less than a degree of recklessness that strongly suggests actual intent."\footnote{Id. at 979.}

3. The Middle Ground: Allegations of Motive and Opportunity May Not Necessarily Be Sufficient to Plead Scienter

The First, Fourth, Fifth, Sixth, Tenth and Eleventh Circuits have held that the Reform Act adopted the strong-inference-of-scienter pleading standard of the Second Circuit, but not the Second Circuit's motive-and-opportunity pleading test.\footnote{Greebel v. FTP Software, Inc., 194 F.3d 185, 197 (1st Cir. 1999); Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 345-46 (4th Cir. 2003); Nathenson v. Zonagen Inc., 267 F.3d 400, 409-411 (5th Cir. 2001); Helwig v. Vencor, Inc., 251 F.3d 540, 551 (6th Cir. 2001); City of Philadelphia v. Fleming Cos., 264 F.3d 1245, 1261-63 (10th Cir. 2001); Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282-1283 (11th Cir. 1999).}

The First, Fourth, and Fifth Circuits have concluded that Congress deliberately failed to codify the pleading standard, leaving the matter for the courts to resolve.\footnote{See Greebel, 194 F.3d at 193 ("Indeed it would be unusual for Congress to legislate on what fact patterns could or could not prove fraud or scienter."); Ottmann, 353 F.3d at 345 ("Both the absence of any statutory language addressing particular methods of pleading and the inconclusive legislative history regarding the adoption of the Second Circuit pleading standards indicate that Congress ultimately chose not to specify particular types of facts that would or would not show a strong inference of scienter."); Nathenson, 267 F.3d at 412 ("Motive and opportunity is properly only an analytical device for assessing the logical strength of the inference arising from particularized facts pled by the plaintiff to establish the necessary mental state.").}

Left with this freedom, these courts have held that while pleading motive and opportunity are relevant to establishing scienter, the facts establishing motive and opportunity may or may not rise to the level of a strong-inference-of-scienter in a particular case.\footnote{Nathenson, 267 F.3d at 409-410.} In other words, courts must engage in a factual determination on a case-by-case basis to determine whether the facts pled demonstrate recklessness, the required level of scienter. The Sixth Circuit, in declining to adopt the motive-and-opportunity pleading test, reasoned that "'motive' and 'opportunity' are simply recurring patterns of evidence" and "whether the facts can be said to establish motive, opportunity, or neither, we are directed only to consider whether they produce a strong inference that the defendant acted at least recklessly."\footnote{Helwig v. Vencor, Inc., 251 F.3d 540, 551 (6th Cir. 2001).} In short, these Circuit Courts have refused to adopt any specific pleading test and instead look to the totality of evidence to determine whether the strong-inference-of-scienter requirement has been met.
D. **Green Tree**

1. **Facts**

The Florida State Board of Administration, charged with investing the State of Florida's employees' pension funds, and two classes of investors, option traders and stock purchasers, filed suit against Green Tree Financial Corporation ("Green Tree"), its CEO and other executives.\(^6\) Green Tree is a financial services corporation that specializes in lending money on manufactured homes (also called house trailers).\(^5\) The interest rates on manufactured home loans are two to four percentage points higher than home loan interest rates.\(^6\) Green Tree's primary profit-making activity consisted of the securitization of these manufactured home loans by pooling a large number of these loans together in a trust, and then selling securities for which the loans served as collateral.\(^6\) Green Tree made its profits from the high interest rates borrowers were paying on the loans and from the low interest rates it paid the holders of the securities.\(^6\) Essentially, "Green Tree could take high-interest-rate manufactured-housing loans and turn them into low-interest rate securities, thereby creating the profitable spreads that fueled Green Tree's growth."\(^6\) Green Tree faced the risk that the borrowers would default on the loans, or that the borrowers would pre-pay their loans before incurring interest charges, keeping the expected interest on the mortgage-backed securities from materializing.\(^7\)

As Green Tree securitized each pool of loans in a trust, it booked a current gain on the transaction, even though it would not realize the expected profits until a later date or would not realize the profits at the rate estimated if loan collections proved unsuccessful.\(^7\) Green Tree recorded the present value of the securitizations by estimating (1) the discount rate, (2) the loan default rate, and (3) the loan prepayment rate.\(^7\) These estimations played an important role in determining the present value and earnings of the mortgage-backed securities.\(^7\) Selecting a pre-payment rate was especially difficult because if interest rates fell, borrowers would likely refinance the loans, causing Green Tree's expected profit not to materialize.\(^7\)

---

64. Fla. State Bd. of Admin. v. Green Tree, 270 F.3d 645, 648 (8th Cir. 2001).
65. Id.
66. Id.
67. Id.
68. Id. at 649.
69. Id.
71. Id.
72. Id.
73. Id.
74. Id.
sequently, a discrepancy between the estimated pre-payment rates and the actual pre-payment rates would have a serious effect on Green Tree's earnings.75

The plaintiffs alleged that Green Tree used "unrealistic and unreasonable" estimates in determining its prepayment rate, which subsequently overvalued the company's assets and earnings.76 Specifically, the plaintiffs alleged that the actual pre-payment rate and the estimated pre-payment rate from 1995 to 1997 varied to such a degree that the financial figures filed with the Securities and Exchange Commission during that time period were "materially false."77 The plaintiffs maintained that Green Tree either knew of the discrepancy between the actual and the estimated rate, or that Green Tree recklessly disregarded the discrepancy between the rates.78

Because of the higher than expected pre-payment rates, on November 13, 1997, Green Tree announced that it planned to increase its pre-payment reserve for its 1997 financials by an estimated $125 to $150 million.79 This news sent Green Tree's stock falling from $42 per share to $30.75 per share.80 In a conference call with analysts the next day, Green Tree's CEO admitted that the company had been assuming that the 1995 loans would pre-pay at a rate of 6% after 24 months, when in reality the 1995 loans had been pre-paying at a rate of 10% when they were only 14 months old.81

On January 27, 1998, Green Tree added $190 million to its reserves, instead of the $125 to $150 million anticipated in November.82 The company reduced its 1996 earnings by $200 million.83 Green Tree's stock fell to $18 per share.84 On April 17, 1998, Green Tree announced that it would be acquired in a merger by Conseco, Inc. ("Conseco").85 In July of 1998, Conseco spent $350 million to write down Green Tree's interest-only securities, which reflected the adjustments made to the pre-pay, default, and discount rates.86

