SOUTH FERRY LP, #2 V. KILLINGER: CAN THE "CORE OPERATIONS INFERENCE" SATISFY THE PRIVATE SECURITIES LITIGATION REFORM ACT'S STRONG INFERENCE OF SCIENTER REQUIREMENT IN THE AFTERMATH OF *TELLABS*?

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I. INTRODUCTION

A. Overview and Relevancy of Securities Litigation

There are two types of securities litigation: public securities litigation and private securities litigation.[1] Public securities litigation includes civil lawsuits brought by the Securities and Exchange Commission ("SEC") and criminal lawsuits referred to the Department of Justice ("DOJ") by the SEC.[2] Although the SEC is the federal agency responsible for the regulation of securities, limited resources hinder the SEC from investigating and prosecuting every fraud claim, which is where private securities litigation comes in.[3]

Proponents of private securities litigation argue that private lawsuits provide a crucial check on directorial accountability by allowing investors, through their lawyers, to seek remedy when a corporation has defrauded an investor.[4] In recent years, private litigation has enabled defrauded investors to receive large settlements from massive corporations, such as Enron, which settled a private lawsuit for $7.2 billion, and Tyco International, which settled a private lawsuit for $2.975 billion.[5] Private lawsuits allow investors "and their lawyers to monitor the behaviors of a corporate board in the interest of reducing . . . costs [to the SEC]."[6] Proponents argue that private lawsuits are pursued by "rational . . . individuals . . . against corporations or boards of directors when they feel they have been victims of fraud."[7] Private securities litigation is meant to foster "an environment where committing securities fraud is less attractive, as private party litigation greatly increases the number of individuals who have an incentive to bring suit" which is intended to deter corporate entities from "engaging in fraudulent activities."[8]

Opponents of private securities litigation argue that there is a great risk for abusive litigation by shareholders filing excessive and frivolous lawsuits, which place a huge burden on corporations because of the costs involved in defending the

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[1] 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, 781 (2005) (discussing securities litigation in general).

[2] *Id.* at 782.

[3] *Id.*

[4] *See generally id.* at 783. This author uses the terms "investor" and "shareholder" interchangeably.

[5] John M. Wunderlich, Note, Tellabs v. Makor Issues & Rights, LTD.*: The Weighing Game*, 39 LOY. U. CHI. L.J. 613, 659 (2008).

[6] Mulreed, *supra* note 1, at 783.

[7] *Id.* at 784. This is a stark departure from the perspective of opponents of private securities litigation who depict money-hungry plaintiffs filing frivolous lawsuits through which their lawyers extort large settlements from corporations, knowing that a corporation would rather settle than proceed to trial, which opponents claim is an abusive strike by plaintiffs and their lawyers against corporations.

[8] *Id.*

corporations against such lawsuits.[9] The United States Chamber of Commerce ("Chamber of Commerce") views private securities litigation as "a serious threat to the health of U.S. businesses, the prosperity of American families and the strength of our nation's global competitiveness."[10] Lisa A. Rickard, the president of the United States Chamber Institute for Legal Reform, noted that "'America's securities class action system is broken, both in its design and application' . . . [and has] caused the destruction of nearly $25 billion of shareholder wealth between 1995 and 2005."[11] Opponents of private securities litigation claim that "systemic failures have been exacerbated by trial lawyers who abuse the class action mechanism for profit" where investors receive a small amount of money as compared to the "huge sums chewed up in legal costs."[12] An overarching concern of opponents is that private securities litigation "forces businesses to mitigate potential damages by settling lawsuits rather than risk going to trial," which generates billions of dollars in settlement money, "weakening the competitive position of the U.S. capital markets."[13]

Private securities litigation initially increased "in the aftermath of corporate scandals involving Enron and WorldCom[]"[14] and compensated for the SEC's limited enforcement abilities.[15] Traditionally, the SEC acted as an advocate for private securities litigation; however, former SEC Chairman, Christopher Cox, who served under the Bush Administration (and helped draft the Private Securities Litigation Reform Act to be discussed later in this article), was known to lead a "pro-business and anti-investor" SEC.[16] The Bush Administration officials pushed to limit investor lawsuits by encouraging "a relaxation of . . . regulations and new restrictions on lawsuits" because they believed that shareholder lawsuits discouraged investment and caused many American corporations to raise capital overseas, rather than domestically.[17] However, critics of the Bush Administration's business-friendly approach argued that corporations used foreign markets to raise capital for reasons other than avoiding securities litigation and that significant limits were already placed upon private shareholder suits which prevented frivolous claims.[18] In fact, private securities lawsuits filed in federal courts decreased from 497 in 2001 to 57 in 2007.[19] Proponents and opponents of private securities litigation agree

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[9] *Id.* at 783.

[10] Press Release, U.S. Chamber of Commerce, Sec. Lawsuit Sys. in Need of Repair, U.S. Chamber Says: New Analysis Outlines Magnitude of Problem, Offers Avenues for Reform (July 24, 2008), *available at* http://www.uschamber.com/press/releases/2008/july/080724_ilr.htm.

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] Steven Labaton, *Investors' Suits Face Higher Bar, Justices Rule*, N.Y. TIMES, June 22, 2007, *available at* http://www.nytimes.com/2007/06/22/washington/22bizcourt.html?_r=2&sq=Tellabs,%20SupreSu%20Court&st=cse&scp=2&pagewanted=print.

[15] Mulreed, *supra* note 1, at 783.

[16] Steven Labaton, *S.E.C. Seeks to Curtail Investor Suits*, N.Y. TIMES, Feb. 13, 2007, *available at* http://www.nytimes.com/2007/02/13/washington/13sec.html?_r=1&scp=1&sq=S.E.C.%20Seeks%20to%20Curtail%20Investor%20Suits&st=cse.

[17] Labaton, *supra* note 14.

[18] *Id.*

[19] *Id.*

that private lawsuits "discourage[] corporate misconduct and encourage[] companies to be more transparent."[20] However, the dispute between the two sides centers on whether shareholders abuse private securities litigation by bringing frivolous lawsuits as a means to extract large settlements.

B. The Scienter Debacle

Private securities litigation is brought under section 10(b) ("Section 10(b)") of the Securities Exchange Act of 1934 ("Exchange Act") and rule 10b-5 ("Rule 10b-5"), promulgated by the SEC under Section 10(b).[21] Section 10(b) and Rule 10b-5 allow investors to "recover damages caused by an act or omission resulting in fraud or deceit in connection with the purchase or sale of any security."[22] One element that plaintiffs must prove is that the defendant acted with scienter, or a wrongful state of mind (i.e., intent to defraud).[23] However, the standard for scienter was never defined under the Exchange Act; therefore, a split developed among the circuits regarding the specificity with which plaintiffs needed to prove scienter.[24] For example, the Second Circuit "required that the facts alleged in the plaintiff's complaint give[] rise to a strong inference of fraudulent intent" while the Ninth Circuit permitted plaintiffs "to allege facts constituting circumstantial evidence of fraudulent behavior," a lower standard than the Second Circuit.[25] The circuit split encouraged plaintiffs to forum shop because a typical private securities lawsuit involves plaintiffs in numerous states, which created the concern for abusive litigation.[26] In 1995, Congress passed the Private Securities Litigation Reform Act ("PSLRA") to combat abusive litigation.[27]The PSLRA was intended to "creat[e] a uniform scienter requirement" and heighten the pleading standard required of plaintiffs.[28] However, Congress failed to define what constitutes a strong inference of scienter, the pleading standard under the PSLRA.[29] Once again, there was a circuit split regarding the scienter standard.[30] Given the circuit split, in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,[31] the United States Supreme Court attempted to clarify the pleading standard for scienter. However, the circuit

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[20] *See id.*

[21] *See* Wunderlich, *supra* note 5, at 619–20.

[22] *Id.* at 619–20; Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006); 17 C.F.R. § 240.10b-5 (2009).

[23] Wunderlich, *supra* note 5, at 620; § 78j(b); § 240.10b-5.

[24] Mulreed, *supra* note 1, at 806.

[25] *Id.* at 806–07 (internal quotation marks omitted).

[26] *Id.* at 807.

[27] Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(1)(2) (2006); Mulreed, *supra* note 1, at 787.

[28] Mulreed, *supra* note 1, at 780, 787.

[29] 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, 637–38 (2008) (arguing that the *Tellabs* rule is too flexible, and, therefore, improper to determine whether the PSLRA pleading standard for scienter has been met).

[30] *Id.* at 638.

