ASSEMBLING THE PIECES OF THE SCIENTER PUZZLE:A NEW APPROACH TO A HOLISTIC REVIEW OF SCIENTER PLEADING UNDER *TELLABS* AND THE PSLRA

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As anyone who has ever grappled with a jigsaw puzzle knows, the picture cannot come into focus until the pieces have been sorted and scrutinized. The same is true for the scienter puzzle — the analysis, dictated by the Private Securities Litigation Reform Act ("PSLRA"), that courts must apply when assessing the merits of a federal securities complaint. Plaintiffs and their counsel would have courts skip past the piece-by-piece evaluation and review scienter allegations *collectively*, forming a general impression of the complaint without analyzing the probative value of its particular components. The Ninth Circuit has partially endorsed this approach, adopting a two-step inquiry in which it first weighs scienter allegations *in isolation* and then in a *holistic* manner. The Sixth Circuit goes further, appearing to recommend a *quick* overall assessment of the complaint without engaging in a thorough review of the individual allegations.

The PSLRA, however, demands more — more than a broad, cursory scan, or a narrow, isolated review. To stem the tide of abusive lawsuits, the PSLRA requires plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[2] That means courts should assess the value of each allegation, each piece of the scienter puzzle, to determine if and how they fit together. "Particularity" is the operative term. Yet because Congress did not define "strong inference" when it enacted the statute, the ensuing debate over what exactly constitutes a strong inference has been obscured and, at times, frustrated the PSLRA's particularity requirement.

The U.S. Supreme Court, in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,[3] endeavored to resolve the strong inference question, but in doing so, it may have opened the door to even more confusion and a series of circuit court opinions that could undermine the PSLRA's intent. Although *Tellabs* is widely cited for directing courts to consider plaintiffs' scienter allegations "collectively," we take the position that *Tellabs* only confirmed that no

2. 15 U.S.C.A. § 78u-4.
3. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007).

single fact (whether present or absent) is dispositive of scienter. In clarifying "strong inference," *Tellabs* never intended to alter the PSLRA's requirement that plaintiffs plead their allegations with particularity. Nowhere does the Court mention a dual inquiry; nowhere does the Court advocate a conclusory review. What *Tellabs* instructs is simply that courts not wear blinders when evaluating scienter allegations—that they not *automatically* reject the possibility of scienter when a complaint contains *omissions and ambiguities*. That is not the same as directing courts to forgo a rigorous analysis of individual scienter allegations. No amount of "collective" or "holistic" reviewing permits plaintiffs to escape their fundamental burden of pleading the who, what, where, and why of an alleged securities fraud.

In Section I of this article, we review the origins of the PSLRA and the importance of its particularity requirement. We also examine the *Tellabs* opinion and its successor, *Matrixx Initiatives, Inc. v. Siracusano*,[4] to discover how the Supreme Court's language might have contributed to the lower courts' potential conflation of the PSLRA's strong inference and particularity requirements. In Section II, we analyze the dual inquiry presented by the Ninth Circuit in *South Ferry LP, No. 2 v. Killinger*[5] and *Zucco Partners, LLC v. Digimarc Corp*.[6] Then we turn to the Sixth Circuit's articulation of a single-step holistic review in *Frank v. Dana Corp*.[7] In Section III, we conclude with the proposal that courts conduct a "holistic" review that hinges on the probative value of each scienter-related allegation. Only by testing the individual pieces of the scienter puzzle to see whether they belong, and if so, whether they form a coherent picture, can courts preserve the deliberately rigorous standards of the PSLRA.

I. BACKGROUND: SCIENTER PLEADING FROM THE PSLRA TO *MATRIXX*

A. Private Securities Litigation Reform Act: Requiring Circumstances Supporting Scienter to Be Pleaded "With Particularity," Not "Generally"

When Congress passed the PSLRA in 1995, it did so with the intent of "protect[ing] investors, issuers, and all who are associated with [the nation's] capital markets from abusive securities litigation."[8] Until then, plaintiffs routinely filed unfounded securities fraud claims that nonetheless forced companies into substantial settlements. While plaintiffs could prepare bare-bones complaints "at relatively modest cost," their discovery

4. Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011).
5. South Ferry LP, No. 2 v. Killinger, 542 F.3d 776 (9th Cir. 2008).
6. Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981(9th Cir. 2009).
7. Frank v. Dana Corp., 646 F.3d 954 (6th Cir. 2011).
8. H.R. Conf. Rep. 104-369, p. 32.

requests imposed huge financial burdens on defendants.[9] Meanwhile, "malleable" pleading standards often made it difficult for defendants to persuade courts to dismiss complaints or grant summary judgment motions.[10] As a result of these financial and procedural imbalances, plaintiffs had an incentive to bring meritless suits because defendants faced an even stronger incentive to settle.

Finding that the "fear of baseless and extortionate securities lawsuits" had injured "the investing public and the entire U.S. economy," Congress sought to "implement procedural protections to discourage frivolous litigation."[11] Among the numerous protections Congress enacted were heightened pleading standards in an effort to "strengthen existing pleading requirements."[12]

Setting a uniform pleading standard was especially important because courts disagreed on whether or not plaintiffs must plead scienter with particularity. In the pre-PSLRA era, courts applied Federal Rule of Civil Procedure 9(b)'s heightened pleading standards to screen securities fraud suits,[13] but found tension in the rule's language.[14] While Rule 9(b) requires plaintiffs to "state with particularity the circumstances constituting fraud or mistake," it also permits plaintiffs to "generally" plead "malice, intent, knowledge, and other conditions of a person's mind."[15] Thus, when applying Rule 9(b) to securities fraud actions, courts were divided on whether plaintiffs must plead scienter with particularity. The Second Circuit, for example, has incorporated Rule 9(b)'s requirement to plead with particularity the "circumstances constituting fraud or mistake" and require that "plaintiffs specifically plead those events which they assert give rise to a strong inference" of scienter.[16] At the other end of the spectrum, the Ninth

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9. Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2086 (1995); Helwig v. Vencor, Inc., 251 F.3d 540, 547 (6th Cir. 2001) ("[C]oncern about 'strike suits' [is] aimed at jackpot discovery and predatory settlement."); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 741 (1975) (the discovery process in securities litigation "permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an in terrorem increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence"); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 501 (1991) ("[S]ettlement outcomes need not approximate—and may not even be significantly affected by—expected trial outcomes. For practical purposes, the merits do not matter.").

10. Weiss and Beckerman, *supra* note 9, at 2086.

11. H.R. Rep. No. 104-369, at 32 (1995) (Conf. Rep.).

12. *Id.* at 41; *see* 15 U.S.C. § 78u-4(b)(2).

13. Fed. R. Civ. P. 9(b).

14. *Id.*

15. *Id.*

16. Ross v. A.H. Robins Co., 607 F.2d 545, 558 (2d Cir. 1979). Other courts in the Second Circuit suggested that Rule 9(b) was intended to "protect against the institution of a

Circuit permitted plaintiffs to "aver scienter generally," which could be accomplished "simply by saying that scienter existed."[17] In its analysis, the Ninth Circuit explicitly rejected the Second Circuit's standard as an improper usurpation of the legislature's role, cautioning that courts "are not permitted to add new requirements to Rule 9(b) simply because [they] like the effects of doing so."[18] Given the "distinctly different standards among the circuits," combined with Rule 9(b)'s perceived failure to "prevent[] abuse of the securities laws by private litigants,"[19] "[s]etting a uniform pleading standard for § 10(b) actions was among Congress' objectives when it enacted the [PSLRA]."[20]

The PSLRA standard, which borrowed the Second Circuit's "strong inference" language, required plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[21] But even though the Second Circuit had offered the most rigorous articulation of the law, Congress was wary of the Second Circuit's history of categorizing indicia of scienter (such as defendants' motive and opportunity to commit fraud) to evaluate securities claims. Wanting to go beyond the Second Circuit and avoid placing implicit limitations on scienter pleading, Congress made clear that "it [did] not intend to codify the Second Circuit's case law interpreting the pleading standard."[22]

In sum, the PSLRA established once and for all that plaintiffs must plead scienter with particularity, not "generally" as the Ninth Circuit had found. But, by also requiring that plaintiffs plead with particularity facts that show "a strong inference" of scienter, Congress created a new source of confusion—what constitutes a strong inference?

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strike suit." O'Brien v. National Property Analysts Partners, 936 F.2d 674, 676 (2d Cir. 1991) (internal quotations omitted). *See also* Wexner v. First Manhattan Co., 902 F.2d 169, 172 (2d Cir. 1990) (explaining that Rule 9(b)'s scienter requirement "must not be mistaken for license to base claims of fraud on speculation and conclusory allegations"); Greenstone v. Cambex Corp., 975 F.2d 22, 25 (1st Cir. 1992) (explaining that if the law allowed a general averment of scienter, "a complaint could too easily evade the 'particularity' requirement in Rule 9(b)'s first sentence").

17. *In re* GlenFed, Inc. Sec. Litig., 42 F.3d 1541, 1547 (9th Cir. 1994) (en banc).

18. *Id.* at 1546.

19. H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.).

20. Tellabs v. Makor Issues & Rights, Ltd., 551 U.S. 308, 320 (2007).

21. 15 U.S.C. § 78u-4(b)(2).

22. H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.) ("Because the Conference Committee intends to strengthen existing pleading requirements, it does not intend to codify the Second Circuit's case law interpreting this pleading standard.").

