PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995
(2001 UPDATE)

Martin D. Chitwood
Lauren E. Wagner
M. Krissi Temple

Chitwood & Harley
Promenade II
1230 Peachtree Street NE
Atlanta, Georgia 30309
(404)873-3900

November 9, 2001

INTRODUCTION

Almost six years ago, over the veto of President Clinton, Congress enacted the Private Securities Litigation Reform Act of 1995 (the "PSLRA").[1] The legislation completely overhauled the rules governing securities class action lawsuits. In the wake of the passage of the PSLRA, gloom and doom predictions abounded for both investors and the securities class action plaintiffs bar. The President, himself, predicted that the proposed legislation would "have the effect of closing the courthouse door on investors who have legitimate claims."[2]

Portraying class action lawsuits as a lottery for lawyers, proponents of the legislation argued that the safeguards of the PSLRA were necessary to allow companies to publish statements regarding their financial prospects, without fear of meritless shareholder lawsuits. With an agenda

---

[1] 15 U.S.C. ' 78u-4

[2] In his veto message, President Clinton voiced three specific objections to the PSLRA: 1) the heightened pleading requirements pertaining to the defendant's state of mind; 2) the language of the Statement of Managers that diluted the nature of the cautionary language required to accompany forward-looking statements (*See* H.R. Conf. Rep. No. 104-369, 104th Cong. 1st sess., at 34 (1995)); and 3). the disparate treatment of plaintiffs and defendants under the bill's provision for mandatory sanctions for violations of Rule 11.

well funded by Silicon Valley-based public companies and the then “Big 6“ accounting firms, a coalition of supporters of the PSLRA waged a campaign to convince the public, and ultimately Congress, that all securities actions are frivolous and benefit only lawyers. The intent behind long-standing securities laws - to protect the investing public- suddenly was displaced with the desire protect corporate defendants, especially start-up technology companies in Silicon Valley. The stated intent of the PSLRA was to eliminate alleged abusive litigation and coercive settlements.[3] The PSLRA was not passed to benefit or protect investors.

Opponents of the PSLRA argued that those lobbying for the new legislation were motivated solely by their desire to protect themselves from legitimate lawsuits and predicted that the PSLRA would curb meritorious lawsuits and, in effect, legalize securities fraud. They observed that the proposed legislation would allow companies to induce investments with unsubstantiated or false statements and erode investors‘ ability to recoup investment losses resulting from the fraud.

How Has the PSLRA Affected Securities Class Action Lawsuits?

Six years later, despite the PSLRA‘s onerous heightened pleading standards and liberal Safe Harbor protections for defendants, securities class action lawsuits have thrived. In fact, post-reform litigation is producing much larger recoveries for plaintiffs.[4] One of the intended goals of the PSLRA was to curtail the number of routinely filed class action lawsuits; an unexpected consequence is that class action lawyers are bringing better, more thoroughly researched securities cases. Higher pleading standards enforced under the PSLRA require lawyers to thoroughly investigate claims prior to filing a complaint.[5] Also, in recent years, institutional investors have

---

[3] *Securities Litigation Conference Report*, Title I and II, Report 104-369, November 28, 1995.

[4] *See*, Mukesh Bajaj, Sumon C. Mazumdar and Atulya Sarin, *Securities Class Action Settlements; An Empirical Analysis,* November 16, 2000 (relying upon data reported in the *Securities Class Action Alert).*

[5] The PSLRA requires plaintiffs to Astate with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.@ 15 U.S.C. ' 78u-4(b)(2).

become more involved in securities class actions. The cases are no longer filed in a rush to the courthouse on behalf of “figurehead“ plaintiffs with little at stake. In short, securities lawyers are bringing better cases.

During the period from 1996 through 2001, 1275 issuers have been named in federal securities class actions.[6] With two months remaining, plaintiffs have filed a record 326 securities class actions in 2001.[7] Not surprisingly, the high-tech business sector is most frequently sued. The aggressive financial reporting policies of new “high growth“ public companies that emerged during the Dot-Com IPO boom (now bomb) era compromised the integrity public company financial reporting. Full disclosure requirements historically have instilled investor confidence in our national markets. Shareholder lawsuits play a vital role in protecting the public disclosure system in this country.

Former Chairman of the SEC, Arthur Levitt, consistently emphasized that “[p]rivate actions are crucial to the integrity of our disclosure system because they provide a direct incentive for issuers and other market participants to meet their obligations under the securities laws.“[8] Indeed, private litigation is a strong deterrent to securities fraud. The SEC recognizes the importance of private actions not only to enforce the antifraud provisions of the federal securities laws, but also to provide a right of financial recovery for the victims of securities fraud.[9]

---

[6] Stanford Law School Securities Class Action Clearinghouse, http://securities.stanford.edu/research.html

[7] *Id.*

[8] *See* Prepared Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Before the House Subcommittee on Telecommunications and Finance, Committee on Commerce, FED. NEWS SERV., Feb. 10, 1995, available in LEXIS, News Library, Curnws File; Prepared Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning Litigation Under TI-IF, Federal Securities Lasw, Before the House Subcommittee on Telecommunications and Finance of the Committee on Energy and Commerce, FED. NEWS Serv., July 22, 1994, available in LEXIS, News Library, Curnws File.

[9] *See id.*

The volatility of the securities markets in recent years has contributed to the upsurge in securities fraud litigation. Over 9,000 new public companies were created in the booming 1980s and 1990s. Pressure for new up-start companies to show earnings growth or revenue increases has been intense. Consequently, fraud is simply more common in today's stock market. Moreover, on-line news and financial services instantly alert investors to dramatic price declines, accounting restatements, illicit insider trading, and other possible indicia of fraud. The Internet provides investors and plaintiffs lawyers with fingertip access to real-time national market trading information and to companies' SEC filings and news releases.

The Internet also is a powerful marketing tool. Ironically, the notice requirement in the lead plaintiff provisions of the PSLRA actually helps lawyers attract lead plaintiffs and other witnesses to participate in class actions.[10] In a report submitted to President Clinton and Congress in April 1997, the Office of the General Counsel for the SEC assessed the impact of the PSLRA during its first year of enactment.[11] The report noted that "the [lead plaintiff] notice may be used as a form of advertising by lawyers representing one or more investors with only a small financial stake in the class action."[12] The Office of the General Counsel for the SEC further recognized that the notice required by the PSLRA "can help attract witnesses, including disgruntled ex-employees and others who may possess useful information."[13] Class action lawyers routinely publish lead plaintiff notices on the Internet.

