The Battle Between Plain Meaning and Legislative History: Which Will Decide the Standard for Pleading Scienter After the Private Securities Litigation Reform Act of 1995?

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THE BATTLE BETWEEN PLAIN MEANING AND LEGISLATIVE HISTORY: WHICH WILL DECIDE THE STANDARD FOR PLEADING SCIENTER AFTER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995?

I. INTRODUCTION

The Private Securities Litigation Reform Act of 1995 (PSLRA)\(^1\) has created much controversy in its attempt to reform the litigation system for securities fraud actions.\(^2\) After a five year effort, Congress enacted the PSLRA over a presidential veto,\(^3\) drawing praise from many business executives.\(^4\) Congress based its passage of the PSLRA on the presumption that "[t]he overriding purpose of our Nation's securities is to protect investors and to maintain confidence in the securities markets, so that our national savings, capital formation and investment may grow for the benefit of all Americans."\(^5\) Congress recognized that private lawsuits for securities fraud promote public and global confidence in our capital markets and deter wrongdoing.\(^6\) However, Congress felt the need to implement procedural protections in order to discourage frivolous lawsuits,\(^7\) and "to protect investors, issuers, and all who are associated with our capital markets from abusive securities litigation."\(^8\)

The purpose of the PSLRA is to: (1) curb abusive practices in the conduct of securities class action suits; (2) put greater control over class action suits in the hands of large shareholders who are not "professional" plaintiffs; (3) require

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4. See id.
6. See id.
7. See id.
8. Id. at 32.
more detailed information about settlements to be disclosed to shareholders; (4) deter plaintiffs from bringing frivolous lawsuits by imposing sanctions in appropriate cases; (5) give courts discretion to grant early dismissal of suits; (6) provide a statutory safe harbor for forward looking statements; and (7) provide a cap on damages by limiting joint and several liability. As a result of the abuses, many "innocent parties [were] often forced to pay exorbitant 'settlements.'" Even defendants who were able to dismiss meritless suits often did so only after expending much time and expense. Compounding these injuries was the reluctance of many judges to impose sanctions for frivolous suits. Additionally, Congress was concerned for the investing public and the entire U.S. economy, which is injured by the unwillingness of qualified individuals to serve on boards of directors and issuers from discussing future prospects publicly for fear of baseless lawsuits. To end these problems and abuses, the PSLRA made many reforms, including the heightening of pleading requirements for securities fraud actions, which is the focus of this comment.

Although the PSLRA intended to strengthen the pleading standard, much controversy has arisen as to its correct interpretation. Many courts interpret the PSLRA as merely codifying the Second Circuit's standard, which held that pleading recklessness or "motive and opportunity" is sufficient for pleading scienter. However, other courts interpret

12. See id.
13. See id.
the PSLRA to be more stringent than the Second Circuit’s approach. The PSLRA’s text does not explicitly say whether it codifies the Second Circuit’s standard or whether it imposes a stricter standard. This uncertainty as to the true meaning of the legislation has led to various contradictory interpretations of the scienter standard.

This comment examines the various interpretations of the PSLRA’s pleading standard for scienter. It begins by tracing a brief history of what standards preceded the PSLRA, followed by the existing interpretations of the PSLRA. The comment then analyzes the varying interpretations based on the PSLRA’s plain meaning and its legislative history. Finally, this comment determines that Congress indeed intended a more stringent standard than that of the Second Circuit. Much controversy exists as to whether legislative history should be used in addition to plain meaning when interpreting statutes generally. Thus, in order to reconcile the contradictory views regarding this debate, this comment suggests that the courts adopt a more uniform approach that follows from both the PSLRA’s plain meaning and legislative history, in order to accomplish Congress’ true intent.


20. See infra Part II.D.
21. See infra Part IV.
22. See infra Part II.A.
23. See infra Part II.D.
24. See infra Part IV.A.
25. See infra Part IV.B.
27. See infra Part IV.B.3.
28. See infra Part IV.B.
29. See infra Part IV.B.1.
II. BACKGROUND

A. History of the PSLRA

Securities fraud actions are brought under Section 10(b)\(^3\) and Rule 10b-5\(^1\) of the Securities and Exchange Act of 1934. The general standard for 10(b) and Rule 10b-5 fraud actions is “knowing or intentional misconduct.”\(^2\) Section 10(b) prohibits the “use or employ[ment], in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe.”\(^3\) The elements of a Section 10(b) claim are: “(1) a false statement or an omission that rendered another statement misleading; (2) materiality; (3) scienter; (4) loss causation; and (5) damages.”\(^4\) Rule 10b-5 makes it illegal “[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading... in connection with the purchase or sale of any security.”\(^5\) Allegations of fraud under Rule 10b-5 must satisfy the requirement of Federal Rule of Civil Procedure 9(b)\(^6\) to survive a motion to dismiss.\(^7\) Rule 9(b) requires that “the circumstances constituting fraud be stated with particularity.”\(^8\) This comment focuses on the scienter requirement for actions under these rules.

The purpose of the PSLRA was to protect investors from abusive securities litigation.\(^9\) Although Rule 9(b) of the Federal Rules of Civil Procedure requires a heightened pleading standard for fraud actions by pleading allegations of fraud with “particularity,” it “has not prevented abuse of the secu-

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31. 17 C.F.R. § 240.10b-5(b) (1994).
35. Voit, 977 F. Supp. at 367 (citing 17 C.F.R. § 240.10b-5(b)).
36. FED. R. CIV. PROC. 9(b).
38. FED. R. CIV. PROC. 9(b).
rities laws by private litigants." Moreover, courts have interpreted Rule 9(b)'s requirement in conflicting ways, leading to different standards among the circuits when deciding a motion to dismiss. Because of these differing standards, the PSLRA was adopted to create more uniformity among courts.

The new pleading standard created by the PSLRA under Subsection (b)(1) restates the rule under Rule 9(b), while Subsection (b)(2) requires that the plaintiff "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." However, the PSLRA does not expressly state what the required state of mind is for scienter.

Additionally, the PSLRA's legislative history has been very controversial, and is where Congress has made specific statements regarding its intent. For example, during Congress' debate over the PSLRA, Senator Arlen Specter proposed an amendment that would have codified the Second Circuit's standard. However, the Conference Committee's Statement of Managers stated that Congress intended a stricter rule than that of the Second Circuit. Thus, the

40. Id.
41. See id.
42. See Martha L. Cochran, Overview and Summary of the Private Securities Litigation Reform Act, 923 PLI/CORP 9, 11 (1996).
45. See id.
46. See John C. Coffee, Jr., The Future of the Private Securities Litigation Reform Act: Or, Why the Fat Lady Has Not Sung, 51 BUS. LAW. 975, 975 (1996).
47. See Olson, supra note 11, at 1117. Senator Specter proposed the following additional words:

For the purposes of paragraph (1), a strong inference that the defendant acted with the required state of mind may be established either—(A) by alleging facts to show that the defendant had both motive and opportunity to commit fraud; or (B) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness by the defendant.

48. See Coffee, supra note 46, at 979. The Statement of Managers stated in their report:

[r]egarded as the most stringent pleading standard, the Second Circuit requirement is that the plaintiff state facts with particularity, and that
amendment was deleted from the final Conference Committee Report. However, though Congress may have desired a more stringent rule, it did not indicate how stringent it should be.

When Senator Alfonse D'Amato submitted the Conference Committee Report to the Senate, he stated that the PSLRA created a uniform standard and that this standard is already incorporated in the law. Thus, he presented it as essentially codifying the Second Circuit's standard. Senator Paul Sarbanes contended that the Conference Report made the pleading standard more rigorous than what currently existed. Senator Christopher Dodd believed that the language of the PSLRA endorsed the Second Circuit's standard, but that it allowed individual courts to have discretion on a case by case basis. However, in his veto message, President Clinton emphasized that he found that the PSLRA was unacceptable because it called for a stricter standard than the Second Circuit's approach. The President expressed concern that the bill would "have the effect of closing the courthouse door on investors who have legitimate claims. Those who are the victims of fraud should have recourse in our courts. Unfortunately, changes made in this bill during conference could well prevent that." These differing interpretations of the PSLRA illustrate its inherent ambiguity.