[31] 551 U.S. 308 (2007).

courts' application of *Tellabs* has proven to be more complex than anticipated and has drastically shifted the pleading standard for scienter in the Ninth Circuit.[32]

C. Case Summary: South Ferry II

In *South Ferry LP, #2 v. Killinger* ("*South Ferry II*"),[33] the Ninth Circuit Court of Appeals vacated in part and remanded in part the United States District Court's decision to deny in part defendants' motion to dismiss based on the pleading standard for securities fraud actions under the PSLRA, which requires a strong inference of scienter or required state of mind.[34] Investors who owned publicly traded securities of mortgage lender Washington Mutual ("WAMU") filed a securities fraud class action alleging that WAMU and its senior executive officers issued materially false and misleading statements.[35] The Ninth Circuit held that (1) allegations of management's role in a company may be relevant to satisfy the strong inference of scienter requirement under the PSLRA, and (2) remand was required for the district court to reconsider the PSLRA scienter requirement based on the totality of the circumstances test set forth in *Tellabs*.[36]

D. Organization

Parts II.A and B of this Note trace the history and development of securities regulations and outline the ambiguity that arose from the poorly defined standard for scienter as initially set forth in Section 10(b) and Rule 10b-5.[37] Part II.C discusses the background, goals, and significance of the PSLRA, and how it heightened the pleading requirements for private securities fraud actions, which created a circuit split with respect to the standard for scienter.[38] Part II.D provides a discussion of the events that led to the Supreme Court's attempt in *Tellabs* to clarify the standard for the strong inference of scienter requirement under the PSLRA in order to provide a clear-cut rule for the circuit courts to apply.[39] Part II.E traces the Ninth Circuit's pre-*Tellabs* approach to the PSLRA standard for strong inference of scienter and addresses whether the core operations inference, as a scienter allegation, can satisfy the PSLRA scienter standard.[40] Part III provides an in-depth overview of *South Ferry II* and a thorough discussion and analysis of the majority opinion.[41] Part IV discusses the impact of *South Ferry II* on the core operations inference, securities plaintiffs, corporate defendants, courts, and the market in general.[42] Part V concludes by arguing that *Tellabs* did not achieve its goal of provid-

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[32] *See generally* Fipp, *supra* note 29 at 635; Mulreed, *supra* note 1, at 810.

[33] 542 F.3d 776 (9th Cir. 2008).

[34] *Id.* at 779, 781.

[35] *Id.* at 779–80.

[36] *Id.* at 785–86.

[37] *See infra* notes 44–73 and accompanying text.

[38] *See infra* notes 74–103 and accompanying text.

[39] *See infra* notes 104–66 and accompanying text.

[40] *See infra* notes 167–98 and accompanying text.

[41] *See infra* notes 199–253 and accompanying text.

[42] *See infra* notes 254–72 and accompanying text.

ing guidance to the circuits in interpreting the strong inference of scienter requirement under the PSLRA, evidenced by the Ninth Circuit's ruling in *South Ferry II*, which drastically differs from the Ninth Circuit's pre-*Tellabs* approach to scienter.[43]

II. BACKGROUND

A. The Origin of the Securities Acts

After the stock market crash in 1929, the U.S. economy suffered a period of "immense . . . turmoil" which resulted in the Great Depression.[44] President Franklin D. Roosevelt placed blame upon "the excesses of big business."[45] In response, he designated two statutes in his New Deal legislation to regulate securities transactions.[46] The goal of these statutes was "to protect investors and . . . maintain confidence in the securities markets, which . . . had eroded after the market crash."[47] Congress passed the Securities Act of 1933 ("Securities Act"), followed by the Exchange Act, passed in 1934.[48]

The Securities Act aimed "to provide investors with sufficient and significant information" regarding the initial sale of securities by an issuer (a corporation "issuing" securities to the public), and prohibited deceit and fraud by issuers.[49] The Securities Act requires issuers to disclose "material information concerning public offerings of securities."[50] The overarching goal of the Securities Act is "to promote honesty and fair dealing in the market."[51]

The Exchange Act was passed in 1934 to complement the Securities Act.[52] The overarching goal of the Exchange Act is to prevent the manipulation of stock prices.[53] The Exchange Act protects "investors from unfair practices by regulating securities exchanges and over-the-counter-markets operating in commerce" (i.e., secondary trading of securities).[54] The Exchange Act also protects investors from fraud or deceit in connection with the purchase or sale of a security "by imposing standardized reporting requirements on publicly traded companies."[55]

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[43] *See infra* notes 273–278 and accompanying text.

[44] Wunderlich, *supra* note 5, at 618.

[45] *Id.* at 618–19.

[46] *See id.* at 619; Fipp, *supra* note 29, at 632 (discussing the federal government's response to the stock market crash of 1929).

[47] Fipp, *supra* note 29, at 632.

[48] Securities Act of 1933, 15 U.S.C. § 77a (2006); Securities Exchange Act of 1934, 15 U.S.C. § 78a (2006); Wunderlich, *supra* note 5, at 619.

[49] Wunderlich, *supra* note 5, at 619.

[50] Fipp, *supra* note 29, at 633.

[51] *Id.* However, this author finds the application of the Securities Act to have been undermined given the current demise of the market, which has resulted from dishonesty and unfair dealing in the market.

[52] *Id.*

[53] Wunderlich, *supra* note 5, at 619.

[54] Fipp, *supra* note 29, at 633.

[55] *Id.* (stating that part of the Exchange Act was the creation of the SEC to enforce the Securities Act and the Exchange Act).

B. Section 10(b) of the Exchange Act and Rule 10b-5

Section 10(b) was incorporated within the Exchange Act.[56]Section 10(b) makes it unlawful:

> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not . . . registered . . . any manipulative or deceptive device or contrivance in contravention of . . . rules and regulations as the [SEC] may prescribe as necessary . . . for the protection of investors.[57]

In 1942, the SEC promulgated Rule 10b-5 "under the authority [of] [Section] 10(b)."[58] Under Rule 10b-5, it is illegal to use:

> [A]ny device, scheme, or artifice to defraud . . . make any untrue statement of a material fact or . . . omit . . . a material fact . . . or . . . engage in any act . . . which operates . . . as a fraud or deceit upon any person in connection with the purchase or sale of any security.[59]

Although Section 10(b) and Rule 10b-5 permit the SEC to regulate securities fraud, "neither [technically] permits private actions for [securities] fraud."[60] In 1946, the United States District Court for the Eastern District of Pennsylvania held that there was an implied private right of action under Section 10(b),[61] and in 1971, the Supreme Court established that a private right of action was available under Section 10(b), and therefore, Rule 10b-5.[62] In a private lawsuit filed under Section 10(b) and Rule 10b-5, the plaintiff must allege and prove the following elements: (1) the defendant made a material misrepresentation or omission; (2) the defendant acted with scienter; (3) the material misrepresentation or omission was made in connection with the purchase or sale of a security; (4) the plaintiff relied on the material misrepresentation or omission; (5) the plaintiff suffered an economic loss; and (6) the material misrepresentation or omission caused the economic loss.[63]

The circuit courts adopted the scienter requirement, but the standard for scienter, or what constitutes a wrongful state of mind, was never defined in the Exchange Act; therefore, the circuit courts deferred to the pleading standard required under Federal Rule of Civil Procedure 9(b) ("Rule 9(b)").[64] Rule 9(b) "applies to actions brought under the federal securities laws."[65] Rule 9(b) requires plaintiffs to state with particularity the circumstances that constitute fraud on part of the de-

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[56] 15 U.S.C. § 78j(b) (2006).

[57] *Id.*

[58] Fipp, *supra* note 29, at 633.

[59] 17 C.F.R. § 240.10b-5 (2009).

[60] Fipp, *supra* note 29, at 634.

[61] *See* Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946)

[62] *Id.* (referring to the Supreme Court's holding in *Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*, 402 U.S. 993 (1971)).

[63] Wunderlich, *supra* note 5, at 620; 15 U.S.C. § 78j(b) (2006); § 240.10b-5.

[64] Wunderlich, *supra* note 5, at 635.

[65] *Id.*

fendant, but Rule 9(b) does not specifically address scienter.[66] The circuit courts agreed that Rule 9(b) governed the pleading standards for securities fraud actions, but they disagreed on its interpretation with respect to the pleading standard for scienter.[67] For example, "[t]he Ninth Circuit [only] required plaintiffs to state that scienter existed," whereas the First Circuit "require[d] a plaintiff to state facts that give rise to an inference of scienter."[68] The Second Circuit applied the strictest standard by requiring plaintiffs to "plead a strong inference of fraudulent intent."[69] The lack of uniform pleading standards for securities fraud actions caused concern because "[p]leadings are . . . the key to the courthouse door . . . [and] absent a well-pled complaint, plaintiffs have no chance of relief."[70] There was a dual concern created by the circuit split: (1) that plaintiffs would forum shop to find a court that applied a more lenient pleading standard for scienter; and (2) that the different standards applied by the circuits would confuse plaintiffs.[71] The circuit split "triggered the need for change and established the importance of uniform pleading requirements in securities fraud actions."[72] In 1995, Congress enacted the PSLRA, and one important goal of the PSLRA was to create uniform pleading standards for securities fraud actions brought under Section 10(b) and Rule 10b-5.[73]

C. The PSLRA: Success or Failure?

1. Background/Goals of the PSLRA

Congress recognized that private securities litigation "provided defrauded investors with . . . necessary relief for their losses."[74] However, Congress was concerned that private securities litigation had "run rampant," and it sought to "reduce frivolous . . . litigation while [still] allowing meritorious claims to proceed."[75] Congress also desired to create a uniform pleading standard for scienter in order to reconcile the circuit split.[76] Essentially, Congress had two goals in passing the PSLRA: (1) reducing frivolous private securities litigation; and (2) creating a uniform scienter requirement.[77]

Under the PSLRA, with respect to each allegation of a material misstatement or omission, plaintiffs must state with particularity facts that give rise to the alleged material misstatement or omission and facts that give rise to a strong infe-

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[66] Fipp, *supra* note 29, at 635; FED. R. CIV. P. 9(b).

[67] Fipp, *supra* note 29, at 635.

[68] *Id.*

[69] Erin E. Rhinehart, *Diluting the Strong Inference Standard*, FED. LAW., May 2008, at 20.