B. Post-PSLRA Courts Disagree When Defining a "Strong Inference" of Scienter, but Agree on the PSLRA's Particularity Requirement

After Congress passed the PSLRA, courts uniformly required plaintiffs to plead facts with particularity to establish scienter.[23] The Ninth Circuit, which had previously required plaintiffs to "aver scienter generally," concluded that the "ordinary meaning of the words" was obvious—facts were "events or circumstances" and particularity required each event or circumstance to be stated with "great detail."[24] Similarly, the Eleventh Circuit confirmed that the general vs. particular pleading conflict in the pre-PSLRA lower courts had at last been "addressed and resolved" in the PSLRA section "expressly requir[ing] plaintiffs to 'state *with particularity* facts" giving rise to a strong inference of scienter.[25] And the Second and Third Circuits—which, as we shall see, disagreed with the Eleventh Circuit on what a "strong inference" meant—nonetheless agreed that the PSLRA's particularity requirement heightened the pleading standard.[26]

Even without accounting for the strong inference requirement, there was no question that the PSLRA heightened the existing pleading standards. The Second Circuit, for example, observed that the "additional [PSLRA] requirement that plaintiffs state facts 'with particularity' represents a heightening of the standard."[27] And as the Fifth Circuit made clear, beyond the demands of Rule 9(b), the PSLRA "*also* requires that the complaint[,] 'with respect to *each* act or omission alleged' to be false or misleading[,] 'state with *particularity facts*'" giving rise to a strong inference of scienter.[28]

What courts questioned, however, was the meaning of strong inference. Although they were clear that facts supporting a strong inference of scienter must be pleaded with particularity, courts were unclear on what facts exactly would support a strong inference. This was especially problematic because Congress left "strong inference" undefined in the PSLRA's text; the term was not susceptible to a plain-meaning

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23. *See, e.g.*, *In re* Cable & Wireless, PLC, 321 F. Supp. 2d 749, 761 (E.D. Va. 2004) (describing the particularity provision in the PSLRA as "plain and unambiguous," requiring no further inquiry as to its definition).

24. *In re* Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 983 (9th Cir. 1999).

25. Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282 (11th Cir. 1999).

26. *In re* Advanta Corp. Sec. Litig., 180 F.3d 525, 534 (3d Cir. 1999) ("[E]ven in jurisdictions already employing the Second Circuit standard, the additional [PSLRA] requirement that plaintiffs state facts 'with particularity' represents a heightening of the standard."); *accord* Novak v. Kasaks, 216 F.3d 300, 311 (2d Cir. 2000).

27. *Novak*, 216 F.3d at 311.

28. Southland Sec. Corp. v. INSpire Ins. Solutions Inc., 365 F.3d 353, 363 (5th Cir. 2004).

interpretation. Moreover, because the PSLRA adopted the Second Circuit's "strong inference" language but disavowed its case law relating to indicia of scienter, courts grappled with the degree to which they should look to the Second Circuit's pre-PSLRA case law for guidance.

Viewing Congress's adoption of the Second Circuit's language as an invitation to retain pre-PSLRA case law, the Second and Third Circuits continued with the standard they had previously applied: plaintiffs could establish scienter by pleading with particularity either (1) motive and opportunity allegations *or* (2) facts that "constitute strong circumstantial evidence of either reckless or conscious behavior."[29] The sufficiency of motive and opportunity allegations, alone, tended to advantage plaintiffs. So did the sufficiency of mere recklessness.[30]

The Ninth Circuit, by contrast, focused on Congress's decision to omit a motive and opportunity test from the PSLRA. As a result, the Ninth Circuit held that plaintiffs must plead facts giving rise to a strong inference of "deliberate recklessness, at a minimum."[31] Because allegations of motive and opportunity were insufficient to establish a strong inference of deliberate recklessness, this test was more favorable to defendants.[32] The Eleventh Circuit similarly concluded that a motive and opportunity analysis, alone, would create a standard too lenient to comply with the rigors of the PSLRA.[33]

The rest of the circuits adopted a "middle ground"[34] in which motive and opportunity allegations may or may not give rise to a strong inference of scienter.[35] This approach advocated a case-by-case test for a strong inference, observing that the PSLRA's silence regarding the motive and opportunity test did not speak to Congress's endorsement or disavowal of that test as a factor in a scienter analysis.[36] Even within this group of "middle ground" interpreters, however, courts could still not agree on *how*

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29. Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (quoting Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124 (2d Cir. 1994)); *accord Advanta Corp*., 180 F.3d at 534-35.

30. *See, e.g.*, *Novak*, 216 F.3d at 308 ("[I]n the ordinary case, adequate motive arose from the desire to profit from extensive insider sales.").

31. *In re* Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 983 (9th Cir. 1999).

32. *Id.* at 979, 988.

33. Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1286 (11th Cir. 1999).

34. Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588, 601 (7th Cir. 2006).

35. *See* Greebel v. FTP Software, Inc., 194 F.3d 185, 197 (1st Cir. 1999); Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 345 (4th Cir. 2003); Nathenson v. Zonagen Inc., 267 F.3d 400, 409-11 (5th Cir. 2001); Helwig v. Vencor, Inc., 251 F.3d 540, 551 (6th Cir. 2001) (en banc); Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 659-60 (8th Cir. 2001); City of Philadelphia v. Fleming Cos., 264 F.3d 1245, 1261-63 (10th Cir. 2001).

36. *Makor*, 437 F.3d at 601. ("Motive and opportunity may be useful indicators, but nowhere in the statute does it say that they are either necessary or sufficient.").

to determine whether a strong inference of scienter existed. The Sixth Circuit, for example, looked for the "most plausible of competing inferences"[37] while the Seventh Circuit tested only whether a "reasonable person could infer that the defendant acted with the required intent."[38]

C. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*: Guidance for How to Determine Whether Particular Pleadings Give Rise to a "Strong Inference" of Scienter

Twelve years after Congress passed the PSLRA, the Supreme Court set out to clear up the confusion and define the meaning of a "strong inference of scienter." In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, plaintiffs sought to recover against Tellabs, a manufacturer of fiber optic equipment, and four of its executives for making alleged false statements about its products and revenue and earnings.[39] While the district court found that plaintiffs had sufficiently established that the alleged misstatements were misleading, it dismissed plaintiffs' case on the basis that plaintiffs had failed to sufficiently demonstrate scienter.[40]

In reversing the district court, the Seventh Circuit set forth its own standard for pleading a "strong inference of scienter"—a standard much lower than that of many other circuits. Finding that plaintiffs need only "allege[] facts from which, if true, a reasonable person could infer that the defendant acted with the required intent," the Seventh Circuit explicitly rejected the Sixth Circuit's requirement that plaintiffs establish "the most plausible of competing inferences."[41] Indeed, the Seventh Circuit barred courts from even comparing competing inferences, making clear that courts should grant a motion to dismiss only if "a reasonable person could not draw such an [inference of scienter] from the alleged facts."[42]

The Supreme Court, vacating the judgment and remanding the case for further proceedings, rejected the Seventh Circuit's standard as too lenient.[43] In defining what qualifies as "a strong inference of scienter," the Supreme Court provided three "prescriptions" but focused its analysis on the third.[44] The first prescription reiterated the standard for all motions to dismiss—that courts must "accept all factual allegations in the complaint as true."[45] The

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37. *Helwig*, 251 F.3d at 553.
38. *Makor*, 437 F.3d at 602.
39. *See* Tellabs v. Makor Issues & Rights, Ltd., 551 U.S. 308, 315 (2007).
40. *Id.* at 316-17.
41. *Id.* at 317 (quoting Makor, 437 F.3d at 601-02).
42. *Id.*
43. *Id.* at 314 ("[The Seventh Circuit's] formulation, we conclude, does not capture the stricter demand Congress sought to convey in [the Reform Act].").
44. *Id.* at 322-24.
45. *Id.* at 322.

second prescription was also not meant to break new ground. In a two-sentence paragraph, the Court affirmed only that the complaint must be considered "in its entirety, as well as [with] other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss," and noted that "[t]he inquiry . . . is 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."[46] Following these short, preliminary statements of the law, the Court then launched into the crux of its decision, finding that, contrary to the Seventh Circuit's holding, courts must in fact consider competing inferences. Because "the inference of scienter must be more than merely 'reasonable' or 'permissible'—it must be cogent and compelling, thus strong in light of other explanations"—the Court held that "[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."[47]

D. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*: Prescribing a "Collective" Review That Does Not Alter the PSLRA's Particularity Requirement for Scienter Pleading

As discussed in Section II, the Supreme Court's second prescription—requiring courts to consider plaintiffs' allegations "collectively" in deciding scienter—has had the potential to complicate scienter jurisprudence. But a careful reading of Justice Ginsburg's majority opinion suggests that this was not the Court's intent. Nowhere does the Court indicate, for example, that plaintiffs can now dispense with pleading facts with particularity and yet still succeed in alleging scienter. By the time of *Tellabs*, indeed, the requirement of pleading scienter with particularity was already well settled and not even an issue before the Court.

In describing its second prescription, the Supreme Court also gave passing reference to two lower court opinions, *Abrams v. Baker Hughes Inc.*[48] and *Gompper v. VISX, Inc.*[49] Neither case excuses plaintiffs from pleading facts with particularity. To the contrary, while the *Abrams* court "consider[ed] whether all facts and circumstances 'taken together' are sufficient to support the necessary strong inference of scienter on the part of the plaintiffs,"[50] it also carefully scrutinized each of plaintiffs' allegations

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46. *Tellabs*, 551 U.S. at 322-23.
47. *Id.* at 324.
48. Abrams v. Baker Hughes Inc., 292 F.3d 424, 431 (5th Cir. 2002).
49. Gompper v. VISX, Inc., 298 F.3d 893, 897 (9th Cir. 2002).
50. *See Abrams*, 292 F.3d at 432 (citing Nathenson v. Zonagen Inc., 267 F.3d 400, 424 (5th Cir. 2001)).

and disregarded those that were too vague to be probative of scienter.[51] And in *Gompper*, the court held only that it "must consider all reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs."[52] It cautioned against reading facts in a "vacuum," regardless of whether that vacuum favors plaintiffs or defendants.[53]

Finally, the Supreme Court's application of its new test to the actual facts of *Tellabs* demonstrates what it meant by a "collective" or "holistic" analysis—terms that it invoked only twice. First, in reiterating that "allegations must be considered collectively," the Supreme Court "agree[d] with the Seventh Circuit that the absence of a motive allegation is not fatal."[54] Thus, the Court meant to confirm that no single fact, whether present or absent, is dispositive of scienter. The Court addressed this issue a second time in response to defendants' contention that plaintiffs failed to establish scienter because plaintiffs' allegations were "too vague or ambiguous."[55] While acknowledging that "omissions and ambiguities *count against* inferring scienter," the Supreme Court also emphasized that courts should not view allegations "in isolation." Thus, courts should not stop at that determination but continue to "assess all the allegations holistically."[56] In sum, by the text of *Tellabs*, a "collective" or "holistic" analysis suggests that courts should not wear blinders—that is, they should not automatically reject the possibility of scienter when plaintiffs fail to allege motive, or when some allegations are ambiguous.