The plaintiffs alleged that they either brought or traded stock options in a market in which the Green Tree stock price was artificially inflated because of the company's misrepresentations concerning the
COMFORT WITH THE MAJORITY

When Green Tree's true financial condition was revealed, the stock price fell, causing the plaintiffs to lose money. The plaintiffs pled several motives that prompted the defendants to disseminate misleading financial information in the market. First, the plaintiffs alleged that the CEO's and officers' compensation packages were tied to Green Tree's financial results, which made it in their personal interest to maintain a high corporate credit rating. Second, the plaintiffs alleged that the defendants desired to maintain a high corporate credit rating to maximize the selling price of the loan pools, thus increasing Green Tree's profitability. Third, the plaintiffs alleged that Green Tree needed to show superior financial results to fend off a pending derivative lawsuit alleging that Green Tree wasted corporate assets by paying excessive executive compensation.

Each class of plaintiffs filed a complaint alleging, in pertinent part, that Green Tree violated section 10(b) and Rule 10b-5. Green Tree moved for a motion to dismiss for failure to state a claim under Rules 12(b)(6) and 9(b) and sections 78u-4 and 78u-5 (the pleading portions) of the Reform Act. Under the Reform Act, a securities fraud claim cannot survive a motion to dismiss unless the allegations show a strong inference of the required state of mind, or scienter. Scienter is an essential element of a section 10(b) and a Rule 10b-5 claim, and the complaint must allege facts giving rise to a strong inference of scienter. In particular, the plaintiff must specify each false statement or omission pertaining to a material fact and "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." The district court held that none of the motives the plaintiffs alleged established the requisite showing of scienter.

The district court then examined whether the complaints alleged facts that amounted to strong circumstantial evidence of scienter.

87. Id.
89. Id. Under a contact that was to expire on December 31, 1996, Green Tree's CEO was to receive 2.5% of the company's pre-tax yearly income.
90. Id.
91. Id.
92. Id. The other violations alleged are not material to this article. They include violations of sections 20(a) and 78(a) of the Securities and Exchange Act of 1934. Id. at 651.
93. Id.
94. Under Rule 12(b)(6), the rule governing the pleading of federal claims, the plaintiff is entitled to all reasonable inferences that may be drawn from the facts pleaded in the complaint.
97. Green Tree, 270 F.3d at 651-652.
98. Id. at 652.
Finding no circumstantial evidence of scienter, the district court dismissed the plaintiffs' complaints with prejudice. The plaintiffs appealed to the Eighth Circuit Court of Appeals.

2. Holding

In Green Tree, the Eighth Circuit joined the circuit courts occupying the middle ground and adopted the case-by-case, fact-specific approach to determine whether the plaintiffs met the strong-inference-of-scienter requirement. The court first examined the plain language of the Reform Act, concluding that the Reform Act's strong-inference-of-scienter standard is subject to competing interpretations. The court next examined the Reform Act's legislative history to determine congressional intent. After a through examination of the Reform Act's legislative history, the court concluded that it "provides nothing but uncertainty about whether the motive-and-opportunity test is an inherent part of the strong inference standard or whether it modifies and relaxes that standard. Ultimately, the [Reform Act] as passed does not resolve this question." The court examined the circuit courts' three interpretations of the Reform Act. The court reasoned that the Second Circuit's interpretation of the motive-and-opportunity test "is the same kind of inquiry undertaken by courts that do not adhere to the motive and opportunity formulation . . . . The search in the Second Circuit line of cases, as well as in the other circuits, is for facts that give a strong reason to believe that there was reckless or intentional wrongdoing." The Eighth Circuit concluded that, aside from the Ninth Circuit's position, "the split in the other Circuits is more apparent than real."

The Eighth Circuit found that the Reform Act adopted the Second Circuit's strong-inference-of-scienter pleading standard, without codifying the particular pleading test that would satisfy this standard. Specifically, the court held that motive and opportunity are generally relevant to show fraud; however, allegations of motive and opportunity will only meet the Reform Act standard if they give rise to a strong-inference-of-scienter. In addition, the court held that when the complaint does not show motive or fraud, the plaintiff must plead

---

99. Id. at 653.
100. Id. at 660.
101. Id. at 658.
102. Id. at 569 (citing Nathenson v. Zonagen Inc., 267 F.3d 400, 420 (5th Cir. 2001); Helwig v. Vencor, Inc., 251 F.3d 540, 552 (6th Cir. 2001); Greebel v. FTP Software, Inc., 194 F.3d 185, 198 (1st Cir. 1999)).
104. Id. at 659-660.
105. Id. at 660.
other allegations tending to show scienter that would have been strong enough to meet the Reform Act standard. While the court found the Second Circuit's case law interpreting the strong-inference-of-scienter instructive, it stated that it must "also look to case law from other circuits developing their own criteria for the badges for fraud." However, the Eighth Circuit cautioned that it must "use subsidiary formulae as an aid to interpreting the strong-inference standard and not as a substitute for it." Thus, aside from the pleading test adopted by the Ninth Circuit, the Eighth Circuit found little difference between the two pleading tests and held that while motive and opportunity are relevant in securities fraud cases, the appropriate inquiry is whether the facts pled give a strong reason to believe that the defendant engaged in reckless or intentional wrongdoing.

Applying the fact-specific test, the court held that Green Tree's CEO's large compensation package, coupled with the timing of the overstatement of profits, provided "a showing of unusual or heightened motive" to commit fraud. The defendant-CEO argued that he received his bonus in the form of stock, and since he did not sell any of his stock during the period in question, the plaintiffs' alleged motive should be defeated. The Eighth Circuit pointed out that the stock bonuses were the first step of the compensation plan and that the plaintiffs' complaint will not be dismissed simply because the CEO's plan failed to come to fruition. The Eighth Circuit stated that it would not "infer innocence by hindsight because the alleged misdeeds did not pay off." The court held that this motive theory was not "too irrational to add to the weight of other circumstantial allegations and we therefore must disagree with the district court's determination to the contrary." As for the officers' compensation packages, the court found that because the officers did not enjoy incentive contracts that were tied to Green Tree's earnings, motive allegations that the officers hoped to share in the CEO's bonuses "fall[s] short of alleging the 'concrete and personal' benefit that would add significantly to the allegations against the other executives."

