

July 7, 1999

NINTH CIRCUIT ENFORCES CURBS ON SECURITIES LAWSUITS *(Brody v. McCracken (In re Silicon Graphics, Inc.))*

The U.S. Court of Appeals for the Ninth Circuit handed the Washington Legal Foundation (“WLF”) a long-awaited victory last week, when it decided that federal securities lawsuits must meet the high pleading standards set by Congress.

In a 2-1 decision, the court determined that the Private Securities Litigation Reform Act of 1995 (PSLRA) was enacted to curb frivolous securities lawsuits in two important ways. First, it requires a person filing a claim of securities fraud to allege that the defendants acted at least with “deliberate or conscious recklessness” raising a “strong inference” that they acted with “fraudulent intent.” This interpretation of PSLRA sets a higher pleading standard than the Second Circuit, which permits complaints to plead only “motive and opportunity or simple recklessness.” Second, PSLRA requires the complaint to state “with particularity all facts on which the belief is formed.” According to the Ninth Circuit, this means that “a plaintiff must provide a list of all relevant circumstances in the greatest detail possible.” Basing a complaint of securities fraud on facts that the plaintiff believes will turn out to be true given information to be gathered during discovery is “not sufficient.”

In a brief filed with the Ninth Circuit, WLF had argued that the lower court properly applied heightened pleading requirements imposed by Congress when it enacted PSLRA over President Clinton’s veto. Congress enacted PSLRA after finding widespread abuse in the filing and prosecution of securities class action lawsuits, which included the filing of boilerplate complaints following any substantial drop in a business’s stock price, and the use of such claims to extort huge settlements and attorney’s fee awards with the threat of costly civil discovery proceedings.

To combat these abuses, Congress enacted a series of procedural reforms, including: heightened requirements for pleading such claims, a requirement that plaintiffs identify all facts in support of allegations made “on information and belief”, a stay of discovery pending the resolution of a defendant’s motion to dismiss a claim, and other provisions relating to attorney’s fees. PSLRA also limited the liability of securities issuers for making forward-looking statements; enacted procedural reforms of class-action suits so that investors, and not their lawyers, would direct the course of litigation; increased the use of sanctions for frivolous claims; and prohibited the use of RICO for securities fraud cases.

WLF’s brief argued that PSLRA applied to this case, even though the lawsuit concerned events which transpired before PSLRA was enacted, because Congress intended to impose PSLRA’s pleading requirements on any case filed after enactment of the legislation. WLF further argued that the lower court correctly interpreted PSLRA as imposing a higher pleading standard than any previously existing for such lawsuits, and that a pleading based on a defendant’s “motive and opportunity” to commit fraud was no longer sufficient. WLF also argued that the plaintiffs were not permitted to withhold from the defendants the facts and sources upon which they based their claims made on information and belief.

WLF was joined in its brief as *amici curiae* by the Allied Educational Foundation, a non-profit charitable organization.

The Washington Legal Foundation is a nonprofit public interest law and policy center with supporters nationwide. It devotes a significant portion of its resources to defending and promoting the principles of free enterprise and individual rights.

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