[70] Wunderlich, *supra* note 5, at 616.

[71] Fipp, *supra* note 29, at 636.

[72] *Id.*

[73] *See id.* at 637.

[74] *Id.* at 636.

[75] *Id.*

[76] *Id.*

[77] Mulreed, *supra* note 1, at 780.

rence of scienter.[78] The PSLRA adopted a higher standard for scienter than the Second Circuit's standard of strong inference of fraudulent intent because it required plaintiffs to plead with particularity facts that constitute a strong inference of scienter with respect to each allegation.[79] In the PSLRA, Congress intended to go beyond the Second Circuit's standard to heighten the pleading requirements for private securities fraud actions in all the circuits.[80]

President Clinton vetoed the PSLRA because of the heightened pleading requirements that "require a plaintiff to plead facts that [the plaintiff] may not yet possess."[81] Clinton aligned with the argument made by plaintiffs that discovery would be necessary to obtain the facts necessary to meet the pleading requirements of the PSLRA, but that the PSLRA precludes them from discovery if they cannot present strong evidence of fraud in their pleadings.[82] Therefore, Clinton was opposed to "any attempt to heighten the [pleading] standard beyond that applied in the Second Circuit."[83] However, Congress argued that the PSLRA was intended "to strike the optimal balance between protecting investors from fraud and preventing opportunistic plaintiffs from [filing] frivolous suits."[84]Congress' overarching goal was to "deter plaintiff's attorneys from bringing 'strike suits' . . . [t]ypically filed in response to significant drop in share value [which] rarely contain specific allegations of fraud[;] . . . [b]y definition, these suits represent bad faith efforts to reach excessive settlements and . . . attorney's fees."[85] The PSLRA was enacted on December 22, 1995, over Clinton's veto,[86] "by a substantial, bipartisan majority of both Houses."[87]

2. Significance of the PSLRA

The PSLRA could be viewed as the most significant securities legislation since the Securities Act and Exchange Act because it "introduced major revisions to the Exchange Act and the rules of private securities litigation."[88] According to the Chamber of Commerce, the PSLRA was the answer to:

> [S]trike suits . . . [where] lawyers recruited . . . plaintiffs who bought a few shares of . . . stock for the . . . purpose of bringing a class action . . . the day after the share price declined . . . and [oftentimes] lawyers . . . file[d] . . . the same boilerplate

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[78] Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(2) (2006).

[79] Fipp, *supra* note 29, at 637.

[80] *Id.* Essentially, if plaintiffs failed to meet the heightened pleading requirements, their case would be dismissed, which was meant to deter the filing of private securities lawsuits.

[81] Wunderlich, *supra* note 5, at 621; Mulreed, *supra* note 1, at 787.

[82] Mulreed, *supra* note 1, at 787–88.

[83] *Id.* at 788.

[84] *Id.* at 788–89.

[85] *Id.* at 789.

[86] *Id.* at 787.

[87] Letter from R. Bruce Josten, Executive Vice President, U.S. Chamber of Commerce, Letter to the U.S. House of Representatives

H.R. 3763, The Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002 (Apr. 24, 2002), *available at* http://www.uschamber.com/issues/letters/2002/020424hr3763.htm.

[88] Mulreed, *supra* note 1, at 787.

> complaint in [each] case . . . [as a means] to extract hefty attorneys' fees from companies . . . .[89]

Such companies wanted to avoid years of litigation.[90] Pro-business groups believe that the PSLRA has achieved its goals because "complaints filed by plaintiffs . . . have more factual detail" allowing meritorious claims to move forward, while insubstantial claims are dismissed, and "the number of [strike] suits settled for nuisance value has declined."[91]

However, the PSLRA seems to have "undercut the aim of reducing expected litigation and settlement costs[] because plaintiffs [have compensated] by bringing higher stakes suits."[92] The PSLRA caused litigation delays and made litigation more costly for plaintiffs; therefore, "plaintiffs br[ought] cases . . . [with] larger damages" and, as a result, settlements became more costly.[93] Thus, the PSLRA's heightened pleading standards could cause "the overall damages involved in a claim [to] actually rise," but the post-PSLRA rise in settlement costs could be attributed to a smaller number of cases where plaintiffs have suffered "real redress."[94]

3. The Post-PSLRA Circuit Split

In the PSRLA, Congress failed to define "strong inference;" therefore, the language in the PSLRA left "ample room for interpretation" among the circuits as to what facts a plaintiff must plead to meet the strong inference of scienter standard.[95] Thus, the PSLRA "was unsuccessful in resolving the circuit split" with respect to the pleading standard for scienter.[96] The PSLRA has been compared to "wet clay" because "the ultimate reading of the PSLRA lies with the federal courts," who have "molded the PSLRA into their respective visions of what the law should be."[97] The lack of guidance in the PSLRA "on how to apply the scienter requirement" has forced the circuit courts to "discern the congressional intent behind the nebulous language of 'strong inference' . . . and [t]he circuits invariably took different paths."[98]

Post-PSLRA, "[t]hree different approaches developed among the circuits [with respect to] the facts [that] a plaintiff must plead to meet the required 'strong inference' of scienter."[99] The Second and Third Circuits used the Second Circuit's pre-PSLRA standard of strong inference of fraudulent intent because they "reasoned [that] Congress intended to adopt the Second Circuits [pre-PSLRA] pleading

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[89] Letter to the U.S. House of Representatives, *supra* note 87.

[90] *Id.*

[91] *Id.*

[92] Wunderlich, *supra* note 5, at 662.

[93] *Id.*

[94] *Id.*; Letter to the U.S. House of Representatives, *supra* note 87.

[95] Mulreed, *supra* note 1, at 808.

[96] *Id.*

[97] *Id.*

[98] Wunderlich, *supra* note 5, at 623.

[99] Fipp, *supra* note 29, at 638.

standard [under which] a plaintiff would succeed if he or she stated a claim that 'establish[ed] a motive and . . . opportunity to commit fraud, or by setting forth facts that constitute[d] circumstantial evidence of either reckless or conscious behavior."[100] The post-PSRLA approach used in the Ninth and Eleventh Circuits was perceived as the most extreme of the approaches, "requiring 'strong circumstantial evidence of deliberately reckless or conscious misconduct."[101] The First, Fourth, Fifth, Sixth, Eighth, and Tenth Circuits developed a middle ground approach in which they applied "a case-by-case approach, requiring courts to look at the totality of the facts to determine if the allegations gave rise to a strong inference of fraudulent intent."[102] Congress' failure to resolve the circuit split regarding the pleading standard for scienter in a securities fraud action brought under Section 10(b) and Rule 10b-5 created the need for the Supreme Court to address the issue.[103]

D. Tellabs: Did the Supreme Court Successfully Define Strong Inference of Scienter?

1. The Impetus for Tellabs

In *Tellabs*, the Supreme Court sought to resolve the circuit split with respect to the pleading standard for scienter.[104] More specifically, the Supreme Court "set out to resolve the . . . dispute concerning whether nonculpable inferences should be considered in assessing whether a strong inference [of scienter] exists."[105] Prior to *Tellabs*, "some circuits required courts to consider nonculpable or innocent inferences, as well as culpable inferences, in determining whether a strong inference of scienter had been alleged," which led to a variety of interpretations from the circuits of the PSLRA's pleading standard for scienter.[106] It became clear that the

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[100] *Id.*

[101] *Id.*

[102] *Id.* at 639.

[103] *Id.* at 640.

[104] *See generally* Wunderlich, *supra* note 5, at 637.

[105] *Id.* at 623.

[106] *Id.*

> In *Brown v. Credit Suisse First Boston Corp.*, . . . a group of investors brought a securities fraud class action . . . [in which they] claimed that the defendant's analysts made misleading statements in the form of false investor ratings about the corporation's stock. The First Circuit held that when assessing whether the plaintiff has pled a strong inference of scienter . . . , a court should . . . consider *all* competing inferences, both culpable and nonculpable . . . . [T]he court . . . [found] that the plaintiff failed to allege a strong inference of scienter because the circumstances surrounding the assignment of the rating were susceptible to . . . nonculpable inferences[,] . . . [which,] when compared with the culpable inference of corruption, was not enough to allege a strong inference of scienter.
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> Similarly, in *Gompper v. VISX, Inc.*, the Ninth Circuit required . . . a court [to] consider nonculpable inferences[] [and] *weigh* these inferences [to] find on balance that there is a strong inference of scienter. The Ninth Circuit was . . . concerned with Congress' intent to eliminate abusive . . . securities litigation. The court stated that the PSLRA "significantly altered pleading requirements" by requiring courts to consider inferences opposing the plaintiff, because a failure to

PSLRA had failed to achieve its goal of creating a uniform scienter requirement and, because "Congress provided little guidance on how to calculate a 'strong inference' of scienter," the circuits created their own rules as to how much evidence plaintiffs needed to allege in their pleadings to avoid dismissal.[107] Therefore, "it was left to the Supreme Court to articulate a uniform . . . standard," which led to *Tellabs*.[108]

