

11-18-2012

In Honor of Walter O. Weyrauch: The Ubiquity of Greed: A Contextual Model for Analysis of Scierter

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Recommended Citation

Ann Morales Olazabal and Patricia Sanchez Abril, *In Honor of Walter O. Weyrauch: The Ubiquity of Greed: A Contextual Model for Analysis of Scierter*, 60 Fla. L. Rev. 401 (2008).

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THE UBIQUITY OF GREED: A CONTEXTUAL MODEL FOR
ANALYSIS OF SCIENTER

*Ann Morales Olazábal**

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Abstract

Some securities fraud plaintiffs contend that greed—in the form of perpetuating a prestigious executive position, ensuring a gainful bonus, or maintaining the appearance of corporate profitability—is a bona fide motive evidencing scienter. But currently, no single judicial standard or analytical rubric guides the analysis of whether allegations of greed indicate scienter in these cases. The Private Securities Litigation Reform Act of 1995 (PSLRA) requires that the complaint state “with particularity” facts giving rise to a “strong inference” that the defendant acted with the scienter required for the cause of action. Plaintiffs have long established scienter through “motive and opportunity” pleading: facts demonstrating the presence of a motive in tandem with the perpetrator’s opportunity to commit the fraud. As part of motive and opportunity pleading, some plaintiffs have contended that greed can be a manifestation of scienter. Such allegations have met disparate and somewhat unreasoned fates.

This Article draws from the over one hundred reported circuit court cases interpreting the “strong inference” standard in a variety of factual settings to propose a framework for more orderly analysis of allegations of corporate and personal avarice. Guided by the way some courts analyze the role of insider stock transactions in scienter pleading, the contextual model identifies three dimensions—magnitude, timing, and atypicality—that can heighten ordinary profit-seeking activities to suspicious or unusual conduct and can provide a motive that properly gives rise to a strong inference of scienter.

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“The point is, ladies and gentlemen, that greed—for lack of a better word—is good. Greed is right. Greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms—greed for life, for money, for love, knowledge—has marked the upward surge of mankind. And greed—you mark my words—will not only save Teldar Paper, but that other malfunctioning corporation called the USA.” Gordon Gekko, Wall Street¹

“[Greed] is a sin directly against one’s neighbor, since one man cannot over-abound in external riches, without another man lacking them” Saint Thomas Aquinas²

1. WALL STREET (20th Century Fox 1987).
2. SAINT THOMAS AQUINAS, SUMMA THEOLOGIAE: A CONCISE TRANSLATION 118 (Timothy McDermott ed. 1989).

I. INTRODUCTION

Greed is “a normal desire that combines eagerness, curiosity, competitiveness, and a need for security, accusation, and protection.”³ One of the Bible’s Seven Deadly Sins, greed is also defined as an “excessive desire to acquire or possess more (especially more material wealth) than one needs or deserves” or as “reprehensible acquisitiveness; insatiable desire for wealth.”⁴ According to behavioral scientists, while simple greed is normal, uncontrolled greed can become pathologic and sociopathic when it exists in the form of an “unlimited appetite without satisfaction,”⁵ “a morbid quest for money that defies the rules of reason,”⁶ a “[d]isregard [for] how financial transactions affect others,”⁷ an “insensitivity to poverty and to the unmet needs of others,”⁸ a disregard of societal norms and laws in pursuit of “ultimate narcissistic fulfillment,”⁹ or an inability to perceive conduct as corrupt or immoral.¹⁰ For the pathologically greedy, “possessions serve an as an energizing elixir, even when they risked corrupt practices to support their psychic elation.”¹¹ To distinguish normal from abnormal greediness, behavioral scientists engage in a “fine grained analysis of circumstance and motive”¹² that results in a precise diagnosis.

According to Smithian economics, greed in the form of self-interest, ambition, and individualism is the linchpin of a capitalist society.¹³ Yet it is indisputable that greed can be a catalyst for fraud. Unlike behavioral science, the legal and business world lacks a definitive analytical framework through which to differentiate normal greed (as in “*I want a*

3. Robert Waska, *Craving, Longing, Denial, and the Dangers of Change: Clinical Manifestations of Greed*, 89 *PSYCHOANALYTIC REV.* 505, 505 (2002).

4. Greed, Dictionary.com, <http://dictionary.reference.com/browse/greed> (last visited Feb. 18, 2008).

5. Arthur G. Nikelly, *The Pleonexic Personality: A New Provisional Character Disorder*, 48 *INDIVIDUAL PSYCHOL.: J. OF ADLERIAN THEORY, RES. & PRAC.* 253, 258 (1992); *see also* Waska, *supra* note 3, at 505.

6. Nikelly, *supra* note 5, at 258.

7. *Id.*

8. *Id.*

9. David P. Levine, *The Corrupt Organization*, 58 *HUM. REL.* 723, 725 (2005). Professor Levine’s article provides a fascinating look at the Enron debacle through a psychological lens.

10. *Id.*

11. Nikelly, *supra* note 5, at 256.

12. *See* Julian Edney, *Greed (Part I)*, 31 *POST-AUTISTIC ECON. REV.* art. 2 (2005), <http://www.paecon.net/PAEReview/issue31/Edney31.htm>.

13. ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 14 (Edwin Cannan ed., Random House 1937) (1776) (“It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.”).

promotion”) from pathological greed (as in “*I want a promotion at any cost*”)—a socially and economically healthy appetite for success versus a ravenous and destructive insatiability for wealth and power. Somewhat confounded by the proper interrelationship of greed and capitalism, business law wavers in its attempts to decipher, qualify, and regulate the repercussions of corporate and personal greed.

In the context of civil securities fraud, the absence of a rubric for gauging the role of avarice as an indicator of scienter has had a debilitating effect on the common law. The Private Securities Litigation Reform Act of 1995 (PSLRA)¹⁴ requires that a complaint “state with particularity facts giving rise to a strong inference that the defendant acted with the [scienter] required [for the cause of action].”¹⁵ Plaintiffs have consistently, albeit controversially, established the necessary intent through “motive and opportunity” pleading: alleging facts evidencing the presence of a motive in tandem with the perpetrator’s opportunity to commit the fraud.¹⁶

Undoubtedly, alleging a motive for the putative securities fraud is important. Indeed, of the approximately one hundred reported circuit court decisions that have addressed scienter since the passage of the PSLRA, not a single case in which there was no apparent motive—or the motive alleged was practically or economically nonsensical—survived the dismissal stage.¹⁷ Thus, motive is an unspoken *sine qua non* of scienter.

Some courts have defined motive in this context as “concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged.”¹⁸ Opportunity “entail[s] the means and likely

14. Pub. L. No. 104-67, 109 Stat. 737 (codified as amended at 15 U.S.C. §§ 77z-1 to 78u-5 (2000 & Supp. IV 2004)). For consistency, this Article refers to the Reform Act as the PSLRA.

15. 15 U.S.C. § 78u-4(b)(2) (2000). Most private securities fraud actions are brought under Rule 10b-5, promulgated by the Securities and Exchange Commission (SEC) under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (2000). Though not explicitly mentioned in the text of the Rule, scienter is nonetheless an essential element of a § 10(b) claim. *See Broudo v. Dura Pharms., Inc.*, 339 F.3d 933, 937 (9th Cir. 2003) (listing the elements of a securities fraud claim under § 10(b)). Scienter is the “intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). The Supreme Court has not further defined scienter other than to indicate that scienter requires something more than negligence. *See id.* at 214–15.

16. *See, e.g., Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994).

17. *See, e.g., R2 Invs. LDC v. Phillips*, 401 F.3d 638, 644–47 (5th Cir. 2005) (holding that scienter had been inadequately pleaded where, among other things, the defendants had no apparent motive for the alleged fraud and their conduct and statements belied the plaintiffs’ assertion that the defendants were trying to deceive or manipulate); *Suez Equity Investors v. Toronto-Dominion Bank*, 250 F.3d 87, 100 (2d Cir. 2001) (dismissing a case against the three of six defendants who had no financial stake in the transaction at issue and therefore no apparent motive to commit the alleged fraud); *Phillips v. LCI Int’l, Inc.*, 190 F.3d 609, 623 (4th Cir. 1999) (noting that the motive alleged by the plaintiffs was inconsistent with what a rational person in the defendant’s position would do to further his “own professional and economic interests”).

18. *Shields*, 25 F.3d at 1130.

prospect of achieving concrete benefits by the means alleged.”¹⁹ However, the term motive and opportunity has become something of a mantra when analyzing scienter in cases brought under § 10(b) of the Securities Exchange Act,²⁰ with the meaning varying significantly from one court to another. With disparate results, some plaintiffs have contended that greed—in the form of perpetuating a prestigious executive position, ensuring a gainful bonus, or maintaining the appearance of corporate profitability—is a bona fide motive evidencing scienter. Because the PSLRA provides no guidance as to the propriety of a motive and opportunity pleading, judicial opinions of the last decade have muddled the issue to the point of obscurity.²¹ Scattered and inconsistent in their analyses, many opinions evade meaningful discussion of the role of greed as an impetus for fraud and fail to differentiate between productive and nefarious forms of greed.

Moreover, among the courts that have dealt with the matter, each has injected its own, often differing, assumptions regarding the role of greed in a capitalistic corporate environment. For example, some courts have dismissively rationalized that “[g]reed is a ubiquitous motive, and corporate insiders and upper management always have opportunity to lie and manipulate.”²² This rationalization de facto exonerates the putative fraudster. Other courts have been more suspicious. Further entangling the issue, a number of courts have blindly adopted the ubiquity-of-greed mantra of their predecessors without discussing the financial motive’s role within the specific case. The result is generalized confusion regarding greed’s logical association with fraudulent intent, a lack of a standardized framework for scrutinizing complaints alleging motive and opportunity to demonstrate scienter, and an ensuing weakening of the intellectual and prescriptive fibers of the common law.

With the PSLRA now into its second decade, there is abundant case law interpreting the strong inference standard in a variety of factual settings, including many appellate opinions that shed light on the role of covetous motives as indicators of fraudulent intent. From this jurisprudence we have constructed a framework for more orderly analysis of the sufficiency of motive allegations. Using as a pattern the Ninth Circuit’s approach to motive allegations involving insider stock

19. *Id.*

20. *Helwig v. Vencor, Inc.*, 251 F.3d 540, 550 (6th Cir. 2001) (“We reaffirm that plaintiffs cannot simply plead ‘motive and opportunity’ as a mantra for recovery under the [PSLRA].”).

21. *See Phillips*, 190 F.3d at 620 (acknowledging the “widespread disagreement among courts” as to what a plaintiff must show to properly plead scienter under the PSLRA (quoting *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999))).

22. *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1286 (11th Cir. 1999) (quoting *Carley Capital Group v. Deloitte & Touche, L.L.P.*, 27 F. Supp. 2d 1324, 1339 (N.D. Ga. 1998)).

transactions, we advocate a contextual model for parsing greed that identifies any one of three dimensions (or any combination thereof) that can heighten ordinary profit-seeking activities to suspicious or unusual conduct and can provide a motive that properly gives rise to a strong inference of scienter.²³

This Article proceeds as follows. Part II provides an overview of the genesis and nature of the strong inference pleading standard and of the debate that surrounded the standard's interpretation during the PSLRA's first decade. This Part also examines the use of facts establishing motive to meet that standard. Part III sketches the existing rubric for analyzing allegations of insider stock transactions as support for an inference of fraud. Part IV extends that rubric to other greedy motives of individuals and corporate defendants. Part V concludes with thoughts on the order and consistency that this contextual approach can and should create in the case law.

II. PLEADING GREED AND THE "STRONG INFERENCE" OF SCIENTER

Congress enacted the PSLRA as part of an attempt to curb perceived abuses of securities fraud litigation.²⁴ Among other major aspects in the PSLRA, Congress established two heightened pleading requirements for private securities litigation. The first requires the complaint to specify each false statement or misleading omission and to explain why the statement is false or misleading.²⁵ As discussed above, the second requires that the complaint state "with particularity" facts giving rise to a "strong inference" that the defendant acted with the requisite scienter.²⁶ Merely reasonable inferences of scienter that can be drawn from a complaint alleging securities fraud will not survive a motion to dismiss. Rather, the complaint will survive only if its allegations collectively give rise to a *strong* inference of scienter.²⁷

23. The purpose of our analysis is to gain insight into the kinds of motives that courts consider relevant to the mix of facts that will ultimately decide the sufficiency of each case. Allegations of "motive and opportunity" are often only one part of a court's broader analysis that, in each case, will have different fact patterns and allegations with varying degrees of substance, cogency, and particularity. *But see* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (holding that the defendant corporations' motive of benefiting from a four-day "float" on a treasury bill was sufficient to satisfy the necessary strong inference of scienter). For purposes of this Article, we focus on the individual allegations of motive in each case and the court's subsequent disposition so that we can comment on the sufficiency of each allegation.

24. See Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937, 970-71 (2003).

25. 15 U.S.C. § 78u-4(b)(1) (2000).

26. *Id.* § 78u-4(b)(2).