The Eighth Circuit found the allegation that the defendants were motivated by the desire to maintain a high credit rating so that the mortgage-backed securities would sell at high prices, failed to meet

106. Id.
107. Id.
108. Id.
110. Id. at 663.
111. Id. at 662.
112. Id.
113. Id. at 664.
the high-inference-of-scienter requirement.\textsuperscript{114} The court stated that "[t]he desire to maintain a high credit rating is universally held among corporations and their executives and consequentially does not contribute significantly to an inference of scienter."\textsuperscript{115}

In addition to the "motive and opportunity" allegations, the court found that the plaintiffs alleged other facts that gave rise to a strong-inference-of-scienter.\textsuperscript{116} Specifically, the court found that the plaintiffs pled with particularity allegations that the defendants issued financial reports that did not take into consideration the great disparity between the actual and estimated pre-payment assumptions for the years 1995 through 1997, knowing that the actual rates deviated greatly from the estimated rates.\textsuperscript{117} The plaintiffs also successfully pled that the defendants published statements with knowledge of facts indicating that the statements were based on discredited assumptions.\textsuperscript{118} The Eighth Circuit found that together these facts and allegations established the requisite strong-inference-of-scienter; thus the plaintiffs survived the motion to dismiss.\textsuperscript{119}

\section*{III. ANALYSIS}

The plain language and legislative history of the Reform Act indicate that Congress neither codified nor rejected the Second Circuit's motive-and-opportunity pleading test, and instead let the courts decide how best to judge whether the plaintiff has pled facts that support the strong-inference-of-scienter requirement. Given this freedom, the Eighth Circuit should have adopted the motive-and-opportunity pleading test and the accompanying Second Circuit case law. The motive-and-opportunity pleading test best furthers the policies and considerations underlying the Reform Act, namely the deterrence of meritless strike suits, the protection of investors in the securities market, and the establishment of a uniform pleading standard for securities fraud claims.

\textsuperscript{114} Id.
\textsuperscript{115} Fla. State Bd. of Admin. v. Green Tree, 270 F.3d 645, 664 (8th Cir. 2001).
\textsuperscript{116} Id. at 665.
\textsuperscript{117} Id.
\textsuperscript{118} Id.
\textsuperscript{119} Id.
A. The Plain Language, Legislative History, and Policies
Underlying the Reform Act Indicate that Congress
Neither Codified Nor Rejected the Second Circuit's
Motive-and-Opportunity Test

1. The Reform Act's Plain Language Indicates That Congress
Neither Codified, Nor Rejected the Second Circuit's
Motive-and-Opportunity Test

Complaints brought under section 10(b) and Rule 10b-5 are subject
to the Reform Act's heightened pleading standard. The Reform Act
first requires that a plaintiff specify each false statement or mislead-
ing omission and explain why the statement or omission is misleading.120 The Reform Act then states that "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 defen-
dant acted with the required state of mind."121

Some commentators have concluded that the plain language of the
Reform Act indicates that Congress rejected the motive-and-opportunity
pleading test because the test is not found in the plain language
of the Act.122 A better interpretation of the plain language of the Re-
form Act is that by failing to codify the motive-and-opportunity test, Congress intended to neither endorse, nor prohibit, a particular man-
er of pleading and instead left it to the courts to decide. Many cir-
cuits that have decided this issue support this interpretation of the
Reform Act.123 The Ninth Circuit, which has imposed the strictest
pleading standard agreed, stating that "[t]he plain text of the [Reform
Act] leaves it open for us to consider circumstantial evidence of reck-
lessness and motive and opportunity" as evidence of the required level
of scienter.124

122. Nicole Briski, Comment, Pleading Scienter Under the Private Securities Litiga-
tion Reform Act of 1995: Did Congress Eliminate Recklessness, Motive and Op-
portunity?, 32 LOY. U. CHI. L.J. 155 (2000); Laurae Rossi, Comment, Choosing the
Best Standard of Pleading Under the 1995 Private Securities Litigation Reform
Act, and Why the 9th Circuit's Standard Under In Re Silicon Graphics Conquers
123. Greebel v. FTP Software, Inc., 194 F.3d 185, 195 (1st Cir. 1999); Novak v.
Kasaks, 216 F.3d 300, 310 (2d Cir. 2000); Ottmann v. Hanger Orthopedic Group,
Inc., 353 F.3d 338, 345 (4th Cir. 2003); Nathenson v. Zonagen, 267 F.3d 400,
411(5th Cir. 2001); Helwig v. Vencor, 251 F.3d 540, 551 (6th Cir. 2001); and In re
Silicon Graphics Sec. Litig., 183 F.3d 970, 977 (9th Cir. 1999). The Eighth Circuit
failed to draw any conclusions from the statutory language and instead concluded
that "where statutory language is susceptible of competing interpretations, we
resort to legislative history to help determine congressional intent." Fla. State
Bd. of Admin. v. Green Tree, 270 F.3d 645, 654 (3d Cir. 1999).
124. In re Silicon Graphics Sec. Litig., 183 F.3d at 977.
The absence of statutory language referring to the motive-and-opportunity pleading test is of little relevance because statutory language normally only refers to substantive elements of a law, such as the required state of mind, as opposed to the specific evidence that can be established to meet these elements. Indeed, it would be unusual for Congress to legislate the particular facts that must be pled to satisfy the scienter requirement of a particular statute. On the other hand, since the Second Circuit motive-and-opportunity test was the most stringent pre-Reform Act pleading test, one could argue that had Congress intended to completely foreclose the usage of this test under the Reform Act, it would have made it explicitly clear in the plain language of the Act. The First Circuit agreed, stating that "had [Congress] desired to eliminate motive-and-opportunity as a basis for scienter, it could have done so expressly in the text of the Reform Act." At a minimum, the plain language of the Reform Act cannot be read as Congressional rejection of the motive-and-opportunity test. Had Congress intended to completely foreclose the use of the most stringent pleading test to date, it likely would have done so within the text of the statute.