2. The Evolution of Tellabs in the District Court and Seventh Circuit

In *Tellabs*, investors brought a securities fraud action against Tellabs, a manufacturer of fiber optic network equipment.[109] The investors had purchased Tellabs stock between December 11, 2000 and June 19, 2001.[110] The investors alleged that Tellabs, Richard Notebaert (Tellabs' chief executive officer and president), and other Tellabs executives (collectively referred to as "Tellabs") violated Section 10(b) and Rule 10b-5.[111] Specifically, they accused Tellabs "of engaging in a scheme to deceive the investing public about the true value of Tellabs' stock."[112] The investors alleged that Tellabs falsely reassured them that it was receiving strong demand for its products and "earning record revenues" although Tellabs knew the opposite was true. The investors claimed that between December 2000 and the spring of 2001, Tellabs misled them in four ways. First, Tellabs claimed that demand for its flagship networking device, the TITAN 5500, was increasing when demand for that product was decreasing.[113] Second, Tellabs indicated that the TITAN 6500, its "next-generation networking device," was ready for delivery and that demand was strong, when in fact, the product was not ready for delivery and demand was low.[114] "Third, [Tellabs] falsely represented [its] financial results for the fourth quarter of 2000 . . . . Fourth, it made a series of overstated revenue projections, when demand for the TITAN 5500 was drying up and production of the TITAN 6500 was behind schedule."[115] The investors argued that Tel-

> do so would eviscerate the PSLRA's strong inference requirement by allowing plaintiffs to plead in a vacuum.
>
> Other circuits required courts to consider nonculpable inferences, but refrained from any weighing of these inferences. For instance, the Tenth Circuit explicitly rejected a weighing of inferences in *Pirraglia v. Novell* . . . [and concluded that] if the plaintiff's complaint alleges facts which give rise to a strong inference of scienter holistically, the plaintiff has pled the requisite strong inference . . . [because] competing inferences are recognized in an evaluative, not preclusive, manner.
>
> In contrast to all other circuits, the Sixth Circuit . . . limit[ed] its consideration to only the most plausible of inferences.

Id. at 623–25.

[107] Labaton, *supra* note 16.

[108] Rhinehart, *supra* note 69, at 20.

[109] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007).

[110] *Id.*

[111] *Id.* at 316.

[112] *Id.* at 315.

[113] *Id.*

[114] *Id.*

[115] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 315 (2007).

labs' positive assessments influenced market analysts to recommend they purchase Tellabs' stock.[116]

The first public indication that Tellabs was suffering economically came in March 2001 when Tellabs reduced its first quarter sales projections.[117] In the following months, Tellabs made cautious statements about projected sales, and, on June 19, 2001, "Tellabs disclosed that demand for the TITAN 5500 had significantly dropped."[118] At the same time, Tellabs "substantially lowered its revenue projections for the second quarter of 2001. . . . [and] [t]he next day, the price of Tellabs stock, which had reached a high of $67 . . . plunged to a low of $15.87."[119] The investors filed a class action on December 3, 2002, in the United States District Court for the Northern District of Illinois, and "Tellabs moved to dismiss the complaint on the ground that the [investors] had failed to plead their case with the particularity that the PSLRA requires. The [d]istrict [c]ourt agreed, and . . . dismissed the [case] . . . ."[120] The investors amended their complaint to include more specific allegations concerning Notebaert's mental state to allege that Notebaert (on behalf of Tellabs) acted with scienter.[121] The district court found that the investors "had sufficiently pleaded that Notebaert's statements were misleading" with respect to Tellabs' products and revenues, but the court concluded that the investors "had insufficiently alleged that [Notebaert] acted with scienter."[122]

On appeal, the Seventh Circuit agreed, in part, with the district court that the investors "had [sufficiently] pleaded the misleading character of Notebaert's statements"; however the Seventh Circuit held that the investors "had sufficiently alleged that Notebaert acted with" scienter.[123] The Seventh Circuit acknowledged that the PSLRA heightened the pleading standard for scienter "by requiring plaintiffs to 'plea[d] sufficient facts to create a strong inference of scienter.'"[124] However, the Seventh Circuit explained that "[i]n evaluating whether [the] pleading standard [for scienter] is met . . . 'courts [should] examine all of the allegations in the complaint and then . . . decide whether collectively they establish such an inference.'"[125] The Supreme Court granted certiorari to "resolve the disagreement among the [c]ircuits on 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."[126]

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[116] *Id.*

[117] *Id.*

[118] *Id*.

[119] *Id.*

[120] *Id.*

[121] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 316 (2007).

[122] *Id.* at 316–17.

[123] *Id*. at 317.

[124] *Id.*

[125] *Id.* at 317–18.

[126] *Id.* at 316.

3. Tellabs: The Supreme Court's Take

In *Tellabs*, the Supreme Court sought to provide a "workable construction of the 'strong inference' [of scienter] standard"[127] set forth in the PSLRA. The Supreme Court clarified that "[t]o establish liability under [Section] 10(b) and Rule 10b-5, a private plaintiff must prove that the defendant acted with scienter, 'a mental state embracing intent to deceive, manipulate, or defraud.'"[128] Although Congress intended to establish "[e]xacting pleading requirements" in the PSRLA, it "left the key term 'strong inference' undefined," which caused the circuit courts to "divide on its meaning."[129] The Supreme Court disagreed with the Seventh Circuit's conclusion in *Tellabs* "that the 'strong inference' standard would be met if the complaint 'allege[d] facts from which, if true, a reasonable person could infer that the defendant acted with'" scienter because this reasoning did not encompass the strict demand imparted in the PSLRA.[130]

The Supreme Court stated that "courts must consider the complaint in its entirety" to inquire "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."[131] Furthermore, "in determining whether the pleaded facts give rise to a 'strong' inference of scienter, the court must take into account plausible opposing inferences" to determine whether there were "plausible nonculpable explanations for the defendant's conduct, as well as [opposing] inferences favoring the plaintiff."[132] The court must evaluate all of the allegations holistically and find the following:

> [I]nference of scienter . . . [is] more than merely "reasonable" or "permissible" . . . [because a] complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.[133]

In other words, the inference of scienter must be "strong in light of other explanations."[134] The Supreme Court vacated the Seventh Circuit's judgment and remanded the case to be reconsidered in accordance with the Supreme Court's holistic or totality of the circumstances approach to the strong inference of scienter standard.[135]

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[127] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322 (2007).

[128] *Id.* at 319.

[129] *Id.* at 314.

[130] *Id.*

[131] *Id.* at 322–23.

[132] *Id.* at 322.

[133] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 323–25 (2007).

[134] *Id.*

[135] *Id.* at 328–29. The Seventh Circuit resolved *Tellabs* on remand in January 2008 in favor of the plaintiffs. Wunderlich, *supra* note 5, at 685. With respect to the false statements made by Notebaert, as Tellabs' CEO and President, "[r]ather than address the issue of scienter from Notebaert's standpoint[,] . . . the Seventh Circuit addressed the issue of scienter from the company's standpoint." *Id.* The Seventh Circuit lumped the two allegations of fraud with respect to demand for the TITAN 5500 and 6500 and, in "weighing the possibility that these statements were simple, honest mistakes against an inference that the CEO knowingly lied," the court determined there was a fifty-fifty balance and held that "the tie

In his concurrence, Justice Scalia expressed his disagreement with the "at least as compelling as any opposing inference" standard set forth by the majority because the PSLRA requires a strong inference for which the test should be "whether the inference of scienter (if any) is *more plausible* than the inference of innocence."[136] Justice Alito, in his concurrence, agreed with Justice Scalia.[137] In his dissent, Justice Stevens argued that Congress intentionally "left the key term 'strong inference' undefined . . . [to] delegate[] significant law-making authority to the Judiciary in determining how that standard should operate in practice."[138]

4. The Impact of Tellabs

The Supreme Court intended for *Tellabs* to unify the pleading standard for scienter among the circuit courts, while maintaining the PSLRA's goal of reducing frivolous claims and allowing meritorious claims to proceed.[139] However, *Tellabs* has been "typecast . . . as injurious to plaintiffs" because the "cogent and at least as compelling as any opposing inferences" standard set forth by the Supreme Court might "be difficult to apply where more than just one nonculpable inference competes with a culpable inference."[140] For example:

> [If] the inference that the defendant acted with scienter is 40%, a nonculpable inference likewise is 40%, and a third alternative accounts for the remaining 20% [and] the third alternative is a nonculpable inference . . . two . . . interpretations emerge. First, the inference of scienter at 40% is at least as likely as the second nonculpable inference, thus it is cogent and compelling (a forty-forty ratio). The inference of [scienter at] 40% . . . is more than likely than the third noncupable inference, and therefore is also cogent and compelling (a forty-twenty ratio). Yet the culpable inference is only 40% likely compared to the nonculpable inferences aggregated at 60% (a forty-sixty ratio); thus, it is not cogent and compelling.[141]

The scenario above demonstrates that the standard set forth in *Tellabs* might "encourage[] defendants to come up with a host of alternative explanations for the alleged fraudulent action" to aggregate nonculpable inferences, which poses a significant risk that meritorious claims could be dismissed when the complaint is assessed holistically.[142] In a sense, *Tellabs* further heightens the pleading standard for scienter because it requires plaintiffs to overcome nonculpable or opposing in-

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should go to the plaintiff." *Id.* at 685–86. However, the "lynchpin on remand was that the [company's] statements . . . involved [its] . . . flagship products." *Id.* Although the Seventh Circuit found in favor of the plaintiffs, they tailored their analysis to reach this decision by addressing the issue of scienter from the company's standpoint, which leaves open the issue of whether it would be more difficult for plaintiffs to plead scienter with respect to an individual. *Id.* Furthermore, the Seventh Circuit found the false statements to be more fraudulent because they dealt with the company's flagship products, which leaves open the issue of whether a plaintiff could successfully plead a strong inference of scienter when false statements are made about less significant products. *Id.*

[136] *Tellabs*, 551 U.S. at 329 (Scalia, J., concurring).