Corporate Governance Changes

In addition to the emerging trend toward larger recoveries in settlements of securities class

---

[10] *See* 15 U.S.C. ' 78u-4(a) (3)(A)

[11] Report to the President and the Congress on the First Year of Practice under the Securities Litigation Reform Act of 1995, U.S. Securities and Exchange Commission, Office of the General Counsel, April 1997.

[12] *Id*. at 65.

[13] *Id*.

actions, lead plaintiffs are insisting on corporate governance changes. Corporate governance evolves from the separation of ownership and control of public corporations. The true owners are the shareholders, but in reality, shareholders have little control over the management of these companies. Through corporate governance enhancements, shareholders can increase management accountability to the true owners. Creating this power shift through federal securities class actions is yet another unexpected result of the passage of the PSLRA.

Acting as lead plaintiffs in securities class action, institutional investors are beginning to design stricter corporate governance measures as part of negotiated out-of-court settlements. Without the threat of pending litigation, many corporations have neglected or even ignored institutional investors' requests for voluntary corporate governance enhancements. These corporations refused to shift power away from insiders to independent outside directors. During the Dot.com phenomena, corporate insiders frequently created self-serving stock option programs and then regularly re-priced their options lower to follow the downward spiral of the stock price. Meanwhile, shareholders were subject to the vagaries of the market.

When institutional investors became active in securities class action litigation, their demands suddenly packed more punch. In *In re Cendant Corporation Litigation*, the California Public Employees' Retirement System, the New York State Common Retirement Fund, and the New York City Pension Funds joined together as Lead Plaintiff in a securities class action after Cendant disclosed, among other things, that the 1995, 1996, and 1997 financial statements for Cendant and one of its predecessors materially misstated revenue and income.[14] In addition to a $2.5+ billion payment, the settlement terms imposed certain corporate governance changes on Cendant. The corporate governance changes agreed to by Cendant include: 1) restructuring the Board of Directors so that there is a majority of independent directors; filling the audit, nominating, and compensation committees members of the Board entirely with independent

[14] *See In re Cendant Corporation Litigation*, 264 F.3d 286, 288 (3d Cir. 2001).

directors; and establishing annual elections of all directors.[15] The mandated changes to the corporate control environment at Cendant attracted little or no press, although the aberrant billion-dollar settlement figure and sizeable attorneys' fees are widely and repeatedly touted as classic examples of why securities class actions are ruining corporate America.

Securities Cases are Particularly Suited for Class Action Treatment

The adoption of Rule 23 of the Federal Rules of Civil Procedure made securities class action suits feasible. The PSLRA did not change established principles regarding Rule 23 requirements.[16] Many securities class actions seek recovery for violations of Section 11 of the Securities Act of 1933 on behalf of plaintiffs who purchased securities in a public offering and Section 10b of the Securities Exchange Act of 1934 and Rule 10(b)-5 promulgated thereunder on behalf of plaintiffs who purchased or sold securities at prices inflated by material misrepresentations or omissions. Cases brought under the federal securities laws are ideally suited for class action treatment because they often involve nationally traded securities.

When the claims asserted arise in connection with securities that are actively traded on a national market, plaintiffs usually are entitled to a presumption of reliance under the "fraud-on-the-market theory."[17] Ordinarily, the claims asserted by plaintiffs in a securities class action arise from the same events and practices and are based on the same legal theories as the claims of absent class members. Thus, the commonality and typicality requirements of Rule 23 are easily met.[18] Because securities class actions are brought on behalf of thousands of shareholders, the

---

[15] *Id. at* 291. The Third Circuit Court of Appeals upheld the district court=s approval of the settlement.

[16] *See In re Oxford Health Plans, Inc. Sec. Litig.*, 182 F.R.D. 42, 49 (S.D.N.Y. 1998).

[17] In *Basic Inc. v. Levinson*, the United States Supreme Court created a rebuttable presumption of reliance on public material misrepresentations to support a Rule 10(b)-5 claim in a class action. 485 U.S. 224, 245 (1988).

[18] *See Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 722-25 (11th Cir. 1987); *Lipton v. Documation, Inc.*, 734 F.2d 740, 743 (11th cir. 1984).

Rule 23 numerosity requirement also is easily met. These shareholders usually suffer damages in amounts that are too small to justify individual litigation, and, therefore, joinder of all class members is almost always considered impracticable.[19] If the named plaintiffs' interests are not antagonistic to those of the other class members and counsel for the class demonstrate that they are qualified, experienced, and will vigorously [20] pursue the litigation, then the adequacy requirements routinely are satisfied.[21]

JUDICIAL INTERPRETATIONS OF THE PSLRA

During the past six years of active securities class action litigation, a number of federal district courts and appellate courts have interpreted most of the key provisions of the PSLRA. The decisions and opinions interpreting the PSLRA, while not entirely consistent, do provide a roadmap for securities litigation in the class action arena.

. APPOINTMENT OF LEAD PLAINTIFF

A. Procedural Requirements

Prior to the passage of the PSLRA, the traditional method to determine who would serve as lead plaintiff in securities class actions was typically the "first come, first served" method. Statement of Managers, p. 3. In seeking to discourage the "race to the courthouse," the PSLRA requires that a plaintiff filing a securities fraud complaint must also file a certification attesting to his or her willingness to serve as lead plaintiff, providing his transaction information and declining any compensation other than what he would receive as a class member. 15 U.S.C.A. §§ 77z-1(a)(2), 78u-4(a)(2). Additionally, in an attempt to discourage the practice of small individual investors becoming "professional plaintiffs" in multiple securities class actions, the PSLRA prohibits any party from being lead plaintiff in more than five securities class actions during any three year period. 15 U.S.C. § 78u-4(a)(3)(B)(vi).

In order to give potential lead plaintiffs with large financial interests the opportunity to serve as lead plaintiff in the action, the Reform Act requires that a plaintiff filing a securities class action complaint must, within 20 days of filing the complaint, provide notice to all potential class members in a "widely circulated national business-oriented publication or wire service." 15 U.S.C.A. §§ 77z-1(a)(3)(A)(i), 78u-4(a)(3)(A)(i). This notice must identify the claims alleged in the action and the class period, and it must inform potential class members of their right to move to serve as lead plaintiff within sixty (60) days of the date of filing the complaint. Id. As a practical matter, such notices also typically include the name, address and phone number of the

[19] *See, e.g., Evans v. U.S. Pipe & Foundry Co.*, 696 F.2d 925, 930 (11th Cir. 1983).

[20] *See In re Oxford Health Plans, Inc. Sec. Litig.*, 182 F.R.D. 42, 49 (S.D.N.Y. 1998).