2. The Reform Act's Legislative History Indicates That Congress Did Not Explicitly Reject the Motive-and-Opportunity Test

The motive-and-opportunity test was the subject of contentious debate on the floors of both the House and Senate. However, many courts have refused to rely on the Reform Act's legislative history, describing it as contradictory, inconsistent and unreliable. Each court seems to pick and choose from the portions of the legislative his-

125. See Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1286 (11th Cir. 1999) (commenting that the Reform Act language "clearly refers to a substantive standard, a condition of the mind, like willfulness or recklessness. Motive and opportunity, on the other hand, do not constitute a substantive standard; rather, motive and opportunity are specific kinds of evidence.").


127. In re Advanta Corp. Sec. Litig., 180 F.3d 525, 534 n.8 (3d Cir. 1999).


129. See Helwig v. Vencor, Inc., 251 F.3d 540, 548 (6th Cir. 2001) ("The muddled legislative history has produced conflicting interpretations of the Reform Act."); Novak v. Kasaks, 216 F.3d 300, 311 (2d Cir. 2000) ("[I]n our view, as is so often the case with legislative history, generally, the legislative history of the [Reform Act] contains 'conflicting expressions of legislative intent.'"); Greebel, 194 F.3d at 195 ("The history and text of the Reform Act show no agreement to restrict the types of evidence which may be used to show a strong inference of scienter."); In re Advanta Corp. Sec. Litig., 180 F.3d at 533 ("Ultimately, we believe there is little to gain in attempting to reconcile the conflicting expressions of legislative intent, including the President's veto statement. The legislative history on this point is contradictory and inclusive and we are reluctant to accord it much weight.").
COMFORT WITH THE MAJORITY

The Eighth Circuit has done so, stating that "the legislative history provides nothing but uncertainty about whether the motive-and-opportunity test is an inherent part of the strong inference standard or whether it modifies and relaxes that standard. Ultimately, the Act as passed does not resolve this question." Although the Reform Act's legislative history does not conclusively indicate whether Congress intended to adopt the motive-and-opportunity test, a reading of the legislative history does indicate that Congress did not intend to completely foreclose the use of the motive-and-opportunity pleading test.

First, the Reform Act's legislative history is notable for what it does not contain. Absent from the Reform Act legislative history is any alternative pleading test that might replace the motive-and-opportunity test. The failure to provide for an alternative test "militates against completely dispensing with the Second Circuit's well developed [motive-and-opportunity test]." It seems unlikely that Congress intended to explicitly reject the motive-and-opportunity test, the pleading test used in the circuit with the most stringent pre-Reform Act pleading standard, without at least discussing the formulation of an alternative test.

Courts and commentators have placed significant emphasis on the fact that the Conference Committee's report clearly stated that Congress did not intend to adopt the motive-and-opportunity pleading test. "Because the Conference Committee intends to strengthen existing pleading requirements, it does not intend to codify the Second Circuit's case law interpreting this pleading standard . . . For this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or"

130. Compare In re Advanta Corp. Sec. Litig., 180 F.3d at 534 n.8 (commenting that the rejection of the Specter Amendment, which codified the motive-and-opportunity test, did not amount to a complete rejection of the motive-and-opportunity test, but instead signaled Congress's intent to leave the matter to judicial interpretation) with In re Silicon Graphics, Sec. Litig., 183 F.3d 970, 978 (9th Cir. 1999) (holding that the rejection of the Specter Amendment was evidence that Congress explicitly rejected the motive-and-opportunity test).


recklessness."\textsuperscript{135} Taken on its face, the Conference Committee statement not only prohibits the pleading of motive and opportunity, but also the pleading of recklessness, which would raise the Reform Act's pleading standard to a higher level than the Reform Act's substantive standard.\textsuperscript{136} The circuits are in agreement that recklessness satisfies the Reform Act's substantive scienter standard.\textsuperscript{137} One commentator noted that the Conference Committee statement "cannot mean one thing for the first two elements in the clause ('motive, opportunity') and something entirely different for the third element ('recklessness'). [The Conference Committee statement] is an all-or-nothing affair: if it does not prohibit the recklessness test, it cannot prohibit the motive-and-opportunity test either."\textsuperscript{138}

In its statement, the Conference Committee may be referring to its refusal to adopt the Specter Amendment,\textsuperscript{139} which attempted to codify the Second Circuit's motive-and-opportunity pleading test.\textsuperscript{140} However, both courts and commentators have concluded that the Conference Committee's failure to adopt the Specter Amendment cannot be seen as a wholesale rejection of the motive-and-opportunity pleading test.\textsuperscript{141} In Senate debate, Senator Chris Dodd, one of the Senate Managers for the Reform Act, stated that the Specter Amendment was rejected because it did not correctly codify the Second Circuit's motive-and-opportunity test and accompanying case law, not because the Conference Committee wanted to reject the motive-and-opportunity test and Second Circuit's case law.\textsuperscript{142} In Senate debates following the Conference Committee's rejection of the Specter Amendment, Senator

\textsuperscript{136} Roskoski, supra note 132, at 2279.
\textsuperscript{137} See supra note 36.
\textsuperscript{138} Roskoski, supra note 120, at 2279.
\textsuperscript{139} Id.
\textsuperscript{140} See supra notes 58, 59.
\textsuperscript{141} Fla. State Bd. of Admin. v. Green Tree, 270 F.3d 645, 658 (3d Cir. 1999); Roskoski, supra note 132, at 2279.
\textsuperscript{142} 141 Cong. Rec. S19060, 19068 (1995). Senator Dodd correctly stated that the Specter Amendment incorrectly codified the Second Circuit's motive-and-opportunity test. The Amendment stated that a plaintiff can establish a strong-inference-of-scienter by showing that the defendant had motive or opportunity to commit fraud, or by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness. Dodd maintained that the Specter Amendment omitted the guidance Judge Newman promulgated in the landmark motive and opportunity case, In re Time Warner Inc. Sec. Litig., 9 F.3d 259 (2d Cir. 1993) ("Where motive is not apparent, it is still possible to plead scienter by identifying circumstances indicating conscious behavior by the defendant, though the strength of the circumstantial allegations must be correspondingly greater."). Dodd further stated, "[t]he Specter amendment did not distinguish at all between the circumstances in part A [pleading motive and opportunity] or part B [pleading facts that constitute a strong circumstantial evidence of conscious misbehavior or recklessness] of his amendment, and therefore did not really follow the
Dodd stated that even though the Specter Amendment was deleted, the courts should still look to Second Circuit case law for guidance. The Third Circuit supports this view, finding that "the fact that Congress considered inserting language directly addressing this line of cases, but ultimately chose not to, suggests that it intended to leave the matter to judicial interpretation." Furthermore, the Congressional Record indicates that the Conference Committee may have declined to codify the Second Circuit's case law because "the Second Circuit caselaw was sufficiently ambiguous that any attempt to further codify it would bog the bill down." These statements indicate that the rejection of the Specter Amendment cannot be read as a per se rejection of the motive-and-opportunity test and Second Circuit case law. Instead, the rejection of the Specter Amendment can only be viewed as Congressional rejection of an inaccurately codified pleading test, or as Congressional rejection of codifying any pleading test.