To further complicate matters, new legislative history was introduced on this subject with the passage of the Secu-

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49. See Coffee, supra note 46, at 979-80. A footnote to the Committee Report explained the deletion of the Specter Amendment: "For this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness." H.R. CONF. REP. No. 104-369, at 48 n.23 (1995).

50. See Coffee, supra note 46, at 980.

51. See id.

52. See id.

53. See Olson, supra note 11, at 1119.

54. See Coffee, supra note 46, at 980. Thus, he appears to be saying that courts could find allegations of motive and opportunity to be sufficient in some cases, but not necessarily in all cases. Id.

55. See id. at 982.

56. Olson, supra note 11, at 1118.
rities Litigation Uniform Standards Act of 1998. On May 4, 1998, the Senate Committee on Banking, Housing, and Urban Affairs stated,

[N]either the PSLRA nor S. 1260 in any way alters the scienter standard in federal securities fraud suits. It was the intent of Congress, as was expressly stated during the legislative debate on the PSLRA, and particularly during the debate on overriding the President’s veto, that the PSLRA establish a uniform federal standard on pleading requirements by adopting the pleading standard applied by the Second Circuit Court of Appeals . . . . The Committee emphasizes that neither the PSLRA nor S.1260 makes any attempt to define that state of mind.

On October 9, 1998, the Statement of Managers stated that “Congress did not, in adopting the Reform Act, intend to alter the standards of liability under the Exchange Act.” The statement made by President Clinton on November 3, 1998, indicated that he signed the new bill only because he believed that it made the Second Circuit standard the uniform standard for pleading securities fraud. These new statements, though not technically part of the PSLRA’s legislative history, will continue to cause debate about this issue for sometime.

Much of the debate regarding the PSLRA is over the use of this conflicting legislative history. Currently the Supreme Court has its own disagreements over the use of legislative history, with Justice Breyer endorsing its use, and Justice Scalia strongly criticizing it. In Shannon v. United States, the Supreme Court declined to give weight to the

57. The Securities Litigation Uniform Standards Act of 1998, Pub. Law 105-353, S. 1260 (1998). The main purpose of this act was to make Federal courts the exclusive venue for most securities class action lawsuits. See H.R. CONF. REP. No. 105-803 (1998). It was enacted “to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than in Federal court.” See id.
61. See Coffee, supra note 46, at 981.
63. See Kenneth R. Dortzbach, Legislative History: The Philosophies of Justices Scalia and Breyer and the Use of Legislative History by the Wisconsin State Courts, 80 MARQ. L. REV. 161 (1996).
64. 512 U.S. 573 (1994).
congressional endorsement of a procedure and instead adopted a different procedure, stating "[w]e are not aware of any case . . . in which we have given authoritative weight to a single passage of legislative history that is in no way anchored in the text of the statute." In *Chevron USA Inc. v. Natural Resources Defense Council, Inc.*, the Court created a two-step method of statutory interpretation which ignored legislative history. Moreover, the Court has shown its dissatisfaction with using legislative history in securities cases by abdicating established methodology in favor of a "more rigid textual approach." Thus, there is much controversy as to whether courts should follow the legislative history or focus merely on the PSLRA's statutory text. A court's acceptance or nonacceptance of the use of legislative history in statutory interpretation could be the deciding factor in the outcome of this issue.

B. Definition of Scienter

In *Ernst & Ernst v. Hochfelder*, the Supreme Court ruled that in any private action for damages under Section 10(b) and Rule 10b-5, the defendant "must have intent to deceive, manipulate, or defraud." The intent of Section 10(b) was to proscribe knowing or intentional misconduct, involving some element of scienter. The Court held that mere

67. See Gregory E. Maggs, Reconciling Textualism and the Chevron Doctrine: In Defense of Justice Scalia, 28 Conn. L. Rev. 393, 399 (1996). The first step requires a court interpreting a statute to determine whether Congress has "directly spoken" to the question at issue by expressing its intent unambiguously. *Id.* If Congress has spoken, the court must follow what Congress has directed. *Id.* If Congress has not spoken, the second step is for the court to decide whether the agency administering the statute has adopted a reasonable interpretation of the statute. *Id.*
69. See Coffee, supra note 46, at 980.
71. *Id.* at 193. Scienter is "a mental state embracing an intent to deceive, manipulate, or defraud." *Id.* at 194 n.12.
72. *Id.* at 197.
73. *Id.* at 201.
negligent wrongdoing is insufficient for the scienter requirement.\textsuperscript{74}

The Supreme Court did not decide whether recklessness is sufficient for scienter under 10(b) and 10b-5 claims; however, it recognized that recklessness is sometimes “considered to be a form of intentional conduct for purposes of imposing liability for some act.”\textsuperscript{75} Because of this recognition, the recklessness standard has long been accepted as sufficient for pleading scienter in these actions.\textsuperscript{76}

The present definition of recklessness in securities actions derives from \textit{Franke v. Midwestern Oklahoma Development Authority}\textsuperscript{77} where the court stated:

\begin{quote}
[Reckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even excusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.]
\end{quote}

This definition of recklessness, requiring more than mere negligence, is “the kind of recklessness that is equivalent to wilful fraud.”\textsuperscript{79} Additionally, “[a]n egregious refusal to see the obvious, or to investigate the doubtful, may in some cases give rise to an inference of . . . recklessness.”\textsuperscript{80} Therefore, recklessness “involves conduct ‘more culpable than mere negligence,’ but with an intent less culpable than ‘deliberately and cold bloodedly . . . conceal[ing] information.’”\textsuperscript{81}

\begin{enumerate}
\item[74.] \textit{Id.} at 210.
\item[75.] \textit{Ernst & Ernst v. Hochfelder,} 425 U.S. 185, 194 n.12 (1976).
\item[77.] 428 F. Supp. 719 (W.D. Okla. 1976).
\item[78.] \textit{Sundstrand Corp. v. Sun Chem. Corp.,} 553 F.2d 1033, 1045 (7th Cir. 1977) (quoting Franke v. Midwestern Oklahoma Dev. Auth., 428 F. Supp. 719, 725 (W.D. Okla. 1976)).
\item[79.] \textit{Sundstrand,} 553 F.2d at 1045 (quoting SEC \textit{v. Texas Sulphur Co.,} 401 F.2d 833, 868 (2d. Cir. 1968)). Willful fraud includes the reckless disregard of the truth where individuals deliberately refrain from taking steps to discover whether their statements were false. \textit{See In re Fischbach Corp. Sec. Litig.,} 1992 WL 8715, at *5 (S.D.N.Y.). Judge Friendly stated that one cannot “escape liability for fraud by closing his eyes to what he saw and could readily understand.” \textit{Id.} (quoting SEC \textit{v. Frank,} 388 F.2d 486, 489 (2d Cir. 1968)).
\item[81.] \textit{Hollinger v. Titan Capital Corp.,} 914 F.2d 1564, 1569 (9th Cir. 1990).
\end{enumerate}
The PSLRA also has not stated whether recklessness satisfies the scienter requirement, "except for the limited requirement of actual knowledge for joint and several liability and forward-looking statements." Thus, it is still not clear if recklessness satisfies the pleading standard for scienter after the adoption of the PSLRA.

C. Standards for Pleading Scienter Before the PSLRA

1. The Second Circuit

The court in In re Time Warner Inc. Securities Litigation held that the facts alleged in a securities fraud complaint must "give[] rise to a 'strong inference' of fraudulent intent." In Shields v. Citytrust Bancorp., Inc., the Second Circuit ruled that a plaintiff may plead scienter by alleging either: (1) "motive" and "opportunity" on the part of the defendant(s) to commit fraud; or (2) "facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." Pleading of motive would entail "concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged." Opportunity entails "the means and likely prospect of achieving concrete benefits by the means alleged."

Before the PSLRA, the standard set by the Second Circuit was the most stringent standard employed by any circuit. Under this standard, merely coupling factual statements with conclusory allegations that the defendant was reckless or had knowledge of falsity would not withstand a motion to dismiss.

