SPEECH WITHOUT SPEAKERS: ELIMINATING ARTIFICIAL BARRIERS TO PLEADING CORPORATE SCIENTER IN SECURITIES FRAUD CLAIMS

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ABSTRACT

To successfully plead securities fraud claims under Rule 10b–5, the Private Securities Litigation Reform Act ("PSLRA") requires that plaintiff-investors raise a "strong inference" that the defendant acted with scienter when issuing a false statement. But pleading scienter presents a challenging issue when the defendant is not a person, but an entity. When the defendant is a corporation, U.S. Circuit Courts of Appeals have adopted different approaches for determining whether the plaintiff has pleaded a strong inference of scienter. Some circuits hold that plaintiffs can raise a strong inference of corporate scienter only if the complaint identifies a speaker who knew her statement was false. Other circuits hold that, in certain instances, plaintiffs can successfully plead corporate scienter without identifying an individual who acted with scienter. In these cases, a plaintiff raises a strong inference of corporate scienter by identifying a dramatically false statement about the company's core operations. When a corporation issues a statement about a core operation that is so dramatically false, it is reasonable to infer that the corporate officials who made such statements knew they were false.

This Note argues that this latter approach, although a correct application of the PSLRA, is unnecessarily limited to dramatically false statements about a company's core operations. Instead, courts should analyze whether a dramatically false statement raises a strong inference

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of corporate scienter on a case-by-case basis. The reasoning underlying this approach, that corporate officials likely know the truth when they issue dramatically false statements concerning core products, applies with equal force when the statement concerns any subject that substantially impacts the company's financial condition and future prospects. Expanding this approach will properly allow plaintiffs to raise a strong inference of scienter against companies that issue dramatically false statements touting the growth and success of their emerging products, even though such products are not yet "core" to the company's operations.

INTRODUCTION

Consider the following hypothetical. A publicly traded pharmaceutical manufacturer develops a revolutionary new drug to treat brain cancer. The company's U.S. Securities and Exchange Commission ("SEC") filings, signed by the CEO, CFO, and board of directors, announce that the company has developed "the first-ever drug treatment for brain cancer" and make several material statements about the drug's positive results in clinic trials. For instance, "Our new drug is 100% safe and effective. The subjects in our clinic trials are in remission and have faced no adverse side effects. The FDA has indicated that the drug will be approved." All of the company's existing revenues derive from other drugs. Naturally, the company's stock price skyrockets in response to the statements.

However, months before the announcements, scientists employed in a foreign country by one of the corporation's subsidiaries discovered in a clinical trial that the new drug that promises to treat cancer has a terrible side effect that would prevent FDA approval. After the positive announcements in the SEC filings, the FDA denied approval because of the drug's side effects. Once the company reveals the FDA news to investors, the stock price plummets. In a TV interview, the CEO and CFO state that the company was unaware of any harmful side effects and believed that the drug would be approved.

Injured investors whose shares lost value sue the parent company for fraud because the misstatements artificially inflated prices for the drug company's shares. However, they cannot identify any specific high-level agent of the parent who knew about the subsidiary's clinical findings detailing the side effects, even though one of the foreign scientists claims he reported his findings to his superiors. After the company moves to dismiss the claim, the investors can only argue that because the misstatements are dramatically false, it is reasonable to infer that some high-level executive must have known about the treatment's side effects

when the company made its misrepresentations in the SEC filings, given how crucial the new product launch was to the company. The investors' claim necessarily fails because the new treatment had not yet become so important to the company's existing revenues for a court to infer that the makers of the announcement must have known about the adverse side effects.

To prevail on securities fraud claims under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5, the plaintiff must prove that the defendant intended to defraud investors by making a material misstatement.[1] The Private Securities Litigation Reform Act ("PSLRA") enhanced the standard for pleading such claims.[2] Specifically, to defeat a motion to dismiss, the plaintiff's complaint must raise a strong inference of fraudulent intent.[3] When the defendant is a corporation, the deceptive intent of an agent responsible for the misstatement is imputed to the company.[4] But what happens when the plaintiff cannot identify any high-level executive who knew the truth prior to discovery? On this issue, courts are divided. Some courts hold that the plaintiff fails to raise a strong inference of scienter when the plaintiff cannot identify a particular corporate agent who knew the statement was false.[5] This Note refers to this standard as the Speaker Approach. Other courts hold that the plaintiff can raise a strong inference of scienter without identifying an individual who acted with scienter. In these cases, a plaintiff can raise a strong inference of corporate scienter by identifying a dramatically false statement about the company's core operations.[6] This Note refers to this standard as the Speech Approach.

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1. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341 (2005); *see generally* Securities Exchange Act of 1934, Pub. L. No. 73-291, §10(b), 48 Stat. 881, 891 (codified at 15 U.S.C. § 78j(b)); Rules and Regulations Under Securities Exchange Act of 1934, 17 C.F.R. 240.10b-5(b) (1948).

2. *See* H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.).

3. *See* 15 U.S.C. § 78u-4(b)(2)(A).

4. *See, e.g.*, Makor Issues & Rts., Ltd. v. Tellabs, Inc., 513 F.3d 702, 708 (7th Cir. 2008) (*Tellabs II*), ("A corporation is liable for statements by employees who have apparent authority to make them."); *see also* RESTATEMENT (SECOND) OF AGENCY § 272 (AM. L. INST. 1958).

5. *See* Southland Sec. Corp. v. INSpire Ins. Sols., Inc., 365 F.3d 353, 366 (5th Cir. 2004); Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1254 (11th Cir. 2008); *In re* Omnicare, Inc. Sec. Litig., 769 F.3d 455, 476 (6th Cir. 2014).