[21] *See Kirkpatrick*, 827 F.2d at 726-27.

attorneys representing the class and invite any potential class member to contact such person for more information.

Under the PSLRA, any group of persons wishing to serve as lead plaintiff must move the court for appointment as lead plaintiff within sixty (60) days of the publication of the statutory notice. 15 U.S.C.A. §§ 77z-1(a)(3)(A)(i)(II), 78u-4(a)(3)(A)(i)(II). The court must rule on any outstanding motions to consolidate (which would include motions to transfer and consolidate brought under 28 U.S.C.§ 1407) prior to ruling on any motions to appoint lead plaintiff. 15 U.S.C.§§ 77z-1(a)(3)(B)(ii), 78u-4(a)(3)(B)(ii). Additionally, the court must rule on any motions to appoint lead plaintiff within ninety (90) days of the publication of the statutory notice. 15 U.S.C. §§ 77z-1(a)(3)(B)(i), 78u-4(a)(3)(B)(i).

Concurrently with the lead plaintiff appointment, the court will typically approve the lead plaintiff's selection of lead counsel. The PSLRA vests the lead plaintiff with the authority to retain lead counsel for the class, subject to the approval of the court. 15 U.S.C.A. §§ 77z-1(a)(3)(B)(v), 78u-4(a)(3)(B)(v). The PSLRA also dictates that attorneys' fees for lead counsel shall not exceed a reasonable percentage of the ultimate recovery to the class. 15 U.S.C.A. §§ 77z-1(a)(6), 78u-4(a)(6). Thus, the lead plaintiff is directed to choose the lead counsel for the class, who will be compensated by a reasonable percentage of the recovery enjoyed by the class.

B. <u>“Most Adequate Plaintiff“</u>

The PSLRA creates a presumption that the most adequate plaintiff is “the person, or group of persons“ that (1) either filed the complaint or made a motion to be appointed lead plaintiff; (2) has the largest financial interest in the relief sought by the class; <u>and</u> (3) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure. 15 U.S.C. § 78u-4(a)(B)(iii)(I).

Generally, four factors have been considered as relevant to the determination of the “largest financial interest“: (1) the number of shares purchased by the movant; (2) the number of net shares purchased by the movant; (3) the total net funds expended by the movant during the class period; and (4) the losses suffered by the movant. <u>Burke v. Ruttenberg</u>, 102 F. Supp. 2d 1280 (N.D. Ala. 2000) (citing <u>First Merchants Acceptance Corp.</u>, 1997 WL 461036 at *5 (N.D. Ill. 1997).

1. <u>PSLRA's Preference for Institutional Investors</u>

The presumption in favor of the person or group with the largest financial stake in the litigation reflects Congress' belief that class members with the largest financial interest have greater incentives to insure that the action is prosecuted in the best interests of the class. Statement, p. 5. To achieve this goal, the PSLRA seeks to encourage the selection of institutional investors as lead plaintiffs in securities class action claims. <u>In re Network Assoc., Inc. Sec. Litig.</u>, 76 F. Supp. 2d 1017, 1020 (N.D. Cal. 1999). In large part, this is due to the fact that institutional investors are the most likely to have the largest financial interest in the case and thus they may often qualify as the “most adequate plaintiff“ as defined by the PSLRA.

Despite Congressional intentions to encourage institutional investors to serve as lead plaintiffs, however, the number of institutional investors that have sought to participate as lead plaintiffs in securities class actions has still remained relatively small.[22] Courts interpreting the lead plaintiff provisions of the PSLRA have generally recognized Congress' intent to encourage participation of institutional investors in securities class actions. See, e.g., In re Lucent Technologies, Inc. Sec. Litig., 194 F.R.D. 137 (D.N.J. 2000). In recent cases where institutional investors have undertaken to participate, however, courts have refrained from automatically conferring lead plaintiff status upon them, in some cases ordering that the role be shared instead. See, e.g. In re Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42 (S.D.N.Y. 1998)(court appointed three groups of investors to serve as joint-lead plaintiffs, including an institutional investor, three individual investors, and a management company which included five pension funds). Courts recognize, moreover, that if an "institutional investor" does not have the largest financial interest in the relief sought by the class, it will not be deemed the "most adequate plaintiff." Netsky v. Capstead Mortgage Corp., No. 3:98-CV-1716, 2000 WL 964935 at *5, (N.D. Tex. July 12, 2000).

2. Rebuttable Presumption of "Most Adequate Plaintiff"

Once the presumptive lead plaintiff has been determined, this presumption can be rebutted only by proving that the "presumptively most adequate plaintiff" will not fairly and adequately protect the interests of the class as a whole, or would be subject to unique defenses that render such plaintiff incapable of adequately representing the class. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I)-(II). The PSLRA provides that this presumption may be rebutted only "by a member of the purported plaintiff class." 15 U.S.C.A. §§ 77z-1(a)(3)(B)(iii)(II), 78u-4(a)(3)(B)(iii)(II). Accordingly, defendants do not have standing to respond to the issue of who should serve as lead plaintiff. Netsky v. Capstead Mortgage Corp., No. 3:98-CV-1716, 2000 WL 964935 at *7 (N.D. Tex. July 12, 2000); Takeda v. Turbodyne Techs, Inc. , 67 F. Supp 2d. 1129, 1138 (C.D. Cal. 1999); Greebel v. FTP Software Inc., 939 F. Supp. 57, 59 (D. Mass. 1996)(the "presumption may be rebutted only upon proof by a member of the purported plaintiff class")(quoting 15 U.S.C.A. § 78u-4(a)(3)(B)(iii)(II)).[23]

However, there has been substantial dispute about the definition of "the most adequate

[22] See, e.g., S.E.C. Office of General Counsel, Report to the President and the Congress on the First Year of Practice Under the Private Securities Litigation Reform Act of 1995 (Apr. 15, 1997), reprinted in 3 Securities Reform Act Litig. Rptr. 27, 56 (May 1998) (ACongress' efforts to encourage more active participation by institutional and other large investors has not yet taken hold...In the 105 cases filed after the first year after passage of the [PSLRA], we have found only eight cases in which institutions have moved to become lead plaintiff.@); See also Memorandum of the S.E.C., Amicus Curiae at 16, In re Oxford Health Plans, Inc. Sec. Litig., MDL Docket No. 1222 (S.D.N.Y.)(asserting that Afew institutions have instituted securities fraud class actions after passage of the PSLRA.@); Seth Goodchild, Nothing Ventured, Nothing Gained: Ten Lessons for Institutional Investors From the 1995 Reform Act, 4 Securities Reform Act Litig. Rptr. 583-84 (Feb.-Mar. 1998)(The PSLRA has not yet brought the dramatic revolution in the leadership of these actions Congress intended...[I]nstitutional investors have remained passive observers in securities litigation, volunteering to serve as lead plaintiff only infrequently.@)