83. 9 F.3d 259 (2d Cir. 1993).
84. Id. at 268 (quoting O'Brien v. National Property Analysts Partners, 936 F.2d 674, 676 (2d Cir. 1991)).
85. 25 F.3d 1124 (2d Cir. 1994).
86. Id. at 1128 (citing In re Time Warner Inc. Sec. Litig., 9 F.3d 259 (2d Cir. 1993)).
87. Id. at 1130.
88. Id.
89. See Olson, supra note 11, at 1108.
90. See id.
2. The Ninth Circuit

In *In re GlenFed, Inc. Securities Litigation*, the Ninth Circuit held that a plaintiff could plead scienter with conclusory allegations so long as the complaint set forth the circumstances indicating the fraudulent nature of the statements. The court refused to adopt the Second Circuit's view that plaintiffs in securities fraud cases must plead facts giving rise to a "strong inference of fraudulent intent." Instead, the court recognized that Rule 9(b) does not require "any particularity in connection with an averment of intent, knowledge or condition of the mind." Therefore, plaintiffs could aver scienter generally by alleging that scienter existed. However, Rule 9(b) imposed an obligation to aver with "particularity the circumstances constituting fraud." "To allege fraud with particularity, a plaintiff must set forth more than the neutral facts necessary to identify the transaction," including "what is false or misleading about a statement, and why it is false." *GlenFed* allowed a plaintiff to draw on contemporaneous statements or conditions to demonstrate why statements were false when made, and "allegations of specific problems undermining a defendant's optimistic claims suffice to explain how the claims are false."

In *Wool v. Tandem Computers, Inc.*, the Ninth Circuit observed that "[a]llegations of fraud based on information and belief usually do not satisfy the degree of particularity required under Rule 9(b)." However, "an exception exists where, as in cases of corporate fraud, the plaintiffs cannot be expected to have personal knowledge of the facts constituting

91. 42 F.3d 1541 (9th Cir. 1994).
93. *Id.* at 1545.
94. *Id.* at 1545 (emphasis omitted). The purposes of Rule 9(b) is "to provide a defendant with fair notice of a plaintiff's claim, to safeguard a defendant's reputation from 'improvident charges of wrongdoing,' and to protect a defendant against the institution of a strike suit." Olson, *supra* note 11, at 1108.
95. *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1547 (9th Cir. 1994).
96. *Id.*
97. *Id.* at 1548 (emphasis omitted).
98. *Id.* at 1549.
99. *Id.*
100. Wool v. Tandem Computers Inc., 818 F.2d 1433 (9th Cir. 1987).
the wrongdoing." Thus, an allegation based on information and belief will be accepted if the misstatement is identified by content, date, and the document in which it appeared, along with the manner in which the representation was false and misleading.

The Ninth Circuit standard was a much less stringent pleading standard than that of the Second Circuit. Congress adopted the PSLRA in order to end this disparity between the circuits. Therefore, the PSLRA indicates that the lenient standard of GlenFed no longer constitutes an adequate pleading requirement for scienter in 10(b) and 10b-5 cases. The current difficulty with the PSLRA lies with the problem that on its face, many argue that it seems to simply codify what the Second Circuit already requires. However, according to its legislative history, the PSLRA may impose requirements that go well beyond those set by the Second Circuit. This new conflict has yet to be resolved.

D. Interpretations of the PSLRA Pleading Standard

1. Arguments in Favor of Adopting the Second Circuit Test After the PSLRA

Many courts have held that the PSLRA merely adopts the Second Circuit standard. These courts argue that de-

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102. Id.
103. See id.
104. See id.
105. See id. at 930.
107. See Coffee, supra note 46, at 978.
spite conflicting views regarding this issue, pleading motive and opportunity or recklessness suffices to withstand a motion to dismiss, and the PSLRA does not impose a more rigorous pleading requirement than that enunciated by the Second Circuit.\(^\text{109}\) Furthermore, these courts argue that the intent of Congress must be deduced from the text of the statute itself.\(^\text{109}\)

Courts adopting the Second Circuit standard first argue that recklessness is sufficient for pleading scienter because it has been commonly accepted in Section 10(b) cases.\(^\text{110}\) In *Marksman Partners, L.P. v. Chantal Pharmaceutical Corp.*,\(^\text{111}\) the district court argued that although the PSLRA elevates the mental state required for certain specified situations to “actual knowledge,” situations that are not expressly specified, such as 10(b) and 10b-5 claims, do not have a more stringent standard.\(^\text{112}\) Thus, the current standard of recklessness suffices under the PSLRA.

These courts further argue that motive and opportunity are also sufficient for pleading scienter despite the fact that the PSLRA contains no references to this test.\(^\text{113}\) Moreover, the courts contend that motive and opportunity are consistent with the intent of Congress “that scienter be pled with more than conclusory or generic allegations.”\(^\text{114}\) Heightening the standard to conform with the Second Circuit test, which is the most stringent standard, “satisfies Congress’ goal of curtailing abusive securities litigation while still leaving room for aggrieved parties to bring valid securities fraud claims.”\(^\text{115}\)

Furthermore, although Congress chose not to expressly

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112. 927 F. Supp. 1297, 1309 (C.D. Cal. 1996). In *Marksman*, plaintiffs brought a securities fraud action under Section 10(b) and Rule 10b-5, alleging that defendants fraudulently reported high sales revenues on consignment sales of their product. *Id.* at 1301. The court held that using the Second Circuit’s approach, plaintiffs had sufficiently alleged a strong inference of scienter. *Id.* at 1315.
113. *Id.* at 1309 n.9.
114. See *id.* at 1310.
115. *Id.* at 1310. See also Rehm v. Eagle Fin. Corp., 954 F. Supp. 1246, 1252 (N.D. Ill. 1997).
codify the Second Circuit's test, these courts argue that Con-
gress did not intend to reject this standard.117 The Marksman
court argued that "Congress chose not to codify motive and
opportunity as pleading requirements but does not indicate
that Congress chose to specifically disapprove the motive and
opportunity test."118

Courts adopting the Second Circuit standard also argue
that the PSLRA's language mirrors the Second Circuit in its
application of Rule 9(b) to pleading scienter by requiring a
"strong inference" of the required state of mind.119 The dis-
trict court in Zeid v. Kimberly120 argued that the fact that
Congress modeled the PSLRA's standard after the Second
Circuit's "strong inference" language demonstrates some ap-
proval of the Second Circuit's case law.121 Moreover, Zeid ar-
gued that the failure to provide an alternative interpretation
of the PSLRA "militates against completely dispensing with
the Second Circuit's test."122

2. Arguments in Favor of Adopting a Standard Stricter
than That of the Second Circuit.

Though some courts insist that the PSLRA merely
adopts the Second Circuit standard for pleading scienter,123
many other courts disagree with this contention, arguing that
the PSLRA was not intended to codify the Second Circuit's
approach.124 These courts focus on the PSLRA's legislative

117. See OnBank & Trust Co. v. Federal Deposit Ins. Corp., 967 F. Supp. 81,
88 n.4 (W.D.N.Y. 1997); Rehm, 954 F. Supp. at 1252; Marksman Partners, L.P.

118. Marksman, 927 F. Supp. at 1311.

Eagle Fin. Corp., 954 F. Supp. 1246, 1252 (N.D. Ill. 1997); Marksman, 927 F.
Supp. at 1310.

120. 973 F. Supp. 910 (N.D. Cal. 1997). Zeid ignored defendant's arguments
that the Second Circuit case law had been superseded, and instead evaluated
the complaint under the Second Circuit precedent. Lerach, supra note 43, at
897.


122. Id. However, courts have significant leeway in interpreting the stan-
dard. Id.


re Silicon Graphics, Inc. Sec. Litig., No. C 96-0393, 1996 WL 664639, at *6 (N.D.
Cal. Sept. 25, 1996); In re Silicon Graphics Inc. Sec. Litig., 970 F. Supp. 746
(N.D. Cal. 1997).
history, which arguably suggests that the PSLRA was intended to surpass the Second Circuit's "motive and opportunity" and "recklessness" standards. These courts first argue that the Conference Committee Report indicates its intent to strengthen the existing standard. In its Conference Report, Congress stated that it sought to "strengthen existing pleading requirements," and that "it [did] not intend to codify the Second Circuit's case law interpreting this pleading standard." Thus, these courts place great emphasis on the explicit words of Congress' intent shown in their report.