6. *See Tellabs II*, 513 F.3d at 710; Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap., Inc., 531 F.3d 190, 195–96 (2d Cir. 2008); *In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1063 (9th Cir. 2014).

This Note argues: first, the Speaker Approach is not the sole method by which a plaintiff can raise a strong inference of corporate scienter; and second, the Speech approach should not be limited to dramatic misstatements about *core operations*. Rather, courts should sustain claims against companies like the hypothetical pharmaceutical manufacturer. Although the plaintiff could not identify a corporate agent with fraudulent intent, and the brain cancer treatment did not constitute a core product, the manufacturer's dramatically false statements about matters which substantially impact the company's value—specifically its future prospects—raise a strong inference of corporate scienter because the high-level agents who approved those statements likely knew they were false.

Part I summarizes the history of securities antifraud legislation, the scienter requirement in Section 10(b) claims, and the PSLRA's heightened standard for pleading corporate scienter. Part II explains the ongoing circuit split in approaches to pleading corporate scienter under the PSLRA, as well as the advantages and disadvantages of each approach. Part III argues that the Speech Approach employed by the Second, Seventh, and Ninth Circuits is most consistent with the text, history, and purpose of the PSLRA. Finally, this Note proposes that the rationale underlying the Speech Approach, that corporate officials likely know the truth when they issue dramatically false statements about core operations, applies with equal force when a dramatically false statement concerns any subject that substantially impacts the company's financial condition, including its future prospects.

I. BACKGROUND

A. HISTORY AND PURPOSE OF THE SECURITIES REGULATORY FRAMEWORK

Securities are the tools by which Americans invest their savings to build retirement income, buy a home, provide education for their children, and attain a better quality of life.[7] Laws regulating the sale of securities greatly impact not only corporations, but also millions of Americans whose money is invested in the stock market, including employees with a pension or 401(k) plan.[8] Securities differ from tangible property because

7. *See* THOMAS LEE HAZEN, SECURITIES REGULATION: CASES AND MATERIALS 1 (Jesse H. Choper et al. eds., 10th ed. 2020).

8. *See id.*

they represent ownership rights in a company.[9] To determine the value of a security, investors must have an informed idea of what the company's value is.[10] In other words, the value of a stock depends on the "profitability or future prospects of the corporation which issued it."[11] And its corresponding market price "depends on how much people are willing to pay for it based on their evaluation of those prospects."[12]

Federal regulation of securities arose in the aftermath of the 1929 stock market crash and the Great Depression.[13] At the time, market prices were heavily influenced by the actions of manipulators, speculators, and insider traders.[14] Brokers and dealers promised easy wealth without any attempt to inform investors about the companies in which they were investing.[15] Unwitting investors fell prey to manipulators who artificially inflated stock prices and then sold their own shares for a higher price.[16] These abusive practices caused many investors to lose their life savings by purchasing what became worthless securities.[17]

Congress enacted federal securities laws to protect investors by requiring publicly traded companies to fully and honestly disclose material information about financial performance.[18] To promote transparency, Section 13 of the Exchange Act compels publicly traded companies to issue periodic reports with extensive information.[19] Annual reports must disclose: (i) audited financial statements, including the company's revenues, expenses, assets, liabilities, and cash flows; (ii) risk factors; and (iii) management's discussion and analysis of financial condition and results of operations, including descriptions of matters that are reasonably likely to have a material impact on future prospects.[20]

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9. *See id.*
10. *See id.* at 2.
11. *Id.* at 1.
12. *Id.*
13. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 (1976).
14. *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 5–8 (Rachel E. Barkow et al. eds., 10th ed. 2022).
15. *See id.* at 5 (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933)).
16. *See id.* at 8.
17. *See id.* at 5 (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933)).
18. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 1.16 (8th ed. 2021) ("The focus on disclosure was based on the conclusion that sunlight is the best disinfectant.").
19. *See* 15 U.S.C. § 78m(a).
20. *See* 17 C.F.R. §§ 240.13a-1, 210.3-01(a), 210.5-02, 210.03-02(a), 210.5-03, 229.105, 229.303(a).

To prevent manipulation and ensure that exchanges reflect accurate prices, the Exchange Act also granted the SEC rulemaking authority to design a securities fraud regulatory framework under Section 10(b).[21] Pursuant to this authority, the SEC promulgated Rule 10b–5, which prohibits individuals and companies from making "any untrue statement of material fact or [omitting] . . . a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[22] A statement can be misleading by omitting material adverse facts—*i.e.*, stating the positive, but leaving out the negative—thereby creating a false impression.[23]

1. Rule 10b–5 and the Scienter Requirement

Although the Exchange Act did not expressly create a private right of action, the Supreme Court has held, based on the statute's text and purpose, that Congress intended to create one under Section 10(b).[24] Private actions to enforce federal securities laws are essential supplements to SEC prosecutions not only to compensate victims, but also to maintain public confidence in the securities market and deter fraud.[25]

To prevail on a private claim under Rule 10b–5, a plaintiff must prove: (1) the defendant made a materially false or misleading statement (2) with scienter (3) in connection with the purchase or sale of a security, (4) the plaintiff relied on the misrepresentation and (5) suffered economic loss, and (6) the loss was caused by the misrepresentation.[26] Scienter is an

21. *See* 15 U.S.C. § 78j(b); *see also* Emily Erickson, Note, *Optimizing Fraud Deterrence by Locating Corporate Scienter in Corporate Design*, 124 COLUM. L. REV. (forthcoming Jan. 2024) (manuscript at 4–5) (on file with author).