27. In 2007, Supreme Court ruled on the question whether and to what extent a court must consider competing inferences in determining whether a complaint establishes the necessary strong

The development of the strong inference requirement is the doctrinal root of our consideration of the role of greed, i.e., motive. As we know, the PSLRA's scienter pleading standard augmented the already heightened pleading prescription for fraud established early on by Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b) states, "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other conditions of mind of a person may be averred generally."²⁸ Although Rule 9(b) provided that state of mind could be averred generally (as opposed to "with particularity"), even before the advent of the PSLRA some circuits had begun to require plaintiffs in securities fraud cases to plead facts that would demonstrate the existence of scienter, rather than merely to plead the conclusion that the defendant acted with scienter.²⁹

Notably, as early as 1987, the Second Circuit began to require plaintiffs suing under § 10(b) of the Securities Exchange Act to plead facts that give rise to a strong inference that the defendants possessed the requisite fraudulent intent. A passage from Judge Newman's opinion in *Beck v. Manufacturers Hanover Trust Co.*³⁰ wound up becoming black-letter law in that circuit:

A common method for establishing a strong inference of scienter is to allege facts showing *a motive for committing fraud and a clear opportunity for doing so*. Where motive is not apparent, it is still possible to plead scienter by identifying circumstances indicating conscious behavior by the defendant, though the strength of the circumstantial allegations must be correspondingly greater.³¹

inference of scienter. *See* *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2510 (2007) (holding that to qualify as strong, an inference must be more than merely reasonable—it must be "cogent and at least as compelling as any [plausible] opposing inference" of non-fraudulent intent).

28. FED. R. CIV. P. 9(b). *See generally* 2 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE, §§ 9.01–.11 (3d ed. rev. vol. 2002).

29. *See, e.g., In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268–69 (2d Cir. 1993) (noting that to establish scienter without "establishing a motive to commit fraud and an opportunity to do so," the plaintiff may "allege facts constituting circumstantial evidence of either reckless or conscious behavior"); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991) ("Although a plaintiff need not specify the circumstances or evidence from which fraudulent intent could be inferred, the complaint must provide some factual support for the allegations of fraud." (citing *Wayne Inv., Inc. v. Gulf Oil Corp.*, 739 F.2d 11, 13 (1st Cir. 1984))).

30. 820 F.2d 46 (2d Cir. 1987), *abrogated on other grounds by* *United States v. Indelicato*, 865 F.2d 1370 (2d Cir. 1989).

31. *Id.* at 50 (emphasis added) (citations omitted); *see also In re Navarre Corp. Sec. Litig.*, 299 F.3d 735, 746 (8th Cir. 2002) (noting that when a complaint does not show motive and scienter, other allegations indicating scienter must be "particularly strong in order to meet the [PSLRA] standard").

While it does not appear to say so, at the extreme, courts applied this language to permit allegations of greedy motives alone to satisfy Rule 9(b).³² Five years later, in 1993, Judge Newman authored the opinion in *In re Time Warner Inc. Securities Litigation*,³³ which held that a complaint passed muster with only motive and opportunity as its basis for alleging scienter.³⁴ Indeed, the only factual allegations supporting scienter in *Time Warner* were the defendants' desires to increase the corporation's stock price and to avoid jeopardizing corporate negotiations.³⁵

For such relatively commonplace capitalist motives alone to give rise to a strong inference of scienter was an extreme position that permitted mere motive and opportunity to commit fraud to serve as a proxy for *intent* to commit fraud. This position resulted in a somewhat loose interpretation of corporate greed as evidence of fraud. Perhaps accordingly, the Second Circuit rather quickly restricted the application of this rule, holding that allegations of widespread motives—even seemingly potent ones like a CEO's desire to remain in that position—would not suffice to plead scienter under Rule 9(b).³⁶ *Shields v. Citytrust Bancorp, Inc.*,³⁷ decided in 1994, exemplifies this thinking and the Second Circuit's refinement of its pre-PSLRA strong inference rule:

32. Because "opportunity" is always present and rarely disputed, the two-part test quickly disintegrates into a single inquiry turning on the sufficiency of the motive alleged. *See, e.g., Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 170 (2d Cir. 2000) (noting that opportunity was not disputed and therefore focusing on the challenge to the sufficiency of the motive alleged). The named individual defendants in most cases, as high-level executives, officers, and directors of a corporation, necessarily occupy positions of power, making them responsible for the alleged misrepresentations to the market. *See Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1191 (10th Cir. 2003) ("Moreover, defendants certainly had the opportunity to defraud investors; as the executives in charge of the firm, they had control over its public statements and could influence the decisions of investors and analysts."); *San Leandro Emergency Med. Group Profit Sharing Plan v. Phillip Morris Cos.*, 75 F.3d 801, 813 (2d Cir. 1996) ("There is no doubt that defendants as a group had the opportunity to manipulate [stock prices] . . . [They] held the highest positions of power and authority within the company."); *Cohen v. Koenig*, 25 F.3d 1168, 1173–74 (2d Cir. 1994). Additionally, other common non-issuer defendants such as outside auditors, as agents of the corporate defendant, will similarly have control over and the opportunity to make intentional misrepresentations within the scope of their work. Courts have repeatedly maintained this uncontroversial proposition. *See, e.g., PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 694 (6th Cir. 2004) ("[T]o allege that an independent accountant or auditor acted with scienter, the complaint must allege specific facts showing that the deficiencies in the audit were so severe that they strongly suggest that the auditor must have been aware of the corporation's fraud." (quoting *In re SmarTalk Teleservices, Inc. Sec. Litig.*, 124 F. Supp. 2d 505, 514 (S.D. Ohio 2000))). For these reasons, this Article focuses on the sufficiency of motive, while maintaining an occasional reference to this type of pleading as "motive and opportunity."

33. 9 F.3d 259, 261 (2d Cir. 1993).

34. *Id.* at 269–71.

35. *Id.*

36. *See Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994).

37. 25 F.3d 1124 (2d Cir. 1994).

If motive could be pleaded by alleging the defendant's desire for continued employment, and opportunity by alleging the defendant's authority to speak for the company, the required showing of motive and opportunity would be no realistic check on aspersions of fraud, and mere misguided optimism would become actionable under the securities laws.³⁸

Other cases of roughly the same vintage as *Shields* elaborated on this narrower version of "motive and opportunity," dismissing as insufficient such motives as an individual or corporate defendant's desire to maintain the corporation's profitability or credit rating³⁹ or to increase an individual's performance-based compensation.⁴⁰ *Shields* and the other Second Circuit opinions issued around that time, particularly *Acito v. IMCERA Group, Inc.*⁴¹ and *Chill v. General Electric Co.*,⁴² were to become especially popular authorities in later decisions both inside and outside the Second Circuit. In fact, this triumvirate of cases, or some combination thereof, from the so-called "Mother Court" of securities laws,⁴³ has lent at least indirect support to nearly all of the post-PSLRA appellate opinions that have considered motive as part of a scienter analysis. This triumvirate would eventually develop into something of an inapposite foundational incantation in many opinions.

Then along came the PSLRA and its strong inference requirement.⁴⁴ Predictably, the PSLRA did not expressly sanction any particular method or methods of establishing the strong inference of scienter.⁴⁵ Nor did any of the legislative history of the PSLRA indicate with any certainty that Congress intended to—or did not intend to—codify the Second Circuit's strong inference jurisprudence.⁴⁶

38. *Id.* at 1130.

39. See *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 814 (2d Cir. 1996).

40. See *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995) ("[I]ncentive compensation can hardly be the basis on which an allegation of fraud is predicated." (alteration in original) (quoting *Ferber v. Travelers Corp.*, 785 F. Supp. 1101, 1107 (D. Conn. 1991))); see also *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 268 (2d Cir. 1996) ("[S]uch a generalized motive, one which could be imputed to any publicly-owned, for-profit endeavor, is not sufficiently concrete for purposes of inferring scienter.").

41. 47 F.3d 47 (2d Cir. 1995).

42. 101 F.3d 263 (2d Cir. 1996).

43. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting).

44. See *supra* notes 14–15 and accompanying text.

45. Joseph Grundfest & A.C. Pritchard, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 STAN. L. REV. 627, 650–66 (2002) (describing Congress's contentment with the ambiguity of the PSLRA).

46. In fact, arguments can be and have been made both ways. *Id.* at 653–58; see also Marilyn F. Johnson et al., In re *Silicon Graphics Inc.: Shareholder Wealth Effects Resulting from the*

The circuit courts, when first addressing the new pleading standard, purportedly fell into three camps.⁴⁷ The Second Circuit naturally took the position that the PSLRA had codified the circuit's standard, including the motive and opportunity formulation.⁴⁸ The Third Circuit joined the Second.⁴⁹ On the other end of the spectrum, the Ninth Circuit posited that Congress had rejected the Second Circuit's rule and consequently that motive and opportunity alone could never establish the requisite scienter.⁵⁰ Preferring a middle ground, the remaining seven circuits chose not to be tethered to any particular formulation of scienter.⁵¹ In the end, the lack of

Interpretation of the Private Securities Litigation Reform Act's Pleading Standard, 73 S. CAL. L. REV. 773, 785–89 (2000) (noting the contentious and contradictory legislative history of the PSLRA); William S. Lerach & Eric A. Isaacson, *Pleading Scienter Under Section 21D(b)(2) of the Securities Exchange Act of 1934: Motive, Opportunity, Recklessness, and the Private Securities Litigation Reform Act of 1995*, 33 SAN DIEGO L. REV. 893, 930–56 (1996) (noting that the various legislative drafts differed significantly); Hillary A. Sale, *Heightened Pleading and Discovery Stays: An Analysis of the Effect of the PSLRA's Internal-Information Standard on '33 and '34 Act Claims*, 76 WASH. U. L.Q. 537, 556–60 (1998) (chronicling the PSLRA's history from the congressional Contract With America through the veto override); Laura R. Smith, Comment, *The Battle Between Plain Meaning and Legislative History: Which Will Decide the Standard for Pleading Scienter After the Private Securities Litigation Reform Act of 1995?*, 39 SANTA CLARA L. REV. 577, 580–84 (1999) (“[T]he debate regarding the PSLRA [standard for scienter] is over the use of . . . conflicting legislative history.”).

47. Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 658 (8th Cir. 2001) (“The Circuits that have interpreted the [PSLRA] have fallen into (at least) three camps.”).

48. See Kalnit v. Eichler, 264 F.3d 131, 138 (2d Cir. 2001) (“The PSLRA’s language echoed this Court’s scienter standard.”); Novak v. Kasaks, 216 F.3d 300, 310 (2d Cir. 2000) (concluding that the PSLRA “did not change the basic pleading standard for scienter in this circuit”). However, the opinion cautioned against employing or relying on “magic words” when pleading scienter. *Novak*, 216 F.3d at 311.

49. *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534–35 (3d Cir. 1999) (“We believe Congress’s use of the Second Circuit’s language compels the conclusion that the [PSLRA] establishes a pleading standard approximately equal in stringency to that of the Second Circuit.”).

50. *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 978–79 (9th Cir. 1999) (“It is . . . clear from the legislative history that Congress sought more specifically to raise the pleading standard above that in the Second Circuit.”).

51. See *Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 345–46 (4th Cir. 2003) (“[C]ourts should not restrict their scienter inquiry by focusing on specific categories of facts, such as those relating to motive and opportunity, but instead should examine all of the allegations in each case to determine whether they collectively establish a strong inference of scienter.”); *Green Tree Fin. Corp.*, 270 F.3d at 659 (“Occupying the middle ground, the First, Fifth, Sixth, Tenth, and Eleventh Circuits have held that the primary effect of the [PSLRA] is to require a pleading to state facts giving rise to a ‘strong inference of scienter.’”); *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 411–12 (5th Cir. 2001) (“What must be alleged is not motive and opportunity as such but particularized facts giving rise to a strong inference of scienter.”); *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1261–63 (10th Cir. 2001) (“We agree with the middle ground . . . [C]ourts must look to the totality of the pleadings to determine whether the plaintiffs’ allegations permit a strong inference of fraudulent intent.”); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 550–52 (6th Cir. 2001) (“[P]laintiffs cannot simply plead ‘motive and opportunity’ as a mantra for recovery under the

a consistent formulation has resulted in scattered and inconsistent jurisprudence,⁵² with some courts and commentators still focusing their discussions on the Second–Ninth polarity rather than on developing a clearer rubric for this very fact-intensive inquiry.⁵³

Despite the lack of a cohesive framework for scienter analysis, motive undoubtedly plays an essential role in securities fraud cases. In an oft-quoted post-PSLRA case, the Sixth Circuit described the role of motive and opportunity this way: “While it is true that motive and opportunity are not substitutes for a showing of recklessness, they can be catalysts to fraud and so serve as external markers to the required state of mind. . . . [M]otive’ and ‘opportunity’ are simply recurring patterns of evidence.”⁵⁴ Likewise, the Seventh Circuit described avaricious motives as useful indicators but noted that the PSLRA does nothing to endorse motive and opportunity pleading as “either necessary or sufficient.”⁵⁵ The Eleventh Circuit has also espoused the notion that greed may prompt fraud, while expressing skepticism as to its potential as a barometer for scienter in the corporate world:

Greed is a ubiquitous motive, and corporate insiders and upper management always have opportunity to lie and manipulate. Furthermore, allowing private securities class actions to proceed to discovery upon bare allegations of motive and opportunity would upset the delicate balance of providing a remedy for genuine fraud while preventing abusive strike suits that the [PSLRA] sought to achieve. Motive and opportunity will ordinarily be relevant, and often highly relevant . . . [but] a showing of motive and opportunity standing alone [is] insufficient to allege securities fraud under the “severe recklessness” standard established by the Eleventh Circuit.⁵⁶

[PSLRA.]”); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195–97 (1st Cir. 1999) (“[W]hatever the characteristic pattern of the facts alleged, those facts must now present a *strong* inference of scienter.”).