Additionally, these courts emphasize the fact that Congress chose not to include in the new standard certain language relating to motive, opportunity, or recklessness. The district court in In re Silicon Graphics, Inc. Securities Litigation (Silicon Graphics I) noted that Congress declined to pass a Senate bill which included an amendment that would have codified the Second Circuit's standard and would have allowed a plaintiff to use allegations of motive and opportunity or recklessness to establish scienter. Thus, the Silicon Graphics I court argued that the Conference Committee's deletion of the Second Circuit standard from the final bill "strongly militates against a judgment that Congress in-

126. See Vott, 977 F. Supp. at 374.
129. Id.
131. No. C 96-0393, 1996 WL 664639 (N.D. Cal. Sept. 25, 1996). In Silicon Graphics I, plaintiffs alleged that defendants issued false and misleading information about the company in an effort to inflate the price of the company's stock. Id. at *1. However, the court held that plaintiff's allegations were not specific enough to raise a strong inference of fraud. Id. at *12. The Ninth Circuit has recently heard the oral argument regarding the Silicon Graphics case and is expected to provide the first published federal appellate opinion on this issue.
132. Id. at *5 (citing AMEND. 1485 S.240, 104th Cong. (1995)).
tended a result that it expressly declined to enact."133

Finally, these courts also point to President Clinton's veto of the PSLRA to show that Congress intended a more stringent standard.134 The President felt compelled to veto the bill because Congress' intent to raise the existing standard was "crystal clear."135 President Clinton stated that Congress intended the PSLRA "to raise the [pleading] standard even beyond the [high pleading standard of the Second Circuit.]"136 The *Silicon Graphics* I court argued that in further emphasizing its "crystal clear" intent to heighten the pleading standard, Congress overrode the veto and passed the bill.137

Because it did not accept the Second Circuit standard as satisfying the pleading requirement of the PSLRA, *Silicon Graphics* I instead requires plaintiffs to allege circumstantial evidence of conscious behavior by the defendants.138 Although Congress chose not to codify the Second Circuit's law relating to motive, opportunity, and recklessness, scienter could be sufficiently pled by alleging the defendant's conscious misbehavior.139

In establishing circumstantial evidence of conscious behavior or actual knowledge, the plaintiff must do more than speculate as to the defendant's motives or make conclusory allegations of scienter.140 Instead, the plaintiff must allege specific facts of misconduct.141 Therefore, a plaintiff cannot couple a factual statement with a conclusory allegation of fraudulent intent in order to adequately plead scienter.142

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133. *Id.* at *6.
139. *See Friedberg*, 959 F. Supp. at 49.
141. *See id.*
The district court, in *Friedberg v. Discreet Logic Inc.*, argued that in light of the fact that the PSLRA eliminated recklessness, conscious behavior can now only take the form of circumstantial evidence indicating an intent to defraud or knowledge of falsity. Thus, the "conscious behavior" approach is more stringent than the "reckless behavior" pleading approach to scienter.

In *Silicon Graphics II*, the role of recklessness was re-evaluated by the court. The district court held that to adequately plead fraud, a plaintiff "must create a strong inference of knowing or intentional misconduct." This "knowing or intentional misconduct includes deliberate recklessness, as described in *Hollinger* and alluded to in *Hochfelder*". However, the court limited the role of recklessness by stating that "[m]otive, opportunity, and nondeliberate recklessness may provide some evidence of intentional wrongdoing, but are not alone sufficient to support scienter unless the totality of the evidence creates a strong inference of fraud."

3. Arguments in Favor of Allowing Recklessness, but not Motive and Opportunity for Pleading Scienter.

Some courts are now adopting the opinion that Congress intended to keep the recklessness prong of the Second Circuit's standard, but that the PSLRA requires more than the pleading of motive and opportunity. Courts such as

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143. 959 F. Supp. 42 (D. Mass. 1997). In *Friedberg*, the plaintiff alleged three specific facts that constituted circumstantial evidence of conscious misbehavior by the defendants. Id. at 50. The court held that these facts constituted a "strong inference" of scienter and thus, rejected the motion to dismiss. Id.

144. Id. at 49 n.2.

145. Id.

146. 970 F. Supp. 746 (N.D. Cal. 1997). After the district court in *Silicon Graphics I* dismissed plaintiff's suit with leave to amend, the plaintiff filed an amended complaint which resulted in the *Silicon Graphics II* decision. This decision is currently on appeal to the Ninth Circuit, and will be the first appellate decision on this issue.


148. Id.

149. Id.

Marksman, argue that recklessness has long been accepted as sufficient for pleading scienter.\textsuperscript{151} Recklessness in this context approximates actual intent and is not a mere heightened form of negligence.\textsuperscript{152} The district court in \textit{In re} Baesa Securities Litigation\textsuperscript{153} recognized that "recklessness," in its classic formulation, describes a conscious state of mind that is inherently deceptive.\textsuperscript{154} Thus, "recklessness" means "a conscious and purposeful disregard of the truth about a known risk."\textsuperscript{155} Even an allegation of gross negligence would be insufficient in a securities fraud action.\textsuperscript{156} \textit{Baesa} stated that "[w]hile the Supreme Court remains free to overrule this determination, nothing in the Reform Act purports to do so."\textsuperscript{157} Thus, \textit{Baesa} holds that pleading recklessness is sufficient under the PSLRA.\textsuperscript{158}

Though recklessness may be sufficient for pleading scienter, these courts argue that pleading motive and opportunity is not sufficient under the PSLRA.\textsuperscript{159} \textit{Baesa} emphasized that while the statute adopts the "strong inference" requirement, it does not mention "motive and opportunity."\textsuperscript{160} Thus, the court concluded that from the plain language of the PSLRA, the mere pleading of motive and opportunity does not, of itself, automatically suffice to raise a strong inference of scienter.

However, despite the fact that these courts do not accept

\begin{itemize}
\item \textit{In re} Stratosphere Corp. Sec. Litig., 1 F.Supp. 2d 1096, 1107 (D. Nev. 1998);
\item 151. See \textit{Baesa}, 969 F. Supp. at 241.
\item 152. See \textit{Glenayre}, 982 F. Supp. at 297.
\item 153. 969 F. Supp. 238 (S.D.N.Y. 1997). In \textit{Baesa}, plaintiffs alleged that defendants issued false and misleading public statements that materially overstated the company's earnings and concealed the company's true deteriorating financial position. \textit{Id.} at 240. The court, however, ruled that mere knowledge of mismanagement does not create a strong inference that the financial statements are false, and thus, the case was dismissed. \textit{Id.} at 243.
\item 154. \textit{Id.} at 241.
\item 156. See \textit{id.} at 2.
\item 158. \textit{Id.} at 239.
\item 159. See \textit{id.}
\item 160. \textit{Id.} at 242.
\item 161. \textit{Id.}
\end{itemize}
motive and opportunity as sufficient pleading standards, they recognize that pleading motive and opportunity may still be relevant when pleading circumstances from which a strong inference of fraudulent intent may be inferred. Under the PSLRA, and in contrast to the Second Circuit, such circumstances are not presumed sufficient to do so. Therefore, even if motive and opportunity are adequately pled, facts giving rise to a strong inference of fraudulent intent must still be alleged.

The Baesa reasoning has been adopted by many courts, including that of the district court in Carley Capital Group v. Deloitte & Touche. In Carley, the court stated that the Baesa approach is consistent with the original Conference Committee Report to the PSLRA and the Joint Explanatory Statement of the Committee of Conference Regarding S. 1260. The court held that even with the new legislative history attached to the Uniform Standards Act of 1998, “the Second Circuit’s two pronged standard of (1) motive and opportunity or (2) conscious misbehavior or recklessness relate to the definition of state of mind and are not incorporated in or repealed by the Reform Act.”

III. IDENTIFICATION OF THE PROBLEM

Prevention of frivolous and abusive litigation is extremely important and is currently a matter of great concern. One area that has felt its share of abuse is securities fraud litigation. To combat this abuse, the PSLRA made great efforts to enact reforms that would discourage plaintiffs from filing poorly pled or weak cases, and hasten their early dismissal under a motion to dismiss.