In *Tellabs*, Justice Alito concurred in the judgment, but filed a separate concurrence in which he warned that the majority's opinion could weaken—rather than strengthen—the PSLRA's heightened pleading standards.[57] Noting that the PSLRA unequivocally requires that "'a strong inference' of scienter must arise from those facts that are stated 'with particularity,'" Justice Alito reasoned "that facts not stated with the requisite particularity cannot be considered in determining whether the strong-

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51. *See, e.g.*, *id.* (finding that plaintiffs' allegations about defendants' exposure to "non-specific internal reports" were not probative of scienter because "[a]n unsupported general claim about the existence of confidential corporate reports that reveal information contrary to reported accounts is insufficient to survive a motion to dismiss," and "[s]uch allegations must have corroborating details regarding the contents of allegedly contrary reports, their authors and recipients").

52. *Gompper*, 298 F.3d at 897. This point perhaps relates more to the Supreme Court's third prescription than its second prescription, since it emphasizes the necessary weighing of competing inferences.

53. *Id.*

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

55. *Id.*

56. *Id.* at 326.

57. *Id.* at 334 (Alito, J., concurring).

inference test is met."[58] He worried, however, that dicta in the majority's opinion suggested otherwise:

> [T]he Court states that 'omissions and ambiguities . . . count against' inferring scienter, and that a court should consider all allegations of scienter, even nonparticularized ones, when considering whether a complaint meets the strong inference requirement. Not only does this interpretation contradict the clear statutory language on this point, but it undermines the particularity requirement's purpose of preventing a plaintiff from using vague or general allegations in order to get by a motion to dismiss for failure to state a claim.[59]

While his cautionary note was no doubt well intended, Justice Alito's reading may have actually breathed life into the issue. To the extent Justice Alito admonishes the Court for crediting vague allegations, Justice Ginsburg's opinion suggests no such thing. To the contrary, Justice Ginsburg states only that "omissions and ambiguities" should "count against" inferring scienter.[60] Justice Alito may have preferred a more explicit, straightforward statement that facts "not stated with particularity" should *never* factor into a court's evaluation of a strong inference. But the majority opinion does not suggest otherwise.[61]

Further, even assuming he is correct that Justice Ginsburg's choice of words fails to convey the rigorous requirements of the statute, Justice Alito interprets the Court's dicta as if they were a concrete point of law. The Court would not have intended peripheral remarks—stated *alongside* the text of a well-settled, easily interpreted, and significant provision in the PSLRA—to override that provision and its consistent past interpretations. Whether plaintiffs must plead facts with particularity was not even before the Court. By taking aim at the Court's dicta, however, Justice Alito's warning ultimately became a self-fulfilling prophecy. As we will discuss in Sections II and III, some lower courts now pick up on Justice Alito's language and endorse vague and ambiguous allegations under the auspices of *Tellabs*. Such an approach threatens the PSLRA's particularity requirement for scienter pleading.

In sum, *Tellabs* set out to clarify unrest in the lower courts over how to evaluate facts already pleaded with particularity. The Court did not suggest that its prescription for conducting a "collective" review would alter settled, post-PSLRA precedent requiring particularity for scienter pleadings. Such a heightened particularity requirement for scienter pleading was indeed the purpose of the PSLRA.

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58. *Id.*
59. *Tellabs*, 551 U.S. at 334 (citation omitted).
60. *Id.* at 326 (majority opinion).
61. *See Id.*

E. *Matrixx Initiatives, Inc. v. Siracusano*: Applying *Tellabs*'s "Collective" Review

The Supreme Court would mention a "holistic" review of scienter on only one other occasion, in *Matrixx Initiatives, Inc. v. Siracusano*, a securities fraud case primarily about the standard for pleading materiality, not scienter.[62] Matrixx was a pharmaceutical company, maker of the nasally inhaled cold remedy Zicam. Plaintiffs claimed that Matrixx's statements about revenues and product safety were misleading "in light of reports that Matrixx had received, but did not disclose, about consumers who had lost their sense of smell (a condition called anosmia)."[63] In response, Matrixx argued that its omission was not material because the company was not aware of a "statistically significant number of adverse events."[64] The district court agreed with Matrixx, holding that the lack of a "statistically significant correlation between the use of Zicam and anosmia" made its nondisclosure immaterial.[65] But the Ninth Circuit reversed, finding that the adverse reports, while not "statistically significant" in occurrence, still would have been "significant to a reasonable investor" and thus were material.[66] Affirming the Ninth Circuit, the Supreme Court held that materiality in securities fraud could not be "reduced to a bright-line rule," namely, requiring allegations of statistical significance.[67]

Though the parties and the Court primarily focused on whether plaintiffs had adequately pleaded the elements of a material misstatement, Matrixx also argued that plaintiffs had failed to allege facts sufficient to establish scienter because plaintiffs did "not allege that [Matrixx] knew of statistically significant evidence of causation."[68] Again, the Court eschewed this "bright-line" rule, instead finding—after conducting a "holistic analysis"—that plaintiffs had alleged facts sufficient to satisfy the scienter requirement.[69] But this "holistic" review involved more than a collection of unparticularized allegations. Rather, the Court identified and weighed individual allegations before concluding that they gave rise to a strong inference that Matrixx acted with scienter.[70] The Court applied, rather than expanded on, *Tellabs* by evaluating the details of the scienter-related facts alleged. Tellingly, *Matrixx* was a unanimous decision; it did not spark the

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62. Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309 (2011).
63. *Id.* at 1314.
64. *Id.* at 1313.
65. *Id.* at 1317.
66. *Id.*
67. *Id.* at 1313-14.
68. *Id.* at 1324.
69. *Id.*
70. *Id.*

ire of Justice Alito, who had protested non-particularized pleading, because *Matrixx* did not endorse such a standard.

II. LOWER COURT INTERPRETATIONS OF *TELLABS*'S "HOLISTIC" REVIEW

In the wake of *Tellabs*, both the Ninth Circuit and the Sixth Circuit introduced their own interpretations of the Court's "holistic" review. The Ninth Circuit added two features to its scienter analysis, finding that: (1) even ambiguous allegations could contribute to a strong inference of scienter; and (2) courts should make a "two-step inquiry," first scrutinizing allegations "in isolation" and then in a "holistic" view. In this section, we discuss the cases that led to these changes, *South Ferry LP, No. 2 v. Killinger* and *Zucco Partners, LLC v. Digimarc Corp.* Then, we raise four objections to the Ninth Circuit's dual-inquiry test: (1) that it potentially confounds the PSLRA's particularity and strong inferences requirements; (2) that "isolation" may not be necessary in light of the "holistic" step; (3) that the "holistic" review could improperly account for ambiguous allegations; and (4) that if the "isolation" step fails to establish scienter, the Ninth Circuit has not clearly explained how the "holistic" step can find a "strong" inference from a series of inadequately pleaded circumstances.

Meanwhile, the Sixth Circuit developed its own post-*Tellabs* "holistic" review in *Frank v. Dana Corp.*, which can be viewed as endorsing a review of the complaint that does not engage in an individual analysis of each fact alleged. As we explain, an overbroad approach has the potential to jeopardize compliance with the rigors of the PSLRA's particularity requirement. It also can create lower court confusion over how to properly take a general impression of a complaint lacking in individualized scrutiny. Courts have said that, in a "holistic" review, the whole may be greater than the sum of its parts. But that maxim should apply when one first knows the value of each part.

A. *South Ferry LP, No. 2 v. Killinger*: Vague and Ambiguous Allegations Now Worthy of Courts' Consideration When Evaluating Scienter Pleadings

In *Metzler Investment GMBH v. Corinthian Colleges, Inc.*,[71] the first reported Ninth Circuit opinion to apply *Tellabs*, the Ninth Circuit took the position that the Supreme Court had affirmed the Ninth Circuit's pre-*Tellabs* case law—*Tellabs*, after all, had cited approvingly the Ninth Circuit's decision in *Gompper*.

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71. Metzler Inv. GMBH v. Corinthian Colls., Inc., 540 F.3d 1049, 1072 n.10 (9th Cir. 2008).

However, in *South Ferry LP, No. 2 v. Killinger*, another Ninth Circuit panel read *Tellabs* to mean that prior Ninth Circuit precedent was too strict, a result of being "focused too narrowly in dismissing vague, ambiguous, or general allegations outright."[72] In *South Ferry*, plaintiff alleged that Washington Mutual and senior management made materially false or misleading statements about the bank's ability to manage certain types of lending risk. The district court denied defendants' motion to dismiss for all but three individual defendants. Specifically, as to scienter, the district court found that plaintiff had satisfied the PSLRA's heightened pleading standard under the principle that "facts critical to a business's 'core operations' or important transactions are known to key company officers" because of the nature of the alleged misstatements and operational problems at issue.[73] Given the significance of those alleged misstatements and operational problems, the district court found that scienter could be inferred.