Courts and commentators also point to Congress's decision to over-ride President Clinton's veto of the Reform Act as further proof that Congress intended to leave the manner of pleading undefined. In part, President Clinton interpreted the Conference Committee's refusal to adopt the Specter Amendment as evidence of Congressional intent to raise the pleading requirements above those of the Second Circuit. President Clinton stated that the failure to adopt the Specter Amendment indicated that the Conference Committee "meant to erect a higher barrier to bringing suit than any now existing—one so high that even the most aggrieved investors with the most painful losses may get tossed out of court before they have a chance to prove their case."

The President's statements should not be afforded much weight in determining the Reform Act's pleading standard. The Supreme Court has previously cast doubt on the use of statements
made by a bill's opponents in determining the Congressional intent behind the bill.149

Furthermore, the veto-override debates illustrate Congressional members' confusion as to whether the Reform Act encompassed Second Circuit case law and the motive-and-opportunity pleading test. Senator Sarbanes commented that the deletion of the Spector Amendment "[left] investors without the protection of the additional Second Circuit holdings."150 In contrast, Senator Domenici stated that, "[t]he President objected to the pleading standard. Yet [the Reform Act contains] the Second Circuit's pleading standard."151

Commentators and courts have also looked to the legislative history of subsequent securities fraud legislation to try to determine the status of the motive-and-opportunity test. The legislative debates surrounding the Securities Litigation Uniform Standards Act of 1998, which designated the federal courts as the exclusive venue for the majority of securities class action suits, again focused on the pleading standard adopted under the Reform Act.152 In its Committee report, the Senate Committee on Banking, Housing and Urban Affairs noted that "[i]t was the intent of Congress . . . that [the Reform Act] establish a uniform federal standard on pleading requirements by adopting the pleading standard applied by the Second Circuit Court of Appeals."153 Therefore, in order to reconcile the legislative history, resulting case law and subsequent securities legislation, the legislative history cannot be viewed as foreclosing the use of the motive-and-opportunity pleading test to satisfy the strong-inference-of-scienter standard.

B. The Eighth Circuit Should Adopt the Motive-and-Opportunity Pleading Test

The Eighth Circuit should have adopted the motive-and-opportunity pleading test, along with the accompanying Second Circuit case law, because the motive and opportunity test best furthers the policies and considerations underlying the Reform Act. The plain language and legislative history of the Reform Act indicate that Congress did not codify or reject a specific pleading test. The Reform Act's plain language and legislative history also indicates that the Reform Act did

149. Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384, 394-395 (1951) ("The fears and doubts of the opposition are no authoritative guide to the construction of legislation. It is the sponsors that we look to when the meaning of the statutory words is in doubt.").


152. Helwig v. Vencor, Inc., 251 F.3d 540, 549 (6th Cir. 2001); Roskoski, supra note 132, at 2282.

COMFORT WITH THE MAJORITY

not prohibit the use of the motive-and-opportunity pleading test, or the Second Circuit case law, to guide the courts in determining whether a securities fraud plaintiff has pled the required level of scienter. Consequently, the circuit courts are free to adopt any pleading test to aid in their determination as to whether the plaintiff has pled a strong-inference-of-scienter.

The Reform Act, which moved through Congress as part of Speaker Newt Gingrich's "Contract with America," sought to curb securities litigation abuses by imposing a uniform heightened pleading standard above that of the previous standard mandated by Rule 9(b) of the Federal Rules of Civil Procedure. The principal proponents of the Reform Act were business lobbyists, major corporations, and the "big six" accounting firms, who believed that, because of their deep pockets, they were the unfair targets of shareholder lawsuits. These parties spent millions of dollars lobbying Congress on behalf of the Reform Act.

The Reform Act's Congressional supporters hoped that the heightened pleading standard would prevent abusive and meritless strike suits filed by "professional plaintiffs" alleging violations of securities laws. The Reform Act supporters found that these suits were often based on nothing more than a company's announcement of bad news, such as lower quarterly earnings due to adverse market conditions, rather than fraudulent activity. The Reform Act supporters believed that these types of meritless suits hurt the investing public at large by increasing the cost of raising capital and chilling corporate disclosure and forward-looking statements. The supporters maintained that even in the case of most frivolous claims, most corporate defendants would rather settle than engage in costly litigation.

---

155. At the time of the passage of the Reform Act, the "big six" accounting firms were Price Waterhouse, L.L.P, Coopers Lybrand, L.L.P., Arthur Anderson, L.L.P., KPMG Peat Marwick, L.L.P., Deloitte & Touche, L.L.P., and Ernst & Young, L.L.P.
157. Id. Arthur Anderson was so pleased with the passage of the Reform Act that it "encased the text of the [Reform Act] in a paperweight and handed it out as a souvenir." Id.
160. Id.
The Reform Act supporters hoped that procedural barriers, such as a heightened, uniform pleading standard, would curtail meritless securities litigation by making it more difficult for a securities fraud plaintiff to survive a motion to dismiss and proceed to the costly and time-consuming discovery phase of litigation.\textsuperscript{162} In drafting this legislation, Congress tried "to strike the appropriate balance between protecting the rights of victims of securities fraud and the rights of public companies to avoid costly and meritless litigation."\textsuperscript{163} Senator Domenici, a Senate Manager and original co-sponsor of the Reform Act, stated that the first aim of the Reform Act was to protect securities investors with meritorious claims.\textsuperscript{164} In its report, the Conference Committee acknowledged that the chief purpose of any securities law must be the protection of the investors.\textsuperscript{165} Permitting the courts to allow securities fraud plaintiffs to plead motive and opportunity, while allowing courts to use Second Circuit case law for guidance as to whether the standard has been met, best reconciles Congress' aims of preventing meritless strike suits, protecting the rights of victims of securities fraud, and establishing a uniform pleading system throughout the circuits.