[137] *Id.* at 333–34 (Alito, J., concurring).

[138] *Id.* at 335 (Stevens, J., dissenting).

[139] Wunderlich, *supra* note 5, at 644; Fipp, *supra* note 29, at 641.

[140] Wunderlich, *supra* note 5, at 646.

[141] *Id.* at 649–50.

[142] *Id.* at 650, 670.

ferences even if the plaintiff is able to present strong evidence of scienter.[143]

The Supreme Court's reading of the PSLRA was that Congress enacted the PSLRA to heighten "the pleading standards required in a securities fraud action."[144] Therefore, the Supreme Court argued that Congress must have "determined it insufficient to allege facts from which a reasonable person could find an inference of scienter," which was the reasoning behind the Supreme Court's disagreement with the Seventh Circuit's reasonable person standard.[145] The driving force behind the Supreme Court's "cogent and at least as compelling as any opposing inference" standard was the plain language of the PSLRA which "requires a 'strong inference,' not a 'reasonable' or 'permissible' inference."[146]

Although the Supreme Court sought to create a uniform pleading standard in *Tellabs*, the majority's "cogent and at least as compelling as any opposing inferences standard" "may have stopped short of accomplishing Congress' objectives in enacting the PSLRA."[147] Justice Scalia argued, in his concurring opinion, that the majority's standard did not encompass Congress' intent behind the PSLRA's strong inference of scienter standard because it did not require that the inference of scienter be more compelling than the inference of innocence.[148] The majority's standard implies that "if there is a[n] [even] 'tie' between culpable and nonculpable inferences . . . plaintiffs 'win' and a defendant's motion to dismiss should be denied,"[149] which Scalia would argue undercuts Congress' intent behind the PSLRA's strong inference of scienter requirement.[150] Scalia's concurrence argued for a stricter standard that requires the inference of scienter to be more plausible than the inference of innocence, which implies that "a tie should go to the defendant and the plaintiffs [sic] complaint should be dismissed" because "Congress' intent [was] to preclude plaintiffs from filing suit in hopes that discovery [would] produce a viable claim."[151] The majority rejected Scalia's standard because they did not want "to require the plaintiff 'to plead more than . . . [the plaintiff] would be required to prove at trial.'"[152] While Scalia would argue that Congress' strong inference of scienter standard in the PSLRA requires plaintiffs to plead "fraud by a preponderance of evidence," the majority would argue that Congress intended for the plaintiff to plead a strong enough possibility of fraud to warrant further investigation.[153]

There have been mixed reactions to *Tellabs* with some commentators ac-

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[143] *See id.* at 670.

[144] Fipp, *supra* note 29, at 641.

[145] *Id.*at 632, 641.

[146] *Id.* at 631, 649 (citing Helwig v. Vencor, Inc., 251 F.3d 540, 551, 553 (6th Cir. 2001); *In re* Cabletron Sys., Inc., 311 F.3d 11, 38 (1st Cir. 2002); *In re* Credit Suisse First Boston Corp., 431 F.3d 36, 48 (1st Cir. 2005)).

[147] Rhinehart, *supra* note 69, at 20.

[148] Fipp, *supra* note 29, at 649.

[149] Rhinehart, *supra* note 69, at 20–21.

[150] Fipp, *supra* note 29, at 649.

[151] Rhinehart, *supra* note 69, at 21.

[152] *Id.* (quoting Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 311 (2007).

[153] *Id.*

knowledging it as "a win for corporate America, while others proclaimed no clear win for either side."[154] The SEC was favorable to the Supreme Court's ruling in *Tellabs* because it submitted a brief in the case, signed by the DOJ, which urged the Supreme Court to adopt a standard that would require courts "to weigh any facts that provided for an innocent explanation of the conduct of the company and its executives."[155] Robin Conrad, executive vice president of the National Chamber Litigation Center, praised the Supreme Court in stating that "[b]y adopting a standard that weeds out baseless allegations of securities fraud, [the] Supreme Court's decision [in *Tellabs*] will go a long way in reducing abusive securities class actions, discouraging blackmail settlements, and providing greater certainty for the financial industry and investors."[156] Investor advocates, moreover, said "the ruling . . . will help many defrauded shareholders, making it clear what they must do to get their cases to court."[157] Moreover, Tellabs stated "the ruling adopted 'about as good a standard as we could have gotten.'"[158] However, "[t]he ruling [might] give[] companies a new tool to win early dismissal of shareholder suits and avoid the expense of mounting a full-scale defense."[159] Critics argued that the Supreme Court's decision in *Tellabs* "tightened the limits on fraud lawsuits by shareholders"[160] and, in doing so, "dealt a blow to investors . . . [by] setting a higher standard for [securities] class-action lawsuits to go forward."[161]

Tellabs is "a significant decision . . . [which] altered the landscape of securities law."[162] "Application of the . . . pleading standard [for scienter] is highly fact-sensitive" because it requires courts to examine the plaintiff's complaint "to determine whether the facts as pled raise a strong inference of scienter," which prompts courts to exercise a great deal of discretion in determining whether the strong inference of scienter requirement has been met.[163] Since *Tellabs*, "lower court opinions remain unclear as to the pleading burden that the PSLRA places [upon] plaintiffs."[164] Thus, *Tellabs* may not have succeeded in establishing a uniform pleading standard for the PSLRA's strong inference of scienter requirement.[165] The Supreme Court's "cogent and at least as compelling as opposing inferences" standard for scienter seems to have left room for lower courts to "use *Tellabs* as a scapegoat for . . . leniency when denying defendants' motions to dis-

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[154] Fipp, *supra* note 29, at 657.

[155] Labaton, *supra* note 16.

[156] Press Release, U.S. Chamber of Commerce, Chamber Lauds Supreme Court Decision in Sec. Fraud Case (June 21, 2007), *available at* http://www.uschamber.com/press/releases/2007/june/07-111.htm. The National Chamber Litigation Center is the public policy law firm of the Chamber of Commerce.

[157] Greg Stohr, *Top U.S. Court Tightens Limits on Shareholder Suits (Update 4)*, BLOOMBERG, June 21, 2007, http://www.bloomberg.com/apps/news?pid=20670001&refer=&sid=a065gqfBaEMQ.

[158] *Id.* (quoting Carter Phillips, Tellabs' lawyer).

[159] *Id.*

[160] *Id.*

[161] Labaton, *supra* note 14.

[162] Rhinehart, *supra* note 69, at 21.

[163] *Id.*

[164] *Id.*

[165] *Id.*

miss or as a shield to protect defendants from meritless lawsuits."[166]

E. The Ninth Circuit's Pre-Tellabs Approach to Scienter and Core Operations Allegations

Prior to the PSRLA, "conclusory allegations of scienter were sufficient [for a plaintiff] to survive a motion to dismiss" in the Ninth Circuit.[167] However, "a plaintiff could [have alternatively] allege[d] facts constituting circumstantial evidence of fraudulent behavior, provided the allegations describe[d] how [the] defendant's behavior was fraudulent."[168] *In re Silicon Graphics, Inc.* was the first case in which the Ninth Circuit interpreted the PSLRA.[169] In *Silicon Graphics*, an investor-plaintiff filed a securities fraud class action against Silicon Graphics, Inc. ("SGI") alleging that six of SGI's top officers "made a series of misleading statements to inflate the value of SGI's stock while they engaged in 'massive' insider trading."[170] The central issue was "what must a plaintiff allege in order to satisfy the requirement that he state facts giving rise to a 'strong inference'" of scienter?[171] The Ninth Circuit held that to meet the PSLRA's strong inference of scienter standard, a plaintiff "must plead, in great detail, facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct" and "[i]n order to show a strong inference of deliberate recklessness, [a] plaintiff[] must state [particular] facts that . . . demonstrat[e] intent, as opposed to mere motive and opportunity."[172] The Ninth Circuit held that the plaintiff "neither state[d] facts with sufficient particularity nor raise[d] a strong inference of deliberate recklessness" and "that the sales of stock were not so suspicious as to create a strong inference of deliberate recklessness."[173]

In *Silicon Graphics*, the Ninth Circuit distinguished between ordinary recklessness and deliberate recklessness, "[w]here ordinary recklessness . . . [was] heightened negligence . . . [which could] occur absent intentional conduct, [but] deliberate recklessness require[d] intentional action."[174] The Ninth Circuit became the first circuit court, post-PSLRA, "to require intentional misconduct."[175] In doing so, the Ninth Circuit attempted to further the PSLRA's overarching goal of "eliminat[ing] frivolous or sham actions."[176]

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[166] *Id.*

[167] Mulreed, *supra* note 1, at 806.

[168] *Id.* at 806–07 ("For example, a plaintiff could allege that [the] defendant disregarded a substantial and unjustified risk that projected earnings were far in excess of likely earnings."). This pre-PSLRA standard was lenient as compared to the Ninth Circuit's interpretation of the PSLRA's strong inference of scienter standard. *Id.*

[169] *In re* Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 973 (9th Cir. 1999).

[170] *Id.* at 979–80.

[171] *Id.* at 973.