52. *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1286 (11th Cir. 1999) (comparing *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259 (2d Cir. 1993), with *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124 (2d Cir. 1994), to conclude that “even within the Second Circuit, the wellspring of the analysis, the status of the motive and opportunity test was somewhat uncertain, having been applied in a seemingly inconsistent fashion”).

53. See, e.g., James V. Fazio, *The Motive and Opportunity Test for Pleading Scienter Under the Federal Securities Laws: Where Is It Now?*, FED. LAW., May 2003, at 51, 51 (discussing the inconsistent standards applied by the circuits).

54. *Helwig*, 251 F.3d at 550.

55. *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601 (7th Cir. 2006), *vacated*, 127 S. Ct. 2499 (2007).

56. *Bryant*, 187 F.3d at 1286 (alterations in original) (quoting *Carley Capital Group v.*

Whether motive or lack thereof is dispositive or merely relevant in a given case,⁵⁷ the fact remains that given the need for allegations of a compelling motive for the purported fraud, courts reviewing dismissals for lack of scienter nearly always engage in motive analysis. Thus, we are inevitably led to philosophically and analytically challenging questions: What is the proper role of greed in a business environment? How and when does the presence of a financial motive evince fraudulent intent?

In an effort to begin to answer these questions, the next Part takes an intensive look at the insider stock transactions model as a predicate to reasoned analysis of other types of greedy motives.

III. INSIDER STOCK SALES: A MODEL FOR THE ANALYSIS OF GREED ALLEGATIONS

Motive may be pleaded in a number of different ways, depending in part on which defendant's scienter is at issue. A plaintiff may adequately plead the motive of individual defendants by showing propitiously timed stock transactions or the defendant's desire to augment compensation or to maintain employment, but demonstrating corporate motives for fraud—such as artificial inflation of stock price in anticipation of a stock-based acquisition—has proven to be more difficult.

Grappling with the greed problem, some courts, including the Second Circuit, have focused on whether a motive provides a “concrete and personal benefit” to the defendant.⁵⁸ Adding to the muddled quality of the jurisprudence in this area, the term “concrete and personal” is exceedingly vague and awkward to apply to a corporation as a defendant. Other courts use a “factors” approach, which examines the totality of the circumstances, to analyze scienter allegations, with the financial motive to keep one's job being one of the factors considered.⁵⁹ Regardless of the specific approach used, the circuit courts apparently agree that a plaintiff may adequately plead motive by alleging facts demonstrating that corporate insiders sold

Deloitte & Touche, L.L.P., 27 F. Supp. 2d 1324, 1339 (N.D. Ga. 1998).

57. *Ottmann v. Hangar Orthopedics Group, Inc.*, 353 F.3d 338, 345–46 (4th Cir. 2003) (“[W]hile particular facts demonstrating a motive and opportunity to commit fraud (or lack of such facts) may be relevant to the scienter inquiry, the weight accorded to those facts should depend on the circumstances of each case.”).

58. *See, e.g., Kalnit v. Eichler*, 264 F.3d 131, 139–40 (2d Cir. 2001), *quoted in In re K-tel Int'l, Inc. Sec. Litig.*, 300 F.3d 881, 894 (8th Cir. 2002); *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 237 (3d Cir. 2004) (quoting *Kalnit*, 264 F.3d at 139); *see also Ottmann*, 353 F.3d at 352 (“[I]n order to demonstrate motive, a plaintiff must show concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged.” (quoting *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 621 (4th Cir. 1999))).

59. *See infra* Part IV.A.

their shares at a profit while artificially inflating the corporation's stock price via misrepresentations about the corporation's performance or prospects. Indeed, insider stock transactions are the most common motive alleged in cases reaching the circuit courts.⁶⁰ Thus, the federal appellate courts have significant experience in analyzing insider stock trades and the financial motive these trades may provide for an inference of scienter in a § 10(b) case.

The details of insider transactions during the period in which purported misrepresentations were made to the marketplace are readily available to plaintiffs,⁶¹ but it is the nature of the stock sales of record that might shed light on an individual defendant's scienter. This insight results because insider stock sales can carry with them the assumption that the insider timed the purchase or sale to accrue gains or avoid losses prior to releasing material information to the public.⁶² To be sure, these allegations are subject to other inferences.⁶³ Therefore, complaints that base a defendant's scienter on motive demonstrated by insider stock trades must allege more than that the defendant benefited from trading because of purported misrepresentations. Instead, to satisfy the strong inference requirement,

60. The near omnipresence of allegations of insider stock transactions in class action fraud-on-the-market cases has compelled some courts to reason that stock sales are the *sine qua non* of motive and concrete personal benefit. *See, e.g.,* Nathenson v. Zonagen Inc., 267 F.3d 400, 420–21 (5th Cir. 2001) (concluding that certain defendants' abstention from trading stock undercut allegations of motive); City of Phila. v. Fleming Cos., 264 F.3d 1245, 1270 (10th Cir. 2001) (noting, in a case finding no inference of scienter, that no insider stock sales had been pleaded); Keeney v. Larkin, 306 F. Supp. 2d 522, 535–36 (D. Md. 2003) (same), *aff'd*, 102 F. App'x 787 (4th Cir. 2004); *see also* Helwig v. Vencor, Inc., 251 F.3d 540, 571–73 (6th Cir. 2001) (Kennedy, J., dissenting) (criticizing the majority for not being more diligent in its analysis of the scope and context of the stock sales). *But see In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 269–71 (2d Cir. 1993) (holding that motive was adequately pleaded in a case with no insider stock transactions).

61. Section 16(a) of the Securities Exchange Act of 1934 and the SEC regulations implementing § 16(a) require insiders to disclose changes in their beneficial interest in company stock. Insiders have traditionally met this requirement by filing a "Form 4" with the SEC. *See generally* Mandated Electronic Filing and Web Site Posting for Forms 3, 4 and 5, 68 Fed. Reg. 25,788 (May 13, 2003) (codified at 17 C.F.R. pts. 230, 232, 239, 240, 249, 250, 259, 260, 269, 274). Section 403 of the Sarbanes-Oxley Act of 2002 amended § 16(a) and now requires insiders to file Form 4 within two business days of a transaction. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 403(a), 116 Stat. 745, 788 (codified at 15 U.S.C. § 78p(a)(2)(C) (Supp. IV 2004)); Form 4, 17 C.F.R. § 249.104 (2007). Since May 2003, these disclosures must be filed with the SEC's publicly available electronic database, EDGAR, as well as on the corporation's website. 15 U.S.C. § 78p(a)(4); Mandated Electronic Filing and Web Site Posting for Forms 3, 4 and 5, 68 Fed. Reg. at 25,788.

62. *See, e.g.,* Stelman v. Alias Research Inc., 174 F.3d 79, 85 (2d Cir. 1999) (holding that the fact that corporate officers sold large portions of their stock during the class period "supports the inference that [the CEO] withheld disclosures that would depress his stock until he had profitably sold his shares").

63. *See supra* note 27.

the insider trades must be “unusual.”⁶⁴ Courts thus will consider contextual matters such as the total number of shares traded, the amount of the profit made, the percentage of an individual’s stock holdings sold, or the number of insiders who traded.⁶⁵

The Ninth Circuit, in its seminal scienter opinion, *In re Silicon Graphics, Inc. Securities Litigation*,⁶⁶ summed up the insider-stock-transactions-as-motive analysis as follows:

Although “unusual” or “suspicious” stock sales by corporate insiders may constitute circumstantial evidence of scienter, insider trading is suspicious only when it is “dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed inside information.” Among the relevant factors to consider are: (1) the amount and percentage of shares sold by insiders; (2) the timing of the sales; and (3) whether the sales were consistent with the insider’s prior trading history.⁶⁷

The other circuits have followed suit in rigorously analyzing the context of insider trades before permitting the trades to be used to support an inference of motive—and thereby scienter—in securities fraud cases. The next section further defines the “unusual” nature of stock sales that can elevate a generalized financial motive to one that may support a strong inference of scienter.

A. *Magnitude, Timing, and Atypicality as Indicators of Scienter:
The Stock Sales Construct*

The factors identified by the Ninth Circuit in *In re Silicon Graphics* can be referred to more generally as magnitude, timing, and atypicality. We argue that these factors can and should provide the foundation for analysis of the “concreteness” of other types of executive- and corporate-benefit allegations in § 10(b) cases. But before extending the analysis, we define these three contextual factors and provide examples that illustrate how courts apply these factors in the setting of insider stock transactions.

64. *In re Daou Sys., Inc., Sec. Litig.*, 411 F.3d 1006, 1022–23 (9th Cir. 2005) (quoting *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 198 (1st Cir. 1999)).

65. See *Rothman v. Gregor*, 220 F.3d 81, 94 (2d Cir. 2000); *Oran v. Stafford*, 226 F.3d 275, 290 (3d Cir. 2000); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 540–41 (3d Cir. 1999).

66. 183 F.3d 970 (9th Cir. 1999).

67. *Id.* at 986 (citations and footnote omitted) (quoting *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1117 (9th Cir. 1989)).

1. Magnitude

In the context of an insider stock trade, courts have recognized that the magnitude or amount of the benefit that accrued to the individual defendant plays an important part in assessing the trade as an indicator of scienter. As we have noted, whether a stock transaction is unusual depends on a number of factors. Magnitude-related considerations include the amount of profit made and the number of shares traded. Courts have also looked at the “proportion of shares actually sold by an insider to the volume of shares he could have sold.”⁶⁸

In *In re Suprema Specialties, Inc.*,⁶⁹ the Third Circuit looked at the relative magnitude of the profit reaped versus the individual’s ordinary compensation in an effort to determine whether the necessary strong inference of scienter could be drawn.⁷⁰ To that end, the court noted that one officer’s “profits from [his] stock sale nearly doubled in one day the total amount of money that he had made over the previous three years combined.”⁷¹ The other officer alleged to have participated in the fraud “netted . . . over four times his annual salary” from the suspect stock sales.⁷² Such exponential figures militated in favor of a finding that the officers intended to commit fraud.⁷³

*Nursing Home Pension Fund v. Oracle Corp.*⁷⁴ provides another example of the comparative analysis courts use when assessing the magnitude of insider stock sales. Investors brought a § 10(b) suit against Oracle Corporation and three of its top executive officers, alleging that the officers had intentionally concealed information about the poor technical quality of a product and its ensuing losses.⁷⁵ A month prior to the inevitable disclosure of lower-than-anticipated sales, one Oracle executive

68. *Id.*; see also *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 380 (5th Cir. 2004) (holding that total sales of more than 40% of the CEO’s stock during the class period supported a strong inference of scienter); *In re Cabletron Sys., Inc.*, 311 F.3d 11, 27, 40 (1st Cir. 2002) (finding that individual defendants’ sales of between one-third and 90% of their stockholdings, along with other factors, gave rise to the necessary strong inference of scienter); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 74–75 (2d Cir. 2001) (finding motive indicative of scienter against an individual defendant who “sold a total of 19,400 shares—approximately 80 percent of his holdings” during the class period, netting him more than \$1.25 million).

69. 438 F.3d 256 (3d Cir. 2006).

70. *Id.* at 278; see also *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1423 (3d Cir. 1997) (considering the magnitude of profits reaped relative to the seller’s ordinary compensation).

71. *In re Suprema Specialties*, 438 F.3d at 278.

72. *Id.*

73. See *id.*

74. 380 F.3d 1226 (9th Cir. 2004).

75. *Id.* at 1228–29.

sold 2.1% of his holdings in the corporation and another sold 7%.⁷⁶ The district court focused on the percentage of stock sold, concluding that the plaintiff's allegations did not establish an unusual or heightened motive.⁷⁷ In fact, the district court's analysis of the proportion of stock sold was in line with previous Ninth Circuit holdings.⁷⁸ On appeal, however, the Ninth Circuit departed from its own prior emphasis on percentage of stockholdings as a relevant indicator, noting that the Oracle executive who sold 2.1% of his stock made an "astronomical" \$900 million in profit from his proportionally small sale.⁷⁹ In light of the sheer size of the benefit reaped, the stock sales were categorized as unusual and, ultimately, this categorization was instrumental in the reversal of the district court's dismissal of the case.⁸⁰

Thus, in the stock sales setting, the magnitude factor may require analysis of several different numbers. Typically, for a court to find that the magnitude factor implies an insider had the requisite intent, the insider must sell a subjectively large number of shares either in relation to his total holdings, or in comparison to the amount the insider could have sold. In the odd case, like *Oracle*, an objectively enormous profit earned or loss avoided may imply the requisite intent.