1. The Motive-and-Opportunity Test, Along with the Second Circuit Case Law, Raises the Procedural Pleading Requirement, Thus Deterring Meritless Strike Suits

Permitting securities fraud plaintiffs to plead motive and opportunity substantially raises the procedural pleading requirement, thus deterring meritless strike suits. Opponents incorrectly argue that the use of the motive-and-opportunity test to prove a strong-inference-of-scienter is contrary to Congressional intent because it does not significantly raise the pre-Reform Act pleading standard.\textsuperscript{166} This assertion

\textsuperscript{162} Prior to the passage of the Reform Act, the pleading standard for securities litigation was governed under Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b) states that plaintiffs must plead allegations of fraud with "particularity." However, the House Conference Report noted that Rule 9(b) has failed to curb meritless security litigation. H.R. Rep. No. 104-369, at 41 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 739. Moreover, the House Conference Report noted that several Circuit Courts had interpreted the requirements established by Rule 9(b) differently, thus creating different pleading standards among the Circuits. \textit{Id.}


\textsuperscript{166} See, e.g., Aron Hansen, Comment, \textit{The Aftermath of Silicon Graphics: Pleading Scienter in Securities Fraud Litigation}, 34 U.C. Davis L. Rev. 769, 796 (2001); Laurae Rossi, Comment, \textit{Choosing the Best Standard of Pleading Under the 1995 Private Securities Litigation Reform Act, and Why the Ninth Circuit's Standard}
COMFORT WITH THE MAJORITY

is incorrect for two reasons. First, the Second and Ninth Circuits were the only circuits that had utilized the heightened motive-and-opportunity test prior to the enactment of the Reform Act.\textsuperscript{167} In the remaining circuits, securities fraud claims had to be pled in accordance with Rule 9(b), which required that the pleader state the circumstances constituting fraud or mistake "with particularity."\textsuperscript{168} The adoption of the strong-inference-of-scienter standard and the motive-and-opportunity test requires the plaintiff to aver facts, such as motive and opportunity, that show that the defendant acted with the requisite state of mind in committing the fraud. The new requirement that the plaintiff plead facts establishing the defendant's state of mind substantially raises the procedural pleading requirement for a securities fraud claim, just as Congress intended.\textsuperscript{169} In jurisdictions already employing the heightened Second Circuit standard, the additional requirement of pleading scienter "with particularity" signifies a heightening of the pleading standard from the pre-Reform Act level in these circuits.\textsuperscript{170} Therefore, the adoption of the strong-inference-of-scienter requirement, along with the motive-and-opportunity test, raises the barriers to pleading scienter in all of the circuits.

The motive-and-opportunity test further deters strike suits because the Second Circuit caselaw indicates that securities fraud plaintiffs will not be permitted to proceed by pleading facts supporting motives commonly held by all corporate insiders, such as the desire to maintain a high corporate rating, the desire to maintain high stock prices, or the desire to increase one's compensation or keep one's job.\textsuperscript{171} Plaintiffs must instead plead with particularity facts that show that the defendant deliberately engaged in the prohibited behavior and benefited in a concrete way from the purported fraud.\textsuperscript{172} Furthermore, Second Circuit case law indicates that merely pleading the catchwords "motive and opportunity" will not be sufficient to meet the heightened standard.\textsuperscript{173} Instead, the Second Circuit has held that other courts should look to their prior case law for guidance as to how the standard is satisfied.\textsuperscript{174} The Eighth Circuit correctly concluded that "the fear that courts applying the motive and opportunity formu-

\textsuperscript{167} Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1286 (11th Cir. 1999).
\textsuperscript{168} \textit{FED. R. CIV. P. 9(b)}.
\textsuperscript{169} Novak v. Kasaks, 216 F.3d 300, 310 (2d Cir. 2000).
\textsuperscript{170} \textit{In re Advanta Corp. Sec. Litig.}, 180 F.3d 525, 534 (3d Cir. 1999).
\textsuperscript{171} See supra note 56.
\textsuperscript{172} Novak, 216 F.3d at 311.
\textsuperscript{173} Id.
\textsuperscript{174} Id.
lation will permit pleadings to go forward without facts strongly suggesting wrongdoing" is unfounded.175

For example, in *Kalnit v. Eichler*,176 the Second Circuit applied the motive-and-opportunity test to determine whether the plaintiffs pled the requisite level of scienter, and found the plaintiffs failed to plead facts establishing a strong-inference-of-scienter. The plaintiffs, a class of investors in the defendants' stock, claimed that the defendants, MediaOne Group, Inc. ("MediaOne") and its directors and officers, failed to disclose material information in connection with a proposed merger between MediaOne and Comcast Corporation.177 The plaintiffs alleged that as a result of the defendants' failure to disclose this information, the plaintiffs sold shares of MediaOne stock at an artificially deflated price.178 Specifically, the plaintiffs alleged that the defendants withheld material information because (1) they were motivated by the desire to protect their lucrative compensation packages; (2) they wanted to avoid personal liability for breaching a contractual provision; and (3) they desired to complete the merger at the highest stock price possible.179 In holding that these generalized motives failed to rise to the level of a strong-inference-of-scienter, the Second Circuit commented that "[a] plaintiff cannot base securities fraud claims on speculation and conclusory allegations."180

2. The Motive-and-Opportunity Test Best Protects Investors in the Securities Market

Congress recognized that the overriding goal of any securities law must be the protection of investors.181 Second Circuit case law provides securities fraud plaintiffs with clear guidance as to which facts are sufficient to establish the strong-inference-of-scienter requirement, which in turn gives investors who have been the victims of securities fraud their day in court.182 The court makes a determination as to whether the allegations rise to a strong inference-of-scienter on a case by case basis. Thus, the case-by-case, fact-specific pleading test is not particularly helpful in providing securities plaintiffs with guidance as to how to satisfy the strong-inference-of-scienter requirement, which increases the likelihood that their claims will not survive a motion to dismiss. The Eighth Circuit in *Green Tree* adopted some Second Circuit case law clarifying which facts are sufficient to estab-

176. 264 F.3d 131 (2d Cir. 2001).
177. *Id.* at 134-35.
178. *Id.*
179. *Id.* at 139-41.
180. *Id.* at 142.
182. See supra notes 54-56.
lish a strong-inference-of-scienter; however, the court refused to go so far as to adopt the whole body of case law.

