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NEWSLETTER

Eleventh Circuit Interprets Heightened Pleading Standard under PSLRA

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The United States Court of Appeals for the Eleventh Circuit has articulated its interpretation of the heightened pleading standard in the Private Securities Litigation Reform Act of 1995, 15 U.S.C. §78u-4 et seq. (West Supp. 1999) (the "PSLRA"), rejecting the view that the PSLRA codifies the Second Circuit's "motive and opportunity" test. According to the Eleventh Circuit, a plaintiff must "plead scienter with particular facts that give rise to a strong inference that the defendant acted in a severely reckless manner." *Bryant v. Avado Brands, Inc.,* No. 98-9253, 1999 U.S. App. LEXIS 21051 (11th Cir. Sept. 3, 1999). The court also concluded that, in deciding a motion to dismiss a complaint under the PSLRA, the district court could take judicial notice of materials filed with the U.S. Securities and Exchange Commission ("SEC").

Shareholders of Avado Brands, Inc. (formerly Apple South, Inc.) initiated a class action against the corporation and several of its officers and directors alleging that the defendant directors and officers had provided false and misleading information concerning the company's financial status. Specifically, the plaintiffs alleged that the directors and officers had undertaken a failed expansion effort that undermined the company's earnings per share, but nevertheless continued to indicate that the company was benefiting financially from the expansion effort. This representation allegedly resulted in inflated stock values (of which some defendants assertedly took advantage by trading their shares in the company). According to plaintiffs, when the company ultimately reported accurate earnings per share information, the stock value dropped 40%.

The defendants moved to dismiss the complaint, attaching to the motion, among other documents, materials that the company had filed with the SEC.

The court reversed the district court's determination that it could not take judicial notice of the materials filed with the SEC. Relying on *Kramer v. Time Warner, Inc.,* 937 F.2d 767 (2d Cir. 1991), the Eleventh Circuit opined that allowing the district court to take notice of publicly-filed documents was consistent with the PSLRA's intent to winnow abusive or frivolous securities litigation. The documents were required to be filed with the SEC, so no serious question regarding their authenticity could be raised. Further, the documents were the very materials that were alleged by plaintiffs to contain the false or misleading statements. At the same time, allowing judicial notice of the statements created no unfairness to plaintiffs because they had to be aware of the statements contained in the publicly-filed documents prior to filing suit. Additionally, the documents were being proffered to prove only what they said and not to prove the truth of the matters asserted in them. The

court indicated that its holding was limited to documents required by law to be filed, and actually filed, with the SEC.

The court next offered its interpretation of the PSLRA pleading requirements. It first held that recklessness is sufficient to establish scienter. The court noted that, at the time the PSLRA was passed, every federal circuit court had held that recklessness (or, in the case of the Eleventh Circuit, "severe recklessness") was sufficient to establish the requisite level of scienter. According to the Eleventh Circuit, Congress necessarily was aware of this precedent when it passed the PSLRA. At the same time, the Eleventh Circuit rejected the Ninth Circuit's holding in *In re Silicon Graphics Inc. Securities Litigation*, _____ F.3d ____, 1999 U.S. App. LEXIS 14955 (9th Cir. July 2, 1999), that the PSLRA raised the substantive level of scienter necessary to establish a §10(b) and Rule 10b-5 violation to "a new and uncertain super-recklessness."

The court next addressed whether the PSLRA adopted Second Circuit precedent that allowed a plaintiff to plead scienter by "alleging facts that show . . . a motive and opportunity to commit fraud." The Eleventh Circuit determined that the PSLRA did not adopt the Second Circuit's test because the PSLRA does not mention the "motive and opportunity test" and "certainly does not expressly codify it." Further, the court noted that "motive" and "opportunity" do not themselves amount to a state of mind, much less the "required state of mind." Thus, while allegations of motive and opportunity may be relevant to establish a severely reckless state of mind, "such allegations, without more, are not sufficient. . . ." The opinion concludes that "a plaintiff must plead with particularity facts which give rise to a strong inference that the defendant acted in a severely reckless fashion – 'the required state of mind' in [the Eleventh Circuit] for many years."

One member of the panel (Senior District Judge Julian Abele Cook, Jr., sitting by designation) dissented, in part, on grounds that the court need not "reach the question of whether motive and recklessness satisfies [sic] the scienter factor since I believe our recklessness holding is sufficient to dispose of this appeal."