162. See id.
165. 1998 WL 804929 (N.D. Ga.).
166. See id. at *13.
167. Id. at *14. See also In re Glenayre Tech., Sec. Litig., 1998 U.S. Dist. LEXIS 20344 at *3 n.3 (stating that motive and opportunity is not sufficient to establish scienter after the enactment of the Securities Litigation Uniform Standards Act of 1998).
169. See id.
170. See Randall S. Thomas & Kenneth J. Martin, Using State Inspection Statutes for Discovery in Federal Securities Fraud Actions, 77 B.U.L. REV. 69,
In the past, federal securities complaints have been difficult to dismiss.\textsuperscript{70} Rule 9(b), which governed the pleading standard for 10(b) and 10b-5 claims before the passage of the PSLRA, created much confusion over the proper standard when pleading these claims.\textsuperscript{172} Although the courts agreed that Rule 9(b) required a complaint to allege with particularity which statements were false, courts have differed as to the required degree of particularity for allegations of the defendant's state of mind.\textsuperscript{173}

To clarify these inconsistencies Congress passed the PSLRA.\textsuperscript{174} Since its adoption, opponents have attacked the PSLRA for having many ambiguous gaps,\textsuperscript{175} which make it difficult for courts to follow.\textsuperscript{176} The source of much of this attack has been the ambiguity regarding the heightening of the pleading standard for scienter.\textsuperscript{177}

The issue analyzed by this comment is whether the PSLRA merely codifies the standard already set by the Second Circuit,\textsuperscript{178} or whether a stricter standard for pleading scienter should be imposed.\textsuperscript{179} The PSLRA neglects to define precisely what the required state of mind is for pleading scienter.\textsuperscript{180} As a result of this omission, courts have continued to apply different standards,\textsuperscript{181} basing their reasons either on a plain reading of the PSLRA or on its lengthy legislative history.\textsuperscript{182} This has led to great confusion and speculation, and will be further complicated by the new legislative history associated with the Uniform Standards Act of 1998. The answer to these problems may lie in the resolution of the ques-

\begin{itemize}
  \item \textsuperscript{70} (1997).
  \item \textsuperscript{171} See Olson, supra note 11, at 1107.
  \item \textsuperscript{172} See id.
  \item \textsuperscript{173} See id.
  \item \textsuperscript{174} See Lerach, supra note 43, at 894-95.
  \item \textsuperscript{175} See Coffee, supra note 46, at 975.
  \item \textsuperscript{176} See id.
  \item \textsuperscript{177} See id.
  \item \textsuperscript{178} See supra Part II.D.1.
  \item \textsuperscript{179} See supra Part II.D.2.
\end{itemize}
tion of whether courts should focus only on the plain text of a statute, or whether they should also examine the legislative history when determining the precise intent of a statute. Much unresolved debate has existed over this issue for some time.

Therefore, the issues in need of resolution are (1) whether the legislative history of the PSLRA indeed shows Congress' intent to create a stricter standard than that of the Second Circuit, and if so, (2) can this legislative history be relied upon by the courts when determining whether scienter has been adequately pled?

IV. ANALYSIS

Despite the arguments that a plain meaning analysis clearly supports the Second Circuit standard for pleading scienter, the plain meaning of the PSLRA only has strong support for including the "recklessness" prong of the Second Circuit standard, with much less support for the "motive and opportunity" prong. The legislative history of the PSLRA may have some role in its interpretation because it is relevant in showing Congress' intent for the standard.

A. Plain Meaning of the PSLRA

The PSLRA provides that plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." However, there is much ambiguity in this statement because the PSLRA neglects to express what state of mind is required. Many courts argue that this language mirrors the Second Circuit's language, and therefore, the Second Circuit's two prong test suffices as the required state of mind. Though

184. See infra Part IV.A.
185. See infra Part IV.B.1.
186. See infra Part IV.B.1.
187. See infra Part IV.B.1.
188. See supra Part II.D.1.
189. See supra Part II.D.1.
the Second Circuit uses "strong inference" language, the PSLRA includes no other language of the Second Circuit. Thus, even a plain meaning argument used by the courts in support of the Second Circuit standard is tenuous at best.

The Zeid court argued that the fact that Congress modeled the standard after the Second Circuit's test by making use of the "strong inference" language demonstrates some approval of the Second Circuit's approach. By using this language, Congress did not intend to increase the required state of mind or to cast doubt on the validity of the existing Second Circuit standard which allowed plaintiffs to raise a strong inference of scienter. However, this language does not refer to the two prongs of the Second Circuit standard, making it very unclear whether Congress intended to adopt this standard. Courts that support the Second Circuit standard by using a plain meaning analysis of the PSLRA contend that Congress' use of similar language is compelling evidence that Congress intended this standard to suffice. However, the mere use of this one phrase, without more, is not convincing evidence that Congress intended to adopt the existing standard, which contains more than just the "strong inference" language.

Although most courts agree that some of the language may indeed be modeled upon the Second Circuit's approach, there is much debate over Congress' silence regarding the Second Circuit standard. Some courts argue that silence regarding the Second Circuit standard does not mean that


192. Zeid, 973 F. Supp. at 917. In addition, the court emphasizes that there is no alternative interpretation which would allow the court to completely dispense with the Second Circuit's two part inquiry. Id.
194. See Shields, 25 F.3d at 1130.
196. See Shields, 25 F.3d at 1130.
the test is invalid. However, other courts disagree and contend that silence shows Congress’ intent not to codify the Second Circuit’s standard. The latter argument has more credibility due to the fact that Congress had the opportunity to clarify any ambiguities as a result of this silence, but instead chose not to explicitly use the Second Circuit’s language about “recklessness” and “motive and opportunity.”

In Marksman, the court reasoned that the fact that Congress chose not to codify the Second Circuit’s standard does not indicate that Congress chose specifically to invalidate the standard. Thus, just because Congress did not make motive and opportunity or recklessness an express part of the pleading standard does not mean that they disapproved of this approach. The Zeid court also recognized this argument, but emphasized that because Congress chose not to codify the case law, courts have significant leeway when interpreting the “strong inference” standard. While the Second Circuit case law provides guidance for interpreting the standard, courts can modify or reject any case law that “is inconsistent with the letter or spirit of the [PSLRA].”

However, other courts that use a stricter standard have good reason to disagree with this idea that silence does not necessarily mean disapproval of the Second Circuit standard. Senator Arlen Specter proposed an amendment that would have codified the standard; however, Congress chose

200. See supra text p. 105.
204. Id.
not to adopt this amendment.\textsuperscript{206} The \textit{Silicon Graphics I} court argued that Congress' deletion of this amendment could not show that the legislators had an intention for a result that they expressly declined to codify.\textsuperscript{207} Furthermore, these courts argue that Congress' silence regarding the standard shows that motive, opportunity, and recklessness were not sufficiently stringent for pleading scienter.\textsuperscript{208} This is a valid argument because it would have been easy for Congress to include the Second Circuit test had it really intended to adopt it.\textsuperscript{209} Congress proposed the amendment because many of its members knew the PSLRA was unclear,\textsuperscript{210} and therefore, any ambiguity could have been clarified by its adoption.

Although Congress may not have wanted to codify the entire Second Circuit standard, credible arguments support the contention that Congress intended to accept at least the recklessness prong of the test.\textsuperscript{211} Though \textit{Baesa}\textsuperscript{212} accepted recklessness as sufficient for pleading scienter under the PSLRA,\textsuperscript{213} it recognized Congress' silence as to motive and opportunity as an intention to discard this standard.\textsuperscript{214} Therefore, the \textit{Baesa} court concluded "from the plain language of the statute that the mere pleading of motive and opportunity does not, of itself, automatically suffice to raise a strong inference of scienter."\textsuperscript{215} This is a persuasive argument because "recklessness" has a long history of being sufficient for pleading scienter,\textsuperscript{216} and therefore, it was probably assumed as sufficient in the PSLRA. However, "motive and

\textsuperscript{206} See \textit{Silicon Graphics}, 1996 WL 664639, at *5 n.23 (citing AMEND 1485 S. 240, 104th Cong (1995)).


\textsuperscript{209} Congress could have simply adopted the Specter amendment. \textit{See supra} text p. 105.


\textsuperscript{211} See \textit{In re Baesa Sec. Litig.}, 969 F. Supp. 238 (S.D.N.Y. 1997).

\textsuperscript{212} \textit{Id}.

\textsuperscript{213} \textit{Id.} at 239.

\textsuperscript{214} \textit{Id.} at 242.

\textsuperscript{215} \textit{Id}.