It appears that the Eighth Circuit is trying to have it both ways—the court does not want to be tied down to the Second Circuit motive-and-opportunity holdings, yet it wants the ability to pull from the Second Circuit case law when it encounters a plaintiff that it deems to have met the strong-inference-of-scienter standard. This judicial flexibility may be advantageous to a court because it allows it to individually evaluate the circumstances of each case. But this approach provides little guidance to securities fraud plaintiffs as to which facts will satisfy the strong-inference-of-scienter pleading standard. Failure to provide securities plaintiffs with some form of guidance will require them to do the impossible get into the defendant’s head in order to successfully plead that the defendant acted with the required state of mind.

The Ninth Circuit’s pleading test, which states that pleading motive and opportunity is never sufficient to plead a strong inference of scienter under the Reform Act, clearly does little to protect the victims of securities fraud with meritorious claims. In the Ninth Circuit, pleading facts that show that the defendant acted with motive and opportunity to commit securities fraud can never satisfy the pleading standard; however, pleading these same facts may be able to satisfy the substantive scienter requirements for the underlying section 10(b) or Rule 10b-5 claim. Thus, commentators have recognized that under the Ninth Circuit’s pleading test, the burden of pleading fraud

183. See Kushner v. Beverly Enterprises, Inc., 317 F.3d 820 (8th Cir. 2003). In Kushner the Eighth Circuit stated that the Second Circuit has held that pleading that the defendant failed to check information it had a duty to monitor satisfies the strong-inference-of-scienter requirement. Id. at 827. The court found that the plaintiffs allegations of large scale Medicare fraud throughout the corporation, including falsifying daily nursing time sheets and inflating Medicare payments, failed to meet the pleading standard because the complaint made “no particular assertion of which defendant was responsible for which statement or omission.” Id. Clearly, the corporation and its directors (the defendants in the lawsuit) had a duty to monitor the corporation’s Medicare compliance system. Thus, it would appear that under the Second Circuit case law the plaintiffs pled a strong-inference-of-scienter.


185. See supra note 58. See also Howard v. Everex Sys. Inc., 228 F.3d 1057, 1064 (9th Cir. 2000).

186. See supra notes 20-22. In In re Silicon Graphics Sec. Litig. 183 F.3d 970, 977 (9th Cir. 1999), the Ninth Circuit initially stated that the Reform Act adopted a heightened substantive standard for scienter, that of deliberate recklessness, which was “some degree of intentional or conscious misconduct.” One year later, the Ninth Circuit held that the Reform Act “did not alter the substantive requirements for scienter under § 10(b).” Howard v. Everex Sys., Inc., 228 F.3d 1057, 1064 (9th Cir. 2000). See also Fla. State Bd. of Admin. v. Green Tree, 270 F.3d 645, 653 (3d Cir. 1999).
is greater than that of proving fraud. The Ninth Circuit's enormously steep pleading standard would certainly keep plaintiffs with legitimate securities fraud claims out of court, which was not the result that Congress intended.

The motive-and-opportunity test and the accompanying Second Circuit case law provides securities fraud plaintiffs with clear guidance as to which facts are sufficient to meet the strong-inference-of-scienter requirement. The Second Circuit has held that the “[m]otive would entail concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged. Opportunity would entail the means and likely prospect of achieving concrete benefits by the means alleged." Through their vast amount of case law interpreting this standard, the Second Circuit has further clarified this standard by holding that the strong-inference-of-scienter standard is met when the plaintiff avers that the defendant (1) personally benefited in a tangible way from the alleged fraud; (2) deliberately engaged in the alleged illegal behavior; (3) knew or had access to information that would suggest that their public statements were not accurate; or (4) failed to confirm information they had a duty to monitor. The motive-and-opportunity test and the accompanying Second Circuit case law provide securities fraud plaintiffs with clear guidance as to how to meet the Reform Act pleading requirements. This standard best accomplishes the Reform Act's goal of protecting victims of securities fraud by allowing litigants with meritorious claims their day in court.

3. The Adoption of the Motive-and-Opportunity Test, Along with the Second Circuit Case Law, Establishes a Uniform Pleading System Throughout the Circuits

Permitting the courts to allow securities fraud plaintiffs to plead motive and opportunity establishes a uniform pleading system throughout the circuits. The motive-and-opportunity test furthers one of the chief goals of the Reform Act—namely, to establish a uniform pleading standard for securities litigation actions throughout the circuits. In contrast, the case-by-case factual approach injects judicial flexibility in a situation where Congress clearly wanted to limit it.
This judicial flexibility has already created conflicting pleading standards within the circuits.

The conflicting standards among the Circuits breed uncertainty, which leads to forum shopping by securities fraud plaintiffs. This is because whether a plaintiff survives a motion to dismiss can hinge on which jurisdiction the suit is filed in.\textsuperscript{192} In contrast with the case-by-case fact specific pleading test, which permits judicial flexibility in determining whether the plaintiff has pled a strong-inference-of-scienter, the motive-and-opportunity test and the accompanying Second Circuit case law provide a uniform standard for the evaluation of securities fraud claims at the motion to dismiss stage. The motive-and-opportunity test, combined with the Second Circuit caselaw, provides the only pleading test that will meet the Reform Act's goals and establish a uniform pleading system that will ensure securities fraud plaintiffs are treated uniformly throughout and within the circuits.