[23] But see King v. Livent, Inc., 36 F. Supp. 2d 187, 191 (S.D.N.Y. 1999)(court determined that the defendants generally do have standing to object, especially where there are no competing plaintiffs); Howard Gunty Profit Sharing v. Quantum Corp., No. 96-20711, slip op. at 6-7 (N.D. Cal. Feb. 6, 1997)(Awhen...there are no other potential lead plaintiffs to challenge a moving party, the Court must rely on the defendants to insure that the requirements of [the PSLRA] are satisfied.@)

plaintiff.“ Specifically, two issues arise from the interpretation of the phrase “the most adequate plaintiff“. First, whether an otherwise unrelated group can aggregate their losses in order to serve as lead plaintiff. Second, whether the courts can “augment“ the presumptive lead plaintiff by the appointment of “co-lead“ plaintiffs. Neither of these issues has been fully resolved by the courts.

a. Aggregation of Shareholder Damages in Order to Determine Financial Interest

Defendants contend that the PSLRA is silent on the issue of whether members of the class or a group of persons (or entities) may aggregate their damages to constitute the “largest financial interest“ for the purpose of determining the “most adequate plaintiff.“ The PSLRA does specifically refer, however, to a “group of persons“ serving as lead plaintiffs. The Securities and Exchange Commission (“SEC“) does not provide guidelines to assist with the interpretation of the term “group of persons“ as defined in the PSLRA. Rather, the SEC has suggested that a court should “only approve a group that is small enough to be capable of effectively managing the litigation and the lawyers.“ In re Baan Co. Sec. Litig., 186 F.R.D., 214, 216 (D.D.C. 1999); see also In re Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42, 48-49 (S.D.N.Y. 1998). The SEC has recommended that no more than three to five persons should serve as lead plaintiffs in order to ensure joint decisionmaking and to manage the litigation effectively. Baan, 186 F.R.D. at 219. So the question remains, does the PSLRA permit aggregation of damages for the purpose of determining the most adequate plaintiff?

The majority of courts addressing this issue have permitted the aggregation of claims by unrelated parties.[24] See In re First Union Corp. Sec. Litig., No. 3:99-CV-237, 2000 U.S. Dist. LEXIS 2267 at *12 (W.D.N.C. Jan. 27, 2000)(“there is now an overwhelming weight of authority allowing the appointment of such an unrelated group to serve as lead plaintiffs.“); Yousefi v. Lockheed Martin Corp., 70 F. Supp. 2d 1061, 1067 (C.D. Cal. 1999)(an individual investor and an institutional investor were appointed co-lead plaintiffs as they suffered the largest financial loss); Reiger v. Altris Software, No. 98-CV-0528, 1999 WL 540893 (S.D. Cal. Sept. 11, 1998)(“Congress made it clear that a court can consider the aggregate group's losses in determining which group has the largest financial interest.“); Gluck v. CellStar Corp., 976 F. Supp. 542, 546 (N.D. Tex. 1997) (“[A]ggregating the shares of several plaintiffs for purposes of [the largest financial interest] calculation is proper under the statutory language.“).

On the other hand, a minority of courts have stated that aggregation of unrelated parties should not be allowed when determining lead plaintiff in a securities class action, holding that unrelated individuals cannot qualify as a “group of persons“ under the PSLRA. These courts

[24] While courts have generally held that aggregation of damages should be allowed, several courts have noted that there are certain instances where the number of proposed lead plaintiffs should be limited. See, e.g., Lubitsch v. Dataworks Corp., No. 98-2012-IEG (S.D. Cal. Feb. 9, 1999)(the court rejected the appointment of a 25-member lead plaintiff group and instead appointed a 3 member subgroup.); Mitchell v. Complete Management, Inc., No. 99 Civ. 1454, 1999 WL 728678 (S.D.N.Y. Sept. 15, 1999)(the court directed the plaintiff group to propose a lesser number of class members for appointment of lead plaintiff, as the initial proposal was for a 141-person lead plaintiff group.)

reason that it would be inconsistent with the Reform Act "to allow a melange of unrelated persons to serve as the lead plaintiff...Such a 'group' would be a 'lead plaintiff' in name only; in substance, those individuals would essentially constitute a collection of lead plaintiffs, unbound by any allegiance to one another and unlikely to function as a unified whole."[25]

The seminal case prohibiting aggregation of damages is In re Network Assoc., Inc. Sec. Litig., 76 F. Supp. 2d 1017 (N.D.Cal. 1999). In that case, the court prohibited the aggregation of unrelated plaintiffs and criticized the proposed aggregation as follows: "The only thing the investors in any group have in common...is the lawyer. They have no link to each other. They are not organized with any group decisionmaking apparatus. They attended no organizing meetings. They have no cohesive identity." Id. Moreover, the Network Associates court pointed out that if aggregation of unrelated investors were allowed, "then a qualified institutional investor with the single largest loss could be trumped by a collage of individual investors with greater aggregate losses but no ability to manage the case." Id. at 1024. See also In re McKesson HBOC Sec. Litig., 97 F. Supp. 2d 993(N.D. Cal. 1999)(the court concluded that a lead plaintiff must be an individual person or entity or at most, a close-knit group of persons and would not allow aggregation of amorphous grouping of unrelated persons.)

In In re Donnkenny, Inc. Sec. Litig., 171 F.R.D. 156, 157 (S.D.N.Y. 1997), the court refused to appoint a lead plaintiff group comprised of two unrelated institutional investors and four other individual class members. The judge reasoned that

> [t]o allow an aggregation of unrelated plaintiffs to serve as lead plaintiffs defeats the purpose of choosing a lead plaintiff. One of the principal legislative purposes of the PSLRA was to prevent lawyer-driven litigation. Appointing lead plaintiff on the basis of financial interest, rather than on a "first come, first serve" basis, was intended to ensure that institutional plaintiffs with expertise in the securities market and real financial interests in the integrity of the market would control the litigation...

Id. at 157-58.

One court recently set forth yet another approach to the aggregation issue. In Wenderhold v. Cylink Corp., 188 F.R.D. 577, 586 (N.D. Cal. 1999), the court held that

> aggregation solely for the purpose of creating a group that would have the largest financial interest in the relief sought by the class would seem to contravene the PSLRA's purpose of shifting control of the litigation from the lawyers to the investors. Uncritical or blanket acceptance of such aggregation would permit lawyers to designate unrelated plaintiffs as a group which would allow and encourage lawyers to direct the litigation.