22. 17 C.F.R. § 240.10b-5(b) (2019).

23. *See id.*; Macquarie Infrastructure Corp. v. Moab Partners, L.P., 601 U.S. ____, No. 22–1165, slip op. at 5 (Apr. 12, 2024) ("Rule 10b–5(b) does not proscribe pure omissions."); *In re* Vivendi, S.A. Sec. Litig., 838 F.3d 223, 239–40 (2d Cir. 2016); RESTATEMENT (SECOND) OF TORTS § 529, cmt. a (1977).

24. *See* Superintendent of Ins. of the State of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976).

25. *See* Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 313 (2007) (*Tellabs I*); Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345 (2005) ("The securities statutes seek to maintain public confidence in the marketplace.").

26. *See Dura Pharms., Inc.*, 544 U.S. at 341–42.

intent to deceive, manipulate, or defraud.[27] A defendant acts with scienter when he knows his statement is false or misleading, or when he recklessly disregards a substantial risk that it was false or misleading.[28] A substantial risk of falsity exists when the falsity is "so obvious" that the defendant must have been aware of it.[29]

2. Pleading Scienter: The PSLRA and Tellabs I

Before the PSLRA, some plaintiffs targeted deep-pocketed defendants with "strike suits"—lawsuits based on dubious claims filed to induce early settlement.[30] In 1995, Congress passed the PSLRA to inhibit these abusive private securities fraud lawsuits while preserving good faith claims.[31] To achieve this goal, the PSLRA imposes heightened pleading requirements for actions arising under Section 10(b).[32] Specifically, the PSLRA requires that a securities fraud complaint "specify each statement alleged to have been misleading [and] the reason[s] why the statement is misleading."[33]

The PSLRA also heightens the Section 10(b) scienter requirement.[34] Although a plaintiff may allege the required mental state generally in other civil fraud claims,[35] under the PSLRA, a securities fraud plaintiff must "state with particularity facts giving rise to a *strong inference* that

27. *See Ernst & Ernst*, 425 U.S. at 193. The Court concluded that Congress' use of "manipulative or deceptive" strongly suggests that Section 10(b) was intended to prohibit knowing or intentional misconduct, not mere negligence. *See id.* at 197–201.

28. *See* Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 704 (7th Cir. 2008) (*Tellabs II*). Although the Supreme Court has never determined that scienter includes reckless behavior, it has recognized that "every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted . . . recklessly." *See Tellabs I*, 551 U.S. at 319 n.3.

29. *See Tellabs II*, 513 F.3d at 704.

30. *See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.); *Tellabs I*, 551 U.S. at 320.

31. *See* H.R. Rep. No. 104-369, at 31; Newby v. Enron Corp., 338 F.3d 467, 471 (5th Cir. 2003).

32. *See* H.R. Rep. No. 104-369, at 41; *Tellabs I*, 551 U.S. at 321. The PSLRA installed other controls to screen out frivolous suits as well: new procedures encouraging institutional investors to serve as lead plaintiffs, limits on damages and attorneys' fees, a safe harbor for forward-looking statements, and sanctions for frivolous litigation. *See Tellabs I*, 551 U.S. at 321.

33. 15 U.S.C. § 78u-4(b)(1).

34. *Id.* § 78u-4(b)(2)(A).

35. *See* Fed. R. Civ. P. 9(b); *Tellabs I*, 551 U.S. at 319.

the defendant acted with the required state of mind."[36] Because a complaint must establish a strong inference of scienter before a plaintiff has the opportunity for discovery, satisfying PSLRA's pleading requirements is no easy task.[37]

Although the PSLRA does not define what constitutes a "strong inference,"[38] in *Tellabs, Inc. v. Makor Issues & Rights,* ("*Tellabs I*"), the Supreme Court outlined a three-step process to determine whether a complaint raises a strong inference of scienter.[39] First, as with any motion to dismiss, courts must accept all factual allegations in the complaint as true.[40] Second, courts "must consider the complaint in its entirety" to determine "whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter."[41] The inquiry is "not whether any individual allegation, scrutinized in isolation, meets that standard."[42] Rather, "courts [must] evaluate scienter allegations holistically."[43] Allegations lacking specific details, such as precise dates, can be paired with other allegations to collectively form a strong inference of scienter.[44]

Third, courts must weigh competing inferences to determine whether the inference of scienter is at least as likely as any plausible non-culpable opposing inference.[45] Allegations supporting an inference of scienter include benefitting personally from issuing a false statement, ignoring obvious red flags indicating that public statements are false, or having access to specific information contradicting public statements, such as internal memoranda.[46] Non-culpable explanations for the defendant's misconduct include a careless mistake, mismanagement based on false information fed from low-level employees, or a disagreement about scientific data.[47] The inference that the defendant acted with scienter

36. 15 U.S.C. § 78u-4(b)(2)(A) (emphasis added).

37. *See id.* at § 78u-4(b)(3)(B)*; see also* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (recognizing the difficulty in pleading scienter without evidence of "specific[] greedy comments from an authorized corporate individual").

38. *See generally id.* § 78u-4(b)(2).

39. *See Tellabs I*, 551 U.S. at 322–24.

40. *See id.* at 322.

41. *Id.* at 322–23.

42. *See id.*

43. Alaska Elec. Pension Fund v. Asar, 768 F. App'x 175, 180 (5th Cir. 2019).

44. *See Tellabs I*, 551 U.S. at 325–26.

45. *See id.* at 323.