C. Some Guidance for Securities Fraud Plaintiffs in the Eighth Circuit

Although the Eighth Circuit has adopted the case-by-case, fact-specific pleading test, the Eighth Circuit has extensively relied on Second Circuit case law interpreting the motive-and-opportunity test to determine whether plaintiffs have met the increased Reform Act pleading standard.\textsuperscript{193} In fact, one commentator noted that the Eighth Circuit's repeated references to Second Circuit case law throughout its opinion in \textit{Green Tree} indicate that "the court has a special affinity towards the decisions and reasoning that have arisen out of the Second Circuit."\textsuperscript{194}

For example, in applying the case-by-case, fact-specific pleading test in \textit{Green Tree}, the court extensively relied on the Second Circuit case law in finding that the plaintiffs had met the Reform Act's heightened pleading standard.\textsuperscript{195} Furthermore, the Eighth Circuit

\begin{footnotesize}
\begin{enumerate}
\item For an interesting comment arguing that, because of its reliance on Second Circuit case law, the Eighth Circuit has implicitly adopted the Second Circuit's interpretation of the motive-and-opportunity pleading test, see Jason L. Fowell, Comment, \textit{The Private Securities Litigation Reform Act of 1995 Writ for Certiorari}, 44 S. Tex. L. Rev. 809, 823-26 (2003).
\item Id. at 824.
\item 270 F.3d at 652-68. In finding that the plaintiffs had pled facts sufficient to meet the Reform Act's heightened pleading standard, the court relied on the following Second Circuit cases: \textit{Hollin v. Scholastic Corp.}, 252 F.3d 63 (2d Cir. 2001);
\end{enumerate}
\end{footnotesize}
has continued to rely on Second Circuit case law in its subsequent holdings. For example, in Migliaccio v. K-Tel International, Inc.,\textsuperscript{196} the Eighth Circuit held that the plaintiffs failed to allege facts sufficient to meet the strong-inference-of-scienter standard. Relying solely on Second Circuit case law,\textsuperscript{197} the Eighth Circuit held that allegations of GAAP violations and general allegations of a desire to increase stock prices, compensation or continued employment are too generalized and insufficient to meet the Reform Act pleading standards.\textsuperscript{198}

In a later case, the Eighth Circuit in Kushner v. Beverly Enterprises, Inc.\textsuperscript{199} also held that the plaintiffs failed to meet the strong-inference-of-scienter standard. The court relied on Second Circuit case law in holding that “[p]leading the simple fact ‘that a defendant’s compensation depends on corporate value or earnings’ does not, by itself, establish motive to fraudulently misrepresent corporate value or earnings.”\textsuperscript{200}

Given the Eighth Circuit’s receptiveness towards Second Circuit case law on this matter, securities fraud plaintiffs bringing cases in the Eighth Circuit should use the Second Circuit’s interpretation of the motive-and-opportunity test as guidance for how to plead the heightened level of scienter required under the Reform Act. Generally, securities fraud plaintiffs should shape their allegations so that they aver that (1) the defendants benefited in a concrete and personal way from the alleged fraud; (2) the defendants knowingly engaged in illegal behavior; (3) the defendants knew or should have know that their public statements were not accurate; or (4) the defendants failed to check information which they had a duty to monitor.\textsuperscript{201} Clearly, however, allegations of widely-held corporate motives such as the desire to maintain a high corporate credit rating, the desire to sustain an appearance of profitability, and the desire to maintain a high stock price to increase compensation or continued employment, are too general to meet the Reform Act’s heightened pleading standard.\textsuperscript{202}


\textsuperscript{197} Id. at 894.

\textsuperscript{198} Id. at 895.

\textsuperscript{199} 317 F.3d 820 (8th Cir. 2003).

\textsuperscript{200} Id. at 830 (citing Fla. State Bd. of Admin. v. Green Tree, 270 F.3d 645, 661 (3d Cir. 1999)).

\textsuperscript{201} Id. (internal citations omitted).

\textsuperscript{202} Novak, 216 F.3d at 307; see also Green Tree, 270 F.3d at 659; Kushner, 317 F.3d at 830.
IV. CONCLUSION AND FUTURE OF THE REFORM ACT

The Reform Act neither codified nor rejected the Second Circuit’s motive-and-opportunity pleading test, instead leaving the matter to the courts to determine. Left with this flexibility, the Eighth Circuit should have adopted the Second Circuit’s motive-and-opportunity test and the accompanying Second Circuit case law. The motive-and-opportunity test and the accompanying Second Circuit case law best further the policies and considerations underlying the Reform Act, namely the deterrence of meritless strike suits, the protection of investors in the securities market, and the establishment of a uniform pleading system for securities fraud claims. In contrast, the case-by-case factual determination pleading test adopted by the Eighth Circuit does little more to deter strike suits, fails to provide securities plaintiffs with guidance on how to satisfy the increased pleading requirements, and injects judicial flexibility in a situation where Congress clearly wanted it limited.

Recent corporate scandals may influence the courts’ interpretation of the Reform Act and the test that satisfies the heightened pleading standard to the benefit of securities fraud plaintiffs. For example, the Ninth Circuit, which has adopted the strictest pleading standard of any circuit court, recently overturned a lower court and allowed a securities fraud case to proceed. The Ninth Circuit’s decision was significant because it was the first time in the nearly twenty cases that had been decided since Silicon Graphics that a lower court’s decision on the merits of the securities fraud plaintiff’s pleading was overturned. In its opinion, the court remarked that it must draw all reasonable inferences from the circumstances averred in securities fraud plaintiffs’ pleadings because of the ability of corporate insiders to “cover their tracks.” In addition, in a case decided last year, the Ninth Circuit held that lower courts should liberally grant securities fraud plaintiffs leave to amend their complaints as long as they were making some progress in their pleadings.

Clearly, the legislative history and the plain language of the Reform Act have led to nothing but confusion as to the proper test to satisfy the Reform Act’s heightened pleading standard. This confusion, which has led to at least three competing interpretations among the circuit courts, leads to forum shopping among securities fraud plaintiffs and undermines Congress’s goal of establishing a uniform pleading system. As with any circuit split, there are two avenues for

205. America West, 320 F.3d at 945.
resolution. The Supreme Court could untangle the Reform Act’s legislative history and set forth the appropriate pleading test under the Reform Act. Or, Congress could act by passing legislation that clearly sets forth the appropriate pleading test. Action by the Supreme Court appears to be the preferred remedy, given that Congressional action created this confusion in the first place.