Id. The court went on to state that there are two circumstances in which aggregation should be

[25] In re Texlon Corp. Sec. Litig., 67 F. Supp. 2d 803, 813 (N.D. Ohio 1999). But see Bowman v. Legato Systems, 195 F.R.D. 655, 658 (N.D. Cal. 2000) (lawyer-selected aggregation of unrelated persons not within PSLRA definition of Agroup@).

permitted: (1) if the aggregation is necessary to address the existence of intra-class periods; and (2) if it can be shown to serve the PSLRA's effort to shift control of the litigation away from the lawyers and to the investors. Id. The court believed this middle course best serves the class and comports with the Reform Act.[26] Id.

b. Appointment of "Co-Lead" Plaintiffs

Another recent trend among several courts is to allow multiple plaintiffs to take active roles as "co-lead" plaintiffs. In In re Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42 (S.D.N.Y. 1998), the court appointed three groups of investors as joint lead plaintiffs, with each group exercising an equal vote. The three groups of investors consisted of (1) an institution; (2) three individual investors; and (3) a management company which included five pension funds. Id. at 44-45. The Oxford Health court noted that all three plaintiffs were qualified to represent the class. Id. The court further noted that multiple lead plaintiffs allows for "broad representation" and would provide the class with the "substantial benefits of joint decisionmaking and joint funding." Id. at 45. See also In re Party City Sec. Litig., 189 F.R.D. 91 (D.N.J. 1999)(the court appointed two co-lead plaintiffs: one institutional investor and one individual investor.); In re Cephalon Sec. Litig., 1998 U.S. Dist. LEXIS 12321 (E.D. Pa. Aug. 27, 1998)(the court allowed two groups of plaintiffs to be appointed co-lead plaintiffs as they had the largest financial interest in the litigation.)

At least one court has disagreed with the Oxford Health holding. In LaPerriere v.Vesta Ins. Group, Inc., No. 98-AR-1407 (N.D. Ala., Acker, J.), the court refused to decide between a group of individual investors and an institutional investor. The court deemed each party "more than adequate" to represent the class as a whole. Id. The judge instead announced the use of an unconventional method of a "coin toss" to determine the lead plaintiff.[27] Id.

______Thus, as evidenced by the plethora of conflicting judicial decisions, courts are still struggling to interpret the lead plaintiff provisions of the PSLRA, nearly five years after its enactment. This struggle is likely to continue, with seemingly conflicting opinions being issued, in large part because of the fact-intensive nature of the issue and because judges continue to be guided by their own judgment as to what result is in "the best interests of the class."

II. THE HEIGHTENED STANDARD FOR PLEADING SCIENTER IN SECURITIES FRAUD CLAIMS

In addition to establishing new guidelines for the appointment of lead plaintiff, the PSLRA changed the standard for pleading scienter in securities fraud claims. Prior to the passage of the PSLRA, the "required state of mind" for a Section 10(b) violation was "knowledge of falsity or recklessness." See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69, n. 6 (9th Cir. 1990)(en banc).

Under the PSLRA, to sufficiently allege scienter, the complaint must "state with

---

[26] No other court has expressly followed Wenderhold's Amiddle@ approach.

[27] Following the Court's order, the competing lead plaintiff groups in Laperriere reached an agreement concerning the appointment of lead plaintiff and lead counsel. That stipulation was approved by the Court and the Acoin toss@ proved unnecessary.

particularity facts giving rise to a **strong inference that the defendant acted with the required state of mind**.“ 15 U.S.C. § 78u-4(b)(2)(emphasis added).[28] The PSLRA does not, however, provide a definition of the term “strong inference.“ Id.; Schaffer v. Evolving Sys., Inc., 29 F. Supp. 2d 1213, 1221 (D. Colo. 1998). Despite the PSLRA's stated aim of providing a uniform standard for pleading Rule 10b-5 claims, the courts have applied a number of different interpretations of the PSLRA's heightened pleading standards. Since the passage of the PSLRA, several separate lines of authority have developed concerning the proper interpretation of the scienter provision.

Most circuit courts addressing the issue have concluded that the PSLRA did not revise substantive pleading requirements.[29] These courts have used the PSLRA's “required state of mind“ clause as a cross-reference to Hochfelder, which establishes that scienter is established if there is knowledge of falsity or recklessness. See In re Advanta Corp. Sec. Litig., 180 F.3d 525, 534 (3d. Cir. 1999)(finding that “although the PSLRA established a uniform pleading standard, it did not purport to alter the substantive contours of scienter.“); In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 550 (6th Cir. 1999)(concluding that the pre-PSLRA definition of scienter, in particular its allowance of “recklessness“ still operated under the PSLRA); Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1284 (11th Cir. 1999)(stating that “when Congress codified the 'required state of mind', it seems to us very clear that Congress was codifying the well-established law that recklessness was sufficient to allege scienter.“); Greebel v. FTP Software, Inc., 194 F.3d 185, 199-200 (1st Cir. 1999)(concurring with other courts' assessments that the PSLRA did not alter the substantive pleading requirements, and further stating that if Congress had intended to change the substantive requirement, it would have done so explicitly as in other portions of the PSLRA); Phillips v. LCI Int'l., Inc., 190 F.3d 609, 620 (4th Cir. 1999)(finding that “to establish scienter, a plaintiff must still prove that the defendant acted intentionally, which may perhaps be shown by

---

[28] Congress was attempting to resolve the circuit courts' divergent Rule 9(b) interpretations with the enactment of the PSLRA. Borrowing language from the pre-PSLRA Second Circuit standard, complaints must now Astate with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.@ But the PSLRA's Conference Committee Report states that its strengthened pleading requirement was only Abased in part@ and not a full codification of the Second Circuit's pleading standard. Conf. Rep. No. 104-369 ' 27 of the Securities Act and ' 21D of the Exchange Act (1995). Indeed, a footnote in the Report states that Afor this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness@ as means for establishing a Astrong inference.@ Id. at 41, n. 23.