2. Timing

As a factor affecting stock sales' worth, timing may involve two somewhat interrelated yet distinct considerations when assessing greedy motives and scienter. The first refers to when the trade occurred in relation to the purported misrepresentation or omission that defrauded the plaintiffs. In the insider stock sales case, trading at a particular time provides circumstantial evidence that the insider knew the best time to trade because he had inside information that enabled him to sell (or buy)

76. *Id.* at 1232.

77. *Id.*

78. *See, e.g.*, No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp., 320 F.3d 920, 939 (9th Cir. 2003) ("Most of the individuals sold 100% of their shares, with the lowest percentage being 88%. The proceeds from these sales totaled over \$12 million."); *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 987 (9th Cir. 1999) ("All but two of the officers in this case sold a relatively small portion of their total holdings . . .").

79. *Oracle Corp.*, 380 F.3d at 1232.

80. *See id.* at 1231–35. On the other hand, where the magnitude of the stock sales cannot be shown, the sales are not suspicious. For example, in *In re PEC Solutions, Inc. Securities Litigation*, the Fourth Circuit affirmed dismissal of a suit where the four individual defendants sold "*de minimis*" percentages of their stock holdings and "the Individual Appellees actually *lost* over \$471 million dollars [sic] in collective stock value during the class period." 418 F.3d 379, 390 (4th Cir. 2005). Because the class's motive allegations were exclusively based on this particular greedy motive, a strong inference of scienter could not be drawn. *Id.*

the stock while the trading public was unaware of the “truth.” Thus, though the insider’s stock trade may not be particularly unusual in magnitude, if that same stock sale is made on the eve of a revelation that would likely cause the company’s stock to plummet, a financial motive is apparent and an inference of scienter is more appropriate.⁸¹ And, just as importantly, if the defendant’s guilty knowledge is obtained later, or the defendant trades after the release of negative information, there is no greedy motive indicative of scienter.⁸²

Timing may also refer to the temporal intersection of several seemingly unrelated events, which together heighten the insider’s motive. Here we refer to the coincidence of relevant peripheral indicia such as market- or industry-wide phenomena,⁸³ trading by other insiders,⁸⁴ or even the

81. See, e.g., *America West*, 320 F.3d at 940 n.18 (finding suspicious a majority shareholder’s sales of 100% of its stock in one class on the “day before the Wall Street Journal reported that [the issuer] faced the prospect of substantial FAA sanctions”); *Rothman v. Gregor*, 220 F.3d 81, 94–95 (2d Cir. 2000) (holding that, though a “massive” profit regardless of percentage of stockholdings sold *could* support a finding of motive and thereby scienter in the proper case, the individual defendant’s profit of \$20 million from sales of stock was insufficient to support such a finding because his guilty knowledge could not be inferred until later; thus, the timing of the sales was not suspicious); *Stevelman v. Alias Research Inc.*, 174 F.3d 79, 85 (2d Cir. 1999) (recognizing that under the pre-PSLRA standard unusual insider trading activity during the class period may permit an inference of bad faith and scienter). *Contra* *Lipton v. PathoGenesis Corp.*, 284 F.3d 1027, 1037 (9th Cir. 2002) (holding that stock sales immediately following a purported misrepresentation are not suspicious because “[o]fficers of publicly traded companies commonly make stock transactions following the public release of quarterly earnings and related financial disclosures”).

82. For example, in *Nathenson v. Zonagen Inc.*, the Fifth Circuit approved of the district court’s finding that the subject stock sales were not probative of scienter, stating: “As the district court correctly observed, ‘[a]t most plaintiffs allege that one outside director sold a fraction of his holdings at times that were unrelated to any Company announcements and at prices that were far below that which he could have obtained by selling a few weeks earlier or later.’” 267 F.3d 400, 420 (5th Cir. 2001) (alteration in original) (quoting *Nathenson v. Zonagen, Inc.*, No. H-98-0693, 1999 U.S. Dist. LEXIS 23551, at *54 (S.D. Tex. Mar. 30, 1999), *vacated on other grounds*, 267 F.3d 400 (5th Cir. 2001)). The Fifth Circuit found that “inauspiciously timed” sales do not meet the plaintiff’s burden of showing a motive for fraud. *Id.* at 421 (quoting *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1118 (9th Cir. 1989)); see also *Rombach v. Chang*, 355 F.3d 164, 177 (2d Cir. 2004) (finding that the plaintiff’s allegation that individual defendants purchased large amounts of stock after the price collapsed failed to establish scienter because there was no allegation that the defendants sold the stock or profited in any way).

83. See, e.g., *In re Cabletron Sys., Inc.*, 311 F.3d 11, 36–37 (1st Cir. 2002) (commenting that an issuer’s nondisclosure of negative industry trends, though the trends are not required to be disclosed, might supply a context for finding that insider stock transactions—and other conduct—were unusual).

84. In fact, a number of cases support this notion by negative implication. Some courts have pointed out that when no other officers sold stock during the same period, a plaintiff’s claim of suspicious insider trading is fatally undermined. The Third Circuit’s opinion in *In re Alpha Pharma Inc. Securities Litigation* presents a typical example of this, pointing to the fact that the insider who stood the most to gain in respect to the alleged fraud did not sell any stock at all. 372 F.3d 137, 152 (3d Cir. 2004); see also *Abrams v. Baker Hughes, Inc.*, 292 F.3d 424, 434–35 (5th Cir. 2002);

defendant's resignation,⁸⁵ at the time of the stock sale. These contextual timing-related facts can also transform an otherwise ordinary sale into a suspicious or unusual one for purposes of effectively pleading scienter.

Practically speaking, courts can and should look collectively at the timing coincidences of the insider stock transactions alleged by plaintiffs. The Ninth Circuit's *In re Daou Systems, Inc.* decision⁸⁶ provides a good example of a case in which both types of timing were in play. The court viewed the timing coincidences as heightening the inference available from the relevant insider stock sales.⁸⁷ There, the plaintiffs alleged that a number of individuals not named as defendants—other corporate executives and family members of the individual defendants—also sold stock during the class period and that “98% of all insider sales . . . took place on only two trading days.”⁸⁸ These facts, together with the allegation that the individual insider defendants' sales corresponded “perfectly with the ‘huge increase in the price of Daou stock that immediately followed [defendants'] false statements and reports,’”⁸⁹ supported the Ninth Circuit's finding that the defendants' timing was suspicious enough to surmount the strong inference hurdle, trumping the defendants' argument that they did not sell at the height of the company's inflated stock prices.⁹⁰

Without any contextual support, allegations of a financial motive to commit fraud fall flat. Timing—whether it be directly relating to the misrepresentation or merely a confluence of disparate and independently irrelevant circumstances—is a key element in determining the merit of motive allegations for purposes of assessing scienter.⁹¹

Nathenson, 267 F.3d at 420–21; *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 540 (3d Cir. 1999). The Ninth Circuit has adopted similar reasoning. *Ronconi v. Larkin*, 253 F.3d 423, 436 (9th Cir. 2001) (“One insider's well timed sales do not support the ‘strong inference’ required by the [PSLRA] where the rest of the equally knowledgeable insiders act in a way inconsistent with the inference that the favorable characterizations of the company's affairs were known to be false when made.” (footnote omitted)); see also *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1424–25 (9th Cir. 1994) (finding no scienter because the defendants “held onto most of their [company's] stock and incurred the same large losses” as the plaintiffs).

85. See, e.g., *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 264–65, 277–78 (3d Cir. 2006) (finding the timing of sales suspect for purposes of a motive analysis because “they occurred just six weeks before [the company's CFO and controller] resigned”).

86. 411 F.3d 1006 (9th Cir. 2005).

87. *Id.* at 1022–25.

88. *Id.* at 1024 (alteration in original) (quoting complaint).

89. *Id.* (alteration in original) (quoting complaint).

90. *Id.*

91. See *Oran v. Stafford*, 226 F.3d 275, 290 (3d Cir. 2000) (finding that the sale of stock alone is not evidence of scienter, but “‘if the stock sales were unusual in scope or timing, they may support an inference of scienter’” (quoting *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 540 (3d Cir. 1999))).

3. Atypicality

The atypicality of an insider stock transaction refers to its extraordinariness in some aspect other than magnitude or time. The atypicality factor is ultimately driven by surrounding facts and relevant history. When alleging insider stock transactions as evidence of a defendant's greedy motive, a plaintiff generally attempts to demonstrate that the defendant's transactions were inconsistent with prior trading practices and unusual "in scope."⁹² To that end, the complaint must offer sufficient trading history for the court to adequately contextualize the subject trades.⁹³ This analysis of the atypicality of insider stock sales may also involve a discussion of the defendants' explanations for the sales. For example, restrictions on trading may tend to mitigate the suspicious amount or timing of sales in comparison with prior transactions.⁹⁴ In this regard, courts should look not only at the historical pattern of the insider's stock transactions but also at the transactions' character as compared to previous trades. For example, in *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*,⁹⁵ the court found that a majority shareholder's stock sales were unusual when viewed in light of that insider's history of selling only warrants.⁹⁶

92. See, e.g., *In re Alparma, Inc. Sec. Litig.*, 372 F.3d 137, 152 (3d Cir. 2004) ("[T]he Complaint fails to allege that the sales of the remaining three individual defendants were unusual in scope (e.g., compared to their total level of compensation or the size of previous sales) or timing . . ."); *Oran*, 226 F.3d at 290 (holding that the individual defendants' stock sales did not support an inference of scienter and noting that after reviewing numbers of shares traded by defendants over a two-year period including the class period the review did "not demonstrate any concerted insider effort to dispose of shares during the Class Period").

93. See, e.g., *In re Cerner Corp. Sec. Litig.*, 425 F.3d 1079, 1085 (8th Cir. 2005) (noting the importance of prior trading history in analyzing whether stock sales were unusual); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1111, 1117 (9th Cir. 1989) (comparing the ten months preceding a ten-month class period to determine whether the alleged insider trading was consistent with the prior pattern of sales).

94. When an insider has been restricted from trading during a period, the proffered trading history may be misleading, and sales, even of substantial amounts or percentages of stockholdings, may be less suspicious. See, e.g., *Ronconi v. Larkin*, 253 F.3d 423, 436 (9th Cir. 2001) (finding that a showing of the trading history spanning seven months before the class period and twelve months after the period was not sufficient where the officers could not have legally traded during part of those periods); *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 987–88 (9th Cir. 1999) (finding that an insider's sale of more than 75% of his stock during the class period was not suspicious because he had been restricted from selling it before that time); see also *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 206–07 (1st Cir. 1999) (finding that stock trades were not unusual and explaining that the vast majority of the defendants' stock trades were made by one individual after he left the company).

95. 320 F.3d 920 (9th Cir. 2003).

96. *Id.* at 941.

Thus, the atypicality prong of a court's analysis requires an assessment of the stock trades' remarkable, exceptional, or anomalous nature when viewed in light of surrounding circumstances. In one case, a variation in scope as compared to a particular defendant's prior trading pattern may be peculiar, while in another an apparent concerted effort to dispose of stock by a number of defendants may raise suspicion. The precise atypicality to which a plaintiff can successfully point in alleging motive as evidence of scienter will necessarily differ from case to case.

* * *

Ultimately, courts should consider atypicality allegations along with any propitious timing or objective magnitude of the sales. An example of this analysis is found in another section of the *America West* opinion, where the Ninth Circuit looked at the trading history of the nine officer and director defendants for whom stock sales allegedly created a motive for fraud.⁹⁷ The court found that the transactions were unusual and noted:

First, the amount and percentage of shares sold by individual insiders was suspicious. Most of the individuals sold 100% of their shares, with the lowest percentage being 88%. The proceeds from these sales totaled over \$12 million. . . .

Although "large numbers [and percentages] do not necessarily create a strong inference of fraud," the numbers and percentages presented by Plaintiffs are troubling. . . .

Second, the timing of the sales also raises suspicions. Unlike other cases where there were timing gaps between the sales or where only one insider did the trading, here all nine of the individuals' sales occurred in succession over a three month period when America West officials were making optimistic statements regarding the company's financial outlook and reassuring analysts that the settlement agreement would have no economic effect. . . .

Third, the prior trading history of each defendant indicates that the sales during the class period [were] unusual and suspicious. None of the individual defendants sold stocks during the twenty months preceding the ten month class period. Nor did they sell for at least four months following the class period. Thus, the sudden flurry of massive insider trading over this three month period of time, after an extended period of inactivity, appears unusual.⁹⁸

97. *Id.* at 939–40.