\textsuperscript{216} See \textit{Hollinger v. Titan Capital Corp.}, 914 F.2d 1564, 1569 (9th Cir. 1990); \textit{Sundstrand Corp. v. Sun Chem. Corp.}, 553 F.2d 1033, 1039 (7th Cir. 1977). \textit{See also} 63 SEC Docket 2066 (1997) (announcing the SEC's position against the ruling in \textit{Silicon Graphics} and stating that Congress did not intend to eliminate recklessness from the standard for pleading scienter).
opportunity” has not been widely recognized outside of the Second Circuit, thus, Congress may not have assumed this prong in the drafting of the PSLRA.\textsuperscript{217}

To support the argument that “recklessness” should suffice under the PSLRA, many courts have reasoned that the text’s plain language can be read to include commonly accepted definitions of scienter, which have long included recklessness.\textsuperscript{218} The Supreme Court in \textit{Ernst \& Ernst v. Hochfelder}\textsuperscript{219} defined scienter as “a mental state embracing intent to deceive, manipulate, or defraud.”\textsuperscript{220} The Court also recognized that recklessness is often considered a form of intentional conduct for purposes of imposing liability for certain acts.\textsuperscript{221} Courts after \textit{Ernst} used that recognition in order to allow recklessness to suffice for pleading scienter in Section 10(b) and Rule 10b-5 actions.\textsuperscript{222} However, because \textit{Ernst} held that mere negligence would not suffice for scienter,\textsuperscript{223} recklessness requires more than just a heightened degree of negligence\textsuperscript{224} in order to survive a motion to dismiss. Furthermore, the Securities and Exchange Commission has consistently supported a recklessness standard in Section 10(b) cases.\textsuperscript{225}

\textit{Baesa} used this common understanding of recklessness in its argument that the recklessness prong of the Second Circuit test is sufficient under the PSLRA.\textsuperscript{226} The court emphasized that “virtually every [c]ircuit [c]ourt to consider the

\textsuperscript{218} See id. at 239.
\textsuperscript{219} \textit{Id.} at 194 n.12.
\textsuperscript{220} \textit{Id.}
\textsuperscript{221} This kind of recklessness is equivalent to wilful fraud. \textit{See Sundstrand Corp. v. Sun Chem. Corp.}, 553 F.2d 1033, 1039 (7th Cir. 1977).
\textsuperscript{222} \textit{Ernst}, 425 U.S. at 210.
\textsuperscript{223} \textit{Hollinger v. Titan Capital Corp.}, 914 F.2d 1564, 1569 (9th Cir. 1990); \textit{Sundstrand}, 553 F.2d at 1045.
\textsuperscript{224} The Securities and Exchange Commission supports the recklessness standard because it “discourages deliberate ignorance and also prevents defendants from escaping liability simply because of the difficulty of proving knowledge or conscious intent on the basis of the circumstantial evidence frequently used in securities fraud cases.” 63 S.E.C. Docket 2066 (1997). The SEC further noted that retreating from this “standard would greatly erode the deterrent effect of Section 10(b) actions.” \textit{Id.} In its friend of the court brief submitted in the \textit{Silicon Graphics} case, the Commission noted that every court of appeals has held that recklessness is sufficient to establish liability in Section 10(b) and Rule 10b-5 actions. \textit{Id.}
\textsuperscript{225} \textit{In re Baesa Sec. Litig.}, 969 F. Supp. 238, 241 (S.D.N.Y. 1997).
issue, including the Second Circuit, held that recklessness suffices.\footnote{227} Furthermore, other courts have argued that recklessness is part of the current standard since it was expressly limited in other parts of the PSLRA, but not in the part concerning pleading.\footnote{228} Under the PSLRA, recklessness is not sufficient to impose liability for "forward-looking statements."\footnote{229} However, nowhere in the PSLRA does it limit recklessness for non forward-looking statements.\footnote{230} Thus, "[w]hen Congress intended, with the Act, to limit liability for reckless conduct, it did say so."\footnote{231} Because liability for recklessness has long been recognized as an inherent aspect of fraud, this allows a strong basis to conclude that scienter is satisfied by showing recklessness under the PSLRA.\footnote{232}

Due to this common understanding about recklessness, a plain meaning analysis indicates that recklessness would be sufficient for pleading scienter under the PSLRA.\footnote{233} However, contrary to the many cases supporting the Second Circuit standard,\footnote{234} there is much less support for allowing "motive and opportunity" as being sufficient.

B. Legislative History of the PSLRA

The PSLRA has a lengthy legislative history and the use of this history in interpreting the PSLRA’s language is quite controversial.\footnote{235} Though some courts have decided to put little weight on this history,\footnote{236} many other courts recognize its

\footnote{227} Id. at 241 (citing \textit{inter alia} Rolf v. Blyth Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1978)).
\footnote{230} See id.
\footnote{231} Lerach, \textit{supra} note 43, at 915 (emphasis omitted).
\footnote{232} See Kuehnle, \textit{supra} note 82, at 127.
\footnote{233} It is important to note that the cases which accept recklessness agree that "simple recklessness" will not suffice. Instead, the level of recklessness must be so extreme that some kind of conscious intent can be inferred. See Richard M. Phillips et al., \textit{Impact of the Reform Act on Federal Securities Class Actions}, SC88 ALI-ABA 351, 377 (1998).
\footnote{235} See Olson, \textit{supra} note 11, at 1116-22.
importance and rely heavily on it when interpreting the PSLRA.\textsuperscript{237}

1. Congress Chose not to Codify the Second Circuit Standard

The first argument courts use when stating that the PSLRA does not codify the Second Circuit standard for pleading scienter is that Congress expressly chose not to codify the standard even though it had an opportunity to do so in its initial drafting of the PSLRA.\textsuperscript{238} The Silicon Graphics I court\textsuperscript{239} emphasized that the Conference Committee Report indicates that Congress intended to strengthen the existing standard.\textsuperscript{240} This language is very compelling. The Supreme Court has expressed that "the authoritative source for finding the Legislature's intent lies in the Committee Reports or the bill, which represen[t] the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation."\textsuperscript{241} The Conference Committee noted that the Second Circuit standard was regarded as the most stringent pleading standard,\textsuperscript{242} but "[b]ecause the Conference Committee intends to strengthen existing pleading requirements, it does not intend to codify the Second Circuit's case law interpreting this pleading standard."\textsuperscript{243} From this language, it is clear that it was the express intent of the Committee to strengthen the pleading standard beyond that of the Second Circuit.\textsuperscript{244} Therefore, through the use of this piece of legislative history, the PSLRA is not a mere codification of the law already in place by the Second Circuit.\textsuperscript{245}

Despite this explicit language regarding Congress' intent,\textsuperscript{246} some courts have chosen to continue applying the Second Circuit standard and ignore this persuasive legislative

\begin{itemize}
\item \textsuperscript{238} See \textit{id.} at *5.
\item \textsuperscript{239} No. C 96-0393, 1996 WL 664639 (N.D. Cal. Sept. 25, 1996).
\item \textsuperscript{240} \textit{id.} at *5 (citing H.R. CONF. REP. NO. 104-369 (1995)).
\item \textsuperscript{241} \textit{id.} at *6.
\item \textsuperscript{242} H.R. CONF. REP. NO. 104-369 (1995).
\item \textsuperscript{243} \textit{id.} at 41.
\item \textsuperscript{244} \textit{id.}
\item \textsuperscript{246} See H.R. CONF. REP. NO. 104-369 (1995).
\end{itemize}
history.\textsuperscript{247} In \textit{Rehm v. Eagle Finance Corp.},\textsuperscript{248} the district court noted that the fact that Congress chose not to codify the Second Circuit standard does not mean that it specifically chose to disapprove of the test.\textsuperscript{249} However, this reasoning is considerably flawed since the Conference Committee explicitly stated that it intended to strengthen the existing standard.\textsuperscript{250} These words are very persuasive in showing that Congress intended a standard somewhat more stringent than that of the Second Circuit.\textsuperscript{251} When weighing Congress' silence regarding the two prongs of the Second Circuit standard\textsuperscript{252} with the rejection of an amendment that would have clarified the issue,\textsuperscript{253} the answer points in favor of Congress' intent to have a standard more stringent than what had already existed.