[29] This conclusion is supported by a review of two other PSLRA provisions: the statutory safe harbor for Aforward-looking@ statements and the proportionate liability provision. Congress expressly provided that for certain Aforward-looking@ statements, the required state of mind shall be Aactual knowledge@ that a statement is false or misleading. 15 U.S.C. ' 78u-5(c)(1)(B). Likewise, in the PSLRA's proportionate liability provision, Congress provided for unrestricted liability to those who act Awith actual knowledge of falsity.@ 15 U.S.C.A. ' 78u-4(g)(10)(A). Thus, where Congress intended to define the state of mind requirement in the PSLRA, it did so. Because Congress did not change the state of mind requirement other than for Aforward-looking@ statements and for purposes of proportionate liability, but instead merely referred to the Arequired state of mind@ in connection with pleading scienter, most commentators and courts have agreed that scienter jurisprudence remained unchanged following the enactment of the PSLRA.

recklessness.“)

A. The Ninth Circuit Standard

The Ninth Circuit, however, has taken a completely different approach. In In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999), the Ninth Circuit court concluded that recklessness “satisfies scienter under section 10(b) to the extent that it reflects some degree of **intentional or conscious misconduct**.“ Id. at 977 (emphasis added). Allegations that the defendant “knew“ or “must have been aware“ suggest intent and consciousness. Id. Thus, in order to meet Ninth Circuit substantive pleading requirements, a plaintiff must allege facts demonstrating a strong inference of "deliberate recklessness," which the court described as "no less than a degree of recklessness that strongly suggests actual intent." Id. Furthermore, plaintiffs must specifically plead their allegations of fraud and all allegations of false and misleading statements must be stated in the complaint with "great detail.“[30] Id. Rejecting the Second Circuit approach, the Ninth Circuit stated that “although facts showing mere recklessness or a motive to commit fraud and opportunity to do so may provide some reasonable inference of intent, they are not sufficient to establish a strong inference of deliberate recklessness.“ Id. at 974.

The Ninth Circuit‘s decision is a significant departure from other interpretations of the “required state of mind“ under the PSLRA.[31] Before Silicon Graphics, plaintiffs were required to plead only that the defendants had acted “recklessly“. In raising the scienter standard to one of “deliberate recklessness“, the Silicon Graphics stringent pleading standard considerably improves defendants‘ chances of obtaining dismissal of securities fraud actions at the pleading stage in the Ninth Circuit. Heliotrope Gen'l, Inc. v. Ford Motor Co., 189 F.3d 971, 980 (9th Cir. 1999).[32]

B. The Second Circuit Standard

Prior to the PSLRA's enactment, in the Second Circuit a strong inference of fraudulent intent could be established in a securities fraud case either (1) by alleging facts that constitute

---

[30] Under this standard, in the context of the negative internal reports alleged in Silicon Graphics, the plaintiffs were required to describe how they learned of the reports, who drafted the reports, which officers received them and their contents, including "countless specifics" regarding details about the company=s internal operations. The plaintiffs= failure in Silicon Graphics to do so resulted in the dismissal of their complaint.

[31] The Silicon Graphics decision has been heavily criticized. In an amicus brief submitted on appeal of the case, the Securities and Exchange Commission requested that the Silicon Graphics court reconsider its decision. See also Bryant, 197 F.3d at 1283, 1284 n. 21 (Athe opinion of the Ninth Circuit in Silicon Graphics would seem to indicate that the PSLRA substantively raised the required level of scienter...[and] is an attempt to import into the law a new and uncertain super-recklessness.@); Andrew B. Weissman, Symposium on Silicon Graphics, 1 Sec. Reform Act Litig. Rptr. 673, 787 (1996)(noting that the court in Silicon Graphics Aincorrectly read Congress' heightened pleading requirements as affecting the substantive elements of a securities fraud claim under Section 10(b) and Rule 10b-5.@)

[32] Defrauded investors in the Ninth Circuit may take some consolation, however, from the recent decision in Howard v. Everex Systems, Inc., 228 F.3d 1057 (9th Cir. 2000)(reversing summary judgment in favor of company CEO). The court made it clear that the Silicon Graphics standard applied only as a pleading standard; the standard on summary judgment remained unaltered.

strong circumstantial evidence of conscious misbehavior or recklessness; or (2) by alleging facts to show that defendants had both motive and opportunity to commit fraud. The High View Fund, L.P. v. Hall, 27 F. Supp. 2d 420, 426 (S.D.N.Y. 1998); see also Oxford Health Plans, 187 F.R.D. at 138.

In Novak v. Kasaks, 216 F.3d 300 (2d. Cir. 2000), the Second Circuit observed, initially, that the PSLRA “raised the nationwide pleading standard to that previously existing in this circuit and no higher (with the exception of the “with particularity“ requirement).“ Id. However, the court reasoned that “litigants and lower courts need and should not employ or rely on magic words such as 'motive' and ' opportunity' because Congress' failure to include language about motive and opportunity suggests that we need not be wedded to these concepts in articulating the prevailing standard.“ Id. The Novak court concluded that “conscious recklessness--a state of mind approximating actual intent“ could satisfy the PSLRA's scienter pleading requirements. Id.

According to the Second Circuit, this standard places them on a “middle ground“ between those courts which believe the PSLRA “effectively adopts the Second Circuit's [old] pleading standard for scienter wholesale, and thus plaintiffs may continue to state a claim by pleading either motive or opportunity or strong circumstantial evidence of recklessness or conscious misbehavior“ and those courts which find the PSLRA to have strengthened the old Second Circuit standard “by rejecting the simple pleading of motive and opportunity.“ Id.

C. The Eleventh Circuit Standard and the rejection of the 'motive and opportunity' test

Several circuit courts have expressly rejected the 'motive and opportunity' test, including the Eleventh Circuit. In Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1286 (11th Cir. 1999), the court held that Congress “did not codify the motive and opportunity analysis.“ The Bryant court noted that the PSLRA's language about the “required state of mind“ involves a “condition of the mind, like willfulness or recklessness.“ Id. The court also noted that allegations of 'motive and opportunity' might be relevant to a showing of scienter, but alone are not sufficient “because motive and opportunity do not constitute a state of mind.“ Id. See also In re World Access, Inc. Sec. Litig., No. 1:99-CV-43-ODE, 2000 WL 1610611 (N.D. Ga. Mar. 28, 2000)(plaintiffs met pleading threshold by alleging eight identifiable problems associated with a switch identified in defendants' press release, averring the defendants' financial statements were false or misleading because they did not make appropriate accounting entries to reflect non-payments arising from disputes about the switches, and by alleging that defendants routinely employed “bill and hold“ practices.)

______The Sixth Circuit is in general agreement with the Eleventh Circuit that “motive and opportunity“ is no longer sufficient to plead scienter. See generally In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 551 (6th. Cir. 1999)(Court held that the “bare pleading of motive and opportunity“could not “standing alone“ establish a “strong inference“ of the required state of mind. The court, however, stated that the PSLRA's pleading requirements could be met by “alleging facts that give rise to a strong inference of reckless behavior.“).

