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Grounding the Short Circuit: The Need for Supreme Court Intervention in Scierter Pleading Requirements for Private Securities Fraud Cases After the Second Circuit's Decision in *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87 (2d Cir. 2007)

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Note*

Grounding the Short Circuit: The Need for Supreme Court Intervention in Scienter Pleading Requirements for Private Securities Fraud Cases After the Second Circuit’s Decision in *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87 (2d Cir. 2007)

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* Joe Ehrich, J.D. Candidate, University of Nebraska College of Law, 2012. The author would like to dedicate this note to his wonderful wife, children, and parents, who inspired and supported him in writing this note and throughout law school.

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I. INTRODUCTION

A securities litigation defense attorney is currently seated at his desk considering the possibility that a securities fraud class action lawsuit will be filed against his client, the Chief Financial Officer (CFO) of Doe Corporation, by a group of the company's shareholders. Doe's share price recently plummeted from \$50 to \$5 after the company announced that it had prematurely recognized revenue and would be forced to restate its revenue projections for the upcoming quarter. Shortly after the announcement, a group of shareholders learned that the CFO's compensation package is tied to the company's attainment of a \$50 common stock share price. Although his client is innocent, the attorney believes the shareholders will view this as a case of securities fraud and file suit against the CFO, alleging that due to the large compensation, he stood to gain from reaching this share price, and with his ability to influence the company's revenue projections, he possessed the motive and opportunity to defraud Doe's investors. Such allegations may create a strong inference that the CFO acted with the required state of mind, or scierter,¹ which is a mental state that reflects a defendant's "intent to deceive, manipulate, or defraud."² Scierter is a required element of a private securities fraud claim.³

Of course, these kinds of allegations could be equally, if not more suggestive of innocent behavior,⁴ and only constitute relevant, not dis-

1. The Second Circuit's position is that these allegations are sufficient to create this inference. *E.g.*, *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 310 (2007)) (stating that allegations of a defendant's motive and opportunity to defraud constitute facts that give rise to a strong inference that the defendant acted with the required state of mind and referring to this requirement as "a 'strong' inference of scierter"). However, due to a split of authority regarding this issue, the adequacy of such allegations in giving rise to such an inference depends upon the circuit where the claim is filed. For a discussion of circuit opinions on this issue, see *infra* section IV.D.

2. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

3. *Id.* at 193.

4. *See Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 655 (8th Cir. 2001) ("[H]aving the motive and opportunity to do wrong are certainly not the same as having the intent to do it."); *Tuchman v. DSC Commc'ns Corp.*, 14 F.3d 1061, 1068-69 (5th Cir. 1994) (quoting *Tuchman v. DSC Commc'ns Corp.*, 818 F. Supp. 971, 976 (N.D. Tex. 1993)) (finding that "[i]t does not follow that because

positive, factors that must be considered with the rest of the complaint's allegations in determining whether a plaintiff has adequately pleaded scienter.⁵ If the plaintiffs file in a federal court in the Third Circuit, where Doe's corporate headquarters is located, they cannot rely only on individual allegations of motive and opportunity to plead scienter. Rather, they must use the complaint's entire allegations, which can include motive and opportunity, to demonstrate an inference of scienter that is at least as compelling as the inference of the CFO's innocent state of mind, which the allegations will also suggest.⁶ The plaintiffs can also expect, after receiving the CFO's likely motion to dismiss,⁷ that a court reviewing their complaint will consider its collective allegations, compare the competing inferences, and only allow it to advance if the scienter inference is at least as likely as the innocent inference.⁸ In holding plaintiffs to these requirements, the Third Circuit applies the stringent scienter pleading standard created by the Supreme Court in *Tellabs*,⁹ which will prompt dismissal of the meritless complaint¹⁰ and spare the CFO from the untenable, albeit almost inevitable, task of settling an invalid claim.¹¹

executives have components of their compensation keyed to performance, one can infer fraudulent intent"); Stephen L. Ascher & Daniel B. Tehrani, *Motive and Opportunity Are Not Enough*, A.B.A. SEC. LITIG. J., Summer 2008, available at http://www.jenner.com/system/assets/publications/695/original/Securities_Lit_Journal_Ascher_Summer2008.pdf?1313771978 (arguing that the motive and opportunity to defraud are not very indicative of intent).

5. *Tellabs*, 551 U.S. at 325.

6. *Id.* at 328 (requiring plaintiffs to plead "an inference of scienter *at least as likely as any plausible opposing inference*"). Because the Supreme Court has applied this review process provision to the pleading requirements that plaintiffs must meet, it is logical to presume that the other provisions also apply in the pleading context.

7. *See infra* note 207 and the sources cited therein.

8. *Institutional Investors Grp v. Avaya, Inc.*, 564 F.3d 242, 252–53, 267–68 (3d Cir. 2009) (stating that in order for a complaint to survive a motion to dismiss, plaintiffs must plead a strong inference of the required state of mind; that this "strong inference of scienter" requirement obligates courts to examine the collective allegations and weigh the competing inferences; and that such an inference must be as compelling as the opposing inference).

9. *See id.* at 267–68 (citing *Tellabs*, 551 U.S. at 313–14, 323–24, 326).

10. *See infra* note 157, the sources cited therein, and the accompanying text.

11. *See* Michael P. Catina & Cindy M. Schmitt, Note, *Private Securities Litigation: The Need for Reform*, 13 ST. JOHN'S J. LEGAL COMMENT. 295, 302–04 (1998) (stating that the prospect of high discovery costs motivated companies in the pre-PSLRA era to settle even frivolous claims); James A. Kassis, *The Private Securities Litigation Reform Act of 1995: A Review of Its Key Provisions and an Assessment of Its Effects at the Close of 2001*, 26 SETON HALL LEGIS. J. 119, 123–24 (2001) (describing how even frivolous claims that survive the motion to dismiss process are commonly settled); Laurae Rossi, Comment, *Choosing the Best Standard of Pleading Under the 1995 Private Securities Litigation Reform Act, and Why the Ninth Circuit's Standard Under In Re Silicon Graphics Conquers the Battle of the Circuits*, 31 SW. U. L. REV. 263, 265 (2002) ("Securities fraud law-

However, if the plaintiffs choose to file in the neighboring Second Circuit, these individual allegations of motive and opportunity *alone* will be sufficient to plead scienter.¹² Further, because courts in the Second Circuit have shown a proclivity for basing their scienter pleading findings solely upon the presence or absence of such allegations, a court reviewing the complaint after a motion to dismiss may summarily find that scienter—and therefore an inference as compelling as the opposing, innocent inference—has been pleaded.¹³ If the court follows this review process, as others in the Second Circuit have done, it will not study the collective allegations, examine and compare the competing inferences, or determine whether the plaintiffs actually pleaded an equally strong inference of scienter.¹⁴ Under such permissive pleading and dismissal review procedures, it is unlikely the court will dismiss the shareholders' lawsuit, even if it is meritless,¹⁵ meaning the CFO may end up paying for something that he did not do.

Why the disparity in pleading standards between these two circuits? Quite simply, the Second Circuit, in *ATSI*, disregarded the pleading and review instructions the Supreme Court established in *Tellabs* by stating that plaintiffs may plead a strong inference of scienter using only allegations of motive and opportunity or conscious misbehavior or recklessness.¹⁶ This decision has allowed plaintiffs to plead scienter using only such individual allegations;¹⁷ encouraged courts within the Second Circuit to conduct abbreviated reviews of complaints at the dismissal stage;¹⁸ undermined the Court's intent for a heightened, uniform scienter pleading standard capable of reducing frivolous litigation and allowing the advancement of meritorious claims;¹⁹ and contributed to the renewal of a wide circuit split over whether motive and opportunity allegations are sufficient to plead scienter.²⁰ In sharp contrast to the divergent policies and practices of the Second Circuit, the Third Circuit adopted the full *Tellabs* provisions.²¹ It therefore utilizes the scienter pleading standard that the Supreme Court intended.

Given the serious consequences of this split, the Second Circuit standard merits further discussion. This Note begins by discussing

suits that withstand a motion to dismiss usually settle due to the exorbitant costs of defending the suit on the merits.”).

12. See *infra* section IV.A.

13. See *infra* section IV.B.

14. See *infra* section IV.B.

15. See *infra* text accompanying note 162.

16. See *infra* section IV.A.

17. See *infra* section IV.A.

18. See *infra* section IV.B.

19. See *infra* section IV.C.

20. See *infra* section IV.D.

21. See, e.g., *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 267–68, 277 (3d Cir. 2009).

the Private Securities Litigation Reform Act (PSLRA), which established the pleading requirements for private securities fraud claims. Part II details the post-PSLRA circuit split over motive and opportunity allegations, and the pleading provisions the Supreme Court established in *Tellabs*. Part III describes the pleading prescriptions created by the Second Circuit in *ATSI*. Part IV discusses how the *ATSI* standard diverges from *Tellabs* by allowing plaintiffs to plead scienter through individual allegations, which has led to only partial application of the *Tellabs* dismissal review process in the Second Circuit and has undermined the Supreme Court's intent for a heightened, uniform scienter pleading standard capable of reducing frivolous claims. This Part also details how *ATSI* contributed to the post-*Tellabs* circuit split over motive and opportunity allegations, and argues that the Supreme Court must rectify this untenable situation by fortifying the *Tellabs* review test. If the Court does not, plaintiffs who sue in the Second Circuit, as the Doe shareholders may, will continue to receive more favorable treatment at the pleading stage and have a greater opportunity to receive undeserved settlements from innocent defendants such as the Doe CFO than those who sue in the Third Circuit.

II. BACKGROUND

A. The Private Securities Litigation Reform Act of 1995 (PSLRA)

In December 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA)²² to eliminate abuses in the private securities fraud class action realm.²³ One abuse was frivolous lawsuits, which, due to the prospect of significant discovery expenses, defendants often settled.²⁴ Congress sought to eliminate frivolous lawsuits through the provisions of the PSLRA,²⁵ such as stronger Rule 11 sanc-

22. Congress passed the bill through a Congressional override of President Clinton's veto. See 141 CONG. REC. S19,180 (daily ed. Dec. 22, 1995); 141 CONG. REC. H15,223-24 (daily ed. Dec. 20, 1995).

23. Michael B. Dunn, Note, *Pleading Scienter After the Private Securities Litigation Reform Act: Or, a Textualist Revenge*, 84 CORNELL L. REV. 193, 194 (1998); Kassis, *supra* note 11, at 120; see also H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 731 (stating that the Conference Report "seeks to protect . . . all who are associated with our capital markets from abusive securities litigation").

24. H.R. REP. NO. 104-369, at 32, 37 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 731, 736; Jeffrey L. Oldham, Comment, *Taking "Efficient Markets" Out of the Fraud-on-the-Market Doctrine After the Private Securities Litigation Reform Act*, 97 NW. U. L. REV. 995, 1021-22 (2003); Catina & Schmitt, *supra* note 11, at 302, 305-06.

25. See H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 731; see also 141 CONG. REC. S19,083 (daily ed. Dec. 21, 1995) (statement of Sen. Reid) (describing the PSLRA as "a bipartisan piece of legisla-

tions,²⁶ a limit on damages,²⁷ and a pleading standard,²⁸ which requires the plaintiff, for each alleged violation, to “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,”²⁹ or scienter.³⁰

The “strong inference” condition was a prominent change because it affected the pleading requirements for and recovery abilities of plaintiffs who sought to bring private securities fraud class action lawsuits. Section 10(b) of the Securities Exchange Act of 1934 makes it illegal to “use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.”³¹ Plaintiffs may bring private actions under

tion designed to curtail the filing of frivolous security strike suits”); 141 CONG. REC. H2,763 (daily ed. Mar. 7, 1995) (statement of Rep. Eshoo) (“[Congress] must craft a piece of legislation that stops the [frivolous litigation].”).