Taking the case on an interlocutory appeal, the Ninth Circuit vacated the district court's opinion and remanded the case for further proceedings. Surveying its precedent, the *South Ferry* court concluded that, before *Tellabs*, plaintiffs could not "rely exclusively on the core operations inference to plead scienter under the PSLRA."[74] But, after *Tellabs*, the court found that the "core operations inference, without more, may in fact raise the strong inference required by the PSLRA[in]unusual circumstances."[75] Despite its earlier finding in *Metzler* that *Tellabs* had left its prior case law intact, the Ninth Circuit now cited the dicta in *Tellabs* that Justice Alito had worried over—that "omissions and ambiguities count against inferring scienter"—to require courts to begin considering omissions and ambiguities in their scienter analysis.[76] Thus, the Ninth Circuit found that core allegations of scienter now suffice, even "in a more bare form, without accompanying particularized allegations, in rare circumstances 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."[77]

If the Ninth Circuit had limited its gloss on "omissions and ambiguities" to the scope of the "core operations" principle, *South Ferry*'s impact would have been limited. Instead, the *South Ferry* court adopted more expansive language, suggesting that for securities cases going forward "[v]ague or ambiguous allegations are now properly considered as a part of a "holistic" review when considering whether the complaint raises a strong

72. South Ferry LP, No. 2 v. Killinger, 542 F.3d 776, 784 (9th Cir. 2008).
73. *Id.* at 781.
74. *Id.* at 784.
75. *Id.* at 785.
76. *Id.* at 784.
77. *Id.* at 786.

inference of scienter."[78] Relying on *Tellabs*, the Ninth Circuit stated that a "series of less precise allegations" can now "be read together to meet the PSLRA's [scienter] requirement."[79] From that point, vague and ambiguous allegations began to creep into the scienter calculus in the Ninth Circuit.[80]

B. *Zucco Partners, LLC v. Digimarc Corp.*: A Two-Step Inquiry for Evaluating Scienter Pleadings

Five months after *South Ferry*, the Ninth Circuit again cited *Tellabs* to augment Ninth Circuit precedent on scienter. In *Zucco Partners, LLC v. Digimarc Corp.*, the Ninth Circuit interpreted *Tellabs* to create a "dual inquiry," requiring courts to first determine "whether any of the plaintiff's allegations, standing alone, are sufficient to create a strong inference of scienter," and if not, to "conduct a 'holistic' review of the same allegations to determine whether the insufficient allegations combine to create a strong inference of intentional conduct or deliberate recklessness."[81]

In *Zucco*, plaintiffs alleged that Digimarc, which specialized in digital watermarking technology, made material misstatements in its financials by improperly capitalizing expenditures that should have been expensed.[82] Digimarc did not dispute that capitalizing the expenditures was wrong, but contended that it did not do so intentionally or with deliberate recklessness.[83] After the district court twice dismissed plaintiffs' complaint for failure to establish scienter, plaintiffs appealed, arguing that the district court failed to analyze scienter under the new standard set out by *Tellabs*.[84]

While the Ninth Circuit ultimately affirmed the district court, it did so only after supplementing Ninth Circuit precedent. In laying out the dual-inquiry test, the *Zucco* court claimed that it was not abandoning its case law but grafting a "holistic" approach onto the "old standards."[85] Presumably, courts were to continue doing what they were doing in the first step; the *Zucco* court, in creating the second step, was simply adding a "holistic" analysis. The problem is that the first step, as described in *Zucco*, was different from what many courts had been doing. Whereas pre-*Tellabs* courts had been scrutinizing each individual allegation to determine whether

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78. *South Ferry*, 542 F.3d at 786.
79. *Id.* at 784.
80. *See, e.g.*, Curry v. Hansen Med., Inc., No. C 09-5094 CW, 2012 U.S. Dist. LEXIS 112449, at *22 (N.D. Cal. Aug. 10, 2012); Stocke v. Shuffle Master, Inc., 615 F. Supp. 2d 1180, 1186-87 (D. Nev. 2009); Henning v. Orient Paper, Inc., CV 10-5887-VBF(AJWx), 2011 U.S. Dist. LEXIS 79135, at *16 (C.D. Cal. July 20, 2011).
81. Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 992 (9th Cir. 2009)
82. *Id.*
83. *Id.* at 988.
84. *Id.* at 988-89.
85. *Id.* at 991.

it was probative of scienter,[86] *Zucco*'s first step now requires courts to examine each individual allegation to determine whether it establishes scienter "standing alone."

This change to the scienter analysis is significant because, as discussed in Section III, it renders the first step unnecessary. Even before *Tellabs*, courts recognized that the proper test is whether plaintiffs' allegations "collectively" create a strong inference.[87] Whether an individual allegation alone demonstrates scienter is, for the most part, irrelevant. By refashioning the first step, the *Zucco* court diverted the analysis from what did matter: whether each individual allegation was in fact probative of scienter. After all, if an individual allegation is not even probative of scienter, courts should not consider it as part of the "holistic" analysis. While the Ninth Circuit suggested in *Zucco* that it was adding a "holistic" second step, its primary effect was to change the focus of the first step and weaken what should be an individualized inquiry into scienter allegations.

1. Dual-Inquiry Issue #1: Weighing Inferences in the First Step Confounds Particularity and Strong Inference Requirements

One of our qualms with the dual inquiry is that the first step confounds the PSLRA's particularity and strong inference requirements. The Ninth Circuit reasoned that if allegations are vague, they do not give rise to a strong inference of scienter. An example in *Zucco* illuminates this point. The court noted that plaintiffs' confidential witnesses were not described with particularity and did not have personal knowledge of the facts to which they attested; their allegations, thus, did not give rise to a strong inference of scienter.[88] But weighing the inferences of vague allegations makes little sense. A vague allegation is just that it should be disregarded as a nullity, not because it isn't compelling, it might speak to damning content, but because it is not detailed enough to meet the demands of the particularity requirement.

Before weighing inferences, courts must demand particularity in facts pleaded, as a threshold matter, according to the plain meaning of the PSLRA. Next, courts can scrutinize the content of those particular facts to evaluate opposing inferences under the instruction of *Tellabs*. Without this screening for particularity vague, but powerful, allegations could receive weight unintended by either the PSLRA or *Tellabs*.

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86. *See In re* Daou Sys., Inc., Sec. Litig., 411 F.3d 1006, 1023 (9th Cir. 2005) (finding "specific allegations of direct involvement in the production of false accounting statements and reports" as being "probative of scienter").

87. *Id.* at 1024.

88. *Zucco*, 552 F.3d at 999-1000.

As we discussed in Section I-B, post-PSLRA courts confirmed the distinction between the "particularity" and "strong inference" requirements.[89] They had little trouble interpreting the plain meaning of the particularity test,[90] even as they disagreed on how to apply the strong inference test.[91]

Conflating these two distinct requirements may explain why some courts, like the Ninth Circuit in *South Ferry*, read the "holistic" review in *Tellabs* as embracing "vague and ambiguous" allegations. When the "holistic" step and particularity requirement (not at issue in *Tellabs*) are viewed as part of the strong inference test (the crux of *Tellabs*), then the change *Tellabs* made to the strong inference test appears also to affect the particularity requirement. When we disentangle these two tests, we simplify future courts' inquiries and remind ourselves what *Tellabs* did not purport to do: weaken the particularity requirement.

Some may argue that facts cannot be deemed either particular or nonparticular, and that particularity more accurately exists on a spectrum. That is, the distinctions between details and ambiguities in facts are too fine for courts to draw a definitive line. But this argument would suggest that the particularity test is difficult if not impossible to administer, which goes against many years of courts applying that element of Rule 9(b) as well as that feature in the PSLRA.[92] And even if particularity is less binary, courts should still first decide whether allegations are particular enough under the PSLRA to proceed to the inference-weighing stage. At that stage, the relative particularity of certain facts alleged could count for or against a scienter evaluation. In this way, courts would avoid the pitfall of confounding these two different requirements.

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89. *In re* Advanta Corp. Sec. Litig., 180 F.3d 525, 534 (3d Cir. 1999) ("[E]ven in jurisdictions already employing the Second Circuit standard, the additional [PSLRA] requirement that plaintiffs state facts "with particularity" represents a heightening of the standard."); *accord* Novak v. Kasaks, 216 F.3d 300, 311 (2d Cir. 2000).

90. *See, e.g.*, *In re* Cable & Wireless, PLC, 321 F. Supp. 2d 749, 761 (E.D. Va. 2004) (describing the particularity provision in the PSLRA as "plain and unambiguous," requiring no further inquiry as to its definition).

91. *See In re* Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 983 (9th Cir. 1999) (The complaint "lacks sufficient detail and foundation necessary to meet either the particularity or strong inference requirements of the PSLRA.") (emphasis added). Indeed, these are distinct elements of the PSLRA.

92. *See, e.g.*, *Advanta*, 180 F.3d at 534 ("This language echoes precisely Fed. R. Civ. P. 9(b) and therefore requires plaintiffs to plead "the who, what, when, where, and how: the first paragraph of any newspaper story.") (quoting DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990)).

2. Dual-Inquiry Issue #2: Weighing Inferences in the First Step Is an Unnecessary Redundancy

Even if facts within each category of circumstances related to scienter are "particular"—as the PSLRA demands of them—they should not be considered in "isolation." This is precisely what *Tellabs* prohibits out of a concern for making one category dispositive for or against scienter.[93] Furthermore, this sort of isolated inquiry creates a redundancy in light of the Ninth Circuit's second "holistic" step. In *Zucco*, for example, no category of scienter-related circumstances (magnitude of falsity, insider trading, executive resignation, private placement during the class period, etc.) alone yielded a strong inference by themselves. But the court still had to view the totality of these allegations in weighing whether the company purposely misstated earnings at specific dates in specific statements. Thus, the isolated analyses were unnecessary. They pertained to a weighing of facts that will still need to be weighed again. Indeed, the critical inference-weighing step occurs later because the ultimate issue is whether a specific misstatement or omission was made with scienter. It makes less sense to ask whether by themselves, certain insider trades, weigh for or against scienter because these trades will later be considered alongside other circumstances as they relate to the misstatement in question.

Courts have already suggested that it would be almost impossible for certain kinds of allegations to create a strong inference of scienter. For example, Ninth Circuit precedent holds that allegations of falsity are not enough by themselves unless it would be "absurd to suggest" that top management was unaware of them.[94] *South Ferry* itself stands for the proposition that core operations allegations of scienter alone could suffice only in the "rare circumstances 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."[95] Conversely, the absence or insufficiency of certain allegations is not necessarily fatal to a scienter inference either. As *Tellabs* states, the lack of a motive does not mean a plaintiff's complaint must fail,[96] just as the lack of insider trading in a fact pattern is not dispositive of nonculpability.[97]

Because a solitary allegation is rarely sufficient, excessive scrutiny of isolated facts is unnecessary. In the rare circumstance that magnitude of falsity is enough to establish scienter, then in the "holistic" review that circumstance will stand out anyway.

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93. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322-23 (2007).
94. Berson v. Applied Signal Tech, Inc., 527 F.3d 982, 987-89 (9th Cir. 2008).
95. South Ferry LP, No. 2 v. Killinger, 542 F.3d 776, 786 (9th Cir. 2008).
96. *Tellabs*, 551 U.S. at 325.
97. Lormand v. US Unwired, Inc., 565 F.3d 228, 254-55 n.17 (5th Cir. 2009).