46. *See* Novak v. Kasas, 216 F.3d 300, 311 (2d Cir. 2000).

47. *See* Makor Issues & Rts., Ltd. V. Tellabs Inc., 513 F.3d 702, 707 (7th Cir. 2008) ("Suppose a clerical worker in the company's finance department accidentally overstated the company's earnings and the erroneous figure got reported in good faith up the line to

"need not be irrefutable, . . . or even the most plausible of competing inferences."[48] But it must be "more than merely reasonable or permissible—it must be cogent" and "at least as compelling as any opposing inference" of non-fraudulent intent.[49] Thus, if an inference of scienter is as likely as an inference of non-fraudulent intent, "a tie goes to the [p]laintiff."[50]

3. What Is Corporate Scienter

Scienter presents a challenging issue when a defendant is a corporation—an entity comprised of scores of individuals, each with their own mind.[51] Historically, in civil actions arising under federal statutes, courts have used the common law agency principle of respondeat superior to hold corporations liable for wrongful acts committed by their employees or agents within the scope of their authority.[52] Respondeat superior, however, requires that the imputed misconduct and intent reside within the same human being.[53] Under this standard, a corporation acts with scienter only when an authorized corporate agent, such as an executive officer, knowingly or intentionally makes a false or misleading statement.[54]

. . . senior management, who then included the figure in their public announcements. Even if senior management had been careless in failing to detect the error, there would be no corporate scienter."); Schueneman v. Arena Pharms., 840 F.3d 698, 709 (9th Cir. 2016) (discounting the non-culpable inference that a pharmaceutical company merely disagreed with the FDA's interpretation of a drug's safety profile).

48. *See Tellabs I*, 551 U.S. at 324 (internal quotation marks omitted).

49. *Id.* (internal quotation marks omitted).

50. Commc'ns Workers of Am. Plan for Emps. Pensions & Death Benefits v. CSK Auto Corp., 525 F. Supp. 2d 1116, 1120 (D. Ariz. 2007).

51. *See, e.g.*, *In re* Marsh & McClennan Cos., Inc. Sec. Litig., 501 F. Supp. 2d 452, 481 (S.D.N.Y. 2006).

52. *See, e.g.*, Institutional Inv. Grp. v. Avaya, Inc., 564 F.3d 242, 251–52 (3d Cir. 2009); Am. Soc'y of Mech. Eng'rs. Inc. v. Hydrolevel Corp., 456 U.S. 556, 567–68 (1982); United States *ex rel.* Bias v. Tangipahoa Parish Sch. Bd., 816 F.3d 315, 326–27 (5th Cir. 2016). *See generally* RESTATEMENT (SECOND) OF AGENCY § 219(1) (AM. L. INST. 1958).

53. *See* Ann M. Lipton, *Slouching Towards Monell: The Disappearance of Vicarious Liability Under Section 10(b)*, 92 WASH. U. L. REV. 1261, 1271 n.35 (2015) (collecting cases).

54. *See* Southland Sec. Corp. v. INSpire Ins. Sols., Inc., 365 F.3d 353, 366 (5th Cir. 2004). Often, this agent will also be named as an individual defendant. *See, e.g.*, *id.* at 385.

The simplest way to plead corporate scienter is by imputing the scienter of an individual agent who commits the wrongful act.[55] However, when the defendant is a vast, multinational company, where employee knowledge is scattered piecemeal among many different people, identifying a single agent who helped make a misleading statement and knew that it was misleading, prior to discovery, could be nearly impossible.[56] Moreover, even if the plaintiff can identify an agent who knew the truth of the matter, a second problem arises if a different agent made the relevant misstatement.[57] In these cases, the critical question is whether identifying a corporate agent who knowingly lied is the sole method of satisfying the PSLRA or whether the plaintiff can raise a strong inference of corporate scienter without identifying *any* individual who possessed scienter.[58]

On this question, the U.S. Circuit Courts of Appeals have come to different conclusions based on opposing applications of the standard articulated by the Supreme Court in *Tellabs I*. Some courts have held that to raise a strong inference of scienter–one that is at least as likely as any opposing inference of non-fraudulent intent—against a corporate defendant, the plaintiff must identify a "speaker" who knew that the statement was false.[59] Other courts, however, have held that if a plaintiff cannot identify a speaker, a plaintiff may raise a strong inference of scienter by identifying a misstatement that is "so dramatic" in its falsity

55. *See* Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap Inc., 531 F.3d 190, 195 (2d Cir. 2008) (noting that in most cases, the most straightforward way to raise a strong inference that a corporate defendant possessed scienter is to plead that an individual whose intent could be imputed to the corporation acted with the requisite scienter).

56. *See* Patricia S. Abril & Ann Morales Olazábal, *The Locus of Corporate Scienter*, 2006 COLUM. BUS. L. REV. 81, 107 (Jan. 1, 2006).

57. *See id.* at 131–32.

58. *See In re* Omnicare, Inc. Sec. Litig., 769 F.3d 455, 473 (6th Cir. 2014) ("For liability to attach to the corporation, must the person misrepresenting a material fact in the name of the corporation have also done so with scienter, or is it enough that some person in the corporate structure had the requisite state of mind? . . . Our sister circuits have answered these questions differently [and] scholars disagree . . . .").