26. Shaun Mulreed, Comment, *Private Securities Litigation Reform Failure: How Scienter Has Prevented the Private Securities Litigation Reform Act of 1995 from Achieving Its Goals*, 42 SAN DIEGO L. REV. 779, 801–02 (2005); Oldham, *supra* note 24, at 1022–23; see 15 U.S.C. § 78u-4(c) (2006).
27. *Mulreed*, *supra* note 26, at 798–800; Oldham, *supra* note 24, at 1023–24; see 15 U.S.C. § 78u-4(e) (2006).
28. See H.R. REP. NO. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 740 (stating that Congress heard testimony “on the need to establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits” and stating that “the Conference Committee intends to strengthen existing pleading requirements”); see also 141 CONG. REC. S19,149 (daily ed. Dec. 22, 1995) (statement of Sen. Bradley) (stating that the pleading standard will ensure that claims that advance are meritorious); 141 CONG. REC. S17,969 (daily ed. Dec. 5, 1995) (statement of Sen. Domenici) (stating that the conference report adopted the Second Circuit’s pleading standard to “weed out frivolous cases early”).
29. 15 U.S.C. § 78u-4(b)(2) (2006).
30. Congress viewed scienter as the “required state of mind.” 193 CONG. REC. H14,041 (daily ed. Dec. 6, 1995) (statement of Rep. Dingell) (referring to the “required state of mind” as “[t]he bill’s elevated pleading standard for scienter”); 141 CONG. REC. S17,966 (daily ed. Dec. 5, 1995) (statement of Sen. Hatch) (noting that the bill’s pleading standard requires plaintiffs to plead with particularity facts that give rise to a strong inference of scienter). Courts have also reached this conclusion. See Brian S. Sommer, Note, *The PSLRA Decade of Decadence: Improving Balance in the Private Securities Litigation Arena With a Screening Panel Approach*, 44 WASHBURN L.J. 413, 420, 424 (2005) (reciting the scienter standard developed by the Supreme Court in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), and stating that “courts have deduced [this requirement] to mean the standard announced . . . in *Hochfelder*”). Due to the interchangeability of these terms, this Note will use the term “scienter” and the phrase “strong inference of scienter” to refer to the pleading requirements of the PSLRA.
31. 15 U.S.C. § 78j(b) (2006).

Section 10(b) and SEC Rule 10b-5,³² which make it unlawful to use a scheme to defraud, make a false statement of a material fact, omit a material fact, or engage in an act that would defraud someone in connection with the purchase or sale of a security.³³ Because the Supreme Court had held that private securities fraud claims must allege scienter, or an “intent to deceive, manipulate, or defraud,”³⁴ a provision that required plaintiffs to plead with particularity facts that give rise to a strong inference of scienter represented a significant change in pleading requirements and a heightened challenge to a plaintiff’s ability to recover.³⁵ Congress, however, viewed this uniform, enhanced scienter pleading standard for all such lawsuits as a way to reduce frivolous lawsuits and allow valid claims to advance.³⁶

While Congress sought a uniform, heightened scienter pleading standard, a dispute arose—and was inconclusively resolved—over the types of allegations sufficient to meet such a standard. Although Congress derived the “strong inference” language from the Second Circuit’s pre-PSLRA pleading standard,³⁷ codification of the circuit’s full standard, under which scienter could be established by allegations of a

32. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 318 (2007) (stating that the Supreme Court has construed Section 10(b) as providing a right of action); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971).

33. 17 C.F.R. § 240.10b-5 (2011).

34. *Ernst*, 425 U.S. at 193.

35. See 141 CONG. REC. S19,047 (daily ed. Dec. 21, 1995) (statement of Sen. Specter) (arguing that the bill’s pleading standard “turns the *Federal Rules of Civil Procedure* on their head” and “makes it a virtual impossibility that sufficient facts can be alleged”); 193 CONG. REC. H14,041 (daily ed. Dec. 6, 1995) (statement of Rep. Dingell) (“The conference report places highly burdensome pleading requirements on plaintiffs.”); 141 CONG. REC. S17,950 (daily ed. Dec. 5, 1995) (statement of Sen. Bryan) (“[The bill’s] pleading requirements are more difficult.”); André Douglas Pond Cummings, *“Ain’t No Glory in Pain”: How the 1994 Republican Revolution and the Private Securities Litigation Reform Act Contributed to the Collapse of the United States Capital Markets*, 83 NEB. L. REV. 979, 1007–08, 1008 n.129 (2005).

36. See H.R. REP. NO. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 740 (stating that Congress heard testimony “on the need to establish uniform and more stringent pleading requirements to curtail the filing of meritless lawsuits”); see also 141 CONG. REC. S17,966 (daily ed. Dec. 5, 1995) (statement of Sen. Hatch) (stating that the bill’s pleading standard “should help weed out at an early stage lawsuits filed against innocent defendants”); Anthony D. Weis, Comment, *Striking an Imbalance: The Interpretation of Section 21D(b)(2) of the Securities Exchange Act of 1934 in Silicon Graphics*, 59 OHIO ST. L.J. 1741, 1772–73 (1998) (stating that the PSLRA imposed, among other provisions, more stringent pleading standards in an effort to strike a better balance between allowing securities fraud victims to pursue a remedy and deterring abuse by frivolous claims).

37. H.R. REP. NO. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 740 (stating that the PSLRA pleading standard was “based in part on the pleading standard of the Second Circuit,” which required a “‘strong inference’ of the defendant’s fraudulent intent”).

defendant's motive and opportunity to commit fraud or strong circumstantial evidence of conscious misbehavior or recklessness,³⁸ became a contentious issue. Senator Arlen Specter, whose amendment incorporating the full Second Circuit standard was added to the Senate bill,³⁹ questioned the logic of codifying the "strong inference" language but not the types of allegations adequate to establish this inference.⁴⁰ However, the conference committee, in its desire to "strengthen existing pleading requirements," declined to adopt the circuit's interpretive case law.⁴¹ This omission prompted President Clinton to issue a veto—which Congress later overrode⁴²—for a bill that he felt would "[close] the courthouse door on investors [with] legitimate claims."⁴³ Unfortunately, the types of allegations sufficient to plead scienter were not decided, as the statute failed to specify any such allegations,⁴⁴ and members of Congress suggested the PSLRA both had and had not codified the Second Circuit standard.⁴⁵

Congress's inconsistent messages and failure to define the adequate types of allegations laid the groundwork for the eventual undermining of its goal of a uniform, heightened pleading standard. The inconsistent messages concerning the adoption of the Second Circuit standard⁴⁶ increased the risk that some courts would adopt the standard while others fashioned a stronger standard,⁴⁷ thus eliminating

38. See, e.g., *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 53 (2d Cir. 1995); *Cohen v. Koenig*, 25 F.3d 1168, 1173–74 (2d Cir. 1994); *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268–69 (2d Cir. 1993).

39. 141 CONG. REC. S9,171–72 (daily ed. June 27, 1995) (statement of Sen. Specter).

40. *Id.* at S9,171.

41. H.R. REP. NO. 104-369, at 41 (Conf. Rep.), reprinted in 1995 U.S.C.A.N. 730, 740.

42. 141 CONG. REC. S19,180 (daily ed. Dec. 22, 1995); 141 CONG. REC. H15,223–24 (daily ed. Dec. 20, 1995).

43. 141 CONG. REC. H15,214–15 (daily ed. Dec. 20, 1995) (veto message of President Clinton).

44. 15 U.S.C. § 78u-4(b)(2) (2006).

45. 141 CONG. REC. S19,067–68 (daily ed. Dec. 21, 1995) (statement of Sen. Dodd) (pointing approvingly to assertions by the academic community that the bill's pleading standard is "faithful to the Second Circuit's test"); 141 CONG. REC. S17,966 (daily ed. Dec. 5, 1995) (statement of Sen. Hatch) (stating that the bill "adopts the [S]econd [C]ircuit pleading standard"); Nicole M. Briski, Comment, *Pleading Scienter Under the Private Securities Litigation Reform Act of 1995: Did Congress Eliminate Recklessness, Motive, and Opportunity?*, 32 LOY. U. CHI. L.J. 155, 169–70 nn.104–05 (2000).

46. See *supra* text accompanying note 45.

47. This is precisely what occurred after the passage of the PSLRA, as the Third Circuit, after reviewing the bill's "contradictory and inconclusive" legislative history, adopted the motive and opportunity test based upon Congress's near-total codification of the Second Circuit standard, which the court saw as indicative of Congress's desire to promulgate a standard equal in strength to the Second Circuit's standard. *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 531–35 (3d Cir. 1999). However, the Ninth Circuit found that the bill's legislative history reflected Congress's desire to create a scienter pleading standard that was stronger

the opportunity for a single, heightened scienter pleading standard for all private securities fraud class action complaints. Congress's failure to define the types of allegations that are sufficient to establish scienter⁴⁸ also created the possibility that even if courts declined to adopt the Second Circuit standard, circuits would search for guidance from dissimilar lines of reasoning and would thus promulgate different standards of varying strengths.⁴⁹ Given this potential for differing interpretations, it is unsurprising that a circuit split emerged.

B. The Post-PSLRA Circuit Split

Despite Congress's intent to create a uniform, heightened pleading standard and the consensus over the adequacy of recklessness in showing scienter, a circuit split over the sufficiency of motive and opportunity allegations emerged in the years following PSLRA's passage. In their respective post-PSLRA opinions, the circuit courts followed the Supreme Court's definition in *Ernst & Ernst v. Hochfelder* that scienter constitutes the intent to deceive, manipulate, or defraud,⁵⁰ and found that plaintiffs can plead scienter by alleging a

than the Second Circuit's and therefore declined to adopt the motive and opportunity test. *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 977–79 (9th Cir. 1999).

48. See 15 U.S.C. § 78u-4(b)(2) (2006).

49. This also occurred after the passage of the PSLRA, as the Eleventh Circuit concluded that while allegations showing only motive and opportunity are insufficient, such allegations, if showing more, might contribute to pleading "the required state of mind." *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1285–87 (11th Cir. 1999) (quoting 15 U.S.C. § 78u-4(b)(2)). After interpreting "the required state of mind" to constitute severe recklessness, the court concluded that only allegations showing severe recklessness, which could include evidentiary motive and opportunity allegations, would suffice. *Id.* at 1285–87. Conversely, the Ninth Circuit found that the legislative history of the PSLRA suggested that Congress had adopted a standard that was stronger than that of the Second Circuit. *In re Silicon*, 183 F.3d at 976–79. It concluded that only allegations showing deliberate recklessness—which does not include allegations of motive and opportunity—are sufficient to establish scienter, a position it derived from its prior holding that deliberate recklessness constitutes "the required state of mind." *Id.* (en banc) (citing *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990)).

50. *E.g.*, *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 593–94 (7th Cir. 2006); *Ottmann v. Hanger Orthopedic Grp., Inc.*, 353 F.3d 338, 343 (4th Cir. 2003); *In re IKON Office Solutions, Inc.*, 277 F.3d 658, 667 (3d Cir. 2002); *Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 653 (8th Cir. 2001); *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 408 (5th Cir. 2001); *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1258 (10th Cir. 2001); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 194, 201 (1st Cir. 1999) (noting that the "required state of mind" is defined in this manner and finding that the PSLRA did not change the substantive scienter definition); *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1281–82 (11th Cir. 1999); *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 548 (6th Cir. 1999); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 975 (9th Cir. 1999); *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999).

form of recklessness,⁵¹ which the circuits defined uniformly.⁵² Despite the circuit unanimity on these issues, the groundwork for a split over the sufficiency of motive and opportunity allegations was laid in *Press*,⁵³ in which the Second Circuit held, without offering any qualification, that facts showing a defendant's motive and opportunity to commit fraud or constituting strong circumstantial evidence of conscious misbehavior or recklessness satisfy the PSLRA's strong inference pleading requirement.⁵⁴ The court reached this conclusion after summarily acknowledging that the PSLRA had heightened the scienter pleading requirements to the Second Circuit's level.⁵⁵ Soon after, the Third Circuit affirmed its use of the same standard.⁵⁶ It concluded that "Congress's use of the Second Circuit's language compels the conclusion that [PSLRA] establishes a pleading standard approximately equal in stringency to that of the Second Circuit."⁵⁷

In adopting a scienter pleading standard that could be met through individual allegations of motive and opportunity, the Second Circuit employed an easily satisfied, plaintiff-friendly standard. Securities fraud defendants are frequently presented with situations that could give rise to a motive and opportunity to defraud,⁵⁸ which means that

51. *E.g., Makor Issues & Rights, Ltd.*, 437 F.3d at 600; *Ottmann*, 353 F.3d at 344; *In re IKON*, 277 F.3d at 667 (using the recklessness concept employed in other circuits to define scienter, although not explicitly stating that recklessness suffices); *Fla. State Bd. of Admin.*, 270 F.3d at 653 n.7, 653–54; *Nathenson*, 267 F.3d at 407–10; *City of Phila.*, 264 F.3d at 1259; *Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000); *Greebel*, 194 F.3d at 198–201; *Bryant*, 187 F.3d at 1283–84; *In re Comshare*, 183 F.3d at 549–50; *In re Silicon*, 183 F.3d at 977.