The First Circuit has partially rejected the “motive and opportunity“ standard. In Greebel v. FTP Software, Inc., 194 F.3d 185, 195 (1st Cir. 1999), the court rejected the contention that “facts showing motive and opportunity can never be enough to permit the drawing of a strong inference of scienter." The court, however, cautioned that "merely pleading motive and opportunity [without more], regardless of the strength of the inferences to be drawn of scienter, is not enough." Id. at 197.

D. Allegations of Insider Trading

Amidst the array of conflicting judicial interpretations of the PSLRA's proper definition of "scienter", one constant has emerged. The circuits are in basic agreement that a specific and well-founded allegation that defendants reaped a direct, significant and unusual economic benefit (usually resulting from insider trading) from the alleged fraud may give rise to a strong inference of scienter. This is so regardless of whether the law of the circuit will infer scienter from allegations of motive and opportunity. Compare, e.g., Silicon Graphics, 183 F.3d at 986 (whereas mere allegations of motive and opportunity are insufficient to give rise to a strong inference of scienter, allegations of suspicious or unusual stock sales by defendants may provide circumstantial evidence of scienter.); with Novak v. Kasaks, No. 98-9641, 2000 WL 796300 (2d. Cir. June 21, 2000).

To support the requisite strong inference of scienter through allegations of stock sales by insiders, plaintiffs must establish that the stock sales during the class period were "suspicious or unusual". Silicon Graphics, 183 F.3d at 986; In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1424 (3rd. Cir. 1997); Acito v. IMCERA Group, Inc., 47 F.3d 47, 54 (2d. Cir. 1995). Among the relevant factors to consider in determining if stock sales are suspicious or unusual are: (1) the amount and percentage of shares sold by insiders; (2) the timing of the sales; (3) whether the sales were consistent with the insider's prior trading history. Silicon Graphics, 183 F.3d at 986; Provenz v. Miller, 102 F.3d 1478, 1491 (9th Cir. 1996); Oxford Health Plans, 187 F.R.D. at 140.

In Oxford Health Plans, the court denied the defendants' motion to dismiss, holding that "plaintiffs' allegations of unusually large insider trades at suspicious times are sufficient to create, along with the other allegations, a strong inference of scienter." Id. at 140. The court noted that the individual defendants sold over 1.2 million shares of Oxford common stock for total proceeds of over $78 million. Id. All of the individual defendants except one sold shares of Oxford for aggregate profits of approximately $33 million. Id. at 139. Although the court recognized that "large volume trades" are not necessarily suspicious if the corporate insider sells only a small fraction of his or her shares in a corporation, it concluded that the defendants' class period sales were "massive by any measure" and created a strong inference of scienter. Id. at 140.

In contrast, the Silicon Graphics court held that "the stock trading by the individual defendants was not dramatically out of line with prior trading practices or otherwise suspicious enough to create a strong inference of the required deliberate recklessness." Id. at 987. In that case, the individual defendants collectively sold 10% of their available holdings in the company. Thus, the court concluded that the allegations of insider trades during the class period were insufficient to establish scienter under the Ninth Circuit's interpretation of the PSLRA.

III. RULE 9(b) PLEADING REQUIREMENTS

In addition to scienter pleading requirements, securities fraud complaints are subject to Rule 9(b)'s imposition that "the circumstances constituting fraud...shall be stated with particularity." "Particularity" requires allegations to "specify the statements the plaintiff contends were fraudulent, identify the speaker, state where and when the statements were made, and explain why the statements were fraudulent." Mills v. Polar Molecular Corp., 12 F.3d 1170, 1175 (2d. Cir. 1993). This "who, what, when, where and how" standard is well-settled and has not been changed by the PSLRA. See generally, In re Advanta Corp. Sec. Litig., 180 F.3d 525, 534 (3rd Cir. 1999). Since the PSLRA's passage, however, two particular Rule 9(b) issues have caused a split among courts: pleadings based on "information and belief" and the so-called "group pleading" doctrine.

A. Pleading on Information and Belief

The PSLRA goes beyond Rule 9(b)'s requirements with the additional requirement that "if an allegation regarding [an allegedly misleading] statement or omission is made on information and belief...[the complaint] must state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1). Whether the PSLRA requires a plaintiff to provide the sources of information has been the subject of debate.

The Eleventh Circuit "does not require that plaintiffs plead with particularity every single fact upon which their beliefs concerning false or misleading statements are based. Rather plaintiffs need only plead with particularity sufficient facts to support these beliefs." In re Theragenics Corp. Sec. Litig., 105 F. Supp. 2d 1342, 1355 (N.D. Ga. 2000)(holding that where facts provide an adequate basis for believing that defendants' statements were false, plaintiffs need not name their confidential personal sources).[33] The First Circuit requires a pleading to "set forth the source of information and the reasons for the belief." Greebel, 194 F.3d at 194. The Eighth Circuit has likewise employed this standard, stating that "where allegations of fraud are...based only on information and belief, the complaint must set forth the source of the information and the reasons for the belief." See In re Engineering Animation Sec. Litig., 2000 U.S. Dist. LEXIS 5118 at *25 (D. Iowa 2000).

Plaintiffs often claim "investigation of counsel" as an allegation's source rather than information and belief. According to some courts, a complaint pled in this method need not set forth with particularity all the facts on which a belief is formed. See Warman v. Overland Data, Inc., 1998 WL 110018 (S.D. Cal. Feb. 20, 1998). But see In re Green Tree, 61 F. Supp. 2d 860, 872 (D. Minn. 1999)(plaintiffs should not be allowed to avoid the heightened pleading standard by claiming 'investigation of counsel.')

B. The Group Pleading Doctrine

Rule 9(b) requires a plaintiff to identify the speaker of the allegedly fraudulent statements. The Group Pleading doctrine is an exception to this rule. This doctrine provides that in the case of corporate fraud where the false or misleading information is conveyed in prospectuses, registration statements, annual reports, press releases, or other "group published information," it is reasonable to presume that these are the collective actions of the officers, therefore, no specific connection between fraudulent representations or omissions need be pleaded when the facts are exclusively within the defendant's knowledge, as is the case when defendants are insiders or affiliates

---

[33]A consensus appears to have developed that the PSLRA does not require plaintiffs in securities fraud cases to reveal the names of confidential sources in order to meet particularity requirements. E.g., Novak v. Kasaks, 216 F.3d 300, 303 (2d Cir. 2000); Fitzer v. Security Dynamics Tech., Inc., No. 98-12496, 2000 WL 1477204 at *7 (D. Mass. Sept. 28, 2000).

participating in the statements at issue. See, e.g., In re Oxford Health Plans, 187 F.R.D. 133, 142 (S.D.N.Y. 1999); In re Health Mgmt., Inc. Sec. Litig., 970 F. Supp. 192, 208 (E.D.N.Y. 1997); In re Checkers Sec. Litig., 858 F. Supp. 1168, 1178 (M.D. Fla. 1994).