98. *Id.* (citation and footnote omitted) (quoting *In re Vantive Corp. Sec. Litig.*, 283 F.3d

As demonstrated here, separately—and inevitably more compelling when all factors overlap in the same case and are viewed together—the magnitude, timing, and atypicality of insiders’ stock sales can and will regularly give rise to a strong inference of scienter to propel a § 10(b) case beyond the pleading stage. In the next Part, we broaden the reach of this factors model for assessing scienter to cases in which the motive allegations involve conduct and circumstances other than insider stock transactions.

IV. EXTENDING THE CONTEXTUAL FACTORS APPROACH TO CASES INVOLVING OTHER EXECUTIVE AND CORPORATE MOTIVES

Although insider stock transactions are frequently used to support the scienter element in a § 10(b) case,⁹⁹ plaintiffs do not always have suspicious stock sales on which to rely to show an insider’s fraudulent motive. But, like the ingenuity that spawns it, fraud’s impetus is also multifarious. In the absence of an insider stock transaction, plaintiff’s allege other motives that typically fall into two broad categories: (1) compensation- and employment-related benefits for individual defendants, and (2) corporate motives generally. Court decisions on these motives are inconsistent and reflect no unifying structure for analysis.¹⁰⁰ Courts need a framework for the orderly and consistent consideration of these motives.

As we saw in connection with insider stock transactions, the three relevant factors that emerge for finding a motive for fraud are magnitude, timing, and atypicality.¹⁰¹ This contextual approach is equally helpful in assessing other possible motives. In the succeeding sections, we demonstrate how courts can and should use the magnitude-timing-atypicality construct to assess, on the one hand, individual employment- and compensation-related motives (other than stock trades) and, on the other hand, a corporate entity’s motives that may give rise to scienter.

1079, 1093 (9th Cir. 2002)); *see also In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1424 (3d Cir. 1997) (finding that allegations of stock transactions by insiders were insufficient and noting that “[t]o the extent plaintiffs choose to allege fraudulent behavior based on what they perceive as ‘suspicious’ trading, they have to allege facts [providing a magnitude or atypicality context] that support that suspicion”).

99. *See supra* note 60 and accompanying text.

100. *See supra* notes 47–53 and accompanying text.

101. *See supra* Part III.A.

A. Executive Compensation and Employment

Does an executive's self-interested desire to increase her compensation or to maintain her employment provide a proper basis for finding a motive for fraud in a § 10(b) case? Unlike the readily ascertainable pecuniary gain of stock sales, these financial motives typically manifest themselves more indirectly. The argument that these indirect financial motives evidence fraudulent intent runs as follows: the corporate executive was spurred to misrepresent corporate information to personally reap an employment or career advantage, such as increased compensation, a bonus, or the perpetuation of a high corporate position.

The First and Sixth Circuits refer to "the self-interested motivation of defendants in the form of saving their salaries or jobs" as a factor directly relevant to the scienter analysis.¹⁰² Thus, in these courts, a defendant's preservation of her employment position and compensation creates a possible motive for fraud. To the extent that a § 10(b) complaint alleges this motive by using particularly pleaded facts, these courts appear to weigh the allegations equally with other circumstances (for example, whether there was an alleged disregard of the most current factual information before making statements). If enough of the enumerated factors are present in the case, the totality of the circumstances permits a court to find the required strong inference of scienter.¹⁰³

Other courts, however, have historically been reluctant to find these types of allegations sufficient.¹⁰⁴ These courts routinely find that a defendant's desire to maintain or increase her compensation simply does not give rise to the required strong inference. Further, these courts tend to assume, almost as a matter of judicial notice in § 10(b) cases, that all executives want to increase their earnings and keep their jobs.

102. See *Helwig v. Vencor, Inc.*, 251 F.3d 540, 552 (6th Cir. 2001) (citing *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 196 (1st Cir. 1999)).

103. See, e.g., *City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 683–86 (6th Cir. 2005) (finding a strong inference of scienter as to corporate defendant Firestone where six of the nine factors identified in *Helwig* were present in the case, including "the self-interested motivation of defendants in the form of saving their salaries or jobs" (citing *Helwig*, 251 F.3d at 552)).

104. See, e.g., *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995) ("[T]he existence, without more, of executive compensation dependent upon stock value does not give rise to a strong inference of scienter."); *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994) ("If motive could be pleaded by alleging the defendant's desire for continued employment, . . . the required showing of motive . . . would be no realistic check on aspersions of fraud, and mere misguided optimism would become actionable under the securities laws."); *Tuchman v. DSC Commc'ns Corp.*, 14 F.3d 1061, 1068 (5th Cir. 1994) ("[I]ncentive compensation can hardly be the basis on which an allegation of fraud is predicated." (alteration in original) (quoting *Ferber v. Travelers Corp.*, 785 F. Supp. 1101, 1107 (D. Conn. 1991))).

For instance, in *Phillips v. LCI International, Inc.*,¹⁰⁵ the Fourth Circuit commented that “allowing a plaintiff to prove a motive to defraud by simply alleging a corporate defendant’s desire to retain his position with its attendant salary . . . would force the directors of virtually every company to defend securities fraud actions . . . every time that company effected a merger or acquisition.”¹⁰⁶ The Third, Fifth, and Ninth Circuits have also deemed these types of allegations too generalized to support a scienter argument.¹⁰⁷ And the influential Second Circuit has repeatedly taken this position. For example, in *Kalnit v. Eichler*,¹⁰⁸ the plaintiffs alleged that the individual defendants were motivated to make misrepresentations to protect lucrative compensation provisions in a pending merger agreement.¹⁰⁹ Citing *Acito v. IMCERA Group, Inc.*¹¹⁰ and *Shields v. Citytrust Bancorp, Inc.*,¹¹¹ the Second Circuit reasoned that “an allegation that defendants were motivated by a desire to maintain or increase executive compensation is insufficient because such a desire can be imputed to all corporate officers.”¹¹²

These opinions seem to imply that incentive-based compensation or other executive benefits can never support a strong inference of scienter. But there are certainly circumstances in which a particular type of benefit might be achieved only through a misrepresentation or omission—when

105. 190 F.3d 609 (4th Cir. 1999).

106. *Id.* at 623 (citation omitted).

107. *See, e.g.*, *GSC Partners CDO Fund v. Washington*, 368 F.3d 228, 237 (3d Cir. 2004) (“In every corporate transaction, the corporation and its officers have a desire to complete the transaction, and officers will usually reap financial benefits from a successful transaction. Such allegations alone cannot give rise to a ‘strong inference’ of fraudulent intent.”); *Fin. Acquisition Partners v. Blackwell*, 440 F.3d 278, 290 (5th Cir. 2006) (finding that an allegation that executives were motivated by a desire to keep their jobs was insufficient); *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 944–45 (9th Cir. 2003) (noting that evidence regarding the possibility of a merger or the creation of alliances was too generalized to establish scienter).

108. 264 F.3d 131 (2d Cir. 2001).

109. *Id.* at 140.

110. 47 F.3d 47, 54 (2d Cir. 1995).

111. 25 F.3d 1124, 1130 (2d Cir. 1994).

112. *Kalnit*, 264 F.3d at 139–40 (citing *Acito*, 47 F.3d at 54, and *Shields*, 25 F.3d at 1130); *see also* *Novak v. Kasaks*, 216 F.3d 300, 307–08 (2d Cir. 2000) (noting that motives generally possessed by most corporate directors and officers, including the desire to keep stock prices high to increase officer compensation, do not suffice as a concrete and personal benefit); *Leventhal v. Tow*, 48 F. Supp. 2d 104, 115 (D. Conn. 1999) (“[T]he allegation that the defendants artificially inflated Citizens’ stock price in order to ‘protect and enhance their executive positions’ and ‘negotiate as favorable a deal as possible’ on a pending employment contract also fail[s] to give rise to a strong inference of scienter. This motive has been rejected routinely.” (citing *Acito*, 47 F.3d at 54, *Ferber v. Travelers Corp.*, 785 F. Supp. 1101, 1107 (D. Conn. 1991), and *Glickman v. Alexander & Alexander Servs. Inc.*, No. 93 Civ. 7594, 1996 WL 88570, at *6 (S.D.N.Y. Feb. 29, 1996))).

the compensation or benefit at issue is objectively large or otherwise out of the ordinary, or when the need to misrepresent corporate performance so as to retain one's job is palpable. This raises an important question: What makes an individual defendant's compensation or employment benefit so unusual or suspicious as to imply a motive for fraud? An analysis of the existing case law demonstrates that consistent use of the magnitude-timing-atypicality construct that this Article proposes would provide future decisions in this area with consistency and, perhaps more importantly, a firmer analytical footing. The following subsections discuss each aspect of this proposed construct.

1. Magnitude

To be sure, some courts have already looked at the magnitude of the benefits alleged in an effort to determine whether insiders had a motive for fraud. In one case, for example, the court declined to find enhanced bonuses a sufficient motive because of their trivial size.¹¹³ Conversely, at least one case in the Eighth Circuit,¹¹⁴ as well as a case in the Fifth Circuit,¹¹⁵ have found that the extraordinary magnitude of the compensation the defendant stood to gain in connection with the fraud supported a finding of motive and scienter. Clearly, the magnitude of the compensation to be protected or gained serves as a useful indicator of whether greed may have tainted a corporate executive's conduct.¹¹⁶

113. *In re Cerner Corp. Sec. Litig.*, 425 F.3d 1079, 1085 (8th Cir. 2005). The plaintiffs alleged that the individual defendants were motivated to make the alleged misstatements by their desire to increase their bonuses and overall executive compensation packages. *Id.* However, the court pointed out that the largest incentive bonus paid to any one individual defendant was approximately \$355,000, and the aggregate bonuses paid were only about \$1 million. The court then summarily concluded that the magnitude of the bonuses did not justify a finding of improper motive. *Id.* The Eighth Circuit has similarly found motive allegations based on increased bonuses insufficient where the largest single bonus was \$630,000, the aggregate of the bonuses concerned was just over \$1.7 million, and no other suspicious circumstances were present. *See Kushner v. Beverly Enters., Inc.*, 317 F.3d 820, 830 (8th Cir. 2003).

114. *Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 661, 664 (8th Cir. 2001) (noting that the \$102 million benefit to an individual defendant was extraordinary and, in conjunction with suspicious timing circumstances, "created a powerful incentive to see to it that Green Tree made plenty of money").

115. *Barrie v. Intervoice-Brite, Inc.*, 397 F.3d 249, 260–61 (5th Cir. 2005) (finding that an executive who stood to earn a bonus of 175% of his annual salary had a motive to commit fraud).

116. Some time ago, one commentator suggested as much. *See Elliott J. Weiss, The New Securities Fraud Pleading Requirement: Speed Bump or Road Block?*, 38 ARIZ. L. REV. 675, 687 (1996) (espousing the view that incentive-based compensation can indeed provide a motive to commit fraud and recommending that courts review the magnitude of the benefit accrued to assess the sufficiency of scienter allegations).

Indeed, the use of the magnitude factor that this Article proposes may have changed the outcome in at least one Second Circuit case. *Albert Fadem Trust v. Citigroup, Inc.*¹¹⁷ was a class action securities fraud suit, filed in the wake of the Enron and WorldCom scandals, alleging that Citigroup's and various individuals' participation in the fraudulent scandals ultimately redounded to the detriment of Citigroup shareholders.¹¹⁸ The plaintiffs alleged that fraud and conflicts of interest generated "huge returns" for Citigroup in its transactions with Enron, Dynegy, and WorldCom, which translated into outlandish compensation to so-called "star" stock analyst defendant Jack Grubman.¹¹⁹ In fact, it was common knowledge at the time that Grubman's largely incentive-based compensation stood at \$20 million per year—a figure unprecedented in the context and history of stock analyst remuneration. This figure did not include any undisclosed profits that he may have made trading on his own account in stocks he followed, stocks for which he and his firm, Smith Barney/Citigroup, were alleged to have given biased recommendations to the investing public.¹²⁰

Nonetheless, the Second Circuit was unwilling to draw a strong inference of scienter, instead finding simply that the complaint provided no basis to conclude that defendants "were undertaking the challenged transactions for motives other than long-term profitability through the cultivation of major clients."¹²¹ The court merely affirmed the district

117. 165 F. App'x 928 (2d Cir. 2006).

118. *Id.* at 929. The facts are set forth more fully in the district court's opinion in the case. *See In re Citigroup, Inc., Sec. Litig.*, 330 F. Supp. 2d 367, 370–74 (S.D.N.Y. 2004), *aff'd sub nom. Albert Fadem Trust*, 165 F. App'x at 928.

119. *In re Citigroup, Inc.*, 330 F. Supp. 2d at 370–71, 374, 380.