52. *E.g., Makor Issues & Rights, Ltd.*, 437 F.3d at 600 (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)); *Ottmann*, 353 F.3d at 343 (quoting *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 621 (4th Cir. 1999)); *In re IKON*, 277 F.3d at 667 (quoting *SEC v. Infinity Grp. Co.*, 212 F.3d 180, 192 (3d Cir. 2000)); *Fla. State Bd. of Admin.*, 270 F.3d at 654 (quoting *Camp v. Dema*, 948 F.2d 455, 461 (8th Cir. 1991)); *Nathenson*, 267 F.3d at 408 (quoting *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961–62 (5th Cir. 1981)); *City of Phila.*, 264 F.3d at 1258 (quoting *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1232 (10th Cir. 1996)); *Rothman*, 220 F.3d at 90 (quoting *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978)); *Greebel*, 194 F.3d at 198 (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)); *Bryant*, 187 F.3d at 1282 n.18 (quoting *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809, 814 (11th Cir. 1989)); *In re Comshare*, 183 F.3d at 550 (quoting *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1025 (6th Cir. 1979)); *In re Silicon*, 183 F.3d at 976 (quoting *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990)).

53. *Press*, 166 F.3d 529.

54. *Id.* at 537–38.

55. *Id.*

56. *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534–35 (3d Cir. 1999).

57. *Id.* at 534.

58. *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1286 (11th Cir. 1999) (quoting *Carley Capital Grp. v. Deloitte & Touche, L.L.P.*, 27 F. Supp. 2d 1324, 1339 (N.D. Ga. 1998)) ("Greed is a ubiquitous motive, and corporate insiders and upper management always have [the] opportunity to lie and manipulate."); *Ascher & Tehrani*,

plaintiffs had an easy task in discerning and alleging such behavior.⁵⁹ The permissiveness of the standard also flowed from its lesser substantive requirement, as motive is a lesser form of intent than recklessness,⁶⁰ and the fact that it could be satisfied without the use of discovery, which critics viewed as a necessity of the PSLRA pleading standard.⁶¹ In demonstrating a willingness to look past weak assertions of motive and opportunity to find that plaintiffs had successfully pleaded such allegations—and thus scienter—the Second Circuit also lent a hand to plaintiffs.⁶² While the Second Circuit after *Press* cautioned that “litigants and lower courts need and should not employ or rely on magic words such as ‘motive and opportunity,’”⁶³ and required that motive allegations entail “a concrete and personal benefit to the

supra note 4; see also *Globis Capital Partners, L.P. v. Stonepath Grp., Inc.*, 241 F. App'x 832, 836 (3d Cir. 2007) (“In every corporate transaction, the corporation and its officers have a desire to complete the transaction, and officers will usually reap financial benefits from a successful transaction.” (quoting *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 237 (3d Cir. 2004))).

59. See Bruce Cannon Gibney, Comment, *The End of the Unbearable Lightness of Pleading: Scienter After Silicon Graphics*, 48 UCLA L. REV. 973, 1013 n.245 (2001) (indicating that a reason why scienter can be plead with ease under the motive and opportunity test is because securities fraud defendants often have the motive and opportunity to defraud); see also Weis, *supra* note 36, at 1773 (“[T]he proof required to establish motive and opportunity [is] most consistent with the type of information typically available to a victim of securities fraud prior to discovery.”).
60. Compare *Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 655 (8th Cir. 2001) (“[H]aving the motive and opportunity to do wrong are certainly not the same as having the intent to do it.”), and *Ascher & Tehrani*, *supra* note 4 (arguing that allegations of motive are not especially probative of intent), with *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976) (“In certain areas of the law[,] recklessness is considered to be a form of intentional conduct.”).
61. Discovery is not necessary to satisfy this standard because the circumstances underlying motive and opportunity allegations can be discovered—and thus this behavior can be alleged—with ease. See *supra* text accompanying notes 58–59. However, critics thought that the PSLRA pleading standard would impose a greater burden on plaintiffs. 141 CONG. REC. S19,071–72 (daily ed. Dec. 21, 1995) (letter from Roberta Cooper Ramo, President of the American Bar Association) (stating that it is “utterly impossible” to plead the defendant’s state of mind prior to discovery); 141 CONG. REC. S19,038 (daily ed. Dec. 21, 1995) (statement of Sen. Sarbanes) (“It simply will be impossible for the plaintiff, without discovery, to meet the [pleading] standard.” (quoting a letter from John Sexton, Dean of the New York University School of Law)); 193 CONG. REC. H14,041 (daily ed. Dec. 6, 1995) (statement of Rep. Dingell) (stating that the pleading standard “will require average investors without discovery to know and state facts in pleadings that are only knowable after discovery”).
62. See *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999) (citing *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 270–71 (2d Cir. 1993)) (“The Second Circuit has been lenient in allowing scienter issues to withstand summary judgment based on fairly tenuous inferences.”).
63. *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000).

individual defendants resulting from the fraud,”⁶⁴ these measures did little to bolster the least stringent post-PSLRA pleading standard.⁶⁵

The Ninth Circuit took the opposite position in *In re Silicon Graphics Inc. Securities Litigation*⁶⁶ by rejecting the motive and opportunity test,⁶⁷ thereby widening the split that began in *Press*. The court adhered to its prior holdings that recklessness demonstrating intentional misconduct is adequate to establish the “required state of mind.”⁶⁸ It thoroughly examined the legislative history of the PSLRA—focusing on the conference committee’s rejection of the Specter Amendment, its failure to adopt the Second Circuit standard and interpretive case law, and Congress’s override of President Clinton’s veto⁶⁹—to reach its conclusion that “Congress adopted a standard more stringent than the Second Circuit standard.”⁷⁰ Based upon this, the court created a new, more stringent standard that required a plaintiff to “plead, at a minimum, particular facts giving rise to a strong inference of deliberate or conscious recklessness,” which could not be satisfied by allegations of a defendant’s motive and opportunity to commit fraud.⁷¹

The refusal of the other circuits to take such decisive positions on the adequacy of allegations of motive and opportunity worsened the circuit split. The First, Fifth, Sixth, Eighth and Eleventh Circuits have each held that allegations that show only motive and opportunity, but do not show that the defendant acted with a form of recklessness that is sufficient to show scienter, are insufficient to satisfy the strong inference standard.⁷² While finding motive and opportunity allegations

64. *Kalnit v. Eichler*, 264 F.3d 131, 139 (2d Cir. 2001) (citing *Novak*, 216 F.3d at 307–08).

65. *See Ascher & Tehrani*, *supra* note 4, at 4 (noting the difficulties experienced by Second Circuit courts in discerning what constitutes a “concrete and personal benefit”); *Gibney*, *supra* note 59, at 983–84 (stating that despite its admonitions concerning motive and opportunity allegations, the Second Circuit retained its pre-PSLRA pleading standard); *Rossi*, *supra* note 11, at 269–70 (stating that as of 2001 and 2002, the Second and Third Circuits had the most lenient pleading standards).

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

67. *Id.* at 978–79.

68. *Id.* at 975–77.

69. *Id.* at 977–79.

70. *Id.* at 979.

71. *Id.*

72. *E.g.*, *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1285–86 (11th Cir. 1999); *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 551 (6th Cir. 1999); *see Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 653, 660 (8th Cir. 2001) (intimating that recklessness still satisfies the scienter requirement after the passage of the PSLRA and finding that motive and opportunity allegations are sufficient to plead scienter if such allegations give rise to a strong inference of scienter, not if such allegations merely show motive and opportunity); *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 410–11 (5th Cir. 2001) (adopting the position articulated in *In re Comshare* and *Bryant* without applying it to the circuit’s specific type of reck-

inadequate, these circuits recognize that such allegations can contribute to pleading scienter and can potentially create a strong inference of a defendant's reckless or knowing state of mind.⁷³ The Fourth, Seventh, and Tenth Circuits joined these circuits in striking a middle ground⁷⁴ that highlights both the disparity in circuit opinions on the adequacy of motive and opportunity allegations, and the holding by the vast majority of circuits that such allegations, standing alone, are insufficient to plead scienter.

Plaintiffs in circuits that eliminated or limited the applicability of motive and opportunity allegations faced greater challenges than their Second Circuit counterparts. Proof of a defendant's deliberate recklessness will "almost always be in the [mind], or sometimes in the files, of the [defendant],"⁷⁵ meaning that Ninth Circuit plaintiffs attempting to establish this mental state faced potential difficulties in uncovering sufficient information to plead adequate allegations.⁷⁶ Although plaintiffs in other circuits could have used motive and opportunity allegations to plead scienter,⁷⁷ the ease with which such allegations are discovered and alleged⁷⁸ likely rendered them insufficient to show the types of recklessness that were probably as difficult to uncover and allege as the Ninth Circuit's similarly-defined "deliberate recklessness."⁷⁹ To plead these forms of recklessness, plaintiffs

lessness); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 197 (1st Cir. 1999) (finding that allegations of motive, standing alone, are insufficient to plead scienter, although not stating that such allegations must show recklessness in order to be adequate).

73. *E.g., Fla. State Bd. of Admin.*, 270 F.3d at 660; *Nathenson*, 267 F.3d at 410–11; *Greebel*, 194 F.3d at 197; *Bryant*, 187 F.3d at 1285–86; *In re Comshare*, 183 F.3d at 551.

74. The Fourth, Seventh, and Tenth Circuits have advised courts to examine the collective allegations of the complaint in order to determine whether scienter had been adequately pleaded and also found that allegations of motive and opportunity could be relevant to establishing scienter. *See Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601 (7th Cir. 2006); *Ottmann v. Hanger Orthopedic Grp., Inc.*, 353 F.3d 338, 345–46 (4th Cir. 2003); *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1263 (10th Cir. 2001).

75. Joseph T. Phillips, Comment, *A New Pleading Standard Under the Private Securities Litigation Reform Act?*, 69 U. CIN. L. REV. 969, 991 (2001).

76. *See Weis, supra* note 36, at 1774 (stating that plaintiffs often lack access to information indicating circumstantial evidence of deliberate recklessness, due in part to the fact that such information is often in the sole possession of the defendant and this inaccessibility prevents plaintiffs from successfully alleging deliberate recklessness); *see also Ascher & Tehrani, supra* note 4, at 3 (noting that the motive and opportunity test is the Second Circuit's response to the impossibility that it perceives in pleading a strong inference of scienter "without a smoking gun reflecting a particular defendant's innermost thoughts").

77. *See supra* text accompanying notes 72–74.

78. *See supra* text accompanying note 59.

79. *See supra* text accompanying notes 51–52.

had to allege a higher degree of intent than a motive to defraud⁸⁰ and “a high level of culpability”⁸¹ without the benefit of a permissive interpretive standard like that of the Second Circuit.⁸² Facing a undermining of Congress’s intent for a heightened, uniform pleading standard by this disparity in plaintiff treatment and circuit views, the Supreme Court formulated an interpretation that it believed would effectuate Congress’ goal.