59. *See, e.g.*, *Southland Sec. Corp.*, 365 F.3d at 366; *In re Omnicare*, 769 F.3d at 476; Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1254 (11th Cir. 2008) ("[When] the allegations . . . relate to allegedly fraudulent public statements, we look to the state of mind of the individual corporate official or officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like)." (internal quotation marks omitted) (quoting *Southland Sec. Corp*., 365 F.3d at 366)).

that the officials who made or approved the statement must have known it was false.[60]

Because a plaintiff must ascribe scienter to the corporate defendant to maintain an action, and *Tellabs I* requires courts to weigh competing inferences,[61] "federal courts have been mired in threshold litigation about the . . . sufficiency of scienter allegations."[62] Since courts must engage in a detailed, fact-specific evidentiary weighing process at the initial pleading stage, it is not surprising that the Circuits have split on the proper approach to alleging a strong inference of corporate scienter.[63]

II. PLEADING A STRONG INFERENCE OF CORPORATE SCIENTER

Courts have adopted one of two standards for pleading corporate scienter. On one hand, the Fifth, Sixth, and Eleventh Circuits hold that a plaintiff can raise a strong inference of corporate scienter only if the complaint identifies a "*speaker*."[64] This Note refers to the approach adopted in these circuits as the "Speaker Approach." On the other hand, the Second, Seventh, and Ninth Circuits hold that, in certain circumstances, plaintiffs can successfully plead corporate scienter without identifying an individual who knew the challenged statement was false.[65] In these cases, the plaintiff raises a strong inference of corporate scienter by identifying a statement about the company's core operations that is so dramatically false that the corporate officials who approved the

60. *See, e.g.*, *Teamsters Loc. 445*, 531 F.3d at 196; Makor Issues & Rts., Ltd. v. Tellabs, Inc., 513 F.3d 702, 710 (7th Cir. 2008); *In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1063 (9th Cir. 2014).

61. *See* Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 323–24 (2007).

62. *See* Michael J. Kaufman & John M. Wunderlich, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 Ohio St. L.J. 507, 509 (2012).

63. *Id.* at 509–10.

64. *Compare Southland Sec. Corp.*, 365 F.3d at 366, *and Mizzaro*, 544 F.3d at 1254 (reasoning that corporate scienter may be imputed only from the state of mind of individuals who make, issue, order, or approve the statement or who furnish information or language for inclusion therein), *with In re Omnicare*, 769 F.3d at 476 (corporate scienter may be imputed from the state of mind of individuals who make, issue, or approve statements, as well as any high managerial agent or director who ratifies, recklessly disregards, or tolerates the misrepresentation after its issuance).

65. *See Teamsters Loc. 445*, 531 F.3d at 196; *Tellabs II*, 513 F.3d at 710; *In re NVIDIA*, 768 F.3d at 1063.

statement must have known that it was false.[66] This Note refers to the approach adopted in these circuits as "the Speech Approach."

A. THE SPEAKER APPROACH

The Fifth, Sixth, and Eleventh Circuits agree that to plead a strong inference of corporate scienter, plaintiffs must identify a speaker responsible for the misrepresentation who knew that it was false.[67] However, these circuits disagree about who constitutes a "*speaker*."[68]

1. Fifth and Eleventh Circuits' Strict Respondeat Superior Rule

The Fifth and Eleventh Circuits apply the most circumscribed definition of a speaker. In *Southland Securities Corp. v. INSpire Insurance Solutions*, the plaintiffs alleged that INSpire Insurance Solutions committed securities fraud by dramatically overstating the earnings estimates of new contracts for the company's proprietary software.[69] Despite the software's inability to process the volume and complexity of large company networks—a feature necessary to perform the new contracts—INSpire's CEO touted that the contracts would generate more than $30 million in revenue during their first year.[70] Only a few days after he made these announcements, the CEO sold thousands of INSpire shares for profits exceeding $2 million.[71]

The court reasoned that the definition of a speaker should be narrowly drawn to include only those employees who make, issue, order, approve, or furnish information for a misstatement.[72] Because corporate liability is premised on the doctrine of respondeat superior, a corporation cannot be liable in tort for one agent's knowledge and another agent's acts.[73] For a principal to be vicariously liable for the acts of its agents, the agent with apparent authority, the one responsible for the misstatement,

66. *See* cases cited *supra* note 65.

67. *See Southland Sec. Corp.*, 365 F.3d at 366; *In re Omnicare*, 769 F.3d at 476; *Mizzaro*, 544 F.3d at 1254.

68. *See* cases cited *supra* note 64.

69. *Southland Sec. Corp.*, 365 F.3d at 370.

70. *Id.* at 375–76.

71. *Id.* at 379.

72. *Id.* at 366–67.

73. *Id.*

must have scienter.[74] In this case, the court held that the CEO's position, involvement in negotiating the contracts, and insider sales raised a strong inference that he knew the statements touting the company's financial projections were false.[75] Because the CEO was acting on behalf of INSpire when he made the statements, his tortious conduct and knowledge could be imputed to INSpire.[76]

2. The Sixth Circuit's Broader Conception of the Speaker Approach

Although a plaintiff still must identify a speaker with scienter, the Sixth Circuit defines a speaker more expansively than the Fifth and Eleventh Circuits. In *In re Omnicare, Inc. Securities Litigation*, the Sixth Circuit set forth three categories of individuals, whose state of mind can be imputed to the corporation: (1) the individual agent who uttered or issued the misrepresentation; (2) any individual agent who authorized, requested, commanded, furnished information for, prepared, suggested or contributed language for, reviewed, or approved the statement containing the misrepresentation; or (3) any high managerial agent or director who ratified, recklessly disregarded, or tolerated the misrepresentation after its issuance.[77] Notably, the third category diverges from the strict respondeat superior rule adopted by the Fifth and Eleventh Circuits. In those Circuits, corporate scienter can only be imputed from individuals involved in making or disseminating the misstatement.[78] In the Sixth Circuit, however, a high-level managerial agent's failure to correct a statement made by others that he knows is false can support a strong inference of corporate scienter.[79]

For instance, in *In re Omnicare*, Vice President of Internal Audit John Stone conducted an audit of the company's Medicare and Medicaid claims for ancillary services in 2007.[80] The audits revealed "pervasive fraud" in which all eighteen Omnicare facilities submitted false

74. *Id.*; *see also* RESTATEMENT (SECOND) OF AGENCY § 275 cmt. b (AM. L. INST. 1958).