120. *See* ARIANNA HUFFINGTON, PIGS AT THE TROUGH: HOW CORPORATE GREED AND POLITICAL CORRUPTION ARE UNDERMINING AMERICA 161–65 (2003) (referring to Grubman's annual \$20 million salary and describing specific conflicts of interest from which he and his employer suffered, as well as the massive profits generated thereby). One commentator has frequently discussed the issues involved in the general shifting of stock analysts' roles from providing investment advice to salesmanship. *See generally* Gretchen Morgenson, *Requiem for an Honorable Profession*, N.Y. TIMES, May 5, 2002, § 3, at 1; Gretchen Morgenson, *Buy, They Say. But What Do They Do? I.P.O. Conflicts Bedevil Analysts*, N.Y. TIMES, May 27, 2001, § 3, at 1; Gretchen Morgenson, *How Did So Many Get It So Wrong?*, N.Y. TIMES, Dec. 31, 2000, § 3, at 1. Details of the conflicts of interest presented by investment banking arms of brokerage houses securing lucrative banking business by promising issuers biased research and overblown stock recommendations, as well as the ensuing industry-wide settlement payments totaling billions of dollars are set forth well and succinctly in PHILIP AUGAR, THE GREED MERCHANTS: HOW THE INVESTMENT BANKS PLAYED THE FREE MARKET GAME 17–21 (2005). *See also* FRANK PARTNOY, INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS 355–56, 366–76 (2003) (detailing the spectacular WorldCom financial failure, Grubman's unique relationship with WorldCom, and his astronomical annual salary during the period 1998–2001).

121. *Albert Fadem Trust*, 165 F. App'x at 930; *accord* Thacker v. Medaphis Corp., No. 97 Civ. 2849, 1998 WL 684595, at *3 (S.D.N.Y. Sept. 30, 1998) (finding that the plaintiff's contention

court's finding that compensation based on corporate revenues was not a "concrete benefit" that could supply a sufficient motive.¹²² Rather than fall back on this ubiquity mantra, the Second Circuit's decision might have been more defensible had it discussed the extraordinary compensation involved and allowed this compensation to inform the court's scienter ruling at the pleading stage.

2. Timing

Like the timing of stock sales, the timing of executive pay or benefits might occasionally transform otherwise routine self-interest into a suspicious motive. *Florida State Board of Administration v. Green Tree Financial Corp.*¹²³ provides a good illustration. In that case, a financial services corporation, its CEO, and several other executives allegedly overstated the corporation's financial value to maximize the CEO's remuneration.¹²⁴ In dismissing the case, the district court cited the Second Circuit's decisions in *Acito* and *Shields* for the general proposition that enhanced executive compensation does not give rise to a motive sufficient to support the necessary strong inference.¹²⁵

On appeal, the Eighth Circuit scrutinized the motive allegations more closely, in particular their magnitude and timing dimensions.¹²⁶ Green Tree's CEO was allegedly the "highest paid business executive in the entire United States" in 1995 and 1996, with an employment agreement worth more than \$102 million in cash and stock in 1996 alone.¹²⁷ Moreover, the court noted the allegation that the CEO's employment contract, which entitled him to 2.5% of the corporation's pre-tax income, was set to expire on December 31, 1996, providing him with an urgent need to capitalize on the contract's favorable provisions before the end of the year.¹²⁸ Reversing the dismissal of the suit, the Eighth Circuit reasoned

that the defendant was motivated by a desire to eliminate competitors and to acquire related companies was insufficient to plead scienter because the motive could be imputed to any corporate officer).

122. See *Albert Fadem Trust*, 165 F. App'x at 930; *In re Citigroup, Inc.*, 330 F. Supp. 2d at 380.

123. 270 F.3d 645 (8th Cir. 2001).

124. *Id.* at 661.

125. *In re Green Tree Fin. Corp. Stock Litig.*, 61 F. Supp. 2d 860, 873 (D. Minn. 1999) (citing *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995), and *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994)), *rev'd sub nom. Green Tree Fin. Corp.*, 270 F.3d at 645. The district court was also persuaded by the fact that the CEO was forced to return much of the compensation involved after the corporation's financials were restated because this disgorgement militated against a finding of scienter. *Id.*

126. *Green Tree Fin. Corp.*, 270 F.3d at 661.

127. *Id.*

128. *Id.* at 650.

that “the magnitude of [the CEO’s] compensation package, together with the timing coincidence of an overstatement of earnings at just the right time to benefit [the CEO,] provide[d] an unusual, heightened showing of motive to commit fraud” on his part as well as the corporation’s.¹²⁹

This approach properly considers the manner in which timing can convert simple self-interest into a greedy motive. As we see below, the atypicality of an alleged compensation-based motive can be equally compelling.

3. Atypicality

Atypicality refers to the unusual quality of a defendant’s motivation to commit fraud: What is it about the executive’s financial motive, other than magnitude or timing, that places it outside the scope of ordinary, commonly accepted business conduct? Indeed in some cases, extraordinary, atypical circumstances can elevate the normal desire to retain a high-paying job, or to be rewarded with a large bonus, to an improper motive for fraud.

In *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*,¹³⁰ the Ninth Circuit considered allegations involving artificial inflation of the company’s stock price. The executives’ eligibility for stock options and bonuses was tied to the company’s financial performance, subject to a final determination by a compensation committee.¹³¹ Although such compensation structures are typical, the unusual circumstance contributing to a finding of improper motive was the fact that the compensation committee was controlled by the executives and shareholders who had clearly orchestrated the fraud (and sold over 90% of their own stock).¹³² This committee generously rewarded the three executives in an unusual manner: these executives were the only ones to receive stock options and had not received any the year before.¹³³ Though none of the executive defendants had engaged in insider trading, the court found that the composition of the compensation committee, along with the suspicious reward, was enough to indicate extraordinary circumstances in which scienter might be established.¹³⁴

The Tenth Circuit’s decision in *Pirraglia v. Novell, Inc.*¹³⁵ similarly exemplifies a proper use of the atypicality factor. In *Pirraglia*, a computer software manufacturer and its executives were accused of making false

129. *Id.* at 661.

130. 320 F.3d 920 (9th Cir. 2003).

131. *Id.* at 944.

132. *See id.* at 939, 944.

133. *Id.* at 944.

134. *Id.* at 941.

135. 339 F.3d 1182 (10th Cir. 2003).

statements about inventory and otherwise engaging in accounting fraud, allegedly motivated by the executives' desire to protect their employment.¹³⁶ Although a desire to protect one's employment is frequently viewed as an insufficient motive, the Tenth Circuit recognized that protection of an executive position may provide a motive for fraud in an unusual setting.¹³⁷ Apparently, former Novell president and CEO Robert Frankenberg had sanguinely predicted revenue growth in his public statements.¹³⁸ When Novell's stock instead fell, Frankenberg was forced to resign his post, and then-executive vice president Joseph Marengi was promoted to president. There was great pressure on the new management to bolster the company's stock price and to increase revenues. When his team's efforts proved unsuccessful, Marengi was also fired. In its analysis of motive, the Tenth Circuit concluded that "the defendants in the instant case had especial cause to think that they would lose their jobs if they failed to produce results, given the recent termination of Frankenberg."¹³⁹ This pressure, the court reasoned, was indicative of scienter, especially because Marengi's feared termination became a reality. The Tenth Circuit took this atypical motive into account in reversing the district court's dismissal of the case.¹⁴⁰ The First Circuit decided a pair of cases similarly.¹⁴¹

Thus, in assessing motive to determine whether a defendant had fraudulent intent, courts should look at the atypicality of the allegations of a personal and concrete benefit. In some cases, the driving force behind an executive's conduct will be stronger, more urgent, or otherwise different from the ordinary capitalistic profit motive. It is such atypicality that can, and in the proper case should, aid in drawing a strong inference of scienter.

* * *

In sum, greed in the form of seeking a personal advantage through job retention or an attractive bonus is often unconvincing as evidence of scienter. This is understandable in an intensely capitalist society that enables and encourages not only mere subsistence but also prosperity. But not all conduct geared at achieving wealth or maintaining a high standard of living is acceptable, even if this conduct is widespread. Courts

136. *Id.* at 1184–85.

137. *See id.* at 1191.

138. *Id.* at 1185.

139. *Id.* at 1191.

140. *Id.* at 1194.

141. *See Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 83–84 (1st Cir. 2002); *In re Cabletron Sys., Inc.*, 311 F.3d 11, 39 (1st Cir. 2002).

considering scienter and motive in § 10(b) cases must distinguish simple self-interest from corrupt or excessively acquisitive motives. The magnitude-timing-atypicality construct distills such motives and aids in assessing their propriety as indicia of scienter. In the following section, we apply this same contextual model to the motives that a corporation might have to commit fraud. Though the way people and corporate entities act may differ, their drives to survive and to excel financially are in fact the same. Thus, the model is equally efficacious in this context.

B. *Corporate Motives*

Although there is some overlap between benefits accruing to individuals and those that might provide a motive for a corporation to commit fraud—insider trading and performance-based compensation are both dependent on stock price, which a company naturally desires to keep high—the allegations of benefits to corporate defendants are somewhat different from those typically pleaded against individual defendants. For instance, some judicial opinions have discussed corporate motivations such as performing especially well in a fiftieth-anniversary year,¹⁴² beginning a campaign to attract new investors,¹⁴³ avoiding delisting by a stock exchange,¹⁴⁴ and maintaining favorable relationships with creditors.¹⁴⁵ Like they have with greedy motives alleged against individuals, courts have reasoned that to allow such “ordinary and appropriate corporate objectives” to sustain a finding of scienter would, in effect, “support a finding of fraudulent intent for all companies that plan to lower costs and expand sales.”¹⁴⁶ Accordingly, these types of motivations have often been rejected as insufficient evidence of scienter.

Similarly, some plaintiffs allege that the fraud was motivated by a desire to sustain the “appearance of corporate profitability, or of the success of an investment,”¹⁴⁷ or to maintain a high corporate credit rating.¹⁴⁸ These complaints often fail as exceedingly generalized and

142. See *In re Scientific-Atlanta, Inc. Sec. Litig.*, 239 F. Supp. 2d 1351, 1366 (N.D. Ga. 2002), *aff’d sub nom.* Phillips v. Scientific-Atlanta, Inc., 374 F.3d 1015 (11th Cir. 2004).

143. See Plotkin v. IP Axess Inc., 407 F.3d 690, 692–93, 697–701 (5th Cir. 2005).

144. See *In re K-tel Int’l, Inc. Sec. Litig.*, 300 F.3d 881, 887–88, 896–99 (8th Cir. 2002) (finding allegations that a corporation sought to avoid delisting from NASDAQ insufficient).

145. See Ottmann v. Hanger Orthopedic Group, Inc., 353 F.3d 338, 352 (4th Cir. 2003).

146. Lipton v. Pathogenesis Corp., 284 F.3d 1027, 1038 (9th Cir. 2002).

147. Chill v. Gen. Elec. Co., 101 F.3d 263, 268 (2d Cir. 1996).

148. See *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 813–14 (2d Cir. 1996) (finding that a “company’s desire to maintain a high bond or credit rating” was insufficient motive for fraud because the motive could be imputed to any company (citing *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995))); see also Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 664 (8th Cir. 2001) (stating in dicta that the desire to maintain a high credit rating or to make a company appear attractive to potential buyers may be “too thin a reed on which to hang an inference of scienter”).

ordinary because allowing such commonly held motives to vault a complaint past the dismissal stage arguably opens the floodgates of securities fraud litigation.¹⁴⁹ Other fraudulent corporate motives alleged include concealing negative information to secure a line of credit,¹⁵⁰ to avoid breaching a loan covenant,¹⁵¹ or to gain regulatory approval.¹⁵² These motives have also been found to be “ordinary and appropriate corporate objectives” and therefore not indicative of scienter.¹⁵³ Complaints that weave a story of the corporation’s desire to keep stock prices high against the backdrop of a corporate acquisition strategy¹⁵⁴ or an upcoming merger¹⁵⁵ have also generally been met with skeptical judicial responses. These courts reason that this type of complaint “is the very type of ‘motive and opportunity’ pleading the PSLRA was meant to eliminate.”¹⁵⁶ As a matter of fact, if the allegations are conclusory and not based on particularized facts, the PSLRA demands their rejection. But not every financial motive a for-profit corporation has is legitimate, and these motive allegations should not be dismissed out-of-hand in a court’s scienter analysis.

It turns out that the reasoning in many of these cases can be traced back to the trio of early Second Circuit cases.¹⁵⁷ A number of post-PSLRA appellate opinions cite or quote *Acito* for the proposition that if scienter can be pleaded merely by alleging that officers and directors possess motive and opportunity to enhance a company’s business prospects, then “virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions.”¹⁵⁸ Of course, this rationale is simple and somewhat persuasive, but only in a

149. See *Acito*, 47 F.3d at 54 (concluding that if motives to enhance a company’s business prospects were indicative of scienter, “virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions”).

150. See *Lipton*, 284 F.3d at 1031.

151. See *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1060 (9th Cir. 2000).

152. See *Lipton*, 284 F.3d at 1038.

153. *Id.*; see also *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1269 (10th Cir. 2001) (holding that common or “shared business motive[s]” such as reducing customer litigation or facilitating a notes offering are insufficient as a matter of law).

154. See, e.g., *In re Daou Sys., Inc., Sec. Litig.*, 411 F.3d 1006, 1012–13, 1024 (9th Cir. 2005); *Keeney v. Larkin*, 102 F. App’x 787, 788–89 (4th Cir. 2004); *Kalnit v. Eichler*, 264 F.3d 131, 140–41 (2d Cir. 2001).