The redundancy inherent in the first step is borne out by the actual results of the dual inquiry. If each step tended to produce divergent results, the dual test's importance would be more apparent, but their results rarely differ.[98] Step two is unnecessary when a court already finds a strong inference of scienter in step one;[99] and when a strong inference of scienter fails in step one, it almost always fails in step two.[100] In effect, distinguishing the two steps and retaining a separate "holistic" review tends to make step two more significant than it should be, as in the rare case when step two yields a strong inference of scienter even after step one does not.[101]

In some situations, a court's isolated, first-step weighing can awkwardly put nullities on a weighing scale. For example, in *Zucco*, plaintiffs specifically alleged that defendants had signed Sarbanes-Oxley certification forms, and that these certifications should contribute to an

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98. *See* Carol V. Gilden, Michael B. Eisenkraft, and Josh Segal, *Essay: The Dangers of Missing the Forest: The Harm Caused by VeriFone Holdings in a* Tellabs *World*, 44 LOY. U. CHI. L.J. 1457, 1473 (2013) (most courts either find no scienter for either individualized or holistic analyses or find scienter in both). *See also* Kovtun v. Vivus, Inc., No. C 10-4957 PJH, 2012 WL 4477647 (N.D. Cal. Sept. 27, 2012); RS-ANB Fund, LP v. KMS SPE, LLC, No. 4:11-CV-00175-BLW, 2012 U.S. Dist. LEXIS 53407 (D. Idaho Apr. 16, 2012); RS-ANB Fund, LP v. KMS SPE LLC, No. 4:11-CV-00175-BLW, 2011 WL 5352433 (D. Idaho Nov. 7, 2011); *In re* Nvidia Corp. Sec. Litig., No. C 08-04260RS, 2011 WL 4831192 (N.D. Cal. Oct. 12, 2011); Curry v. Hansen Med., Inc., No. 5:09-CV-05094-JF (HRL), 2011 WL 3741238 (N.D. Cal. Aug. 25, 2011); Kyung Cho v. UCBH Holdings, Inc., No. C 09-4208 JSW, 890 F. Supp. 2d 1190 (N.D. Cal. 2011); La. Pac. Corp. v. Money Mkt. 1 Inst. Inv. Dealer, No. C 09-03529 JSW, 2011 WL 1152568 (N.D. Cal. Mar. 28, 2011); *In re* Rigel Pharm., Inc., No. C 09-00546 JSW, 2010 WL 8816155 (N.D. Cal. Aug. 24, 2010); Desserault v. Yakima Chief Prop. Holdings, LLC, No. CV-09-3055-RMP, 2010 WL 2232945 (E.D. Wash. June 3, 2010); *In re* Century Aluminum Co. Sec. Litig., 749 F. Supp. 2d 964 (N.D. Cal. 2010); *In re* Taleo Corp. Sec. Litig., No. C 09-00151 JSW, 2010 WL 597987 (N.D. Cal. Feb. 17, 2010); *In re* Medicis Pharm. Corp. Sec. Litig., 689 F. Supp. 2d 1192 (D. Ariz. 2009); *In re* Cadence Design Sys., Inc. Sec. Litig., 654 F. Supp. 2d 1037 (N.D. Cal. 2009); *In re* PMI Group, Inc., No. C 08-1405 SI, 2009 WL 1916934 (N.D. Cal. July 1, 2009); Brant v. Kipp, No. CV 08-8320 AHM (RZx), 2009 WL 1444691 (C.D. Cal. May 21, 2009); City of Alameda v. Nuveen Mun. High Income Opportunity Fund, No. 08-4575 SI, 2009 WL 1424529 (N.D. Cal. May 20, 2009).

99. *See, e.g.*, N.M. State Inv. Council v. Ernst & Young LLP, 641 F.3d 1089, 1095 (9th Cir. 2011) ("We hold that these factual allegations were each sufficient to support an inference of scienter by EY. While a holistic review is therefore unnecessary, these primary allegations certainly support an inference of scienter when viewed collectively with other claims.").

100. *See supra* note 97 for cases in which a dual inquiry is applied but the court finds no scienter in either step.

101. The Ninth Circuit in *VeriFone* appears to recognize the potential for redundancy in the first step (and the relative priority of the second step) when it states that it will only take a "holistic review of the allegations," eschewing step one to avoid certain "pitfalls" of a "piecemeal" approach. *In re* VeriFone Holdings, Inc. Sec. Litig., 704 F.3d 694, 703 (9th Cir. 2012). While our focus here is not the shortcomings of whatever a "piecemeal" approach may be, we do agree that the dual inquiry seems to make step one dispensable.

inference of scienter.[102] The court rejected this claim because the boilerplate language in these forms adds "nothing substantial to the scienter calculus."[103] If something is an analytical nullity—adding nothing to the calculus—how could it weigh for or against scienter? For such nullities, a first step to weigh inferences "in isolation" is unnecessary.

3. Dual-Inquiry Issue #3: Improper to Consider Vague and Ambiguous Allegations

As discussed in Section I, the particularity requirement for scienter pleading has always been distinct from the requirement to plead particular facts with a "strong inference." To the extent *Tellabs*' dicta suggest that courts should consider vague and ambiguous allegations, such a proposition is out of line with post-PSLRA precedent and contrary to the plain language of the statute.[104] Nor should it be the basis for the scienter standards of lower courts, as it is in *South Ferry* and *Zucco*. Furthermore, as we have explained, *Tellabs* suggests that courts not stop at vague allegations, but that they consider the entirety of the complaint—that is, every page—in the search for *particular facts* giving rise to a strong inference of scienter.[105] As in *Tellabs*, the lack of a motive should not prompt a court to disregard the rest of the allegations; and as in *Gompper* (cited by *Tellabs* for its "holistic" review), the court should consider the totality of the scienter circumstances, not just those that favor one party.[106] The thoroughness recommended by this prescription does not mandate a weakening of the PSLRA's particularity standards.

4. Dual-Inquiry Issue #4: Step Two Lacks Defined Content, Generating Confusion and Potential for Abuse

Finally, the Ninth Circuit's dual inquiry fails to explain how a strong inference in the second step can arise from a series of inadequately pleaded circumstances in the first. Neither *South Ferry* nor *Zucco* articulates a

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102. Zucco Partners, LLC. v. Digimarc Corp., 552 F.3d 981, 1003 (9th Cir. 2009).

103. *Id.*

104. 15 U.S.C. § 78u-4(b)(2). Plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Id.* The "ordinary meaning of the words" are obvious—facts are "events or circumstances" and particularity requires each event or circumstance to be stated with "great detail." *See In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 983 (9th Cir. 1999).

105. *See supra*, Section I, C-D.

106. Gompper v. VISX, Inc., 298 F.3d 893, 897 (9th Cir. 2002) (A court "must consider all reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs").

framework for arriving at this second-step conclusion.[107] Would the sheer volume of inadequate or imprecise allegations suffice? Courts have already suggested that a legion of inadequate allegations may not be enough, even in a "holistic" review.[108] If sheer volume were satisfactory, then the plaintiffs' bar would have the incentive to submit tome-length complaints, leaving parties to engage in futile litigation over how long is long enough. Also, courts have held that the "sheer volume of confidential sources cited cannot compensate" for witnesses described without "sufficient particularity," no matter how many sources are in the complaint.[109] "Cobbling together a litany of inadequate allegations does not render those allegations particularized in accordance with Rule 9(b) or the PSLRA."[110]

We posit that step two's undefined formula has the potential to confuse courts, parties, and future advocates. For example, in *In re Medicis*, the court identified three possible bases for scienter for Medicis' alleged misstatement of revenue reporting: (1) the company's violation of GAAP was so simple and obvious that defendants must have known of the error; (2) the company did not disclose what the court considered a "'tenuous' accounting methodology;" and (3) the company's motive to use the accounting methodology because it facilitated a late-quarter change in revenue reporting.[111] All of the allegations were particular enough, but none of these circumstances alone gave rise to a strong inference of scienter.

Nevertheless, in a "holistic" review, the *Medicis* court concluded that "though Plaintiffs' allegations may not be sufficient to give rise to the requisite state of mind if considered 'in isolation,' they do give rise to a

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107. One scholar, Geoffrey Miller, attempts to provide some illustration of how "synergy" is created between allegations. *See* Geoffrey P. Miller, *The Continuing Evolution of Securities Class Actions Symposium: Pleading After* Tellabs, 2009 WIS. L. REV. 507 (2009). He also acknowledges that *Tellabs* does not address the "subtle but important questions" about how to deal with "multiple predicate allegations." *Id.* at 527. That is, certain allegations may have varying degrees of correlativeness. Miller suggests that "perfectly correlated" events (the right to exercise an option and actually exercising it) do not strengthen inferences of scienter. *Id.* at 527-28. In contrast, independent events (not correlated, such as approving option grants when the stock price is low relative to the time of expiration) lead to stronger inferences of scienter. *Id.* The more often these independent events appear in a complaint, the stronger inference of scienter. *Id.* Miller's point is intuitive, but if a dual test persists (contrary to our recommendation), it would benefit from an articulation, like Miller's, of what fosters synergy between otherwise inadequate allegations.

108. *See, e.g.*, Zucco Partners, LLC. v. Digimarc Corp., 552 F.3d 981, 1006-07 (9th Cir. 2009).

109. *See, e.g.*, Cal. Pub. Emps. Ret. Sys. v. Chubb Corp., 394 F.3d 126, 155 (3d Cir. 2004); *Zucco*, 552 F.3d at 995 ("[C]onfidential witnesses whose statements are introduced to establish scienter must be described with sufficient particularity to establish their reliability and personal knowledge.").

110. *Chubb*, 394 F.3d at 155.

111. *In re* Medicis Pharm. Corp. Sec. Litig., No. CV-08-1821-PHX-GMS, 2010 U.S. Dist. LEXIS 81410, at *24 (D. Ariz. Aug. 9, 2010).

cogent inference of scienter when considered collectively."[112] The court did not explain the nature of the synergy between these allegations or why the allegations deserved greater weight when combined..

Without a fuller discussion of the synergistic effect of inadequate allegations, the district court created the unfortunate impression that it has contradicted itself. Further, the lack of a second-step description does not help future parties craft arguments that, for instance, may or may not build upon correlated or non-correlated events.[113] Instead, a reader may wonder how something arose out of nothing.