75. *Southland Sec. Corp.*, 365 F.3d at 380.

76. *Id.* The Eleventh Circuit adopted the same standard in Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1254 (11th Cir. 2008).

77. *In re* Omnicare, Inc. Sec. Litig., 769 F.3d 455, 476 (6th Cir. 2014).

78. *See Southland Sec. Corp.*, 365 F.3d at 366; *Mizzaro* 544 F.3d at 1254.

79. *In re Omnicare*, 769 F.3d at 476–77.

80. *Id.* at 462.

reimbursement claims.[81] Two additional audits confirmed that the examined facilities submitted numerous improper claims and overbilled Medicaid patients.[82] Stone reported his findings to the Internal Audit and Corporate Compliance Committees.[83] Despite these audits, Omnicare's SEC filings from 2007 to 2010 routinely stated that "[Omnicare] believe[s] that [its] billing practices materially comply with applicable state and federal requirements."[84] Stone may have furnished information for and reviewed the statement.[85] Additionally, the court found that Stone was "potentially" a high managerial agent who tolerated the misrepresentation despite knowing it was false, and therefore his knowledge could be imputed to Omnicare.[86] However, the court ultimately held that non-culpable inferences were stronger than the inference of scienter asserted by the plaintiffs.[87]

3. Critique of the Speaker Approach

The Speaker Approach is effective in diminishing the costs of frivolous lawsuits by sustaining only those 10b–5 claims in which a plaintiff can pinpoint a single bad actor who fraudulently deceived the investing public while acting on the corporation's behalf.[88] However, the Speaker Approach is both under-inclusive and over-inclusive in holding

81. *Id.*
82. *Id.* at 462–63.
83. *Id.*
84. *Id.* at 464.
85. *Id.* at 483.
86. *Id.*
87. *Id.* at 484. The Sixth Circuit uses the *Helwig* factors to weigh the plaintiff's inference of scienter against non-culpable inferences. *See* Helwig v. Vencor, Inc., 251 F.3d 540, 552 (6th Cir. 2001). These factors include: (1) insider trading at a suspicious time or in an unusual amount; (2) divergence between internal reports and external statements on the same subject; (3) closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information; (4) evidence of bribery by a top company official; (5) existence of an ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit; (6) disregard of the most current factual information before making statements; (7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication; (8) the personal interest of certain directors in not informing disinterested directors of an impending sale of stock; and (9) the self-interested motivation of defendants in the form of saving their salaries or jobs. *See In re Omnicare*, 769 F.3d. at 473 (quoting *Helwig*, 251 F.3d at 552).
88. *See* Erickson, *supra* note 21, at 31–32.

corporations liable for securities fraud.[89] Although the Sixth Circuit's broader conception of the Speaker Approach is a stronger deterrent of corporate misconduct than the strict respondeat superior rule, neither standard sufficiently protects investors against the very harms that the Exchange Act and the PSLRA were designed to combat.[90]

The Speaker Approach is under-inclusive because it allows corporations to evade claims by creating procedures which discourage employees from reporting adverse information to officers who are responsible for disseminating information to investors.[91] Since respondeat superior requires that a single corporate agent make a false statement with scienter, corporations can evade liability by making statements only through representatives who can be shielded from adverse information about the company's business and thus could never harbor scienter.[92]

Furthermore, because *Tellabs I* requires courts to weigh the inference of scienter against non-culpable inferences, in a Speaker Approach jurisdiction, not only must a plaintiff identify a single individual who made, approved, or failed to correct a misstatement with fraudulent intent,[93] but such an assertion must be as likely as the defendant's innocent explanations.[94] This step of the "strong inference" inquiry requires the plaintiff to defeat a motion to dismiss with limited internal information. While the defendant can raise any number of innocent explanations, the plaintiff is limited to inferences in which one agent made the misstatement and knew the truth.[95] The plaintiff cannot point to the magnitude of the fraud concealed by the misstatement to demonstrate that the officials likely knew that the statement was false, no matter how logical such an inference may be.[96] This was the result in *Omnicare*. Although Stone performed an audit that revealed pervasive fraud by eighteen different Omnicare facilities and reported those results to high-

89. *Id.* at 31.

90. *Cf.* Abril & Olazabal, *supra* note 56, at 113–14.

91. *See id.* at 113–14, 146–50.

92. *Cf.* Southland Sec. Corp. v. INSpire Ins. Sols., Inc., 365 F.3d 353, 366 (5th Cir. 2004).

93. *Id.*

94. *See* Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 323–24 (2007).

95. *See, e.g.*, *In re* Omnicare, Inc. Sec. Litig., 769 F.3d 455, 484 (2014).