Even without the use of this legislative history, \textit{Baesa}\textsuperscript{254} correctly reconciles the problem of Congress' ambiguity in not codifying the standard, and its statement that it intended to strengthen the standard.\textsuperscript{255} \textit{Baesa} argues against using legislative history to interpret the statute,\textsuperscript{256} and bases its holding on the plain meaning of the statute.\textsuperscript{257} The court noted that the Congressional byplay "that accompanies the enactment of a controversial law like the Reform Act inevitably yields a rich cornucopia of legislative history on which courts of every appetite can feed. But when it comes to interpreting such byplay, courts are poorly equipped to separate the husks from the kernels."\textsuperscript{258} However, \textit{Baesa} interprets the plain language of the statute to require more than the pleading of motive and opportunity.\textsuperscript{259} Thus, the court reconciles the use of plain meaning of the statute and Congress' intent to enact

\textsuperscript{248} \textit{Rehm}, 954 F. Supp. at 1246.
\textsuperscript{249} \textit{Id.} at 1252 (citing \textit{Marksman}, 927 F. Supp. at 1311).
\textsuperscript{251} See \textit{id.}
\textsuperscript{252} See supra text pp. 119-20.
\textsuperscript{253} See supra text p. 105.
\textsuperscript{254} \textit{In re Baesa Sec. Litig.}, 969 F. Supp. 238 (S.D.N.Y. 1997).
\textsuperscript{255} \textit{Id.} at 242.
\textsuperscript{256} \textit{Id.}
\textsuperscript{257} \textit{Id.}
\textsuperscript{258} \textit{Id.} at 242 n.2.
\textsuperscript{259} \textit{Id.} at 242.
a more stringent standard than that of the Second Circuit.\textsuperscript{260} This interpretation adequately recognizes the express intent of Congress to create a stricter standard, as well as Congress' possible intent to keep the recklessness prong, which has long been held sufficient for pleading scienter.\textsuperscript{261}

Another important piece of legislative history, which many courts consider, is the presidential veto of the PSLRA.\textsuperscript{262} This is an indication that Congress intended a more stringent standard than that of the Second Circuit. The President was compelled to veto the bill because he believed it was "crystal clear" that Congress intended to raise the standard beyond what already existed under the Second Circuit.\textsuperscript{263} The President informed Congress that he would be willing to support the high pleading standard of the Second Circuit, but would not support anything beyond the level of that standard.\textsuperscript{264} He believed the PSLRA would erect a barrier "so high that even the most aggrieved investors with the most painful losses may get tossed out of court before they have a chance to prove their case."\textsuperscript{265} The court in \textit{Silicon Graphics I}\textsuperscript{266} argued that "[f]urther emphasizing its 'crystal clear' intent to heighten the pleading standard, Congress overrode the veto."\textsuperscript{267} Despite this language by the President, those supporting the Second Circuit standard argue that "the President's characterization of the Reform Act cannot determine what Congress itself intended."\textsuperscript{268} However, the better rationale is that if the President read the PSLRA as supporting a stricter standard, and Congress did not make any

\textsuperscript{260} \textit{In re Baesa Sec. Litig.}, 969 F. Supp. 238, 242 (S.D.N.Y. 1997).


\textsuperscript{262} H.R. DOC. NO. 104-150, at 240 (1995).


\textsuperscript{266} No. C 96-0393, 1996 WL 664639 (N.D. Cal. Sept. 25, 1996).

\textsuperscript{267} \textit{Id.} at *5.

\textsuperscript{268} Coffee, \textit{supra} note 46, at 982.
changes to the PSLRA to clarify their intent, it is indeed most likely that the President's interpretation was correct and Congress agreed with his initial reading of the PSLRA.\textsuperscript{269}

Although Congress never explicitly wrote into the bill its intent to have a more stringent standard than the one already existing in the Second Circuit, it is quite clear from the language in the Conference Committee Report that Congress indeed intended a more stringent standard.\textsuperscript{270}

2. Congress Did Not Intend to Alter the Standard of Liability

With the passage of the Uniform Standards Act of 1998, new legislative history was included regarding the scienter standard.\textsuperscript{271} This new "history" appears to suggest that Congress wanted to adopt the Second Circuit standard as the uniform approach.\textsuperscript{272} However, this raises a number of new questions. First, this is legislative history created more than two and a half years after the passage of the PSLRA. Congress again was given the ability to make their intentions clear in actual legislation, but it chose not to.\textsuperscript{273} Thus, if Congress indeed wanted to make the Second Circuit standard the uniform approach, it should have put this in actual legislation. Furthermore, though many encourage the use of legislative history to interpret ambiguous statutes,\textsuperscript{274} it is much more questionable to use legislative history created years after the passage of the original statute by a different Congress.\textsuperscript{275}

\begin{footnotes}


\textsuperscript{270} H.R. CONF. REP. NO. 104-369 (1995). See also Michael A Dorelli, Note, Striking Back at "Extortionate" Securities Litigation: Silicon Graphics Leads the Way to a Truly Heightened and Uniform Pleading Standard, 31 IND. L. REV. 1189, 1217 (1998) (stating that the Silicon Graphics standard is sensitive to the goal of Congress to create reform and creates a balance between "the need to prevent redress, deceptive, and manipulative practice in securities litigation and the maintenance of respectable capital markets.").

\textsuperscript{271} See supra notes 57-60 and accompanying text.

\textsuperscript{272} See S. REP. NO. 105-182 (1998).

\textsuperscript{273} See S. REP. NO. 105-182 (1998) (statement of Senators Sarbanes, Bryan, and Johnson) (noting a shortcoming of the new Bill was its failure to codify liability for reckless conduct).

\textsuperscript{274} See infra Part IV.B.3.

\textsuperscript{275} See S. REP. NO. 105-182 (1998) (statement of Senators Sarbanes, Bryan, and Johnson). In their statement, Senators Sarbanes, Bryan, and Johnson stated:

\end{footnotes}
Also, when looking closely at this new "history," it focuses only on Congress' intent to preserve the "recklessness" standard. Conspicuously missing in both the Senate and House reports is any explicit desire to keep the "motive and opportunity" prong of the Second Circuit standard. Since the trend among most cases is to keep "recklessness," these new statements seem to make little difference. Additionally, in Carley Capital Group v. Deloitte & Touche, the district court addressed this new language and held that it did not codify the Second Circuit standard in any way. The court held that though recklessness is sufficient, "the 'motive and opportunity' standard, if honestly applied, lowers the bar for securities fraud cases below that mandated by the Supreme Court in Hochfelder." Although these different pieces of legislative history were written to help define the standard intended by Congress, their contradictions are problematic for those who argue that legislative history should be used to interpret the PSLRA.

3. Arguments for and Against Using Legislative History

Much controversy currently exists over whether legislative history should be used at all when interpreting a statute. Some argue that legislative history is an important part of statutory interpretation and cannot be dispensed

[Legislative history] is not a substitute for legislative language. Federal courts do not uniformly consider legislative history when deciding questions of statutory interpretation. Even those courts that do may not consider legislative history prepared in a succeeding Congress when interpreting a statute enacted in a preceding Congress.... The Bill therefore would preempt State class actions in favor of a uniform Federal standard potentially containing a disastrous flaw, namely no imposition of liability for reckless conduct.


277. 1998 WL 804929 (N.D. Ga.).

278. Id. at *14. The court instead followed Eleventh Circuit precedent which has never adopted a scienter standard that allows for the pleading of "motive and opportunity." Id.

279. Id. at *14; Sturm v. Marriott Marquis Corp., 1998 WL 804925 (N.D. Ga.).

280. See Breyer, supra note 62; Dortzbach, supra note 63.

281. See Dortzbach, supra note 63, at 162.
with. Justice Breyer has argued that under the following five circumstances, a court should turn to legislative history for help in interpreting a statute: (1) avoiding an absurd result; (2) preventing the law from turning on an error in drafting; (3) understanding the meaning of specialized terms; (4) understanding the "reasonable purpose" a provision might serve; and (5) choosing among several possible "reasonable purposes" for language in a politically controversial law. Use of legislative history to interpret the PSLRA could fall under a number of these reasons, including the last regarding a controversial law. Justice Breyer further argues that although use of legislative history has some pitfalls, it is significantly better than the alternative of relying on canons of interpretation. Though there are persuasive arguments on both sides of this issue, use of legislative history to interpret the PSLRA is very compelling due to its length and the controversy surrounding its meaning regarding the scienter issue.

Some scholars have argued that without looking at legislative history, many securities law doctrines will be imperiled. In Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., the Supreme Court's treatment of legislative history was a departure from past methodology. The Court ignored the legislative history of the securities law at issue and came to a very controversial conclusion by striking down aiding and abetting liability under Section 10(b). The Court stated that strict adherence to statutory language is "[t]he starting point in every case involving construction of a statute." The Court then based its decision almost exclusively upon the plain language of Section 10(b).