C. The Supreme Court Weighs In: *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*

In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the Supreme Court sought to interpret the “strong inference” requirement in a manner that would effectuate the goals of the PSLRA and resolve a circuit split over the consideration of competing inferences.⁸³ Investors accused Tellabs, Inc. and its current and former officers of misrepresenting the true value of the company’s stock,⁸⁴ and the Court addressed “whether, and to what extent, a court must consider competing inferences in determining whether a securities fraud complaint gives rise to a ‘strong inference’ of scienter.”⁸⁵ Recognizing Congress’s intent to create—through PSLRA’s heightened standard—both a uniform pleading standard for, and a reduction in abuses of, private securities fraud claims,⁸⁶ the Court noted that “‘Congress did not throw much light on what facts . . . suffice to create [a strong] inference,’ or on what ‘degree of imagination courts can use in divining whether’ the requisite inference exists.”⁸⁷ As a result, the circuits had split over whether courts should consider competing inferences in determining the strength of an inference of scienter.⁸⁸ To resolve this conflict, the Court sought to offer an interpretation of the strong inference requirement that would advance “the PSLRA’s twin goals to curb frivolous, lawyer-driven litigation, while preserving investors’ ability to recover on meritorious claims.”⁸⁹

80. See *supra* note 60.

81. Brief for Securities and Exchange Commission as Amici Curiae Supporting Appellants at 17, *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970 (9th Cir. 1999) (No. 97-16240), 1997 WL 33551249, at *17.

82. See *id.* (recognizing that all circuits employ the same recklessness standard and stating that the “threshold for a finding of recklessness is quite high”).

83. 551 U.S. 308 (2007).

84. *Id.* at 314–15.

85. *Id.* at 317–18.

86. *Id.* at 320–21.

87. *Id.* at 321–22 (quoting *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601 (7th Cir. 2006)).

88. *Id.* at 322.

89. *Id.*

To further these goals, the Court held that when deciding whether plaintiffs have pleaded scienter at the motion to dismiss stage, a court “must consider the complaint in its entirety”⁹⁰ and “take into account plausible opposing inferences”⁹¹ in order to determine if the inference of scienter is “cogent and at least as compelling as any opposing inference of nonfraudulent intent” and therefore strong.⁹² The Court summarized its standard in a question that it instructed reviewing courts to ask: “When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?”⁹³ It noted that this question requires plaintiffs to “plead facts rendering an inference of scienter *at least as likely* as any plausible opposing inference.”⁹⁴

In its decision, the Supreme Court shed important light on the adequacy of allegations of motive and opportunity.⁹⁵ In refuting the contention that a defendant’s lack of pecuniary motive is dispositive, the Court found that “motive can be a relevant consideration . . . [but] the absence of a motive allegation is not fatal”⁹⁶ and that because “allegations must be considered collectively[,] the significance that can be ascribed to an allegation of motive, or lack thereof, depends on the entirety of the complaint.”⁹⁷ The potential relevancy of motive allegations came after repeated calls for the Court’s guidance on the types of allegations sufficient to plead scienter.⁹⁸ It also offered crucial gui-

90. *Id.* at 322.

91. *Id.* at 323.

92. *Id.* at 314.

93. *Id.* at 326.

94. *Id.* at 326 (emphasis in original).

95. *Id.* at 325; see also Alan I. Raylesberg, Robert A. Schwinger & Robert Sidorsky, *Tellabs Decision Should Reduce Frivolous Fraud Suits*, SEC. L. 360, 2, 5 (July 5, 2007), <http://www.chadbourne.com/files/Publication/e3fad19-294e-4fa9-a4b5-ddefc30ceace/Presentation/PublicationAttachment/ff277cd0-2906-469d-a7a1-ef5f0d25ca2a/Securities%20Law%20360%20tellabs%20piece%207%2007.pdf> (arguing that one of the key aspects of *Tellabs* is its handling of the individual sufficiency of motive and opportunity allegations, which had divided the circuits); see also *Securities Litigation Update*, SIDLEY AUSTIN LLP, 3 (June 26, 2007), http://www.sidley.com/files/News/5e20a7bb-4d47-4af8-a063-011bd7ea41eb/Presentation/NewsAttachment/f933eb1a-22e7-4fe8-bc11-04c00a94613e/Securities_Litigation_Update_062607.pdf (stating that the Court’s finding that the absence of motive allegations, when considered against the entire complaint, may be a relevant factor in evaluating scienter offers important guidance for future securities fraud claims).

96. *Tellabs*, 551 U.S. at 325.

97. *Id.*

98. *E.g.*, Briski, *supra* note 45, at 200 (calling on the Court to definitively rule on the types of allegations sufficient to plead scienter in order to resolve the circuit split); Jason L. Powell, Comment, *The Private Securities Litigation Reform Act of 1995 Writ for Certiorari*, 44 S. TEX. L. REV. 809, 838 (2003) (“[I]t is time for the Supreme Court to . . . shed some light on [the types of allegations sufficient to plead scienter].”); Christopher J. Hardy, Comment, *The PSLRA’s Heightened*

dance to the Second Circuit Court of Appeals as it reconfigured its scienter pleading standard.

III. THE POST-TELLABS SECOND CIRCUIT RESPONSE: *ATSI COMMUNICATIONS, INC. V. SHAAR FUND, LTD.*

The Second Circuit issued its first post-*Tellabs* opinion, *ATSI Communications, Inc. v. Shaar Fund, Ltd.*,⁹⁹ only twenty days after the *Tellabs* decision.¹⁰⁰ The plaintiff in *ATSI*, a telecommunications provider, accused its investors of engaging in misrepresentations and market manipulation in violation of Section 10(b) and Rule 10b-5 by causing a “death spiral” in the price of the corporation’s stock by fraudulently inducing the corporation to sell them its convertible stock.¹⁰¹ At the same time, the defendants were allegedly aggressively short-selling the corporation’s stock and covering their short positions through the sale of the corporation’s preferred stock.¹⁰² The alleged end result was a drop in the price of the corporation’s stock from \$6 to \$0.09 per share¹⁰³ and large profits for the defendants.¹⁰⁴ After it repeatedly failed to satisfy the pleading requirements of the *Federal Rules of Civil Procedure* Rule 9(b) and the PSLRA, the plaintiff appealed to the Second Circuit,¹⁰⁵ which provided the circuit with its first opportunity to consider the appropriate scienter pleading standard in light of the *Tellabs* decision.

In formulating its post-*Tellabs* scienter pleading standard, the *ATSI* court incorporated the Second Circuit’s pre-*Tellabs* standard and selectively adopted several *Tellabs* provisions. The court began its brief discussion by stating the overriding PSLRA requirement that particularly-stated “facts giving rise to a strong inference that the de-

Pleading Standard: Does Severe Recklessness Constitute Scienter?, 35 U.S.F. L. REV. 565, 592 (2001) (stating that the Supreme Court must promulgate a uniform federal pleading standard for securities fraud actions in order to resolve the circuit split and effectuate the purpose of the PSLRA).

99. 493 F.3d 87 (2d Cir. 2007).

100. The Second Circuit decided *ATSI Commc’ns, Inc.* on July 11, 2007. *Id.* The Supreme Court decided *Tellabs* on June 21, 2007. *Tellabs*, 551 U.S. 308.

101. *ATSI Commc’ns, Inc.*, 493 F.3d at 93. Convertible stock is a convertible security, which is “[a] security . . . that may be exchanged by the owner for another security, [especially] common stock from the same company, and [usually] at a fixed price on a specified date.” BLACK’S LAW DICTIONARY 1476 (9th ed. 2009). For an excellent hypothetical describing how the “death spiral” process works, see *At Death’s Door*, STOCKPATROL.COM (Mar. 12, 2002), <http://www.stockpatrol.com/article/key/deathspiral>.

102. *ATSI Commc’ns, Inc.*, 493 F.3d at 93. Preferred stock is “[a] class of stock giving its holder a preferential claim to dividends and to corporate assets upon liquidation but that [usually] carries no voting rights.” BLACK’S LAW DICTIONARY 1553 (9th ed. 2009).

103. *ATSI Commc’ns, Inc.*, 493 F.3d at 97.

104. *Id.* at 93.

105. *Id.* at 98.

endant acted with the required state of mind” must be pleaded for each alleged violation.¹⁰⁶ Next, the court summarily affirmed the Second Circuit’s pre-*Tellabs* case law by finding that allegations “(1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness” are, without qualification, adequate to give rise to a strong inference of scienter.¹⁰⁷ The court also adopted the *Tellabs* prescriptions that a court reviewing a complaint must consider opposing, innocent inferences and that an inference of scienter is only strong if it is cogent and at least as compelling as any opposing inference.¹⁰⁸ However, the court failed to mention the *Tellabs* requirement that the collective allegations serve as the basis for determining the successful pleading of such an inference of scienter and the significance of the presence or absence of an allegation of motive.¹⁰⁹

Proceeding under the newly-established standard, the court found that none of the complaint’s allegations gave rise to a strong inference of scienter.¹¹⁰ The allegation that convertible preferred stock—a legitimate investment vehicle—created an opportunity for profit through manipulation was insufficient to raise a strong inference of scienter.¹¹¹ After finding that the defendants failed to provide sufficient particular facts to give rise to a strong inference of scienter,¹¹² the court affirmed the district court’s dismissal of the plaintiff’s complaint and denial of leave to amend.¹¹³ Despite the actual holding, the most significant aspect of the case—because it raised issues that involve the Supreme Court, Congress, and other circuits—was the court’s affirmation that allegations of motive and opportunity, conscious misbehavior, or recklessness are, without qualification, sufficient to plead a strong inference of scienter,¹¹⁴ even after the *Tellabs* Court’s finding that such allegations may be relevant to such a pleading.¹¹⁵

IV. ANALYSIS

In prescribing the review process that courts must conduct upon a motion to dismiss, the *Tellabs* Court established, and the *ATSI* standard contradicts, specific requirements for pleading scienter. The

106. *Id.* at 99.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.* at 104.

112. *Id.* at 104–05.

113. *Id.* at 108.

114. *Id.* at 99.

115. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 325 (2007).

Court's instruction to lower courts to consider the complaint's collective allegations and competing inferences and look for an equally compelling inference in determining whether plaintiffs plead scienter mandates that plaintiffs utilize the collective allegations to show such an equally compelling inference.¹¹⁶ Therefore, the Court's finding that motive allegations, although relevant, must be considered within the framework of the collective allegations carries a clear pleading implication: individual allegations of motive and opportunity or conscious misbehavior or recklessness, if part of the collective allegations that demonstrate an equally compelling inference, can contribute to pleading a strong inference of scienter, but alone are inadequate.¹¹⁷ The *ATSI* standard, however, allows such allegations to independently suffice,¹¹⁸ which contradicts the *Tellabs* Court's pleading position¹¹⁹ and undermines its review process;¹²⁰ defies the intent of the Supreme Court;¹²¹ has contributed to a wide circuit split;¹²² and has created the need for Supreme Court intervention.¹²³

116. See *id.* at 323–24, 328 (stating that in order for the complaint to survive, a court must find that the inference of scienter is as compelling as the opposing inference and that “[a] plaintiff alleging fraud in a § 10(b) action . . . must plead facts rendering an inference of scienter *at least as likely* as any plausible opposing inference” (emphasis in original)); E. Powell Miller, *The Supreme Court's Decision in Tellabs: The Death Knell for Securities Fraud Class Actions? Not so Fast*, 86 MICH. B. J. 40, 42 (Oct. 2007), available at <http://www.michbar.org/journal/pdf/pdf4article1230.pdf> (quoting *Tellabs*, 551 U.S. at 328) (stating that while *Tellabs* requires courts to weigh facts, a plaintiff's pleading burden only demands that “the weight of the factual allegations . . . be ‘as likely as’ any inferences that the defendant acted with a non-fraudulent intent”); Raylesberg, Schwinger & Sidor-sky, *supra* note 95, at 2, 5 (stating that prior to *Tellabs*, the Second and Third Circuits allowed plaintiffs to plead scienter from individual allegations and noting that the *Tellabs* Court's instruction to courts to consider the collective allegations imposes a greater burden on plaintiffs than they had previously faced in such circuits).

117. See *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 277 (3d Cir. 2009) (adopting *Tellabs*'s prescription to consider allegations of motive and opportunity with the collective allegations in assessing whether a plaintiff has pleaded scienter); SHEPPARD MULLIN RICHTER & HAMPTON LLP, *Third Circuit Applies Tellabs to Reject Motive and Opportunity Test in Favor of a “Holistic Approach” to Pleading Scienter in Securities Fraud Actions*, CORP. & SEC. L. BLOG (June 18, 2009), <http://www.corporatesecuritieslawblog.com/securities-litigation-third-circuit-applies-tellabs-to-reject-motive-and-opportunity-test-in-favor-of-a-holistic-approach-to-pleading-scienter-in-securities-fraud-actions.html> (stating that the *Avaya* court found that “allegations of motive and opportunity, standing alone, were insufficient to support a strong inference of scienter” but could contribute to such an inference “when accompanied by other . . . facts”).