96. *See Southland Sec. Corp.*, 365 F.3d at 366 (holding that the plaintiff must look to the state of mind of the individual corporate officials who make, issue, order, approve, or furnish information for statements).

ranking officers, the court found that the inference of scienter was not strong enough.[97]

The Speaker Approach can be over-inclusive when it allows claims to proceed against a corporation based on the knowledge of a lower-level employee who furnishes information for the misstatement, even though corporate officers made the misstatements in good faith.[98] Suppose a mid-level manager of a subsidiary in a foreign country intentionally falsified sales records that contribute to the parent company's earnings reports. If the false sales records materially affect the parent's revenues and the stock price declines once the truth is revealed, then the lower-level employee will constitute a speaker of the misstatement because he furnished false information for the earnings report with scienter. Under the Speaker Approach, his scienter will be imputed to the corporation, even though the executives who made the misstatements did so in good faith.[99]

Finally, the Speaker Approach inhibits potentially meritorious claims by placing the onerous burden on plaintiffs to identify an individual with a guilty mind before the opportunity for discovery.[100] Especially when the defendant is a vast, multinational corporation, this rule will often pose an insurmountable bar to an otherwise valid claim.[101] This result is not mandated by the PSLRA's heightened pleading standard, which requires only that the plaintiff raise a strong inference of the defendant's scienter; it does not limit the ways in which a plaintiff can do so.[102]

97. *In re Omnicare*, 769 F.3d at 484.

98. *See* Lipton, *supra* note 53, at 1276–80 (commenting that courts have expressed discomfort with Southland's rule because it allows the scienter of low-level officers and employees who intentionally furnish false information to be imputed to the corporation without any proof that high-level agents knew the statement was false).

99. *See id.*

100. *See* 15 U.S.C. § 78u-4(b)(3)(B); Erickson, *supra* note 21, at 10.

101. *See* Abril & Olazábal, *supra* note 56, at 107 ("Even when overwhelming circumstantial evidence of guilt within the organization exists, it is often difficult, if not impossible, to locate the single guilty agent or the constellation of guilt in the corporation.").

102. *See* 15 U.S.C. § 78u-4(b)(2)(A).

B. THE SPEECH APPROACH

1. Tellabs II and Its Progeny

The Second, Seventh, and Ninth Circuits hold that, contrary to the Speaker Approach, in some cases, a plaintiff can raise a strong inference of corporate scienter without identifying any individual who had scienter.[103] Instead, the strong inference derives from identification of a statement that is so dramatically false or a projection that is so unrealistic that the corporate agents who approved it must have known that it was false.[104] The rationale of this standard was formulated by the Seventh Circuit in *Makor Issues & Rights v. Tellabs, Inc.* ("*Tellabs II*") after remand from the U.S. Supreme Court.[105]

Tellabs, the corporate defendant, manufactured equipment for fiber optic cable networks.[106] Its principal customers were telephone companies.[107] Its flagship product, the TITAN 5500, accounted for more than half of Tellabs' sales when the company announced that the 5500's successor product, the TITAN 6500, was "available now" and that Sprint had signed a multiyear, $100 million contract to buy it.[108] Tellabs' officers told its shareholders that "customers are buying more and more Tellabs equipment," the company expected "sustained growth," customers were "embracing" the 6500, and at the same time, the 5500 was "still going strong," among other similar bold and conspicuous statements about customer demand.[109] In reality, no sales pursuant to the Sprint contract closed, and not a single TITAN 6500 product shipped during the stated period.[110] The largest purchaser of the 5500 ceased purchasing the product almost entirely.[111] Tellabs engaged in channel stuffing by sending tens of millions of units of the 5500 to distributors who did not want them to

103. *See* Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap. Inc., 531 F.3d 190, 195–96 (2d Cir. 2008) ; Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 710 (7th Cir. 2008); *In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1063 (9th Cir. 2014).
104. *See Tellabs II*, 513 F.3d at 710.
105. *Id.*
106. *Id.* at 706.
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.* at 707.
111. *Id.*

create the illusion of high demand and significant anticipated revenue.[112] After announcing a major drop in revenues, Tellabs' share price declined to $16 from its peak price of $67.[113]

After concluding that the statements were materially false, the Court examined whether plaintiffs could raise a strong inference of corporate scienter without identifying a person who knowingly made a misrepresentation.[114] Writing for a unanimous panel, Judge Posner held that "it is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud,"[115] and posited an oft-cited hypothetical:

> Suppose General Motors announced that it had sold one million SUVs in 2006, and the actual number was zero. There would be a strong inference of corporate scienter, since so dramatic an announcement would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false.[116]

Like General Motors' fictional statement, the difference between Tellabs' statements and its internal information was egregious. Because Tellabs' misrepresentations were so dramatic, the court held that it was reasonable to infer that the senior officers involved in approving the statements must have known they were false.[117] This inference was logical particularly because the TITAN 5500 and its successor 6500 were the manufacturer's "most important products"—"[t]hey were to Tellabs as Windows XP and Vista [were] to Microsoft" in 2008.[118] Any opposing inference of non-fraudulent intent—that the false statements were merely careless or innocent mistakes based on false information fed from employees—was exceedingly unlikely.[119] Thus, the statements themselves created a strong inference that at least one corporate agent who approved them possessed scienter.