C. *Frank v. Dana Corp.*: The Potential for a Holistic Review to be a General Impression of the Complaint

While the Ninth Circuit retains a two-step review, a Sixth Circuit court appears to endorse a review that may amount to a general impression of the complaint.[114] In *Frank v. Dana Corp.*, the Sixth Circuit's language in explaining the standard suggests a quick analysis so as to avoid the "unnecessary inefficiency" of a review of the individual allegations.[115] In *Frank*, plaintiffs sued an auto parts manufacturer and its top executives for misstating actual and projected earnings in quarterly and annual filings. When the company restated earnings, its stock dropped twenty percent.[116]

The first set of *Frank* cases involved a dispute over the proper way to evaluate a "strong inference" of scienter. In 2007, on the heels of *Tellabs*, the district court dismissed the complaint but applied the Sixth Circuit's old standard requiring that plaintiffs' inferences in favor of scienter be the "most plausible" of competing inferences.[117] The Sixth Circuit then vacated the district court's dismissal, remanding with the instructions to determine whether an inference of scienter is "at least as compelling" as nonculpable inferences.[118] On remand, the district court again dismissed the complaint because, even after viewing the totality of the circumstances, the nonculpable inference that the company's inadequate internal controls was the reason behind the misstatements was stronger than inferences of scienter.[119] In 2011, the Sixth Circuit again heard the case on appeal, this

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112. *Id.* at *33.

113. *See supra* note 54, discussing the potential for synergies in support of scienter for non-correlated events alleged together.

114. *See, e.g.*, Frank v. Dana Corp., 646 F.3d 954 (6th Cir. 2011); Ashland, Inc. v. Oppenheimer & Co., 648 F.3d 461 (6th Cir. 2011); *In re* Level 3 Commc'n, Inc. Sec. Litig., 667 F.3d 1331 (10th Cir. 2012).

115. *Frank*, 646 F.3d at 961.

116. *Id.* at 957.

117. Frank v. Dana Corp., 525 F. Supp. 2d 922, 930 (N.D. Ohio 2007).

118. Frank v. Dana Corp., 547 F.3d 564 (6th Cir. 2008).

119. Frank v. Dana Corp., 649 F. Supp. 2d 729 (N.D. Ohio 2009).

time reversing the district court's conclusions by applying a new "holistic" review of scienter under the recently decided *Matrixx v. Siracusano*.

In describing the proper scienter standard, the *Frank* court cites *Matrixx*'s analysis of Justice Sotomayor's opinion: "Writing for the Court, Justice Sotomayor expertly addressed the allegations 'collectively,' did so quickly, and, importantly, did not parse out the allegations for individual analysis."[120] Most significantly, the *Frank* court stated that a review of the individual allegations in light of *Matrixx* and *Tellabs* would be "an unnecessary inefficiency."[121] The court explains that "reviewing each allegation individually before reviewing them holistically risks losing the forest for the trees."[122] But *Matrixx* itself provides little to support *Frank*'s statement of the law. The Supreme Court identified very specific facts alleged indicating the company's awareness of at least some adverse reactions to its Zicam cold remedy.[123] These facts alleged were discussed individually; by contrast, *Frank* may be read to reject the consideration of individual allegations or a "parsing" of the complaint.

A brief summary of the scienter-related circumstances alleged in *Frank* reveals the case's potential to broaden the Sixth Circuit's standard. Plaintiffs alleged several categories of facts suggestive of scienter: defendants' access to internal accounting reports; defendants' statements that they had evaluated the accounting systems during the class period; the high magnitude of the falsity; the temporal proximity of the company's positive and corrective statements; the incentive to earn bonuses by misstating results; the CFO's retirement after the corrective disclosure; the Sarbanes-Oxley certifications signed by the individual defendants; and the SEC's investigation of the company's accounting practices.[124] The district court in 2009 analyzed each category of allegations, evaluating whether they were probative of scienter. Several categories did not add anything to scienter, such as the Sarbanes-Oxley certifications, the CFO's retirement, the ongoing SEC investigation, and the basic motive for the executives to receive higher bonuses by making the company look healthy. A desire to have companies appear successful, according to extensive case law, "does not comprise a motive for fraud."[125] Also, without more facts regarding

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120. *Frank*, 646 F.3d at 961.

121. *Id.*

122. *Id.*

123. Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309, 1324 (2011) (finding that the timing of a press release regarding Zicam safety was suggestive of scienter because it allegedly followed doctors' negative reports to the company about effects of Zicam and was preceded by the company's decision to hire a consultant to review the product).

124. *Frank*, 646 F.3d at 959-61.

125. *Frank*, 649 F. Supp. 2d at 740-41 (citing Ley v. Visteon Corp., 543 F.3d 801, 813 (6th Cir. 2008)); *accord* ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase, Co., 553 F.3d 187, 198 (2d Cir. 2009); Cozzarelli v. Inspire Pharm. Inc., 549

defendants' state of mind when signing SOX certifications, the mere act of signing a false statement "contributes nothing to the scienter inquiry" under prior case law.[126] The district court then undertook a "holistic" view of its analysis to determine whether, taken together, the circumstances suggested the inference of scienter to be as strong as nonculpable inferences. The court found that the nonculpable inference that defendants had been relying on faulty accounting controls was stronger than the inference that they intentionally misstated earnings.[127]

The Sixth Circuit did not make the same calculus. Whereas the district court evaluated each category of allegations for probativeness (SOX certifications, the CFO's retirement, and so on),[128] the Sixth Circuit conducted no such evaluation. In 2011, it listed the facts alleged in support of scienter and accepted them as true.[129] Then the court concluded that, holistically, these untested facts gave rise to a strong inference of scienter because it was "difficult to grasp" that the top two executives were being honest when they reported "gangbuster earnings" nine months before filing for bankruptcy.[130] The court added that the bonuses the CFO and CEO stood to earn and the incentive to misstate financial health to obtain a loan also contributed to the strong inference.[131] The Sixth Circuit's analysis seemingly finds the statements' temporal proximity to the correction and the speakers' motive as the principal reasons in favor of scienter. As the court itself acknowledged, however, it would not "sort through each allegation individually" and would "not parse" the facts alleged, but instead review the scienter pleadings.[132] While the facts of *Frank* may have permitted this kind of brief analysis, the articulation of a quick review is susceptible to misapplication.

F.3d 618, 627 (4th Cir. 2008); Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Grp., 537 F.3d 527, 544 (5th Cir. 2008); *In re* Ceridian Corp., Sec. Litig., 542 F.3d 240, 247 (8th Cir. 2008); Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736, 748 (9th Cir. 2008).

126. *Frank*, 649 F. Supp. 2d at 742 (citing *Ind. Elec. Workers'*, 537 F.3d at 545) ("Absent extrinsic facts that defendants recklessly signed the SOX statements, false SOX statements contribute nothing to the scienter inquiry."); *accord In re Ceridian Corp.*, 542 F.3d at 248 (quoting Kushner v. Beverley Enters., Inc., 317 F.3d 820, 827 (8th Cir. 2003) (district court properly ignored false SOX statements because "a showing in hindsight that the statements were false does not demonstrate fraudulent intent")); *Glazer Capital Mgmt. LP*, 549 F.3d at 747 (requiring extrinsic facts that defendants were "severely reckless" in signing false SOX statements for them to be probative).

127. *Frank*, 649 F. Supp. 2d at 742.

128. *Id.* at 737-42.

129. Frank v. Dana Corp., 646 F.3d 954, 959-61 (6th Cir. 2011).

130. *Id.* at 961-62.

131. *Id.*

132. *Id.* at 961.

1. General Impression Issue: Not Analyzing Allegations Individually Risks Compliance with Circuit Court Precedent, the PSLRA, and Tellabs

In our view, the language in *Frank* should remind us that it is important to distinguish between an "individualized" review (which is essential) and a review of allegations "in isolation" (which is unhelpful). A review of allegations "in isolation," as discussed above,[133] is like the first step in the Ninth Circuit's dual inquiry. This kind of analysis asks whether any given scienter-related circumstance—alone—gives rise to a strong inference. In an "isolated" inquiry, the court weighs inferences for and against scienter for insider trading individually, magnitude of falsity individually, motive individually, and so on. As we explained, such an inquiry is unnecessary and redundant; more, it is at odds with *Tellabs*'s prescription not to evaluate allegations "in isolation."

By contrast, reviewing allegations "individually" simply means evaluating each scienter-related circumstance for its probativeness one at a time. It is a parsing, but not a parsing performed "in isolation." In a proper parsing, the inquiry is whether facts have been pleaded with sufficient particularity, and if so, whether they are probative of scienter. No weighing of inferences occurs when reviewing allegations individually. Courts may apply circuit precedent to assist determinations of probativeness, such as when evaluating the sufficiency of confidential witness pleadings.[134] If certain allegations don't add anything to the scienter calculus, such as claims of motive related only to pecuniary gain or signatures on SOX certifications,[135] they should be considered nullities and not added to a weighing of inferences. Without a review of individual allegations, courts lack sufficient data to draw informed opposing inferences. A fact-finder would be unable to properly assess the value of each allegation—each piece of the scienter puzzle—to determine if and how they fit together in a "holistic" review.

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133. *See supra* Section IIB.

134. *See, e.g.*, Institutional Investors Grp. v. Avaya, Inc., 564 F.3d 242, 263 (3d Cir. 2009) (confidential witness allegations are enhanced by stating the basis of the witness's knowledge, the reliability of his or her sources, the corroborative nature of other facts alleged, the coherence and plausibility of the allegations, and more); Mizzaro v. Home Depot, Inc., 544 3d 1230, 1239-40 (11th Cir. 2008) (if a plaintiff provides a basis for the confidential witness's knowledge, including the position(s) held, the proximity to the offending conduct, and the relevant time frame, such pleadings can be given more weight).

135. Frank v. Dana Corp., 649 F. Supp. 2d 729, 742 (citing Ind. Elec. Workers' Pension Trust v. Shaw Grp., 537 F.3d 527, 545 (5th Cir. 2008)); *In re* Ceridian Corp. Sec. Litig., 542 F.3d 240, 248 (8th Cir. 2008); Glazer Capital Mgmt. LP v. Magistri, 549 F.3d 736, 747 (9th Cir. 2008).