118. *Infra* section IV.A.

119. *Infra* section IV.A.

120. *Infra* section IV.B.

121. *Infra* section IV.C.

122. *Infra* section IV.D.

123. *Infra* section IV.E.

A. The *ATSI* standard conflicts with *Tellabs* by allowing plaintiffs to plead scienter through individual allegations

The scienter pleading standard established in *ATSI* and currently employed in the Second Circuit allows plaintiffs to plead scienter using individual allegations of motive and opportunity, conscious misbehavior, or recklessness.¹²⁴ This position arises from the *ATSI* court's finding that these allegations are, without qualification, adequate to plead scienter, and its failure to adopt the *Tellabs* caveat that the collective allegations must serve as the basis for evaluating an inference of scienter and the significance of the presence or absence of motive allegations.¹²⁵ This is in direct contravention of *Tellabs*. While the Second Circuit has since adopted *Tellabs*'s prescription to consider the collective allegations in determining whether a strong inference of scienter exists,¹²⁶ it continues to allow the unqualified sufficiency of individual allegations, and has failed to adopt the caveat cautioning similar collective evaluation of motive allegations.¹²⁷ This condition, if included, would have demonstrated both the insufficiency of individual allegations and that scienter may only be pleaded from collective allegations.¹²⁸ Instead, this standard, based upon its text, still ap-

124. *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007).

125. *Id.* Prior to *Tellabs*, the Second Circuit required that allegations of motive show "a concrete and personal benefit to the individual defendants resulting from the fraud." *Kalnit v. Eichler*, 264 F.3d 131, 139 (2d Cir. 2001). However, this requirement is also absent from the *ATSI* court's decision. *ATSI Commc'ns*, 493 F.3d at 99.

126. *E.g.*, *Condra v. PXRE Grp. Ltd.*, No. 09-1370-cv, 2009 U.S. App. LEXIS 27949, at *3-4 (2d Cir. Dec. 21, 2009); *State Univs Ret. Sys. v. Astrazeneca PLC*, No. 08-3185-cv, 2009 U.S. App. LEXIS 13674, at *2 (2d Cir. June 25, 2009); *Malin v. XL Capital, Ltd.*, No. 07-3749-cv, 2009 U.S. App. LEXIS 4984, at *4 (Mar. 5, 2009) (noting that *Tellabs* requires consideration of the collective allegations).

127. *E.g.*, *Condra*, 2009 U.S. App. LEXIS 27949, at *3-4; *W. Va. Inv. Mgmt. Bd. v. Doral Fin. Corp.*, No. 08-3867-cv, 2009 U.S. App. LEXIS 19954, at *3-4 (2d Cir. Sept. 3, 2009); *State Univs. Ret. Sys.*, 2009 U.S. App. LEXIS 13674, at *2-4.

128. This caveat would have acted as a "tiebreaker" of sorts between the conflicting aspects of the standard. Language stating that plaintiffs can plead scienter through individual allegations and instructing courts to consider the collective allegations in evaluating whether a plaintiff has pleaded scienter would suggest that individual or collective allegations can serve as the basis for pleading scienter. However, a prescription telling courts that the significance of individual motive allegations—and by implication, individual allegations of all types—in pleading scienter can only be discerned from reference to the complaint's collective allegations sends the message that such collective allegations are the only basis for pleading scienter, because the question of whether a plaintiff has pleaded scienter can only be answered by reference to such collective allegations, and not the individual allegations. See *Ascher & Tehrani*, *supra* note 4, at 2 (arguing that the *Tellabs* Court, through this caveat, implicitly rejected the motive and opportunity test).

pears to allow plaintiffs to plead scienter through such individual allegations. This directly conflicts with *Tellabs*.¹²⁹

Although neighboring circuits and practitioners may share a common perception that plaintiffs can plead scienter through individual allegations in the Second Circuit, circuit case law suggests that it has become legally-sanctioned reality. For example, the Third Circuit found that “allegations of motive and opportunity are not entitled to a special, independent status . . . [and] are to be considered along with all the other allegations in the complaint,”¹³⁰ and noted that “[t]he Second Circuit has continued to treat motive and opportunity allegations as a separate category, but it does not appear to have explicitly examined whether that practice is consistent with *Tellabs*.”¹³¹ Thomas O. Gorman, Chair of the SEC and Securities Litigation Group at Porter Wright Morris & Arthur,¹³² has noted that the *ATSI* court utilized the circuit’s prior motive and opportunity test to craft a pleading standard that is arguably inconsistent with *Tellabs*.¹³³ Similarly, attorneys with Morgan Lewis—which handles securities fraud defense cases¹³⁴—agree that the Second Circuit continues to use this test, which offers “an independent route to [pleading] scienter.”¹³⁵ Further, post-*ATSI* Second Circuit opinions suggest that plaintiffs are actually pleading scienter using only these individual allegations,¹³⁶

129. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322–23 (2007) (citing *Abrams v. Baker Hughes Inc.*, 292 F.3d 424, 431 (5th Cir. 2002)) (holding that the determination of whether a plaintiff has pleaded a strong inference of scienter depends on “whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard”); *see also* Ascher & Tehrani, *supra* note 4, at 2 (stating that because the motive and opportunity test allows for a finding of a strong inference of scienter based on only two types of facts, no matter what else is alleged, it is inconsistent with *Tellabs*).

130. *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 277 (3d Cir. 2009).

131. *Id.* at 277 n.51.

132. Thomas O. Gorman, *Tellabs and Pleading a Strong Inference of Scienter: Is a New Split Emerging Over Its Application In Private Securities Litigation?*, CELESQ ATTORNEYS ED CENTER, 1 (Apr. 1, 2009), <http://www.secactions.com/articles/tell/Article4.pdf>.

133. *Id.* at 26–27 (stating that the *ATSI* court held that scienter can be pleaded using the Second Circuit’s pre-*Tellabs* test and arguing that, to the extent the test allows plaintiffs to rely solely on allegations of motive and opportunity to plead scienter, it is inconsistent with *Tellabs*).

134. Brian Herman et. al., *2009 Year In Review: Selected Federal Securities Litigation Developments*, MORGAN LEWIS, 4 (Jan. 28, 2010), http://www.morganlewis.com/pubs/SecuritiesLF_2009SecLitDev_28jan10.pdf.

135. *Id.* at 2.

136. *See, e.g., In re CIT Grp. Inc. Sec. Litig.*, No. 08 Civ. 6613, 2010 U.S. Dist. LEXIS 57467, at *13–14 (S.D.N.Y. June 10, 2010) (declining to evaluate allegations of motive after finding allegations of recklessness sufficient to establish a strong inference of scienter); *Citiline Holdings, Inc. v. iStar Fin., Inc.*, No. 08 Civ. 3612 (RJS), 2010 U.S. Dist. LEXIS 29706, at *22 (S.D.N.Y. Mar. 26, 2010) (finding that the plaintiff had pleaded scienter based upon the plaintiff’s allegations of motive

which hinders any argument that the standard is merely ambiguous, rather than contrary to *Tellabs*. This points to one conclusion: the standard articulated in *ATSI* and currently in effect in the Second Circuit allows plaintiffs to plead scienter using individual allegations, in contravention of *Tellabs*.

B. The *ATSI* standard prevents full use of the *Tellabs* review process

Permitting plaintiffs to plead scienter through individual allegations, as the Second Circuit does,¹³⁷ encourages courts ruling on motions to dismiss to base their holdings on the presence or absence of such allegations and conduct abbreviated *Tellabs* analyses.¹³⁸ The circuit's position that the mere presence of such allegations is sufficient to plead scienter encourages courts, when these allegations are present, to summarily proclaim that a plaintiff has pleaded a strong inference of scienter without considering the collective allegations or comparing the competing inferences.¹³⁹ Further, courts in the Second

and opportunity and strong circumstantial evidence of misbehavior and recklessness without discussing the complaint's collective allegations); *Cornwell v. Credit Suisse Grp.*, 08 Civ. 3758 (VM), 2010 U.S. Dist. LEXIS 13927, at *16–22 (S.D.N.Y. Feb. 11, 2010) (after finding that that the plaintiff had not sufficiently alleged motive and opportunity, the court found that the plaintiff had pleaded scienter through allegations of recklessness without discussing the complaint's collective allegations); *Billhofer v. Flamel Techs. SA.*, no. 1:07-cv-09920 (CSH), 2009 U.S. Dist. LEXIS 97287, at *29–31, 36 (S.D.N.Y. Oct. 1, 2009) (failing to find scienter through allegations of motive and opportunity, and concluding, without discussing the complaint's collective allegations, that the plaintiff had pleaded scienter based upon allegations constituting strong circumstantial evidence of conscious misbehavior or recklessness); *Gildepath Holding B.V. v. Spherlon Corp.*, No. 04 Civ 9758 (KMK), 2007 U.S. Dist. LEXIS 54889, at *43 (S.D.N.Y. July 25, 2007) (stating there was no need to evaluate allegations of conscious misbehavior after finding allegations of motive and opportunity sufficient to establish a strong inference of scienter, although later analyzing allegations of conscious misbehavior).

137. *Supra* section IV.A.

138. Prior to *Tellabs*, the Second Circuit test allowed courts to “[focus] discretely on the presence or absence of . . . particular kinds of allegations” in evaluating whether scienter had been pleaded. *Raylesberg, Schwinger & Sidorsky, supra* note 95, at 5. Because this is also the Second Circuit's post-*Tellabs* standard, courts are still allowed to do this.

139. *See Ascher & Tehrani, supra* note 4 (stating that under the Second Circuit test, the requisite strong inference is shown so long as plaintiffs allege motive and opportunity or conscious misbehavior or recklessness, and arguing that this “motive and opportunity test” conflicts with the *Tellabs* dismissal review provisions because it “isolat[es] two categories of factual allegations to the exclusion of all others and thereby ignor[es] the plaintiff's inability to plead any other types of allegations” and thus does not holistically or comparatively consider all the facts and all the inferences from those facts); *see also Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 277 n.51 (3d Cir. 2009) (finding that, because the non-culpable inference is not always less compelling than the inference of scienter

Circuit may believe that plaintiffs can only plead scienter through these allegations and thus may conclude, without conducting a full analysis, that the innocent inference is more plausible and scienter is lacking when such allegations are deficient or absent. The court seemingly demonstrated this result in *Malin v. XL Capital Limited*,¹⁴⁰ in which the court affirmed a lower court's finding of a lack of scienter and its decision not to examine the complaint's entire allegations after it found the motive and recklessness allegations insufficient.¹⁴¹ In other recent Second Circuit cases, courts found and failed to find strong inferences of scienter after focusing only on the presence or absence of individual allegations.¹⁴² Thus, the divergence of the *ATSI* pleading standard from the *Tellabs* pleading provisions has encouraged Second Circuit courts to forego most of the Supreme Court's dismissal review process.

Short-circuited analyses also create the potential for a finding that scienter has been pleaded in situations where the plaintiff's inference is not actually as cogent or compelling as the non-culpable inference, which is a result that conflicts with *Tellabs*. The Second Circuit has been willing to use weak assertions to find that motive and opportunity, which "are not particularly probative of [fraudulent] intent,"¹⁴³ have been sufficiently alleged.¹⁴⁴ This willingness increases the like-

suggested by allegations of motive and opportunity, such allegations, contrary to the Second Circuit's position, are not an independent route to establishing scienter); *Securities Litigation Update*, *supra* note 95, at 3 (stating that in order to comply with *Tellabs*, the Second Circuit will have to abandon its pre-*Tellabs* "strong inference" approach, under which motive and opportunity allegations were analyzed separately and alone could suffice to show scienter).

140. No. 07-3749-cv, 2009 U.S. App. LEXIS 4984 (2d Cir. Mar. 5, 2009).

141. *Id.* at 3-4.