Defendants have argued that the group published information doctrine is inconsistent with the PSLRA, which requires that "the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading" and "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." See 15 U.S.C.A. § 78u-4(b)(1) and (b)(2). Nonetheless, courts faced with this argument have generally rejected it, finding that the PSLRA did not abolish the group-published information doctrine. See In re Theragenics, 105 F. Supp. 2d at 1358 (N.D. Ga. 2000)(holding that the group pleading doctrine survives and is consistent with the PSLRA); In re BankAmerica Corp. Sec. Litig., 78 F. Supp. 2d 976 (E.D. Mo. 1999).

IV. ADDITIONAL PSLRA PROVISIONS

The Reform Act also contains a number of other provisions that substantially change traditional securities law.

A. The Statutory Safe Harbor

The PSLRA contains a "safe harbor" from liability that allows a company or its principals to release statements predicting the company's future economic performance and describing the assumptions underlying such statements. 15 U.S.C.A. §§ 77z-2, 78u-5. In that safe harbor, corporations and individual defendants may avoid liability for "forward-looking" statements that prove false if "the statement is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." 15 U.S.C. § 78u-5(c)(1)(A)(i). Even if the "forward-looking" statement has no accompanying cautionary language, the plaintiff must prove that the defendant made the statement with "actual knowledge" that it was false or misleading. 15 U.S.C.A. §§ 77z-2(c)(1)(B), 78u-5(c)(1)(B); Harris v. Ivax Corp., 182 F.3d 799, 803 (11th Cir. 1999).

A "forward-looking" statement includes (1) statements containing projections of revenues, income, earnings per share, or other financial items; (2) statements of the plans and objectives of management for future operations; and (3) statements of future economic performance. 15 U.S.C. § 78u-5(i)(1); Harris, 182 F.3d at 803-807(statement in drug company's press release that challenges unique to period in its history were not behind it, when considered in context of anticipated improvements in business, qualified as "forward-looking" statements.)

The safe harbor provision has two prongs that operate in the disjunctive:

- Under the "**actual knowledge**" prong, the issuer is protected with respect to the forward-looking statement if the plaintiff fails to prove that the statement was made with actual knowledge that the statement was false or misleading. 15 U.S.C.A. §§ 77z-2(c)(1)(B), 78u-5(c)(1)(B).

- Under the "**bespeaks caution**" prong, the person making the forward-looking statement is protected if the statement is identified as a forward-looking statement and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement. 15 U.S.C.A. §§ 77z-2(c)(1)(A), 78u-5(c)(1)(A). The "bespeaks caution" doctrine provides a mechanism by which a court can rule as a matter of law that the defendants' forward-looking statements contained enough cautionary language or risk disclosure to protect the defendant against securities fraud. This doctrine reflects nothing more than the proposition that statements must be analyzed in context.

B. Proportionate Liability

The PSLRA also limits the application of joint and several liability to defendants who knowingly commit a violation of securities laws. 15 U.S.C.A. § 78u-4(g)(2)(A). All other defendants are proportionately liable based on their percentage of responsibility for the damages. 15 U.S.C.A. § 78u-4(g)(2)(B)(i). Knowledge, for purposes of proportionate liability, exists when the defendant (1) makes an untrue statement of a material fact with knowledge of its falsity, and persons are likely to rely on the misrepresentation; (2) omits to state a fact necessary to make a material statement true, with actual knowledge that without the omitted fact, the representation is false, and persons are likely to reasonably rely on the omission; or (3) in cases not involving false representations, engages in conduct with actual knowledge of the facts and circumstances that make such conduct a violation of the securities laws. 15 U.S.C.A. § 78u-4(g)(10)(A). Reckless conduct does not constitute a knowing commission of a violation of the securities laws for these purposes. 15 U.S.C.A. § 78u-4(g)(10)(B).

C. Automatic Stay of Discovery

The PSLRA provides that discovery is automatically stayed when a defendant files a dispositive motion to dismiss in a securities fraud claim. 15 U.S.C.A. §§ 77z-1(b)(1), 78u-4(b)(3)(B). This provision was enacted to protect defendants in private federal securities litigation from expending substantial time and resources in responding to discovery requests unless and until the court determines that a valid claim has been stated. Congress used the following reasoning:

> The cost of discovery often forces innocent parties to settle frivolous securities class actions. According to the general counsel of an investment bank, "discovery costs account for roughly 80% of total litigation costs in securities fraud cases." In addition, the threat that the time of key employees will be spent responding to discovery requests, including providing deposition testimony, often forces coercive settlements.

Statement, pp. 7-8. Thus, post-PSLRA, courts have held that discovery shall be stayed during the pendency of any motion to dismiss. See, e.g., Medhekar v. U.S. District Court, 99 F.3d 325 (9th Cir. 1996)(holding that a defendant need not provide the self-executing discovery required by Fed.R.Civ.P. 26 pending a motion to dismiss a federal securities claim.)

______In addition, the PSLRA limits a court's discretion to provide relief from this restriction to those situations where exceptional circumstances make particularized discovery necessary to preserve evidence or prevent undue prejudice to a party. 15 U.S.C.A. §§ 77z-1(b)(1), 78u-4(b)(3)(B). The PSLRA also provides that the parties shall preserve all documents that are relevant to the allegations of the complaint during the pendency of the motion to dismiss. 15 U.S.C.A. §§ 77z-1(b)(2), 78u-4(b)(3)(C).

D. Mandatory Sanctions

The PSLRA also establishes a rebuttable presumption that the appropriate sanction for filing a complaint that violates Rule 11(b) is an award of all attorney's fees and costs incurred in the action. 15 U.S.C. §§ 77z-1(c)(3)(A), 78u-4(c)(3)(A). The PSLRA also provides that other filings for which Rule 11 requirements are not satisfied will justify an award of attorneys' fees incurred by the prevailing party for that particular filing. Id. The PSLRA does not, however, provide for sanctions against defendants who defend meritorious actions in bad faith.

CONCLUSION

After six years, it is still too early to determine the impact of the PSLRA on securities class action litigation. Indeed, given the pace at which courts struggle to interpret its provisions, six more years may pass before we have enough information to reach any definitive conclusions on the PSLRA's impact. In light of the widely varying interpretations found in different jurisdictions, review by the Supreme Court may be necessary to really determine whether the PSLRA has met its intended goals, or has been turned on its head by clever investors and plaintiffs attorneys.