For example, following *Frank*, in *Ashland, Inc. v. Oppenheimer & Co.*,[136] the court decided to "forgo [an] itemized analysis" of the complaint in which prior courts would evaluate the probativeness of scienter allegations using a nonexhaustive list of factors known to be probative of scienter.[137] Often, such cursory analyses favor plaintiffs, but on the rare occasion that they favor defendants, the inquiry is still no sounder. That is what happened in *Ashland*: The court stated a simply put conclusion that plaintiff failed to provide facts to support a strong inference of scienter.[138] It did not indicate how it scrutinized the *Ashland* complaint, other than to suggest that it formed a general impression of the complaint's inadequacy. Prior courts relied on nonexhaustive checklists, which directed them to consider suspicious insider trading, proximity of timing between misstatements and corrective disclosures, motive, and more.[139] These were not dispositive requirements, but examples of frequent types of scienter-related allegations that should attract the attention of courts. Although they helped focus courts on which allegations are especially probative of scienter, they did not require an "isolated" weighing like the Ninth Circuit's first step. Unfortunately, the description of the scienter review in *Frank* has encouraged a diminishing role for these lists of scienter factors, replacing individual attention to the facts alleged with a quick impression and a simply put conclusion.

Following the Sixth Circuit's reasoning, the Tenth Circuit in *In re Level 3 Communications*,[140] found that the district court's "conclusory" method of analyzing scienter would have been sufficient because it was "under no duty to catalog and individually discuss the reports and witnesses plaintiff describe[s]" citing *Frank* as authority for this proposition.[141] Nevertheless—demonstrating that courts have difficulty interpreting the *Frank* approach—the court *still* reviewed the specific facts pleaded to affirm the district court's more cursory dismissal. It found that Plaintiff "gives us a great volume of puzzle pieces that, despite our best efforts, we cannot fit together."[142] In other words, the court identified, as it should, *each*

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136. Ashland, Inc. v. Oppenheimer & Co., Inc., 648 F.3d 461, 469 (6th Cir. 2011).

137. This checklist had been provided by *Helwig v. Vencor Inc.*, 251 F.3d 551, 552 (6th Cir. 2001) (en banc). Factors include insider trading at a suspicious time or in an unusual amount, divergence between internal reports and external statements on the same subject, evidence of bribery by a top company official, and more. *Id.* For similar nonexhaustive descriptions of scienter-related factors, see *Greebel v. FTP Software Inc.*, 194 F.3d 185, 196. *See also* In re Navarre Corp. Sec. Litig., 299 F.3d 735, 747-48 (8th Cir. 2002).

138. *Ashland*, 648 F.3d at 469-70.

139. *See, e.g.*, *Helwig*, 251 F.3d at 552; *Greebel*, 194 F.3d at 196; *In re Navarre Corp.*, 299 F.3d 735, 747-48 (8th Cir. 2002).

140. *In re* Level 3 Commc'n, Inc. Sec. Litig, 667 F.3d 1331, 1344 (10th Cir. 2012).

141. *Id.*

142. *In re Level 3*, 667 F.3d at 1345.

piece of the puzzle to test its probative value. The court thus examined allegations about access to internal reports, motive, and statements issued after the class period.[143]

In a similar example, a district court interpreting *Frank* stated that *Frank* "does not mean . . . that the [c]ourt cannot critically examine Plaintiff's allegations," underscoring the degree to which the Sixth Circuit's decision may be associated with imprecision.[144] Instead, the district court declined to evaluate scienter allegations "in a vacuum."[145] The court went on to scrutinize the statements of individual witnesses, whether inadequate internal controls added anything to scienter, and the magnitude of the misstatement for probativeness of scienter.[146] Indeed, the court went beyond a conclusory analysis while also rejecting an isolated inquiry, à la the Ninth Circuit's first step.

Thus, *Frank*'s apparent suggestion to avoid any individual parsing of the complaint has generated divergent interpretations. That these courts parse through each piece of the scienter puzzle demonstrates the tendency for judges to want to know precisely what they are analyzing. And to determine the probative value of what they are analyzing, courts should be able to consult case law regarding SOX certifications, motive allegations, insider trading as it pertains to scienter, confidential witness pleading, and more. Otherwise, courts may undertake a conclusory review that consists of little more than a general impression of the complaint. When any allegation, even those that are vague and ambiguous, contributes to a court's suspicion that it is difficult to grasp that defendants did not act with scienter, such a review risks running afoul of the particularity requirement of the PSLRA.

III. A PLAN FOR ASSEMBLING THE SCIENTER PUZZLE

A. Proposed Approach

To avoid the potential pitfalls of a dual inquiry and an alternative general impression test, we propose a different course: a "holistic" review that, like a puzzle, is based on the probative value of each piece. Courts should first vet the complaint for allegations that lack particularity, then analyze each fact alleged to determine its probativeness according to case law and past fact patterns. Next, the court can explain how the allegations may or may not fit together by corroboration or another kind of synergy.

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143. *Id.* at 1344-47.

144. Ricker v. Zoo Entm't, Inc., No. 1:11-CV-00490, 2012 U.S. Dist. LEXIS 105418, at *12-13 (S.D. Ohio July 30, 2012).

145. *Id.*

146. *Id.* at *13-19.

The "holistic" review is a particularized review, one that considers the totality of the facts related to scienter for each act of fraud alleged.

1. *Particularity and Probativeness Screening*

Anyone confronted with the complexities of a jigsaw puzzle knows to begin by examining its individual pieces. Likewise, before considering scienter allegations "collectively," courts should screen each fact alleged in support of scienter for (i) particularity and (ii) probativeness. The particularity screening will ensure compliance with the PSLRA's particularity requirement, in effect telling a judge whether plaintiffs' individual allegations count as "pieces" at all. The probativeness evaluation is not a weighing of inferences, but a basic evidentiary inquiry into the degree to which a fact alleged actually suggests scienter. It tells a judge the size and shape of the many pieces before the court.

The PSLRA requires plaintiffs to plead "facts with particularity" that give rise to a strong inference of scienter.[147] "Particularity," as courts have already stated, means facts pleaded with great detail.[148] To comply with this requirement, courts should first disregard, before proceeding further, facts pleaded without sufficient detail. This is not a totally novel standard, as courts have already used the "particularity" test to apply Rule 9(b)'s particularity requirement to securities fraud cases.[149] Furthermore, post-PSLRA courts have enforced a particularity requirement applied separately from a "strong inference" inquiry.[150]

After applying a test for particularity, the court should determine the probative weight of each scienter-related fact alleged. Here, a court takes the time to consider the size and shape of the puzzle pieces pleaded by plaintiffs. The inquiry tests the degree to which a particular fact is

147. 15 U.S.C. § 78u-4(b)(2).

148. *In re* Silicon Graphics Inc. Sec. Litig., 183 F.3d 970, 983 (9th Cir. 1999).

149. *See* Robin v. Arthur Young & Co., 915 F.2d 1120, 1127 (7th Cir. 1990). ("Plaintiffs must provide more than conclusory allegations to satisfy rule 9(b)'s requirement that the circumstances of the fraud be pleaded with particularity.").

150. For example, in *Central Laborers' Pension Fund v. Integrated Electrical Serv*ices, 497 F.3d 546, 552 (5th Cir. 2007), the plaintiffs argued that vaguely-described confidential witnesses should still be considered because the lack of detail "go[es] to the weight accorded [their] statements rather than the validity of considering them in ruling on the motion to dismiss." In response, the court concluded that without particular details, such as job descriptions, responsibilities, or employment dates, the ambiguous allegations were of "no scienter value" at all. *Id.* As a result, the court disregarded these facts as bases for a strong inference before determining whether a strong inference existed. The court conducted this kind of particularity screening for each individual allegation, as some were detailed enough to proceed to the court's "in toto" inference of scienter. *Id.* at 555. Passing the test, the alleged GAAP violations and public restatements of financials were alleged with sufficient detail and could provide some basis to infer scienter. *Id.* at 552.

suggestive of scienter, taking into account any applicable precedent that may assist courts in sizing up the quality of scienter allegations. For example, courts have found allegations of direct involvement in the composition of false reports,[151] suspicious insider trading,[152] and proximity of a misstatement to a corrective disclosure[153] to be probative of scienter under an array of circumstances and fact patterns. This precedent assists courts in determining whether the facts alleged satisfy the scienter requirement. Courts also have used nonexhaustive lists of categories of allegations that are probative of scienter[154] to flag certain facts for probativeness on a case-by-case basis. These lists are helpful insofar as they alert courts to fact patterns that may be compared to the case at hand.

Just as some allegations are probative of scienter, others should be given almost no weight, even if pleaded with detail. For example, Sarbanes-Oxley certifications, alone, are worth almost no probative weight unless accompanied by other facts alleging that defendants knew or should have known that accounting irregularities or other red flags would result in a material misstatement.[155] Without more, mere signatures on Sarbanes-Oxley certifications "add nothing to the scienter calculus" and should be accorded no probative weight, pending the "holistic" review.[156]

At this stage in the screening, courts should not be weighing inferences for or against scienter. To determine whether a strong inference of scienter exists for each fact alleged would be to weigh that fact in isolation, and as we have discussed above, such an inquiry has many shortcomings.

The "probativeness" inquiry allows a court to carefully consider the individual allegations and to apply the guidance of case law to the facts alleged. Once each puzzle piece has been identified for its size and shape,

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151. *In re* Daou Sys,. Inc., Sec. Litig., 411 F.3d 1006, 1023 (9th Cir. 2005).

152. *In re Silicon Graphics*, 183 F.3d at 983; Greebel v. FTP Software, Inc., 194 F.3d 185, 197 (1st Cir. 1999).

153. Ley v. Visteon Corp., 540 F.3d 376, 384-85 (6th Cir. 2008) (noting the nonexhaustive factors that are "probative of scienter") (citing Helwig v. Vencor Inc., 251 F.3d 551, 552 (6th Cir. 2001) (en banc)).

154. *See Helwig*, 251 F.3d at 552; *Greebel*, 194 F.3d at 196; *In re* Navarre Corp. Sec. Litig., 299 F.3d 735, 747-48 (8th Cir. 2002).

155. Cent. Laborers' Pension Fund v. Integrated Elec. Servs., 497 F.3d 546, 555 (5th Cir. 2007).

156. Zucco Partners, LLC. v. Digimarc Corp., 552 F.3d 981, 1004 (9th Cir. 2009); Garfield v. NDC Health Corp., 466 F.3d 1255, 1266 ("Boilerplate language in a corporation's 10-K form, or required certifications under Sarbanes-Oxley section 302(a), however, add nothing substantial to the scienter calculus. Our sister circuits to rule on such questions have unanimously agreed that allowing Sarbanes-Oxley certifications to create an inference of scienter in 'every case where there was an accounting error or auditing mistake made by a publicly traded company' would 'eviscerat[e] the pleading requirements for scienter set forth in the PSLRA.'").

the pieces can now be viewed together to see whether they fit together, and if so, how.