155. See, e.g., *Kane v. Zisapel*, 32 F. App’x 905, 905–06 (9th Cir. 2002); *Phillips v. LCI Int’l, Inc.*, 190 F.3d 609, 622–24 (4th Cir. 1999) (affirming the dismissal of a case in which the plaintiffs’ allegations that a corporate director sought to depress the stock price to assure the success of a merger did not provide the director with adequate personal motive, but failing to discuss the viability of the motive vis-à-vis the corporate-entity defendant).

156. *Kane*, 32 F. App’x at 906 (quoting *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 988 (9th Cir. 1999)).

157. See *supra* notes 41–42 and accompanying text (discussing *Shields*, *Acito*, and *Chill*).

158. *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995).

“Henny Penny”¹⁵⁹ sort of way. Since the passage of the PSLRA, the Second Circuit itself has explained that *Acito*, *Shields*, and *Chill v. General Electric Co.*¹⁶⁰ should not be read to make the task of pleading corporate scienter insurmountable.¹⁶¹ This admonition is critical because pleading and proof of corporate, as opposed to individual, scienter is uniquely elusive,¹⁶² especially in cases where plaintiffs do not have access to “specifically greedy comments from an authorized corporate individual.”¹⁶³

In assessing a corporation’s motive, given that scienter is easier to conceal within a compartmentalized corporate structure, courts must scrutinize motives more carefully and must not resort to the short shrift of the ubiquity mantra. Certainly a more rigorous look at the context of the putative motive for fraud can reveal intentions on the part of a corporation that are strongly suggestive of scienter. In the next few subsections, we apply our contextual model to assess (1) the magnitude of a corporate advantage to be gained, (2) the questionable timing of a misrepresentation so as to aid in achieving a corporate objective, and (3) the atypicality of a benefit to a corporation that would accrue as a result of an alleged fraud.

1. Magnitude

Corporate motives such as earning fees or cultivating clientele have traditionally been seen as insufficient indicators of scienter. The opinions in *In re Suprema Specialties, Inc. Securities Litigation*,¹⁶⁴ *Klein v. Autek Corp.*,¹⁶⁵ and *GSC Partners CDO Fund v. Washington*¹⁶⁶ together reflect the judiciary’s unwillingness to find that an underwriter’s or law firm’s purported motive to earn fees, without more, is sufficient to show scienter.¹⁶⁷ However, when the fees or the benefits to the entity defendant

159. “Henny Penny” (a.k.a. Chicken Licken, Chicken Little, or The Sky is Falling) is a fable of unknown origin about a chicken who concludes that the sky is falling after being hit in the head with a falling acorn. The Sky is Falling, Wikipedia, [http://en.wikipedia.org/wiki/The_Sky_Is_Falling_\(fable\)](http://en.wikipedia.org/wiki/The_Sky_Is_Falling_(fable)) (last visited Feb. 18, 2008). The phrase “the sky is falling” has become part of our modern lexicon, used to indicate a “hysterical or mistaken belief that disaster is imminent.” *Id.*

160. 101 F.3d 263 (2d Cir. 1996).

161. *See, e.g.,* *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999).

162. *See generally* Patricia S. Abril & Ann M. Olazábal, *The Locus of Corporate Scienter*, 2006 COLUM. BUS. L. REV. 81 (discussing various issues associated with ascribing intent to a corporation).

163. *Press*, 166 F.3d at 538.

164. 438 F.3d 256 (3d Cir. 2006).

165. 147 F. App’x 270 (3d Cir. 2005).

166. 368 F.3d 228 (3d Cir. 2004).

167. *See In re Suprema Specialties*, 438 F.3d at 282–83; *Klein*, 147 F. App’x at 277; *GSC Partners*, 368 F.3d at 238. *But see Press*, 166 F.3d at 538 (holding that a bank’s alleged motive to take advantage of the “float” between the maturity date and the date funds are disbursed to a client

are of considerable magnitude, courts should look closely at such motives.

In *Fidel v. Farley*,¹⁶⁸ the Sixth Circuit hinted at this approach.¹⁶⁹ In this § 10(b) case against the accounting firm Ernst & Young, the plaintiffs alleged, among other things, that the significant fees earned by the firm from its client, Fruit of the Loom, provided the motive to defraud.¹⁷⁰ Discussing the insufficiency of the motive allegations to establish scienter, the court stated:

Absent any allegations that Ernst & Young's fees from Fruit of the Loom *were more significant* than its fees from other clients or that Fruit of the Loom represented a significant *portion of Ernst & Young's revenue*, it is difficult to surmise how Ernst & Young's desire to keep Fruit of the Loom as a client would be any different from its desire to keep any client and thus be indicative of fraud.¹⁷¹

If such an approach had been followed in *Albert Fadem Trust v. Citigroup, Inc.*,¹⁷² discussed earlier with respect to the magnitude of an executive's compensation,¹⁷³ surely the court would have been more inclined to recognize defendant Citigroup's strong motive for fraud. There, plaintiffs alleged that billions of dollars in corporate earnings (and, perhaps more importantly, losses avoided) were at stake in Citigroup's dealings with Enron, Dynegy, and WorldCom.¹⁷⁴

2. Timing

Timing, as they say, is everything. Just as auspiciously timed stock sales can put money into the pockets of greedy executives, so too can well-timed misrepresentations about a company's finances reap benefits, or, perhaps more often, forestall imminent negative consequences to corporations.

after expiration of a treasury bill sufficed, albeit "barely," to plead scienter in a case alleging the bank's misrepresentation of the availability of funds at maturity).

168. 392 F.3d 220 (6th Cir. 2004).

169. *See id.* at 233.

170. *Id.* at 223, 228, 232.

171. *Id.* at 233 (emphasis added).

172. 165 F. App'x 928 (2d Cir. 2006).

173. *See supra* notes 117–22 and accompanying text.

174. *See PARTNOY, supra* note 120, at 296–392 (detailing the financial frauds at Enron, Dynegy, and WorldCom, and the billions of dollars that Citigroup had at stake in those companies); *see also* AUGAR, *supra* note 120, at 177–203 (arguing that investment bankers at Citigroup, and other banks, were largely responsible for the epic financial failures at the turn of the millennium and describing Citigroup's Robert Rubin's now infamous "This is probably a bad idea" conversation—about a possible government bailout of Enron—with Peter Fisher of the U.S. Treasury Department).

Though *actual* corporate profitability, both short- and long-term, benefits firms, their employees, and their investors, the *appearance* of profitability has an entirely different effect. By definition, when a company creates an appearance of profitability, the truth is otherwise, and the company has manipulated information (typically accounting figures) to disguise the truth. This behavior is, in fact, fraud. Yet too often this motive to manipulate has also been dismissed as normal, acceptable, profit-seeking conduct. In fact, a number of courts have gone so far as to state that the desire to make a company *seem* more profitable is “universally held among corporations and their executives,” and thus this desire is insufficient to prove scienter as a matter of law.¹⁷⁵

Because the federal securities laws require publicly traded corporations to announce their earnings to investors every three months, by way of financial reports filed with the SEC,¹⁷⁶ it is no surprise that corporations have been known to engage in—and thus plaintiffs have brought securities fraud suits based on—false quarterly reporting. Indeed, a rosy facade bespeaking success is at the heart of many § 10(b) cases alleging that misleading corporate financial reports defrauded investors.¹⁷⁷

No doubt companies legitimately use their quarterly and annual financial reports to display and even highlight their profitability.¹⁷⁸ But creating an illusion of success requires intentional deceit.¹⁷⁹ As the reader is well aware, in the decade immediately following the passage of the PSLRA, the securities markets went through a classic boom and bust.¹⁸⁰

175. Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 664 (8th Cir. 2001) (citing *Novak v. Kasaks*, 216 F.3d 300, 307 (2d Cir. 2000), and *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 814 (2d Cir. 1996)); see also *In re K-tel Int'l, Inc. Sec. Litig.*, 300 F.3d 881, 894 (8th Cir. 2002); *Kalnit v. Eichler*, 264 F.3d 131, 139 (2d Cir. 2001) (“Insufficient motives, we have held, can include (1) the desire for the corporation to appear profitable . . .” (emphasis added) (citing *Novak*, 216 F.3d 307–08)).

176. 17 C.F.R. § 240.13a-13 (2007).

177. See, e.g., *Plotkin v. IP Axxess Inc.*, 407 F.3d 690, 701–02 (5th Cir. 2005); *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 82–83 (1st Cir. 2002). Incredibly, as recently as 1994, the Second Circuit scoffed at the possibility of such a short-term point of view developing into a motive for fraud: “It is hard to see what benefits accrue from a short respite from an inevitable day of reckoning.” *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994).

178. It is well settled that mere puffery does not constitute fraud. See, e.g., *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1427 (3d Cir. 1997) (finding that “a general, non-specific statement of optimism or hope that a trend will continue” was vague and therefore immaterial and non-actionable).

179. In fact, in one Seventh Circuit decision that found scienter allegations against a corporate defendant sufficient, the court noted the following about one questionable business practice: “While there may be legitimate reasons for attempting to achieve sales earlier via channel stuffing, providing excess supply to distributors in order to create a misleading impression in the market of the company’s financial health is not one of them.” *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 598 (7th Cir. 2006), *vacated*, 127 S. Ct. 2499 (2007).

180. Michael Lewis, *In Defense of the Boom*, N.Y. TIMES MAG., Oct. 27, 2002, at 44, 94.

Unlike the bull-run that led to the 1929 Crash¹⁸¹ or even the “Go-Go” days of the 1960s,¹⁸² the gimmick that distinguished the bubble that lasted from the late 1990s to the early years of the new millennium was what one writer has dubbed “the cult of the number.”¹⁸³ The “number” is quarterly earnings per share, a figure that some find far too easy to manipulate.¹⁸⁴ Confirming this cynical conclusion, a study by the General Accounting Office in 2002 reflected that while the number of earnings restatements in all of 1997 was 92, by 2001 the number had swelled to 225, with another 125 restatements in the first half of 2002.¹⁸⁵ Moreover, in that same period, the average size of the companies restating their earnings quadrupled—from companies with a market capitalization of \$500 million to firms ostensibly worth \$2 billion.¹⁸⁶ Clearly securities issuers’ keenness to meet Wall Street’s expectations—and the inevitable tie to quarterly earnings announcements—was palpably strong in that era. Unfortunately, this type of “short-termism” continues to be a serious concern.¹⁸⁷

Lewis labeled the bubble market of the late 1990s “expected” and cynically posited that “[a] boom without crooks is like a dog without fleas. It doesn’t happen.” *Id.*

181. *See* Stock Market Crash of 1929, Britannica Online Encyclopedia, <http://www.britannica.com/eb/article-9069750/stock-market-crash-of-1929> (last visited Feb. 18, 2008).

182. *See* JOHN BROOKS, THE GO-GO YEARS: THE DRAMA AND CRASHING FINALE OF WALL STREET’S BULLISH 60S, at 127–49 (John Wiley & Sons 1999) (1973).

183. ALEX BERENSON, THE NUMBER: HOW THE DRIVE FOR QUARTERLY EARNINGS CORRUPTED WALL STREET AND CORPORATE AMERICA 219–25 (2003) (arguing that a ruthless and relentless drive to display positive corporate earnings in the years 1997 to 2001 corrupted both Wall Street and Corporate America); *see also* John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 315 (2004) (stating that one reason for companies restating financials between 1997 and 2002 was an “attempt[] by management to prematurely recognize income”).

184. BERENSON, *supra* note 183, at xv–xix (arguing that earnings per share is an approximation that is likely based on accrual accounting, making “the number” easy to manipulate). *See generally* ARTHUR LEVITT, TAKE ON THE STREET: WHAT WALL STREET AND CORPORATE AMERICA DON’T WANT YOU TO KNOW (2002) (exposing conflicts of interest and self-dealing practices in Corporate America and on Wall Street, and discussing “the true story behind the numbers”).

185. U.S. GEN. ACCOUNTING OFFICE, FINANCIAL STATEMENT RESTATEMENTS: TRENDS, MARKET IMPACTS, REGULATORY RESPONSES, AND REMAINING CHALLENGES 15 (2002), *available at* <http://www.gao.gov/new.items/d03138.pdf>.

186. *Id.* at 17.