142. Some courts have found a strong inference of scienter upon review of only the plaintiff's allegations of motive and opportunity or conscious misbehavior or recklessness. *In re CIT Grp. Inc. Sec. Litig.*, No. 08 Civ. 6613, 2010 U.S. Dist. LEXIS 57467, at *13-14 (S.D.N.Y. June 10, 2010); *The Pa. Ave. Funds v. Inyx, Inc.*, No. 08 Civ. 6857 (PKC), 2010 U.S. Dist. LEXIS 19177, at *34-38 (S.D.N.Y. Mar. 1, 2010); *Varghese v. China Shenghuo Pharm. Holdings, Inc.*, 672 F. Supp. 2d 596, 607-10 (S.D.N.Y. 2009); *In Re Tommy Hilfiger, Sec. Litig.*, 04-cv-7678, 2007 U.S. Dist. LEXIS 55088, at *9-11 (S.D.N.Y. July 20, 2007). Other courts have found scienter lacking based only upon review of deficient forms of such allegations and the correspondingly insufficient inferences of fraudulent intent raised by these allegations. *Ashland, Inc. v. Morgan Stanley & Co., Inc.*, 700 F. Supp. 2d 453, 468-69 (S.D.N.Y. 2010) *aff'd*, 652 F.3d 333 (2d Cir. 2011) (conscious recklessness analysis only); *Trinity Bui. v. Indus. Enters. of Am., Inc.*, 594 F. Supp. 2d 364, 370 (S.D.N.Y. 2009); *Garber v. Legg Mason, Inc.*, 537 F. Supp. 2d 597, 615-17 (S.D.N.Y. 2008).

143. *Ascher & Tehrani*, *supra* note 4; *see also Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 655 (8th Cir. 2001) ("[H]aving the motive and opportunity to do wrong are certainly not the same as having the intent to do it.").

144. *See Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999) (citing *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996)) ("The Second Circuit has been lenient in allowing scienter issues to withstand summary judgment

lihood that a court may find that scienter has been pleaded, which it can do once it establishes the presence of such allegations, when in fact the opposing, unexamined inference is actually more cogent and compelling. Further, these factors, coupled with the strong presence in the Second Circuit of claims predicated upon such allegations,¹⁴⁵ make the advancement of less plausible inferences of scienter, which is counter to *Tellabs*,¹⁴⁶ an even stronger possibility.

C. *ATSI* conflicts with the Supreme Court's intent to create a heightened, uniform scienter pleading standard capable of reducing frivolous litigation

The *Tellabs* Court sought to formulate a heightened, uniform scienter pleading standard in order to facilitate the PSLRA's twin goals of reducing frivolous litigation and keeping courts open to meritorious suits.¹⁴⁷ Because Congress chose the PSLRA's heightened, uniform pleading standard as the mechanism to effectuate these goals,¹⁴⁸ the Court's desire to interpret the standard in a manner that would effectuate these goals¹⁴⁹ demonstrated its intent to formulate such a heightened, uniform standard to bring about these goals.¹⁵⁰ Presented with the task of resolving a circuit split over whether competing inferences should be considered in evaluating the pleading of scienter,¹⁵¹ the Court sought to create this standard through the pro-

based on fairly tenuous inferences."); *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 270–71 (2d Cir. 1993).

145. Since the *ATSI* decision, 147 securities fraud claims arising from Section 10(b) and Rule 10b-5 have been filed in the Second Circuit. Because the standard allows motive and opportunity or conscious misbehavior or recklessness allegations, it can be presumed that most if not all of these complaints contain allegations of these mental states. Cornerstone Research and Stanford Law School provided this data concerning the number of case filings to the author. The author would like to thank both parties for their generous contribution. The views expressed in this paper are the views of the author and do not represent in any way the views of Cornerstone Research or Stanford Law School.

146. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007).

147. *Id.* at 322.

148. *Supra* text accompanying note 36.

149. *Tellabs*, 551 U.S. at 322.

150. The Court acknowledged that Congress sought to create "a uniform pleading standard for §10(b) actions" in enacting the PSLRA and that it designed the bill's "heightened pleading requirements" to reduce frivolous litigation. *Id.* at 320–21. Thus, the later expression of the Court's desire to interpret the "strong inference" requirement in a manner that would effectuate the litigation changes sought through the enactment of the PSLRA, *id.* at 322, indicates the Court's intent to provide a uniform, heightened interpretation of the scienter pleading standard to accomplish these changes.

151. *Id.* at 317–18.

mulgation of consistent, strong review provisions¹⁵² and corresponding pleading requirements.¹⁵³

Through its review and pleading prescriptions, the Supreme Court advanced its goal of a heightened, uniform scienter pleading standard capable of reducing frivolous litigation and allowing the advancement of meritorious claims. By mandating the consideration of all allegations, examination and comparison of the competing mental inferences and a finding that the scienter inference is at least as compelling as the opposing inference, the Court promulgated a consistent, strong review process, as these conditions require courts to both conduct more thorough analyses and demand stronger showings of plausibility at the dismissal stage than they previously had.¹⁵⁴ By

152. The Court stated its aim to interpret the “strong inference” standard to effectuate the goals of the PSLRA in its discussion of the circuit split over the proper dismissal review process, *id.* at 322, which it had expressed a desire to resolve, *id.* at 317–18. This indicates the Court’s decision to further this goal of a uniform, heightened pleading standard by promulgating strong, consistent review process prescriptions. See also John M. Wunderlich, Note, *Tellabs v. Makor Issues & Rights, Ltd.: The Weighing Game*, 39 *LOY. U. CHI. L.J.* 613, 637 (2008) (stating that the *Tellabs* Court laid out its review process provisions while keeping in mind Congress’s desire to create a uniform standard to reduce frivolous litigation).

153. The Supreme Court instructed courts to only allow a complaint to survive dismissal if its inference of scienter is at least as compelling as the opposing inference, and thus strong and not simply reasonable. *Tellabs*, 551 U.S. at 323–24. The Court’s later incorporation of this heightened “equally plausible” condition into its pleading requirements, *id.* at 328, coupled with its overriding desire to provide a raised standard, *supra* text accompanying note 148, indicates that the former was done to effectuate the latter. See also James B. Fipp, Note, *Securities Law—How Strong is Strong Enough?: The Tellabs Court Lacked the Needed Strength for Pleading Scienter in Securities Fraud*; *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 *S. Ct.* 2499 (2007), 8 *WYO. L. REV.* 629, 641–42 (2008) (stating that the *Tellabs* Court considered the Seventh Circuit standard and the greater strength that Congress sought in the “strong inference” requirement against Congress’s desire to achieve a heightened pleading standard before finding that plaintiffs were required to plead a cogent inference of scienter).

154. The Second and Third Circuits allowed courts to find scienter based on individual allegations of motive and opportunity and did not require consideration of a complaint’s collective allegations. See *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529 (2d Cir. 1999); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534–35 (3d Cir. 1999). Additionally, the pre-*Tellabs* Seventh Circuit review process did not require consideration or comparison of the competing inferences. *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 602 (7th Cir. 2006). *Tellabs* therefore obligates these circuits to conduct a more rigorous analytical process. The Seventh and Tenth Circuits did not require that the inference of scienter be as compelling as the non-culpable inference. See *Makor Issues & Rights, Ltd.*, 437 F.3d at 602 (allowing a finding that scienter had been pleaded if “a reasonable person could infer that the defendant acted with the required intent”); *Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1188 (10th Cir. 2003) (“If a plaintiff pleads facts with particularity that, in the overall context of the pleadings . . . give rise to a strong inference of scienter, the scienter requirement . . . is satisfied.”). Thus, *Tellabs* imposes stronger requirements than these circuits had previously employed. See

also imposing the substance of these review conditions on plaintiffs,¹⁵⁵ the Supreme Court brought stringency to the pleading criteria for these types of claims, as plaintiffs seeking to plead scienter must match an opposing inference¹⁵⁶ that may be stronger than their inference of the defendant's fraudulent intent.¹⁵⁷ They must do so using the complaint's entire allegations, which forces them to utilize a broader base of assertions to demonstrate scienter, which may be more difficult than relying on only a few allegations.¹⁵⁸ These rigorous review and pleading requirements pose a challenge to frivolous, but not meritorious, claims,¹⁵⁹ and are thus capable of prompting the

also Securities Litigation Update, supra note 95, at 3 (arguing that *Tellabs* encourages lower courts to “approach allegations of scienter . . . with a degree of close scrutiny that is virtually unparalleled at the pleading stage”).

155. *See supra* text accompanying note 116.

156. *Tellabs, Inc.*, 551 U.S. at 328.

157. *E.g.*, *Rosenberg v. Gould*, 554 F.3d 962, 966 (11th Cir. 2009) (comparing two inferences—(1) the defendant knew that backdated options had caused overstated earnings and (2) the defendant was unaware of the effect of such options—and finding the latter more compelling); *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 65–67 (1st Cir. 2008) (finding the inference that the defendants misrepresented school's budget less compelling than opposing, non-culpable inference); *Gompper v. VISX, Inc.*, 298 F.3d 893, 895–97 (9th Cir. 2002) (finding that plaintiffs' allegations of defendants frequent patent litigation equally, or perhaps more likely, indicate the defendants' non-fraudulent intent); *Ronconi v. Larkin*, 253 F.3d 423, 432–33 (9th Cir. 2001) (finding that defendants' statement that quarterly earnings were less than expected due to its consolidation with another entity only indicates that the consolidation had not occurred as rapidly as expected, not that the defendants had acted with scienter); *see also Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 277 (3d Cir. 2009) (“It cannot be said that, in every conceivable situation in which an individual makes a false or misleading statement and has a strong motive and opportunity to do so, the nonculpable explanations will necessarily not be more compelling than the culpable ones.”); Geoffrey P. Miller, *Pleading After Tellabs*, 2009 WIS. L. REV. 507, 524–25 (describing the competing inferences that specific types of allegations may give rise to).

158. *See Raylesberg, Schwinger & Sidorsky, supra* note 95, at 5 (noting the requirement that courts consider the collective allegations and intimating that plaintiffs, such as those in the Second Circuit, will face a greater challenge in pleading scienter based upon the complaint's collective allegations, rather than based upon individual allegations); *see also Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999) (arguing that to require more than bare allegations of motive and opportunity would, absent overwhelming evidence of fraud, make pleading scienter virtually impossible).

159. *See Client Alert: Supreme Court Raises Pleading Bar for Securities Fraud Lawsuits*, LEVENFELD PEARLSTEIN, LLC (July 2007), http://www.llegal.com/sec_data_point_062907/ (describing the “equally-compelling” requirement and stating that “facially meritorious claims will survive under this standard”); Interview with Patrick O. Hunnius, Partner, White & Case (Oct. 1, 2007), available at http://www.whitecase.com/talking_10012007/ (reciting *Tellabs*'s “equally-compelling” pleading requirement and noting that this ruling will “[deter] the filing of meritless actions”); John B. Missing, Jonathan R. Tuttle, Colby A. Smith & Ada Fernandez Johnson, *Raising the Bar: Supreme Court Clarifies Scienter Pleading*

litigation changes that Congress sought. Also, because the nation's highest court made them for lower court adoption, these promulgations advance the goal of uniformity in the review process and pleading requirements.