[172] *Id.* at 974.

[173] *Id.* at 984.

[174] Mulreed, *supra* note 1, at 810.

[175] *Id.*

[176] *Id.* (quoting Nursing Home Pension Fund, Local 144 v. Oracle Corp., 380 F.3d 1226, 1235 (9th Cir. 2004)).

In *In re Vantive Corp.*, plaintiffs brought a securities fraud action against the Vantive Corporation ("Vantive").[177] The plaintiffs alleged that Vantive "made knowingly false and misleading statements about the competitive prospects of . . . [its] products and the growth of . . . [its] sales force, and falsely forecasted . . . [future] revenues."[178] The plaintiffs argued that internal company reports contained information contrary to public statements made by management, and that management, by virtue of their position within Vantive, would have known of the reports.[179] However, the Ninth Circuit held that the plaintiffs failed to meet the PSLRA's strong inference of scienter standard because they did not plead sufficient facts to show deliberate recklessness on part of Vantive.[180] Essentially, the plaintiffs failed to connect the existence of the internal reports and actual knowledge on behalf of management, and the Ninth Circuit refused to infer knowledge based on the general allegation that management was informed of important issues in the company.[181]

In *In re Read-Rite Corp.*, plaintiffs brought a securities fraud action against Read-Rite and some of its executives (collectively referred to as "defendants"), alleging that the defendants "made several fraudulent statements . . . regarding the status of product development and the demand for Read-Rite's products."[182] The Ninth Circuit agreed with the district court's conclusion that the plaintiffs' complaint did not sufficiently contain "factually particular allegations" to show that the defendants' contemporaneously knew that their statements were false when made.[183] The Ninth Circuit acknowledged that the plaintiffs "may have established a 'reasonable inference,'" with respect to Read-Rite's executives, "that, based upon their job duties[,] . . . [they] would [have] be[en] aware of the falsity of some or all of the statements."[184] However, the Ninth Circuit held that "[t]he existence of a 'reasonable inference' . . . does not satisfy the PSLRA's requirement" for strong inference of scienter.[185]

In *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, plaintiffs brought a securities fraud action against Oracle Corporation ("Oracle") and three of its top executives.[186] The plaintiffs alleged that Oracle released a new software program "without sufficient technical development . . . [which caused] numerous defects in the program" and "growing customer awareness of the defects . . . hurt

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[177] *In re* Vantive Corp. Sec. Litig., 283 F.3d 1079, 1083–84 (9th Cir. 2002).

[178] *Id.* at 1084.

[179] *Id.* at 1087–88. Thus, management engaged in intentional misconduct, warranting deliberate recklessness. *Id.*

[180] *Id.*

[181] *Id.* This case presented one of the first formulations of the core operations inference, which is the principle that it can be inferred that key officers in a company, by virtue of their management positions, have knowledge of the core operations of the business. *See* South Ferry LP, 2 v. Killinger, 542 F.3d 776 (9th Cir. 2008).

[182] *In re* Read-Rite Corp., 335 F.3d 843, 845 (9th Cir. 2003).

[183] *Id.* at 847.

[184] *Id.* at 848. This "reasonable inference" most likely would have met the Ninth Circuit's pre-PSLRA standard for scienter.

[185] *Id.* at 848–49.

[186] Nursing Home Pension Fund, Local 144 v. Oracle Corp., 380 F.3d 1226, 1227 (9th Cir. 2004).

Oracle's sales[,] . . . but . . . Oracle covered up its losses by creating phony sales invoices and improperly recognizing past customer overpayments as revenue."[187] The Ninth Circuit held that the plaintiffs' allegations were sufficient under the PSLRA because they went beyond a mere inference of management knowledge of all core operations by including detailed admissions made by Oracle's executives regarding their access to information within the company.[188] *Nursing Home* set the tone for core operations allegations in the Ninth Circuit by making clear that to satisfy the PSLRA's strong inference of scienter standard through a core operations allegation, a plaintiff must plead "specific allegations of fraud, and . . . specific allegations that corporate officers had reason to know of the company's fraudulent operations."[189]

Plaintiffs had another victory with the core operations inference in *In re Daou Systems, Inc.*[190] In *In re Daou*, plaintiffs alleged that Daou and some of its top executives "systematically and fraudulently violated the Generally Accepted Accounting Principles ('GAAP') . . . to artificially inflate the price of Daou's stock."[191] As a result, plaintiffs argued "that they incurred substantial personal losses due to their respective purchases of Daou stock at fraudulently inflated prices."[192] Based on *Nursing Home*, the Ninth Circuit held that the plaintiffs' allegations were sufficient to create a strong inference that Daou's executives acted with the requisite degree of scienter because the plaintiffs relied on specific admissions from the executives that they were involved in every detail of Daou and monitored portions of Daou's database.[193] Like the plaintiffs in *Nursing Home*, the plaintiffs in *In re Daou* went beyond generalized allegations and provided specific allegations that management was directly involved "in the production of false accounting statements and reports . . . [which was] more probative of scienter than the allegations involved in *Nursing Home*."[194]

In *South Ferry LP #2, v. Killinger* ("*South Ferry I*"),[195] the plaintiffs brought a securities fraud action against WAMU, alleging that WAMU's senior executive officers issued materially false and misleading statements that WAMU had successfully integrated information systems.[196] The district court applied the Ninth

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[187] *Id.* at 1228

[188] *Id.* at 1234. In *Nursing Home*, the Ninth Circuit departed from its previous holdings in *In re Vantive* and *In re Read-Rite*, where plaintiffs failed to meet the PSLRA's strong inference of scienter standard with respect to their "core operations" allegations; however, *Nursing Home* was distinct from *In re Vantive* and *In re Read-Rite* because the plaintiffs did not generally allege that by virtue of their positions, management must know of the company's core operations. Rather, in *Nursing Home*, unlike *In re Vantive* and *In re Read-Rite*, the plaintiffs were able to provide actual admissions by Oracle's executives that they had knowledge of and access to the company's core operations. *Id.* This was a turning point in the Ninth Circuit for plaintiffs regarding what facts to plead to meet the strong inference of scienter standard with respect to core operations allegations. *Id.*

[189] Mulreed, *supra* note 1, at 813.

[190] *In re* Daou Sys., 411 F.3d 1006 (9th Cir. 2005).

[191] *Id.* at 1012.

[192] *Id.*

[193] *Id.* at 1022.

[194] *Id.* at 1023.

[195] *See generally* 399 F. Supp. 2d 1121 (W.D. Wash. 2005).

[196] *See* S. Ferry LP, # 2 v. Killinger (*South Ferry II*), 542 F.3d 776 (9th Cir. 2008).

Circuit's principles from *Nursing Home* and *In re Daou* with respect to pleading a strong inference of scienter with core operations allegations. [197] The district court concluded that WAMU's senior executive officers "had knowledge of 'core operations' at WAMU based on their management positions" and that the plaintiffs pleaded sufficient facts by providing "specific statements [made by WAMU's executives] indicating [their] first-hand knowledge of WAMU's technological and operational systems."[198] However, the district court certified the case for interlocutory appeal by the Ninth Circuit, and in *South Ferry II*, the Ninth Circuit applied the *Tellabs* totality of the circumstances test to determine whether the plaintiffs met the Supreme Court's cogent and at least as compelling as opposing inferences standard in pleading their core operations allegations to meet the PSLRA's strong inference of scienter requirement.

III. DISCUSSION

A. South Ferry II: Parties Involved

The plaintiffs in *South Ferry II* were "WAMU shareholders who s[ought] to represent a class of individuals who owned WAMU stock between April 15, 2003 and June 28, 2004" ("class period").[199] The defendants were WAMU, Kerry Killinger, Thomas Casey, and Deanna Oppenheimer.[200] WAMU was "a publicly-traded financial services company that serve[d] individuals and small businesses."[201] Killinger, Casey, and Oppenheimer (collectively referred to as "WAMU's officers") "served as officers of WAMU during the class period."[202] Killinger served as President, CEO, and the Chairman of WAMU's Board of Directors, while Casey served as Executive Vice-President and CFO, and Oppenheimer served as President of WAMU's consumer group.[203] Thus, Killinger, Casey, and Oppenheimer held "key officer positions."[204]

B. South Ferry II: Factual History

South Ferry II involved "two types of risk present in WAMU's mortgage lending business."[205] "When WAMU originates a home loan, it may later sell that loan to another institution" while retaining the mortgage servicing rights ("MSRs").[206] "The holder of MSRs . . . provides billing and other services to mortgage customers for the life of the loans" even if another institution owns

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[197] *Id.*

[198] *Id.* at 779, 781–82.

[199] *Id.* at 780.

[200] *Id.* at 779.

[201] *Id.* at 779–80.

[202] *South Ferry II*, 542 F.3d 776, 779–80 (9th Cir. 2008).