187. A July 2006 report of the Business Roundtable’s Institute for Corporate Ethics and the CFA Institute’s Centre for Financial Market Integrity defines short-termism as “the excessive focus of some corporate leaders, investors, and analysts on short-term, quarterly earnings and a lack of attention to the strategy, fundamentals, and conventional approaches to long-term value creation” and recommends that Corporate America refocus on “long-term value.” DEAN KREHMEYER ET AL., CFA INST., BREAKING THE SHORT-TERM CYCLE 3–4 (2006), *available at* <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2006.n1.4194>; *see also* Harris Collingwood, *The Earnings Game: Everyone Plays, Nobody Wins*, HARV. BUS. REV., June 2001, at 65, 65 (“There’s

Former SEC Chairman Arthur Levitt and others have catalogued some of the popular revenue recognition tricks and aggressive accounting methods that corporations use to “beat the estimate,” including such practices as “channel stuffing,” “big bath” restructuring charges, creative acquisition accounting a.k.a. “merger magic,” “cookie jar reserves,” other less common methods of “earnings management,”¹⁸⁸ and outright fraud.¹⁸⁹ In fact, many of the § 10(b) suits filed in the last ten years have sought retribution for what former Chairman Levitt expressly denominated a “Numbers Game” in his oft-quoted 1998 remarks that were aptly so titled:

Increasingly, I have become concerned that the motivation to meet Wall Street earnings expectations may be overriding common sense business practices. Too many corporate managers, auditors, and analysts are participants in a game of nods and winks. In the zeal to satisfy consensus earnings estimates and project a smooth earnings path, wishful thinking may be winning the day over faithful representation.

As a result, I fear that we are witnessing an erosion in the quality of earnings, and therefore, the quality of financial reporting. Managing may be giving way to manipulation; Integrity may be losing out to illusion.¹⁹⁰

In fact, some of the judicial opinions that consider a corporation’s improper revenue recognition practices or failure to timely make necessary writeoffs or writedowns do find such allegations to be sufficient to meet the scienter pleading requirement. But rather than seeing this conduct as indicative of motive, these opinions tend to conclude that this conduct, if particularly alleged, represents intentionally fraudulent conduct that a priori establishes scienter. For example, in *Novak v. Kasaks*,¹⁹¹ the Second Circuit addressed allegations that the defendants issued financial statements that overstated the corporation’s financial condition by “accounting for inventory that they knew to be obsolete and nearly worthless at inflated values and by deliberately failing to adhere to the

a tyrant terrorizing nearly every public company in the United States—it’s called the quarterly earnings report. It dominates and distorts the decisions of executives, analysts, investors, and auditors. Yet it says almost nothing about a business’s health.”); Joe Nocera, *A Defense of Short-Termism*, N.Y. TIMES, July 29, 2006, at C1 (describing quarterly earnings as an obsession).

188. See Arthur Levitt, Chairman, SEC, Remarks at the NYU Center for Law and Business: The “Numbers Game” (Sept. 28, 1998), available at <http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt>; see also BERENSON, *supra* note 183, at 208–10.

189. For a number of other suspect practices ranging from merely unethical to probably illegal, see Jerry Useem, *New Ethics . . . or No Ethics?*, FORTUNE, Mar. 20, 2000, at 82.

190. Levitt, *supra* note 188.

191. 216 F.3d 300 (2d Cir. 2000).

Company's publicly stated markdown policy."¹⁹² And in the face of internal calls to write off the obsolete inventory, the "[d]efendants' response . . . was that AnnTaylor could not 'afford' to eliminate or write-down the Box & Hold inventory because doing so would 'kill' the Company's reported financial results and/or profit margins and damage the Company on 'Wall Street.'"¹⁹³

In that case, the Second Circuit found that the plaintiff's allegations supported an inference that the defendants had acted with conscious recklessness.¹⁹⁴ The court's finding was no doubt based at least in part on the damning internal admission of nefarious motive. Notably, *Novak* sheds no light on how a court faced with allegations of these types of Generally Accepted Accounting Principles (GAAP) violations should rule absent a compelling quote from management that the company could not afford to disclose the truth for fear of being "killed" by the market.

Isolated, immaterial, or ill-timed GAAP violations obviously do not amount to fraud.¹⁹⁵ But Corporate America's emphasis on "the number" renders this typical securities fraud fact pattern inherently suspect. Accounting irregularities ought to be viewed in their unique timing-related context because this context provides a very powerful motive for a corporation to commit fraud—the obsessive need to meet the expectations and desires of capital-market participants. Unfortunately, in cases involving this fact pattern, another mantra has entered the § 10(b) jurisprudence: "allegations of GAAP violations or accounting irregularities, standing alone, are insufficient to state a securities fraud claim."¹⁹⁶

Rather than rely on this intellectual shortcut for assessing scienter, courts should heighten their scrutiny of allegations of accounting shenanigans that smack of systematic gaming of the quarterly financial-reporting requirements. Courts that require more than this very powerful, time-sensitive corporate motive along with a particularized description of

192. *Id.* at 304.

193. *Id.* (alteration in original) (quoting amended complaint).

194. *Id.* at 312. Other courts have reasoned similarly. *See, e.g.,* Plotkin v. IP Axess, Inc., 407 F.3d 690, 699–700 (5th Cir. 2005); *In re Cabletron Sys., Inc.*, 311 F.3d 11, 39 (1st Cir. 2002).

195. *See, e.g.,* PR Diamonds, Inc. v. Chandler, 364 F.3d 671, 685–86 (6th Cir. 2004) (holding that accounting irregularities were not egregious or pervasive enough to support a finding of scienter).

196. *Novak*, 216 F.3d at 309; *see also* Svezese v. Duratek, 67 F. App'x 169, 173–74 (4th Cir. 2003) (holding that accounting shenanigans without other evidence of fraudulent intent do not support an inference of scienter); *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1261 (10th Cir. 2001) (reciting that GAAP violations alone do not establish scienter). *But cf.* *Barrie v. Intervoice-Brite, Inc.*, 397 F.3d 249, 263–64 (5th Cir. 2005) (finding GAAP violations sufficient when considered together with the bonuses and profits from stock sales enjoyed by the defendants responsible for the accounting irregularities).

material GAAP violations misconstrue the strong inference requirement.¹⁹⁷ While there is not always fire where there is smoke,¹⁹⁸ smoke at the pleading stage entitles plaintiffs to investigate whether there is fire and, if the case eventually survives summary judgment, requires a jury to make the ultimate determination.¹⁹⁹

3. Atypicality

Few courts have considered the atypicality of an alleged motive for a corporation to commit fraud when discussing scienter pleading. In *Rothman v. Gregor*,²⁰⁰ the corporate defendant used its stock to acquire four companies.²⁰¹ By inferring a concrete motive to keep the company's stock price artificially high, the Second Circuit reasoned that "[a]lthough virtually every company may have the desire to maintain a high bond or credit rating, . . . not every company has the desire to use its stock to acquire another company."²⁰² Courts should seek precisely this type of distinction. Explicitly, courts should not be swayed to either the facile proposition that every publicly traded corporation is motivated to make a profit or the conspicuously capitalist extension of this proposition—the more profit, the better.

Two other cases, one from the Ninth Circuit and one from the Sixth, reached the same conclusion as the Second Circuit. Both cases involved allegations that the corporate defendants needed to keep their stock price high for particular, atypical reasons. In *Howard v. Everex Systems, Inc.*,²⁰³ the plaintiffs contended that the reason for the fraud was the company's need to maintain a net worth of \$90 million so as to avoid violating loan covenants and to fund the subsequent year's business plan.²⁰⁴ Faced with this not so run-of-the-mill circumstance, the Ninth Circuit reiterated that

197. See, e.g., *In re Great Atl. & Pac. Tea Co., Sec. Litig.*, 103 F. App'x 465, 469 (3d Cir. 2004) (finding that "A & P's desire to manage its earnings in order to meet analyst and market expectations" was a "general corporate motive" and therefore insufficient to give rise to a strong inference of scienter).

198. *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 85 (1st Cir. 2002) ("Where there is smoke, there is not always fire.")

199. *Cf. Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2511–12, 2512 n.7 (2007) (dismissing the Seventh Circuit's concern that a Rule 12(b)(6) dismissal of a federal securities fraud complaint based on a consideration of competing inferences might improperly usurp the jury's role).

200. 220 F.3d 81 (2d Cir. 2000).

201. *Id.* at 93.

202. *Id. Contra Darby v. Century Bus. Servs., Inc.*, 96 F. App'x 277, 283 (6th Cir. 2004) (concluding that a motive to inflate the company's stock price to make corporate acquisitions with stock more affordable was not enough to indicate scienter).

203. 228 F.3d 1057 (9th Cir. 2000).

204. *Id.* at 1060, 1064.

motive and opportunity alone do not suffice to adequately plead scienter but allowed this atypical motive to bolster other scienter allegations. This combination of allegations permitted the court to draw the necessary strong inference.²⁰⁵ Similarly, *PR Diamonds, Inc. v. Chandler*²⁰⁶ involved a company's somewhat anomalous need to keep its stock price high to maintain its ability to borrow under the terms of a credit agreement.²⁰⁷ The Sixth Circuit recognized this "more particularized sort[] of motive allegation[] [as] more probative of scienter."²⁰⁸ Although the focus of both of these courts in analyzing the motive allegations was on the level of particularity with which the plaintiffs pleaded their facts, assuming the allegations are particularized, these motives stand out as atypical and therefore should shape the courts' scienter determination.

Indeed, the atypicality of a corporation's motive is a critical factor that enables courts assessing motive to separate commonplace and acceptable objectives from improper corporate motives that reflect scienter. Dicta in the Sixth Circuit's opinion in *City of Monroe Employee Retirement System v. Bridgestone Corp.*²⁰⁹ succinctly set out the rationale for using atypicality as an indicator of an improper motive. The complaint in *Bridgestone* alleged that a tire manufacturing company and its parent corporation deliberately withheld data revealing a serious product defect so that, among other possible financial motives, the companies could report huge profits.²¹⁰ Somewhat predictably, the defense countered that such avarice was an "ordinary corporate event" endemic to the corporate world and therefore not indicative of scienter.²¹¹ Sidestepping the motive and opportunity discussion, the court noted that "[e]ven if a regular occurrence, [an avaricious motive] is not an event this court sanctions as being legitimately ordinary."²¹² Aside from its ethical component, this somewhat offhand comment by the Sixth Circuit properly recognizes that some greed-based motives, although seemingly ordinary due to their omnipresence, are extraordinary due to their circumstances. Boiling it down in *Bridgestone*, the companies' need for positive public relations and their engaging in routine conflict management was one thing, but misrepresentations to consumers and the investing public in the face of an

205. *Id.* at 1063–64; *see also In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 977–79 (9th Cir. 1999) (noting that while motive and opportunity alone are insufficient to show scienter at the pleading stage, they may still be considered as circumstantial evidence of scienter).

206. 364 F.3d 671 (6th Cir. 2004).

207. *Id.* at 689–90.

208. *Id.* at 690.

209. 399 F.3d 651 (6th Cir. 2005).

210. *Id.* at 684–85.

211. *Id.* at 685 n.28.

212. *Id.*

inevitable products liability debacle was quite another. At the heart of this distinction is the “atypicality” prong of this Article’s proposed analytical model.

V. CONCLUSION

Undoubtedly, greed motivates. But greed can either be “good” or be “a sin directly against one’s neighbor.”²¹³ And, to date, no standard judicial approach exists for analyzing greed in securities fraud cases. In fact, the only method for pleading avarice that can produce fraud is the seldom understood and oft-maligned motive and opportunity test. Unfortunately, history has witnessed several evolutions of this concept. Careful examination of the available circuit court cases dealing with scienter in the § 10(b) context reveals that the very notion of “motive and opportunity” has been irreparably tarnished. In too many cases, what was once one prong of an established two-part scienter analysis turned into a conclusory “label”²¹⁴ or “magic words”²¹⁵ approach to pleading scienter. And even when courts did not engage in such conclusory reasoning, the disassembled analytical infrastructure of the inquiry and the plausibility of the ubiquity mantra convinced some courts to dismiss allegations of greed without meaningfully delving into the context of the allegations.

There is nothing inherently wrong with a *Shields* approach to capitalist conduct, which maintains that “[i]n looking for a sufficient allegation of motive, we assume that the defendant is acting in his or her informed economic self-interest.”²¹⁶ But despite that premise, courts must make a clear distinction between rational self-interest—whether personal or corporate—and greed that has created the appearance of success where none exists. So natural and abundant are economic incentives that they do not logically or inevitably result in fraud. But neither should the near-universal desire for success (or at least survival) automatically exonerate one who does intend to defraud.

To understand the analytical and philosophical entanglement posed by greed without stumbling on the historical variants of motive and opportunity pleading, a practical contextual model is needed. We have not had to look very far to find this construct because it is one established

213. See *supra* notes 1–2 and accompanying text.

214. See *Helwig v. Vencor, Inc.*, 251 F.3d 540, 550 (6th Cir. 2001) (“In this wash of allegations, ‘motive’ and ‘opportunity’ are simply recurring patterns of evidence. We decide cases on facts, not labels.”).

215. *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2002) (“Although litigants and lower courts need and should not employ or rely on magic words such as ‘motive and opportunity,’ we believe that our prior case law may be helpful in providing guidance as to how the ‘strong inference’ standard may be met.”).

216. *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1130 (2d Cir. 1994).

method of analyzing stock sales for scienter. Greed allegations should be examined through a contextual lens, taking into account the relative magnitude, timing, and atypicality of alleged motives to determine whether these motives are suspicious enough to indicate scienter. Only by thoughtfully sifting the diverse and highly detailed facts of each securities fraud case through this rubric can we come to grips with greed and distinguish the pathological from the normal and the conclusory from the legally sufficient.