The Second Circuit's pleading requirements and dismissal review process directly conflict with the *Tellabs* Court's goal of a uniform, heightened scienter pleading standard capable of reducing frivolous claims. Instead of facing the challenge of pleading a strong inference of scienter from the complaint's collective allegations,¹⁶⁰ Second Circuit plaintiffs can plead scienter using only individual allegations of motive and opportunity,¹⁶¹ which can be discovered and pleaded with ease.¹⁶² In addition to allowing this type of pleading, the courts of the Second Circuit have adopted an abbreviated dismissal review process. They do not scrutinize the mere presence or absence of such allegations is dispositive to a court's scienter decision, the collective allegations, or competing inferences nor do they demand a showing of equal plausibility.¹⁶³ By allowing a plaintiff to satisfy the plaintiff's pleading obligations and avoid dismissal through the mere pleading of allegations of motive and opportunity, the Second Circuit imposes conditions that meritless claims can likely meet¹⁶⁴ in place of requirements that

Standard for Federal Securities Fraud Actions, DEBEVOISE & PLIMPTON LLP (June 26, 2007), <http://www.debevoise.com/files/Publication/99dc03e0-c4fb-4fd7-b9c5-0d2d662d54fc/Presentation/PublicationAttachment/f32b8490-7543-4173-bdc4-1c2d9e3bdac9/RaisingTheBarSupremeCourtClarifiesScienterPleadingStandards> ForFederalSecuri.pdf (stating that *Tellabs* should make it more difficult for plaintiffs to "pursue cases where the alleged fraudulent scheme is implausible" and "to bring cases whose allegations paint a picture of economically irrational conduct"); Miller, *supra* note 116, at 42 (stating that the *Tellabs* balancing test will allow meritorious claims to be brought); Raylesberg, *supra* note 95, at 5 (stating that *Tellabs* will prompt "even more rigorous and intensive scrutiny of the factual allegations in securities fraud complaints, with more such complaints being dismissed at an early pre-discovery stage as a result"); *Securities Litigation Update*, *supra* note 95, at 3 (arguing that the *Tellabs* comparative analysis "should prove of considerable assistance to defendants faced with claims of dubious merit"); see also Peter Lattman, *Tellabs: Securities Lawyers React*, WALL ST. J. L BLOG (June 21, 2007, 1:03 PM), <http://blogs.wsj.com/law/2007/06/21/tellabs-securities-lawyers-react/> (quoting Stan Bernstein, who submitted an amicus brief for the plaintiffs in *Tellabs*, as stating that the decision is a balance between preserving the ability to recover on meritorious suits and reducing frivolous litigation).

160. See *supra* text accompanying note 156.

161. *Supra* section IV.A.

162. See *supra* text accompanying notes 58–62.

163. *Supra* section IV.B.

164. Pleading allegations of motive and opportunity in the Second Circuit is not highly challenging in part because securities fraud defendants are frequently presented with the motive and opportunity to defraud and the circuit has previously employed a plaintiff-friendly interpretation that allows even weak allegations to suffice. *Supra* text accompanying note 56–60. Frivolous claims are likely able to capitalize upon this permissiveness and successfully plead such allegations, as

were capable of reducing such suits.¹⁶⁵ These measures are unique to the Second Circuit,¹⁶⁶ which reduces hope for uniformity in the review process and pleading requirements. Thus, it appears that current Second Circuit practices present no opportunity for the fulfillment of the Supreme Court's goal of a heightened, uniform scienter pleading standard capable of reducing frivolous litigation.

D. The *ATSI* decision ensured a circuit split and provided a guide for the renewal of the wide split over motive and opportunity allegations

After *ATSI*, the other circuits developed their respective post-*Tellabs* standards by adopting the Supreme Court's provisions and affirming their prior scienter definitions. In August 2007, the Fifth Circuit—in its first post-*Tellabs* decision¹⁶⁷—adopted *Tellabs*'s prescription that a strong inference of scienter must be at least as compelling as the opposing inference¹⁶⁸ and based upon the entire complaint.¹⁶⁹ The circuit also affirmed its pre-*Tellabs* holding that scienter constitutes “intent or severe recklessness.”¹⁷⁰ During 2008 and 2009, the Third, Fourth, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits adopted *Tellabs* and affirmed that plaintiffs can show scienter through a form of recklessness.¹⁷¹ With the Second Circuit also affirming that recklessness satisfies the scienter requirement,¹⁷² the circuits again agree on this issue.

commentators have noted that these weak attributes prevent the “motive and opportunity” test from deterring or eliminating such claims. See Briski, *supra* note 45, at 200 n.357; Gibney, *supra* note 59, at 1013.

165. *Supra* section IV.A.

166. See *infra* text accompanying notes 173–80.

167. *Cent. Laborers' Pension Fund v. Integrated Elec. Servs., Inc.*, 497 F.3d 546 (5th Cir. 2007).

168. *Id.* at 551.

169. *Id.* at 552.

170. *Id.* at 551 (quoting *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 408 (5th Cir. 2001)).

171. *E.g.*, *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 267–68 (3d Cir. 2009); *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 991 (9th Cir. 2009) (stating that plaintiffs must establish “a strong inference of deliberate recklessness”); *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1238–39 (11th Cir. 2008); *Frank v. Dana Corp.*, 547 F.3d 564, 570–71 (6th Cir. 2008); *Ley v. Visteon Corp.*, 543 F.3d 801, 809 (6th Cir. 2008); *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618, 623–24 (4th Cir. 2008); *Elam v. Neidorff*, 544 F.3d 921, 928 (8th Cir. 2008); *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702, 704–05 (7th Cir. 2008); *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 58–59 (1st Cir. 2008).

172. *E.g.*, *One Communs. Corp. v. JP Morgan SBIC LLC*, Nos. 09-1815-cv, 09-2324-cv, 2010 U.S. App. LEXIS 12386, at *4–5 (2d Cir. June 17, 2010); *Campo v. Sears Holding Corp.*, No. 09-3589-cv, 2010 U.S. App. LEXIS 7043, at *4 (2d Cir. Apr. 6, 2010); *W. Va. Inv. Mgmt. Bd. v. Doral Fin. Corp.*, No. 08-3867-cv, 2009 U.S. App. LEXIS 19954, at *4 (2d Cir. Sept. 3, 2009); *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007).

Despite their unanimity on one issue, the circuits have again diverged over the sufficiency of motive and opportunity allegations. In *Cornelia I. Crowell GST Trust v. Possis Med., Inc.*,¹⁷³ the Eighth Circuit retreated from its prior position to find that allegations of motive and opportunity are, without qualification, adequate to plead scienter.¹⁷⁴ The First, Fourth, Fifth, Seventh and Eleventh Circuits appeared to retreat from their pre-*Tellabs* positions that such allegations can be relevant¹⁷⁵ by failing to affirm both those positions and the *Tellabs* provision concerning the potential relevancy of motive allegations.¹⁷⁶ However, the Ninth Circuit retained its pre-*Tellabs* position that such allegations do not satisfy the scienter requirement,¹⁷⁷ while the Sixth and Third Circuits both found that these allegations may be relevant.¹⁷⁸ The Sixth Circuit came to this finding by retaining its pre-*Tellabs* position,¹⁷⁹ and the Third Circuit did so by incorporating *Tellabs*.¹⁸⁰ The result is that all the circuits other than the Eighth Circuit disagree with the Second Circuit's position on the sufficiency of motive and opportunity allegations,¹⁸¹ with the majority of the circuits opposed to an even greater degree than they were prior to *Tellabs*.¹⁸²

173. 519 F.3d 778 (8th Cir. 2008).

174. *Id.* at 782. Prior to *Tellabs*, the Eighth Circuit found that motive and opportunity allegations could establish a strong inference of scienter, but also found that certain types of motives would be insufficient to do so. See, e.g., *In re K-tel Intern., Inc. Sec. Litig.*, 300 F.3d 881, 894 (8th Cir. 2002). However, the court in *Cornelia* stated that such allegations are, without qualification, sufficient to plead scienter. 519 F.3d at 782.

175. For a description of these positions, see *supra* text accompanying notes 73–74.

176. E.g., *Mizzaro*, 554 F.3d at 1238–39; *Cozzarelli*, 549 F.3d at 623–24; *Makor Issues*, 513 F.3d at 705; *ACA Fin.*, 512 F.3d at 58–59; *Cent. Laborers' Pension Fund v. Integrated Elec. Servs., Inc.*, 497 F.3d 546, 551–52 (5th Cir. 2007).

177. E.g., *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 991 (9th Cir. 2009).

178. *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 277 (3d Cir. 2009); *Ley v. Visteon Corp.*, 543 F.3d 801, 813 (6th Cir. 2008) (citing *In re Comshare Inc. Sec. Litig.*, 183 F.3d 542, 550 (6th Cir. 1999)). Unlike the Sixth Circuit, the Third Circuit does not find that allegations showing only motive and opportunity are insufficient to plead scienter, but suggests that such allegations may be relevant. Compare *Institutional Investors Grp.*, 564 F.3d at 277, with *Ley*, 543 F.3d at 813. Thus, while both circuits potentially allow the use of such allegations, their respective positions on the adequacy of such allegations differ.

179. *Ley*, 543 F.3d at 813.

180. *Institutional Investors Grp.*, 564 F.3d at 277.

181. *Compare ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007) (stating that motive and opportunity allegations satisfy the “strong inference” requirement), with *supra* text accompanying notes 171–178.

182. Prior to *Tellabs*, eight of the eleven circuits held the position that motive and opportunity allegations could be relevant to pleading a strong inference of scienter. *Supra* text accompanying notes 73–74. The Second Circuit found that such allegations were, without qualification, sufficient to plead scienter. E.g., *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 537–38 (2d Cir. 1999). Viewing the circuits' respective positions on this issue as a continuum, there was a definite dif-

As the first circuit to promulgate its post-*Tellabs* pleading requirements, the Second Circuit could have, at a minimum, avoided contributing to the circuit split. The circuit would have had no culpability in the split if it had simply incorporated the *Tellabs* Court's caveat concerning motive allegations, as under these circumstances the eight remaining circuits that adopted positions contrary to the Second Circuit's¹⁸³ would have been solely responsible for the split. This would have represented a positive step toward resolving the dispute over these allegations, as the primary court on one extreme of the debate would have adopted a moderate position¹⁸⁴ and placed pressure on the Ninth Circuit, the circuit occupying the other extreme,¹⁸⁵ to issue a similar holding. Such a decision could also have prompted the Eighth Circuit to avoid adopting the motive and opportunity test,¹⁸⁶ and would have provided a model standard that, if imitated, would have facilitated consistent pleading standards across the circuits.¹⁸⁷

ference in opinion between these "maybe-motive" circuits and the extreme of the "yes-motive" Second Circuit. However, five of these circuits joined the Ninth Circuit in adopting the "no-motive" stance after *Tellabs*, *supra* text accompanying notes 173–75, and the Second Circuit retained its "yes-motive" stance, *see, e.g., ATSI Commc'ns, Inc.*, 493 F.3d at 99, resulting in a greater divergence in opinion between the majority of the circuits and the Second Circuit than had been the case prior to *Tellabs*.

183. See *supra* notes 173–77 for a discussion of these positions. The Sixth Circuit is among these eight circuits because, although it finds that allegations of motive and opportunity may be relevant to pleading scienter, it only considers such allegations sufficient if "those facts . . . simultaneously establish that the defendant acted recklessly or knowingly." *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 551 (6th Cir. 1999). *Tellabs* holds that such allegations may be relevant to pleading scienter and does not require the showing of a specific type of mind for that conclusion to be reached. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 325 (2007).
184. For a discussion of the circuits' respective pre-*Tellabs* positions on the adequacy of motive and opportunity allegations, see *supra* section II.B.
185. *Supra* section II.B.
186. While the Eighth Circuit gave no indication that the Second Circuit influenced its finding that individual allegations of motive and opportunity are sufficient to plead scienter, *Cornelia I. Crowell GST Trust v. Possis Med., Inc.*, 519 F.3d 778, 782 (8th Cir. 2008), it had previously followed the Second Circuit's findings concerning the sufficiency of such allegations. *In re K-tel Int'l, Inc. Sec. Litig.*, 300 F.3d 881, 894 (8th Cir. 2002). Thus, it is possible that the Eighth Circuit considered the Second Circuit's position on these allegations.
187. The Eighth and Third Circuits considered the Second Circuit's stance on the adequacy of motive and opportunity allegations when formulating their own positions on the issue. *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242 (3d Cir. 2009); *In re K-tel Int'l*, 300 F.3d 881. Notably, this was not done in the context of attempting to discern Congress's intent in enacting the PSLRA. *Institutional Investors Grp.*, 564 F.3d at 277; *In re K-tel Int'l*, 300 F.3d at 894. The willingness of these circuits to refer to the Second Circuit's position when formulating their own opinions indicates that the Second Circuit's stance carried weight with these circuits and could have conceivably been imitated by these and other circuits.