[203] *Id.*

[204] *Id.*

[205] *Id.*

[206] *Id.* at 780.

them.[207] MSRs hold an independent value "because WAMU is paid a portion of each loan payment for the services it provides."[208] The MSR-related risk "is the risk that WAMU will lose MSR-related revenue due to the pre-payment of loans that it services."[209] The MSR-related risk is exacerbated by falling interest rates which increase the likelihood "that borrowers will refinance . . . to take advantage of cheaper financing."[210] Given that WAMU's MSR-related revenue generates "from the services that it provides over the life of [a] loan, a loan . . . fully repaid at an early date . . . causes WAMU to lose future MSR-related revenue."[211]

Another risk associated with WAMU's mortgage lending business is the "pipeline risk."[212] The pipeline risk "is the risk that WAMU will commit to fund a loan at a certain interest rate only to see market interest rates change by the time the loan is finalized."[213] A typical scenario occurs when borrowers "'lock in' an interest rate . . . several weeks before they . . . close a mortgage deal. A loan in this lock-in period is referred to as a loan 'in the pipeline.'"[214] If mortgage rates fall:

> [B]orrowers may find that the rate that they have locked in is higher than the prevailing rates at the time of their closing. Those borrowers may abandon a lender with a loan in the pipeline . . . . Conversely, when [interest] rates are rising, borrowers may lock in rates that turn out to be below market by the time of their closing . . . .[215]

This situation results in the lender funding at below market rates.[216] In order "[t]o manage MSR-related and pipeline risk[s], WAMU hedges its expected MSR and mortgage-origination revenues with securities and derivative instruments . . . [and] [i]n a rising interest rate environment, WAMU also relies on a[] . . . 'natural hedge' to protect its revenues."[217] When interest rates rise, WAMU's pipeline risk increases, but MSR revenues "provide . . . protection from this pipeline risk," which is a natural hedge that "allows WAMU to have a . . . steady revenue stream despite volatil[e] . . . rates."[218]

The plaintiffs alleged that WAMU's officers "made materially false or misleading statements concerning WAMU's ability to manage MSR-related and pipeline risk[s] during the class period" and "that [WAMU's officers] repeatedly assured investors that the natural hedge . . . would allow WAMU to thrive in an

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[207] *Id.*

[208] *South Ferry II*, 542 F.3d 776, 780 (9th Cir. 2008).

[209] *Id.*

[210] *Id.*

[211] *Id.*

[212] *Id.*

[213] *Id.*

[214] *South Ferry II*, 542 F.3d 776, 780 (9th Cir. 2008).

[215] *Id.*

[216] *Id.*

[217] *Id.*

[218] *Id.* at 781.

environment where interest rates were increasing."[219] The plaintiffs also alleged that WAMU's officers "assured investors that WAMU had fully integrated the information systems that are central to WAMU's ability to maintain and update their various hedges in a timely fashion during periods of interest rate volatility."[220] The plaintiffs accused WAMU of being "unprepared for the interest rate volatility that occurred . . . because it failed to integrate its information systems to permit it to keep a close watch on the hedges that it maintains."[221] WAMU's officers moved to dismiss the plaintiffs' complaint, but the district court denied their motion.[222] WAMU's officers "argue[d] that the district court erred by inferring that [they] had knowledge of 'core operations' at WAMU based on their management positions . . . and that such an inference does not satisfy the . . . pleading requirements of the [PSLRA]."[223]

C. South Ferry II: Procedural History

The district court concluded that the plaintiffs met the PSLRA's pleading standard for scienter by inferring that WAMU's officers "had knowledge of WAMU's difficulties with their information systems 'because of the nature of the statements they . . . were making and the nature of [the] specific alleged operational problems.'"[224] The district court relied on the core operations inference, which is "the principle that it may be inferred that facts critical to a business' 'core operations' or important transactions are known to key company officers."[225] WAMU's officers:

> [M]oved for reconsideration or, alternatively, for a certification from the district court that interlocutory appeal was appropriate . . . to determine whether the district court properly imputed scienter in the [plaintiffs'] allegations based on the inference that key officers had knowledge of the 'core operations' of the company.[226]

The district court granted the certification motion but denied the motion for reconsideration.[227] When it granted the certification motion, the district court recognized that the plaintiffs' allegations "rel[ied] on circumstantial evidence and an inference of knowledge arising from the connection between" the positions held by WAMU's officers and the core operations of WAMU.[228] In the interlocutory appeal, the district court intended for the Ninth Circuit to rule on whether or not the core operations inference is a proper allegation in pleading a strong inference of

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[219] *Id.*

[220] *South Ferry II*, 542 F.3d 776, 781 (9th Cir. 2008).

[221] *Id.*

[222] *Id.*

[223] *Id.* at 779.

[224] *Id.* at 781.

[225] *Id.*

[226] *South Ferry II*, 542 F.3d 776, 781 (9th Cir. 2008).

[227] *Id.*

[228] *Id.*

scienter.[229] "The decisions of a district court on motions to dismiss are reviewed de novo[;]" therefore, the Ninth Circuit "accept[ed] as true all well-pleaded allegations."[230]

D. South Ferry II: Majority Opinion[231]

In *South Ferry II*, the Ninth Circuit stated that "[u]nder the PSLRA, [the plaintiffs] must 'state with particularity facts giving rise to a strong inference that the defendant[s] acted with the required state of mind.'"[232] In order to prove the required state of mind, "the plaintiffs must show that [the] defendants engaged in '*knowing*' or '*intentional*' conduct . . . or . . . 'deliberate recklessness.'"[233] Deliberate recklessness is reckless conduct that "reflects some degree of intentional or conscious misconduct."[234] The Ninth Circuit clarified that under *Tellabs*, "a strong inference [of scienter] 'must be cogent and compelling, thus strong in light of other explanations.'"[235] In applying the *Tellabs* standard, the Ninth Circuit stated that it must consider "[w]hen 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?"[236]

Prior to *Tellabs*, the Ninth Circuit "require[d] plaintiffs to plead, at a minimum, particular facts giving rise to a strong inference of deliberate recklessness" and "specif[ied] that 'plaintiffs . . . c[ould] no longer aver intent in general terms of mere 'motive and opportunity' or 'recklessness,' but . . . must state specific facts indicating no less than a degree of recklessness that strongly suggests actual intent.'"[237] The Ninth Circuit explained that the district court found that the plaintiffs met the strong inference of scienter standard "because of alleged public statements [made] by [WAMU's officers] that WAMU's information systems were fully integrated and effective at a time when WAMU was suffering technology problems that affected its ability to control MSR[-]related and pipeline risk and hedge effectively."[238] In evaluating the district court's reasoning, the Ninth Circuit "consider[ed] whether a scienter theory that infers that facts critical to a business's 'core operations' or an important transaction are known to a company's key officers satisfies the PSLRA's heightened pleading standard."[239]

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[229] *Id.* at 781–82.

[230] *Id.* at 782.

[231] In *South Ferry II*, there was only a majority opinion and no dissenting or concurring opinions.

[232] *South Ferry II*, 542 F.3d at 782.

[233] *Id.* The knowing or intentional conduct and deliberate recklessness standard was set forth in *Silicon Graphics* by the Ninth Circuit as a requirement for pleading scienter. *See generally In re* Silicon Graphics, Inc., 183 F.3d 970 (9th Cir. 1999).

[234] *South Ferry II*, 542 F.3d at 782.

[235] *Id.*

[236] *Id.* This author feels that the Ninth Circuit's interpretation of the *Tellabs* standard was accurate based upon the majority opinion in *Tellabs*. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322–25 (2007).

[237] *South Ferry II*, 542 F.3d at 782.

[238] *Id.*

[239] *Id.* at 783.

Silicon Graphics "set[] a very high bar for securities plaintiffs . . . [by] requir[ing] that plaintiffs state with particularity all facts on which their belief of scienter is formed."[240] However, the plaintiffs in *Silicon Graphics* made general allegations "that the defendants had actual knowledge of the facts they were alleged to have misstated," and the Ninth Circuit did not find "a strong inference from [these] general allegations."[241] In *In re Vantive*, the plaintiffs failed to present detailed allegations to show "actual knowledge on the part of the defendants," and, again, the Ninth Circuit "[w]ould not infer such knowledge from the general allegation that management was informed about important issues in the company."[242] In *In re Read-Rite*, the Ninth Circuit held that core operations allegations could establish a reasonable inference of scienter "but were not sufficiently detailed to meet" the strong inference of scienter requirement under the PSLRA.[243]

Reading *Silicon Graphics*, *In re Vantive*, and *In re Read-Rite*, "without reference to *Tellabs*, will generally prevent a plaintiff [in the Ninth Circuit] from relying exclusively on the core operations inference to plead scienter under the PSLRA."[244] *Silicon Graphics*, *In re Vantive*, and *In re Read-Rite* appear "too demanding and [are] focused too narrowly in dismissing vague, ambiguous, or general allegations . . . [because] *Tellabs* suggests that while a high level of detail is required under the PSLRA, a court should [assess] the complaint as a whole."[245] Therefore, *Tellabs* requires courts to "consider the totality of the circumstances, rather than . . . develop separate[] rules of thumb for each type of scienter allegation."[246] "In light of *Tellabs*," core operations allegations "can be one relevant part of a complaint that raises a strong inference of scienter" because *Tellabs* "permits a series of less precise allegations to be read together to meet the PSLRA requirement."[247] Post-*Tellabs*, "[v]ague or ambiguous allegations [can be] considered as . . . part of a holistic review when considering whether the complaint raises a strong inference of scienter . . . [and] [t]he allegations, read as a whole, must raise an inference of scienter that is 'cogent and compelling'"[248]

In its application of *Tellabs* in *South Ferry II*, the Ninth Circuit concluded that there were three scenarios in which "allegations regarding management's role in a company may be relevant and help to satisfy the PSLRA scienter requirement."[249] The first scenario is that core operations "allegations may be used in any form along with other allegations that, when read together, raise an inference of scienter that is 'cogent and compelling, thus strong in light of other explanations.'"[250] The second scenario is that core operations "allegations may indepen-

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[240] *Id.*

[241] *Id.*

[242] *Id.*

[243] *South Ferry II*, 542 F.3d 776, 784 (9th Cir. 2008).