2. *Holistic Review to Weigh Inferences For and Against Scienter*

After screening allegations for probativeness and particularity, courts can analyze them together in a "holistic" weighing of inferences in favor or against scienter. At this stage, the puzzle pieces may combine with some corroboration or synergy to merit more probative weight. If they do, courts will be able to explain, on a case-by-case basis, precisely why specific allegations have more or less inferential weight when taken together. For example, Miller's suggestion of synergy may apply since typically uncorrelated events appearing together will generate stronger inferences of scienter.[157] Courts can also consider any corroborating interrelationships between the facts alleged when formulating an inference of scienter. At the same time, the lack of any synergy or corroboration can contribute to nonculpable inferences against scienter. In sum, a "holistic" review should consider the totality of scienter-related facts when crafting opposing inferences. Because any synergies will be noted and explained, courts will avoid potentially confusing parties and future courts by making conclusory general impressions of complaints.

Depending on the facts of each case, a court might conduct several "holistic" analyses, each for scienter as to a particular kind of misstatement. Scienter does not exist as to a CEO's penchant for fraud generally, but it can as to his or her state of mind in making a particular misstatement or omission. Therefore, courts should take care to avoid mixing all scienter-related circumstances alleged for all misstatements in a "holistic" review.

Consider *Zonagen*,[158] which was cited by *Abrams*,[159] to support the "holistic" review endorsed by the Supreme Court in *Tellabs*. In *Zonagen*, the Fifth Circuit vacated the lower court's dismissal of a Rule 10(b)(5) claim, finding that plaintiffs alleged sufficient facts to support a strong inference of scienter. Plaintiffs' allegations were grouped into multiple kinds of misstatements.

In one category of misstatements, biopharmaceutical manufacturer Zonagen allegedly exaggerated the results of its drug trials in Phase III reports. Zonagen claimed that its product, Vasomax, was "fast-acting" and an "improved formulation," but the court found these statements to be non-actionable "puffing," that is, little more than "optimistic generalizations."[160] Plaintiffs also alleged that insider trading by an outside director was

157. Miller, *supra* note 106, at 527.
158. Nathenson v. Zonagen, 267 F.3d 400 (5th Cir. 2001).
159. Abrams v. Baker Hughes, Inc., 292 F.3d 424 (5th Cir. 2002).
160. *Zonagen*, 267 F.3d at 419.

suggestive of scienter as to the Phase III reports, but the court found such allegations insufficient.[161]

Nevertheless, a different category of claim, that Zonagen misstated Vasomax patent coverage in press releases and other SEC filings, supported a strong inference of scienter. Zonagen asserted in a 1996 press release that a new patent "cover[ed] its use of Vasomax."[162] In fact, the patent did not apply to Vasomax—it was for use only with dissolving tablets, and Vasomax was a pill to be swallowed.[163] Was this misstatement an innocent, or at most negligent, mistake? The court noted that Zonagen was essentially a one-product company, making Vasomax the CEO's sole focus.[164] More specifically, patent protection for Vasomax was described by the CEO as crucial for the company.[165] Executives in the small company also had plenty of time to learn of the patent's content having acquired it in 1994, two years before the misstatement.[166] The court's conclusion: a strong inference in favor of scienter in misstating patent coverage.[167]

Zonagen examines the totality of the facts relating specifically to one kind of misstatement—the scope of the Vasomax patent. It does not add scienter-related facts from the Phase III study misstatements to the "holistic" review of Vasomax patent misstatements. In other words, a court should not look to the entire swath of facts alleged in a complaint when viewing allegations holistically and weighing inferences for or against scienter. Each group of misstatements presents a different situation with a different state of mind, and the circumstances of scienter do not necessarily apply across misstatements. As a result, a court may conduct several "holistic" reviews of scienter if plaintiffs allege, for example, misstatements in a 10-K one year and unrelated misstatements in an 8-K in another year. Each review accounts for the multiple facts contributing to scienter for each misstatement.

B. Gilden, et al.'s Holistic Review and Our Proposed Approach

Although we suggest an initial screening, followed by a weighing of inferences, our proposal's first step is not like the "isolation" step in the Ninth Circuit's dual test, nor is our second step the same as a quick review. We propose a "holistic" review that actively requires synergies between

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161. *Zonagen*, 267 F.3d at 420-21.
162. *Id.* at 423.
163. *Id.*
164. *Id.* at 425.
165. *Id.*
166. *Id.*
167. *Id.*

individual facts alleged, even as it rejects the "isolation" of facts in a vacuum.

While our proposal aims to give courts the particular tools they need to comply with the PSLRA and *Tellabs*, we are aware that some commentators advocate going the other direction—making the "holistic" review as broad as possible.[168] In their "*Dangers of Missing the Forest*" essay, Carol V. Gilden, Michael B. Eisenkraft and Josh Segal capitalize on language in *Frank* to advocate an unfettered approach as they also lament the Ninth Circuit's two-step analysis.[169] According to Gilden et al., the Ninth Circuit's dual inquiry is troubling because the first step even exists.[170] These commentators, plaintiffs' lawyers, assert that "[p]iecemeal parsing of the complaint hurts plaintiffs" by "ignoring the significance of contextual evidence" and encouraging "narrow framing."[171] It is unclear precisely what kind of review is too narrow or inconsiderate of context. Gilden et al. only state that "narrow frames simplify analysis," citing psychology studies as they warn courts of "mental laziness" in not considering a broader view.[172]

Though we agree that the Ninth Circuit's first step should be augmented, we do not agree with Gilden et al. on the reasons for doing so. An "isolated" weighing of scienter inferences for each fact supporting scienter is unnecessarily redundant. Courts, however, should not do as Gilden et al. and *Frank* suggest and relax the pleading standard by eliminating individualized inquiry altogether. Piecemeal weighing of scienter facts "in isolation" can risk losing the forest for the trees, to use Gilden et al.'s metaphor, but a court should be able to look at each tree to determine whether there is a forest.[173] That a fact-by-fact study may "hurt plaintiffs"[174] is not a persuasive reason for rejecting a careful evaluation of the pleadings.

Gilden et al. object to the individualized inquiry not only because it is too narrow or disfavors plaintiffs, but because it purportedly conflicts with *Tellabs* and *Matrixx*. Without much color from the text of either, Gilden et al. conclude that these cases eschewed any kind of methodical process, favoring instead one holistic evaluation.[175] As we have discussed, the Supreme Court does not establish a new, monolithic review. Instead, the Court leaves in place the PSLRA's distinction between the particularity requirement and the strong-inference test—a distinction that presumes more

168. Gilden, Eisenkraft, and Segal, *supra* note 97, at 1457.
169. *Id.*
170. *Id.* at 1464.
171. *Id.* at 1472.
172. *Id.* at 1471.
173. *Id.* at 1472.
174. *Id.*
175. *Id.* at 1461.

than one inquiry when evaluating scienter pleadings. Also, the Court does not reject the need to analyze, fact-by-fact, the individual allegations for their probativeness—evaluations that courts had long conducted using precedent and comparisons with past fact patterns. Rather, the Court in *Tellabs* and *Matrixx* reminds us that a "holistic" review should not be blinded by certain ambiguities or inadequately alleged facts related to scienter. To follow *Tellabs* means to view the totality of the circumstances surrounding each alleged act made with scienter.

Our proposal is also in line with what courts have in practice been doing since *Tellabs*, despite their articulations of a broader standard. For example, in *Ashland* and *Level 3*, along with *Ricker*, courts have cited the quick *Frank* review even as they have examined the individual allegations as pieces of a puzzle to be fit together. Though courts may still manage to reach a sound judgment using flawed language, an overbroad articulation of a standard can end up frustrating the application of that standard. We aim to restore the "holistic" review to its original purpose, bringing it from quick and conclusory back to calculated and conscious of the rigors of the PSLRA.

C. Conclusion: Scienter Review as a Puzzle, Not a Forest

It strikes us that the runaway interpretations of *Tellabs* have perhaps been encouraged by wordplay nearly as much as analysis. Courts, when articulating their positions on this subject, have shown a fondness for citing clichés to support overbroad scrutiny so as not to miss the "forest." But proverbs like "the whole is greater than the sum of its parts" and "don't miss the forest for the trees" are not helpful for envisioning a *Tellabs* compliant review of scienter allegations.[176] These phrases are cautious truisms that every court should remember when reviewing any set of allegations. They do not, however, provide a unique analogy to the scienter pleading context in securities fraud litigation, especially when one considers the PSLRA's deliberately heightened particularity requirement. Though

176. *See, e.g.*, Frank v. Dana Corp., 646 F.3d 954, 961 (6th Cir. 2011) ("[R]eviewing each allegation individually before reviewing them holistically risks losing the forest for the trees."); *In re* VeriFone Holdings, Inc. Sec. Litig., 704 F.3d 694, 703 (9th Cir. 2012); Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 1006 (9th Cir. 2009) (scienter allegations may give rise to an inference that is "greater than the sum of its parts"); Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156, 1165 (9th Cir. 2009) ("[W]e must perform a second holistic analysis to determine whether the complaint contains an inference of scienter that is greater than the sum of its parts."); Hughes v. Huron Consulting Grp., Inc., 733 F. Supp. 2d 943, 947 (N.D. Ill. 2010) ("In their battle over the trees, the parties largely lose sight of the forest of plaintiffs' theory.").

they rightly emphasize a consideration of all the facts, timeworn sayings don't illustrate how to view such facts together.

We find it helpful to visualize scienter under the PSLRA, not as an adage, but as a puzzle. A court cannot claim to see a full picture of the puzzle simply by dumping the pieces onto a table and taking a general impression. Furthermore, a court cannot hope to assemble the puzzle if the court never pauses to recognize when a piece is so vague and ambiguous that it may not belong to the puzzle at all. Nor can a court peer into a single piece, when one does exist, and assume that it alone is the entire puzzle. In a "holistic" review, the court understands the content of each piece by evaluating its probative value; only by knowing what is on each piece can the court begin to put them together.

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