Instead, the *ATSI* court promulgated a standard that ensured a circuit split, regardless of the subsequent pleading standards created by the other circuits, and provided a guide for the renewal of the significant pre-*Tellabs* split. The court's finding that motive and opportunity allegations are, without qualification, sufficient guaranteed a division with another circuit, like the Sixth, that also affirmed its prior case law,¹⁸⁸ as the Second Circuit's pre-*Tellabs* position differed from the stances of nearly every circuit.¹⁸⁹ The court's failure to include the *Tellabs* prescription to consider these allegations within the collective allegations ensured a split with a circuit, like the Third, that adopted this caveat,¹⁹⁰ and as seen, *ATSI* conflicts with the standards that actually emerged.¹⁹¹ Further, other circuits should not have adopted the *ATSI* standard simply because it was the first post-*Tellabs* standard, as the *ATSI* court's failure to explain its affirmation of its motive and opportunity test¹⁹² offered no basis upon which other circuits could have justified their adoption of a position contrary to their own pre-*Tellabs* stances.¹⁹³ *ATSI* also provided a guide for the renewal of the significant pre-*Tellabs* split, as the court's failure to adopt the *Tellabs* caveat and its affirmation of the Second Circuit's prior position on these allegations demonstrated how to craft a standard from these tenets. The Ninth Circuit followed this script in forming its post-*Tellabs* scienter pleading standard from its pre-*Tellabs* finding that motive and opportunity allegations are inadequate,¹⁹⁴

188. After *Tellabs*, the Sixth Circuit affirmed its prior holding that allegations showing only motive and opportunity are insufficient to plead a strong inference of scienter, but those that give rise to a strong inference of reckless behavior are adequate to satisfy this requirement. *Ley v. Visteon Corp.*, 543 F.3d 801, 809 (6th Cir. 2008) (citing *In re Comshare*, 183 F.3d at 550). Because the Second Circuit has retained its pre-*Tellabs* position that such allegations are, without qualification, sufficient to plead scienter, *see, e.g.*, *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007), a split exists between the circuits.

189. *Supra* section II.B.

190. *See SHEPPARD MULLIN RICHTER & HAMPTON LLP, supra* note 117 (stating that the Third Circuit, in holding in accordance with *Tellabs* that motive and opportunity allegations can contribute to pleading scienter, split with the Second Circuit, which continues to find that such allegations are sufficient to do so).

191. *Supra* text accompanying note 179.

192. *ATSI Commc'ns*, 493 F.3d at 99.

193. For a description of the circuits' respective pre-*Tellabs* positions, *see supra* section II.B.

194. *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 991 (9th Cir. 2009). Although the *Zucco* court affirmed its pre-*Tellabs* scienter pleading standard, it also interpreted *Tellabs* in a manner that produced a dual-inquiry test in which plaintiffs may plead scienter from either individual allegations or the complaint's collective allegations. *Id.* at 991–92. Thus, the court essentially crafted a new standard, although this Note focuses instead on the court's retention of the Ninth Circuit's prior position on the adequacy of motive and opportunity allegations.

and in the process renewed its wide split with the Second Circuit.¹⁹⁵ While the Ninth Circuit did not mention *ATSI* when it crafted its standard,¹⁹⁶ parallels exist between the standards of both circuits,¹⁹⁷ and the Second Circuit's role in creating this split is apparent in the circuit's affirmation of a standard that the vast majority of circuits did not employ.

E. The Supreme Court should fortify the *Tellabs* standard

The Supreme Court must rectify the Second Circuit's contrary pleading position and the divergent circuit opinions. It can do so by integrating a categorical approach into the *Tellabs* review process. The Court should create three categories of plausibility—unlikely, moderately likely, and likely—that can be applied to the competing illicit and innocent inferences of a defendant's mental state depending upon the strengths of these inferences.¹⁹⁸ Under this approach, courts must first consider all the allegations, assess either inference, assign it a level of plausibility, and repeat the analysis for the other inference before determining if the inference of scienter is at least as compelling as the opposing inference and if the complaint may survive.¹⁹⁹ Further, the Court should specify that plaintiffs can establish scienter by allegations of motive, opportunity, conscious misbehavior, recklessness and intent that plaintiffs plead from the complaint's collective allegations and establish an inference as compelling as the opposing inference.²⁰⁰

Adoption of this categorical approach will ensure that courts fully apply the *Tellabs* review process. This approach removes the “magic

195. Gorman, *supra* note 131, at 28–29 (“[T]here appears to be a split . . . between at least the Second and Ninth [Circuits] over . . . what constitutes a Section 21D(b)(2) strong inference of scienter.”).

196. *Zucco*, 552 F.3d at 991–92.

197. Thomas O. Gorman, *What Did the Supreme Court Resolve In Tellabs?*, SEC ACTIONS, <http://www.secactions.com/?p=766> (last visited Mar. 12, 2012) (noting that both the Second and Ninth Circuits still apply their pre-*Tellabs* case law concerning the sufficiency of motive and opportunity allegations).

198. Many of the inferences that arise from commonly-utilized allegations are already unofficially classified. For instance, motive and opportunity allegations are generally regarded as not highly probative of intent and recklessness is considered a higher form of intent than motive. *Supra* text accompanying note 60.

199. The *Tellabs* Court found that “[t]he strength of an inference [of scienter] cannot be decided in a vacuum.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 323 (2007). Because the proposed review process considers multiple factors, it appears consistent with the Court's directive to avoid an isolated review of scienter.

200. This finding would avoid the pre-*Tellabs* confusion over the types of allegations sufficient to plead scienter. *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87 (2d Cir. 2007).

bullet” status from motive and opportunity allegations²⁰¹ and emphasizes the categorization of the competing inferences, which indicates that this process, not these allegations, is the key to discerning whether plaintiffs have pleaded scienter.²⁰² Under this test, courts will no longer rely solely on these allegations and fail to conduct the appropriate review process, but will focus on this categorization step,²⁰³ which requires courts to consider the collective allegations, the competing inferences, and the strength of the inference of scienter. This categorization displays the strength of each inference²⁰⁴ and thus completes the *Tellabs* comparative analysis, and prevents the survival of a less-compelling inference of scienter, as could occur under the current Second Circuit review process.²⁰⁵

If adopted, this approach will effectuate the heightened, uniform scienter pleading standard that the Supreme Court intended, resolve the current circuit split, and forestall future conflicts. The *Tellabs* pleading provisions, which correspond with the case’s review conditions,²⁰⁶ comprise the other half of the Supreme Court’s intended pleading standard.²⁰⁷ The Court’s announcement that plaintiffs must comply with these provisions,²⁰⁸ coupled with lower court application

201. See Ascher & Tehrani, *supra* note 4, at 2 (describing motive as “dispositive” to the Second Circuit test).

202. This focus on classification over individual allegations is consistent with the process and result that the *Tellabs* Court stated is central to any scienter inference inquiry. The Court stated that this inquiry does not turn on individual allegations, but instead the opposing inferences must be considered and only an inference of scienter that is at least as compelling as the opposing inference can be considered “strong.” *Tellabs, Inc.*, 551 U.S. at 322–24. Classification of the strengths of the opposing inferences appears key to a process that requires consideration of these inferences and an ultimate conclusion as to the relative strengths of each.

203. One commentator has argued that the standard may be ambiguous for reasons not addressed in this Note. See Geoffrey P. Miller, *Pleading After Tellabs* 6–8 (NY Univers. Law & Economics, Working Paper No. 127, 2008), available at http://lsr.nellco.org/cgi/viewcontent.cgi?article=1131&context=nyu_lewp (analyzing whether *Tellabs* requires one or two tests for its “cogency and at least as equally compelling” provisions and detailing Judge Posner’s use of a two-tiered test). The implementation of a formulaic, categorical approach is unlikely to resolve the ambiguity identified by this commentator, however it may help to clarify other ambiguity regarding the standard.

204. *Supra* note 197.

205. *Supra* section II.B.

206. See *Tellabs*, 551 U.S. at 328.

207. *Supra* text accompanying notes 150–51.

208. Justice Ruth Bader Ginsburg, writing for the Supreme Court in *Tellabs*, announced that the principles of the review dismissal process promulgated by the Court also applied to plaintiffs attempting to plead scienter. See *Tellabs*, 551 U.S. at 328. Despite the recent failure of the Second Circuit to properly follow these tenets, the circuits previously uniformly followed one of the Court’s prescriptions, which suggests that future compliance, rather than divergence, may be likely. See *supra* text accompanying note 50 (explaining that all circuits

of the modified *Tellabs* review process and dismissal of non-compliant complaints,²⁰⁹ will compel plaintiffs to cooperate with these prescriptions. Further, the Court's specification of potentially-relevant types of allegations will resolve the current, and prevent a future, circuit dispute over motive and opportunity allegations by providing needed pleading guidance.²¹⁰ It will also further demonstrate that plaintiffs cannot plead scienter using individual allegations. Given these likely benefits, and the untenable status quo, the Supreme Court should grant certiorari and promulgate such a categorical approach at the next opportunity.

V. CONCLUSION

Now imagine the securities litigation defense attorney reviewing the shareholders' class action securities fraud lawsuit against his client, which the shareholders' filed in the Second Circuit. The plaintiffs have relied solely on the CFO's incentive compensation to plead scienter, alleging that the potential for such an award gave him the motive to defraud and his company position gave him the opportunity to defraud. Such an allegation might have failed to withstand the stringent Third Circuit pleading requirements and dismissal review

adopted the Court's finding in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), that scienter constitutes "the intent to deceive, manipulate or defraud").

209. Plaintiffs will likely be unable to avoid a court's dismissal review process, as the filing of a motion to dismiss is common. See Rossi, *supra* note 11, at 265 ("[A] critical defense strategy in all securities litigation is to dispose of the case on the pleadings."); Brent Wilson, Comment, *Pleading Versus Proving Scienter Under the Private Securities Litigation Reform Act of 1995 In the Ninth Circuit After In Re Silicon Graphics and Howard v. Everex: Meet the Pleading Standards and the Fat Lady Has Already Sung*, 38 WILLIAMETTE L. REV. 321, 334 (2002) ("A motion to dismiss . . . is typically a defendant's first line of defense.").
210. An absence of clear guidance from authoritative bodies and rules contributed to the circuit splits that occurred before and after the passage of the PSLRA. See Briski, *supra* note 45, at 162-64 (describing the split between the Second and Ninth Circuits that resulted from each adopting separate sentences of *Federal Rule of Civil Procedure* 9(b), depending upon which sentence each found most persuasive); see *supra* text accompanying notes 46-49 for a description of the Congressional ambiguity that led to the post-PSLRA split. However, the post-*Tellabs* circuit split over motive allegations did occur after the Court clearly stated its position regarding the adequacy of such allegations. *Tellabs*, 551 U.S. at 325 ("[M]otive can be a relevant consideration [in establishing a strong inference of scienter]"). See *supra* section IV.D. for a description of the circuit split. Despite this, a clear holding by the Court that the most commonly-pleaded types of allegations are all only potentially relevant to pleading scienter would likely prevent misinterpretation or retreat by the circuits to their respective prior positions, as occurred after *Tellabs*, and therefore would resolve the circuit split. *Supra* section IV.D. (detailing the post-*Tellabs* position of each circuit). And because two of these prior splits have occurred amidst confusion over a given issue, a clear Supreme Court holding on the adequacy of these types of allegations would not be conducive to a future split.

process, but it will likely be regarded as sufficient to show a strong inference of scienter in the Second Circuit. While the allegation must itself demonstrate motive and opportunity, the ease with which plaintiffs plead such behavior in the Second Circuit²¹¹ leaves little doubt that this allegation will suffice. Because such an individual allegation is sufficient to navigate the circuit's weak, non-uniform pleading standard, the CFO will likely settle rather than defend the case.²¹² As the attorney picks up the phone to offer that advice, he hopes that the Supreme Court will intervene to prevent circuits like the Second from creating their own pleading universes through weak, non-uniform pleading requirements that both allow meritless claims to advance and force unfortunate defendants to settle these claims. His client and others in similar positions deserve nothing less.

Joe Ehrlich

211. *Supra* text accompanying notes 58–62.

212. See Kassis, *supra* note 11, at 124 n.34; Rossi, *supra* note 11, at 265; Shannon Rose Selden, *(Self-)Policing the Market: Congress's Flawed Approach to Securities Law Reform*, 33 J. LEGIS. 57, 75 n.96 (2006) (statement of SEC Chairman Arthur Levitt, noting “that if the defendant does not prevail on an early motion to dismiss, ‘the economics of litigation may dictate the settlement even if the defendant . . . would prevail at trial’”).