[244] *Id.*

[245] *Id.*

[246] *Id.*

[247] *Id.*

[248] *Id.*

[249] *South Ferry II*, 542 F.3d 776, 785 (9th Cir. 2008).

[250] *Id.* This view evaluates all of the circumstances together. *Id.* at 786.

dently satisfy the PSLRA where they are particular and suggest that defendants had actual access to the disputed information."[251] The third and final scenario is that core operations "allegations may . . . satisfy the PSLRA standard in a more bare form, without accompanying particularized allegations . . . where the nature of the relevant fact is of such prominence that it would be 'absurd' to suggest that management was without knowledge of the matter."[252] The Ninth Circuit vacated and remanded the case to the district court for further proceedings in accordance with *Tellabs* and *South Ferry II* because the district court's decision was made pre-*Tellabs*; therefore, the district court was unable to apply the *Tellabs* standard in its reasoning.[253]

IV. IMPACT

A. On the Courts

South Ferry II provided three scenarios for courts within the Ninth Circuit to consider when examining "core operations" allegations to determine whether a plaintiff has met the PSLRA pleading standard for strong inference of scienter.[254] Moreover, *South Ferry II* "specifically instruct[ed] federal courts to assess the [plaintiff's] 'allegations holistically as required by Tellabs.'"[255] In doing so, *South Ferry II* "reduce[d] the level of detail [that] federal courts in the [Ninth] Circuit will require for imputing scienter to corporate officers."[256]

The Ninth Circuit applied its *South Ferry II* holding in *Berson v. Applied Signal Technology, Inc.*[257] In *Berson*, the plaintiffs had purchased stock in Applied Signal Technology, Inc. ("defendant") "six months before [defendant] revealed that its revenue [fell] 25% from the preceding quarter . . . [and] [i]mmediately following this disclosure, the stock price dropped [by] 16%."[258] The plaintiffs brought a securities fraud action against defendant under Section 10(b) and Rule 10b-5, alleging that the drop in defendant's revenue was a direct result of "four stop-work orders the company received, which halted tens of mil-

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[251] *Id.* The Ninth Circuit provided *Nursing Home* and *In re Daou* as examples of core operations allegations that went "beyond a mere inference of management knowledge of all 'core operations,'" which was sufficient to meet the strong inference of scienter standard "because [the allegations] included details about the defendants' access to information within the company." *Id.* Interestingly, "the [Ninth] Circuit did not hold that defendants must have 'knowledge' of the disputed information, but rather 'actual access' to the dispute information." Blair A. Nicholas, South Ferry*: Applying* Tellabs*, 9th Circuit Lowers the Bar for Pleading Scienter Under the PSLRA*, 14 SEC. LITIG. & REG. (ANDREWS LITIG. REP.) 1, 2 (2008).

[252] *South Ferry II*, 542 F.3d at 786.

[253] *Id.*

[254] Corporate & Securities Law Blog, http://www.corporatesecuritieslawblog.com/securities-litigation-ninth-circuit-reaffirms-that-the-core-operations-inference-standing-alone-is-insufficient-to-support-a-strong-inference-of-scienter-in-securities-fraud-actions.html (Sept. 23, 2008).

[255] Nicholas, *supra* note 251.

[256] *Id.*

[257] Berson v. Applied Signal Tech., Inc., 527 F.3d 982 (9th Cir. 2008).

[258] *Id.* at 984.

lions of dollars of work [defendant] had contracted to do."[259] The plaintiffs claimed that:

> Investors were surprised by the drop in revenue . . . because [defendant] continued to count the stopped work as part of its 'backlog' –a term [that defendant] defines as the dollar value of the work it has contracted to do but hasn't yet performed.[260]

Although the plaintiffs did not allege particular facts that defendant's high-level managers knew about the stop-work orders, they presented, with particularity, the existence and devastating impact of the work-stop orders.[261] Based on the plaintiffs' complaint, the Ninth Circuit concluded that defendant's high-level managers must have known about the stop-work orders because they were responsible for defendant's day-to-day operations.[262] Therefore, the Ninth Circuit applied the third scenario from *South Ferry II* and "permitted [the] plaintiff[s] to rely exclusively on the core-operations inference 'without particularized allegations about [the] defendants' access to the relevant information'"[263]

B. On the "Core Operations Inference"

South Ferry II addressed whether the core operations inference, "an inference that senior management must be aware of all matters, including wrongdoing, affecting a company's core operations," satisfies the PSLRA's pleading standard for scienter.[264] In *South Ferry II*, the Ninth Circuit analyzed core operations inference standing based upon the Supreme Court's interpretation of scienter in *Tellabs*.[265] Prior to *Tellabs*, the Ninth Circuit determined the merits of each scienter allegation individually; therefore, an allegation based upon the core operations inference would have been examined separately from other scienter allegations.[266] However, in *South Ferry II*, the Ninth Circuit applied the *Tellabs* standard and held that the core operations inference can be reviewed cumulatively with other scienter allegations in determining whether a plaintiff has met the PSLRA's strong inference of scienter requirement, which provides more possibilities for core operations allegations to satisfy the PSLRA's standard for scienter.[267]

C. On Securities Plaintiffs

The Ninth Circuit presides over the second highest number of private securities class actions in the United States; therefore, *South Ferry II* played a significant

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[259] *Id.*

[260] *Id.*

[261] *Id.* at 987.

[262] *Id.* at 988.

[263] Nicholas, *supra* note 251.

[264] Corporate & Securities Law Blog, *supra* note 254.

[265] *Id.*

[266] *See generally* Nicholas, *supra* note 251.

[267] *See id.*

role in securities litigation.[268] Although *South Ferry II* made it difficult for plaintiffs to successfully plead securities fraud based on core operation allegations alone, the totality of the circumstances approach used by the Ninth Circuit in *South Ferry II* lowered the bar for plaintiffs to plead scienter because it permits courts to read together a series of less precise allegations in determining whether the PSLRA requirement for scienter has been met.[269] Prior to *South Ferry II*, the Ninth Circuit had the most stringent requirement for scienter, but, post-*South Ferry II*, the Ninth Circuit has loosened the requirement for scienter, which might allow for a higher number of private securities lawsuits to succeed at the pleading stage.[270]

D. On Corporate Defendants

In the Ninth Circuit, private securities fraud actions based solely on core operations allegations will likely reduce because plaintiffs, except in rare cases such as *Berson*, will need to plead additional scienter allegations to meet the PSLRA's pleading standard for scienter. In *South Ferry II*, the Ninth Circuit concluded that the core operations inference alone will generally not meet the strong inference threshold required under the PSLRA.[271] However, private securities lawsuits pleading core operations allegations, in addition to other scienter allegations, might have a higher success rate at the pleading state, thereby reducing a defendant's ability to have the motion dismissed.[272]

V. CONCLUSION

Tellabs was intended to resolve the circuit split with respect to what facts a plaintiff must plead in order to meet the PSLRA's strong inference of scienter standard, and whether the reviewing court should consider opposing inferences in its analysis.[273] *Tellabs* might have "resolve[d] the circuit split concerning the weighing of inferences in securities fraud litigation,"[274] but it left undefined the term "strong inference." Therefore, it failed to resolve the circuit split with respect to what evidence constitutes a strong inference of scienter.[275] *Tellabs* arguably "reduced the heightened pleading standard Congress intended in enacting the PSLRA by allowing plaintiffs to benefit from facts not pled with particularity."[276] *Tellabs*' totality of the circumstances test leaves much room for interpretation by the circuit courts, and therefore, "will likely . . . lead to another split among [the] circuits."[277] Likewise, *South Ferry II* leaves much room for interpretation by dis-

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[268] *Id.*
[269] *Id.*
[270] *Id.*
[271] *Id.*
[272] Nicholas, *supra* note 251.
[273] *See generally* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007).
[274] Wunderlich, *supra* note 5, at 690.
[275] Fipp, *supra* note 29, at 659.
[276] *Id.*
[277] *Id.*

trict courts within the Ninth Circuit because its holding was based upon *Tellabs*. Thus, the pleading standard for scienter will continue to vary, resulting in vastly different outcomes for similar cases. Therefore, Congress or the Supreme Court will need to develop a clear definition as to what evidence constitutes a strong inference of scienter to enable the circuits to apply an equivalent standard for scienter. The Supreme Court, under Chief Justice Roberts, has devoted much of its time to business cases; therefore, securities fraud litigation will continue to be a significant issue, particularly in the aftermath of the sub-prime mortgage crisis. The Bush Administration was known to be business-friendly, whereas the Obama Administration will likely be plaintiff-friendly, which could lead to pro-investor legislation and pro-investor court decisions, particularly if President Obama is able to further shift the make-up of the Supreme Court beyond his appointment of Justice Sonia Sotomayor.[278]

[278] Robert Barnes & Carrie Johnson, *Pro-Business Decision Hews to Pattern of Roberts Court*, WASH. POST, June 22, 2007, http://www.washingtonpost.com/wp-dyn/content/article/2007/06/21/AR2007062100803.html; *see generally* Labaton, *supra* note 16.