282. See Breyer, supra note 62, at 845.
283. Id. at 861.
284. Id.
285. Id.
286. Id.
287. Id.
288. Dortzbach, supra note 63, at 171.
289. See Coco, supra note 68, at 557.
291. See Coco, supra note 68, at 562.
292. See id. at 561.
294. See id. at 564.
Because use of legislative history may have led to a different ruling, it is evident from *Central Bank* that discarding legislative history can significantly impact the outcome of a statute's interpretation. The interpretation of the pleading standard under the PSLRA could also possibly have a different outcome if the Court dispenses with the use of its legislative history.\(^\text{295}\)

Another argument in favor of legislative history is that scholars emphasize the reliability of Conference Committee Reports in their arguments for the use of legislative history.\(^\text{296}\) Historically, committee reports constitute nearly fifty percent of the Supreme Court's references to legislative history materials.\(^\text{297}\) Ordinarily, these reports are considered the most reliable and persuasive element of legislative history.\(^\text{298}\) As Justice Harlan noted, they represent the "considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation."\(^\text{299}\) Thus, under this view, the Conference Committee Report on the PSLRA would have much weight in showing Congress' true intent for the pleading standard for scienter. This argument is quite persuasive considering Congress' explicit words revealing its intent for a more stringent pleading standard.\(^\text{300}\) Though the Committee Reports associated with the Uniform Standards Act of 1998 adds somewhat conflicting information,\(^\text{301}\) it was included years later and has much less weight than the original report which shows the intent at the actual time of the passage of the PSLRA.

Others argue that legislative history should not be considered when interpreting a statute; instead, courts must look to the statute itself to determine its intent.\(^\text{302}\) Among the


\(^{297}\) See id. at 43.

\(^{298}\) See id.

\(^{299}\) *Id.* (quoting *Zuber v. Allen*, 396 U.S. 168, 186 (1969)).


\(^{301}\) See supra notes 57-60.

\(^{302}\) See Kenneth W. Starr, *Observations About the Use of Legislative Hist-
arguments waged against using legislative history are that it is unconstitutional, it necessarily relies upon a fiction of legislative intent, and it is easily manipulated by legislators. Critics claim that legislative history lacks legitimacy because a legislature never voted on it, nor did an executive member sign it into law. They also claim that in many cases, no collective intent existed in forming the meaning assumed to be evidenced within the committee reports, and legislative history is subject to many possible interpretations. Critics worry that judges will use legislative history to improperly arrive at incorrect results and to improperly usurp power from the legislative and executive branches.

Justice Scalia and other critics suggest that less reliance should be placed on legislative history and that the relative importance of committee reports and floor debates should be reversed. Scalia uses a textualist approach that focuses on what the text of a statute actually says and not on what its sponsors intended it to mean. Scalia argues that legislative history lacks legitimacy since it is not the law itself. He contends that judges could create an intent for the legislature where none truly existed, and therefore, use of legislative history is dangerous. Scalia stated that "[t]he law is what the law says, and we should content ourselves with reading it rather than psychoanalyzing those who enacted it." Therefore, Scalia contends that the plain meaning of the text is the most reliable evidence of Congress' intent.
Recently, the Supreme Court has engaged in a pattern of statutory interpretation that suggests it believes it should not use legislative history as extensively as it has in the past. In Shannon v. United States, the Court stated that "courts have no authority to enforce [a] princip[le] gleaned solely from legislative history that has no statutory reference point." Currently, the Supreme Court will pay little attention to statements in the legislative history that are not "anchored" to some provision in the statutory text. This trend could prevent the use of legislative history for interpreting the PSLRA even though it has much relevance in showing Congress' true intent for the pleading standard.

If a court focuses only on the statutory text and ignores the abundant legislative history, it may conclude that following the Second Circuit's test comports with the requirements of the PSLRA. However, a strong argument exists that from the legislative history, Congress intended a stricter standard than that of the Second Circuit. Because recklessness has generally been acceptable for pleading scienter, Congress probably intended to keep this prong of the Second Circuit's test. However, "motive and opportunity" has been more controversial, and therefore, is insufficient under the PSLRA.

V. PROPOSAL

Whether or not the use of legislative history is appropriate when interpreting statutory text, it is clear that the Supreme Court has been leaning toward a plain meaning approach for some time. Thus, when the issue of pleading

(1994).
318. See Coffee, supra note 46, at 976.
320. See Olson, supra note 11, at 1120.
321. See supra Part IV.B.1.
322. See supra Part IV.A. This is also supported by the new "history" of the Uniform Standards Act of 1998, which makes numerous references to the importance of preserving the "recklessness" standard. See S. REP. NO. 105-182 (1998); H.R. CONF. REP. NO. 105-803 (1998).
323. See supra Part IV.B. See also Carley Capital Group v. Deloitte & Touche, 1998 WL 804929 at *14 (N.D. Ga.).
324. See Outzs, supra note 315, at 297-98.
scienter under the PSLRA reaches the appellate courts, and possibly the Supreme Court, plain meaning will carry more weight than legislative history.\(^{325}\) Though this approach could lead to a result that contradicts the true intent of Congress,\(^{326}\) plain meaning and legislative history could be reconciled if a court follows the \textit{Baesa} reasoning.\(^{327}\)

In \textit{Baesa}, the court held that the PSLRA does not heighten the scienter requirement by requiring more than "recklessness," but the PSLRA does make the pleading of "motive and opportunity" insufficient to raise a "strong inference" of scienter.\(^{328}\) \textit{Baesa} derived this holding from the plain text of the statute rather than its legislative history.\(^{329}\) This result not only complies with the Supreme Court's desire to use plain language in statutory interpretation, but it also achieves Congress' intent to heighten the pleading standard by making the Second Circuit's "motive and opportunity" prong insufficient.

Therefore, Congress' intent to heighten the pleading standard can be achieved with only a plain meaning analysis of the statute. The "recklessness" prong, which has been commonly accepted,\(^{330}\) can and should remain part of the standard for pleading scienter. However, the pleading of motive and opportunity is not necessarily stringent enough in itself, and without more, it should not withstand a motion to dismiss under the PSLRA.

VI. CONCLUSION

The Second Circuit standard for pleading scienter has long been considered the most stringent standard in the nation.\(^{331}\) However, under the PSLRA, much confusion has arisen as to what the present standard is for pleading scient-

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326. \textit{See supra} Part IV.B.1.
330. \textit{See id.} at 239.
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and courts in various circuits have come to different conclusions as to the present standard. Some continue to adopt the Second Circuit standard, while others impose a stricter standard of "conscious behavior." As the Zeid court noted in its discussion of the conflicting interpretations of Marksman and Silicon Graphics I, "[t]he fact that these two courts, in well-reasoned opinions, provide different assessments of Congress' intent illustrates the inherent ambiguity of the legislative record."

Because of this ambiguity, the issue of pleading scienter after the PSLRA will surely continue unless Congress makes its standard more explicit in the body of actual legislation. Whether the courts accept only a plain meaning analysis of the PSLRA or look to its legislative history, it is already quite clear that Congress intended something stricter than the standard already imposed by the Second Circuit. However, no one knows how much more stringent Congress intended the standard to become, and the result in a particular case may depend upon whether a court uses a plain meaning approach or considers the legislative history as well.

The Baesa decision is probably our best solution to this ambiguous congressional act because its decision survives either approach. Baesa keeps a standard that has long been recognized as sufficient and discards another standard that is more controversial. Though there is much anticipation regarding the forthcoming Ninth Circuit opinion, which will be the first appellate decision on this issue, it will be but one of many appellate decisions to inevitably decide this issue. Whatever the Ninth Circuit's outcome, the controversy surrounding the standard for pleading scienter will continue until either Congress clarifies its intent in actual legislation or the Supreme Court resolves the issue. Furthermore, the new

332. See supra Part II.D.
333. See supra Part II.D.
334. See supra Part II.D.1.
335. See supra Part II.D.2.
340. See supra Part IV.B.1.
341. See supra text pp. 104-5.
343. See supra note 146.
statements associated with the Uniform Standards Act of 1998 regarding the scienter standard will continue to create even more debate. Though the final resolution of this issue is unclear, *Baesa* and its followers should be very influential.

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