The Second Circuit most recently applied the Speech Approach in *Jackson v. Abernathy*.[120] In that case, the defendants were manufacturers

112. *Id.* at 706.
113. *Id.* at 707.
114. *Id.*
115. *Id.* at 710.
116. *Id.*
117. *Id.* at 709.
118. *Id.* at 709.
119. *Id.* at 710–11.
120. 960 F.3d 94, 98–99 (2d Cir. 2020).

of medical equipment.[121] The plaintiffs alleged that the defendants intentionally misled investors by stating that their surgical gown was scientifically rated as the most protective against infections, but, in fact, the gown had failed numerous quality control tests.[122] Unable to identify an individual whose scienter could be imputed to the corporation, the plaintiffs argued that the gown was a "key product" of "such core importance" to the defendant's business that the officers who made the statements must have known they were false.[123] But the plaintiffs failed to allege that any misrepresentation was dramatically false.[124]

The court reaffirmed the Seventh Circuit's holding in *Tellabs II* that, "in exceedingly rare instances," corporate scienter can be inferred without identifying individuals with scienter, but only when the misstatement is "so dramatic" that the senior officials who approved it must have known it was false.[125] Because the plaintiffs failed to identify such a misstatement, their claim failed. The bare assertion of the product's core importance, without evidence to support that assertion, is not enough to raise a strong inference of fraudulent intent.[126]

To plead corporate scienter using the Speech Approach, the misstatement must concern a "core operation" of the company and there must be an extreme incongruity between the statement and the truth.[127] While many courts think of a core operation as the company's primary product or service, [128] some courts have recognized that core operations extend to any matter of importance that might affect the company in a significant way. [129] For example, in *Solow v. Citigroup*, the court found that a bank's statements that capital and liquidity were "strong" and "plentiful," although in truth its assets were in distress, were sufficiently contradictory and core to the bank's business to raise a strong inference of Citigroup's scienter without identifying any corporate insiders with

121. *Id.* at 96.
122. *Id.*
123. *Id.* at 98–99.
124. *See id.* at 99.
125. *Id.* at 98–99 (internal quotation marks omitted).
126. *See id.* The Ninth Circuit embraced the Speech Approach in *In re* NVIDIA Sec. Litig., 768 F.3d 1046, 1063 (9th Cir. 2014) (observing that when a company's statements are "so important" and "so dramatically false," such statements could raise a strong inference that at least some corporate officials knew of their falsity upon publication).
127. *See* Kaufman & Wunderlich, *supra* note 62, at 517.
128. *See, e.g.*, *Jackson*, 960 F.3d at 99.
129. *See* Kaufman & Wunderlich, *supra* note 62, at 517–18.

scienter.[130] Similarly, in *In re MBIA, Inc. Securities Litigation*, plaintiffs raised a strong inference of scienter where a bond insurer failed to disclose an eight billion dollar exposure to collateralized debt obligations backed by residential mortgages, which risked the company's creditworthiness.[131]

2. Advantages and Disadvantages of the Speech Approach

The Speech Approach creates a presumption that when senior officials disseminate dramatically false information about the company's most important product or services, they do so knowingly.[132] In so doing, this Approach imposes corporate liability in the prototypical fraud cases that Congress sought to redress when it enacted the Exchange Act, even though the plaintiff cannot identify in its complaint which individuals knew the truth.[133] This result mitigates the harshest consequences of the Speaker Approach by providing a remedy for investors who face financial injuries but cannot yet identify an individual with scienter at the pleading stage.[134] The Speech Approach prevents corporations from "evading liability through tacit encouragement and willful ignorance," as they potentially could under the respondeat superior rule.[135] Instead, the Speech Approach incentivizes companies to establish systems of reporting from lower-level employees to top executives.[136]

On the other hand, the Speech Approach may be over-inclusive as a means of holding corporations liable for fraud because claims against corporations may survive a motion to dismiss, even though no agent knowingly made a false statement.[137] Under the Speech Approach, a

130. *See* Solow v. Citigroup, Inc., 827 F. Supp. 2d 280, 290–91 (S.D.N.Y. 2011).

131. *See In re* MBIA, Inc. Sec. Litig., 700 F. Supp. 2d 566, 572 (S.D.N.Y. 2010).

132. *See, e.g.*, Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 710 (7th Cir. 2008).

133. *See* Cox, *supra* note 14, at 8 (noting that before the Exchange Act was enacted, the absence of legal duties to disclose material information enabled corporate insiders to mislead investors and take advantage of inside information).

134. *See* Abril & Olazábal, *supra* note 56, at 113–14.

135. *In re* Omnicare, Inc. Sec. Litig., 769 F.3d 455, 477 (6th Cir. 2014).

136. *See* Erickson, *supra* note 21, at 32 (noting that a respondeat superior rule of corporate scienter allows corporations to evade liability by making statements through "walled-off representatives" who are shielded from information about the company's business and thus would never harbor scienter).

137. Matt McCabe, Note, *Out on a Limb: Support for a Limited Version of Collective Scienter*, 89 ST. JOHN'S L. REV. 939, 962 (2015) (stating that one of the main critiques of

plaintiff could raise a strong inference of scienter by identifying a dramatically false statement, only for the defendant to rebut that inference in a later stage of the litigation. However, courts that apply the Speech Approach have emphasized that it applies only in the most egregious cases of fraud that would otherwise be dismissed if the plaintiff could not identify a speaker with scienter at the pleading stage.[138]

The Speech Approach can also be under-inclusive in holding corporations liable for fraud because it does not capture false statements about a company's new products.[139] Under the current conception of the Speech Approach, corporate scienter will be inferred from an egregiously false statement only when that statement concerns the company's most important products, as reflected by existing revenues.[140] Thus, most false statements about new products would not qualify under the Speech Approach because they do not yet generate significant revenues. In those cases, even when executives deceive investors regarding a new product, the corporation will evade liability if the new product is deemed beyond the scope of the company's core operations.

III. ELIMINATING ARTIFICIAL BARRIERS TO PLEADING CORPORATE SCIENTER

This Part first demonstrates that the Speech Approach correctly interprets the PSLRA because it is consistent with the text, history, and purpose of the statute, as well as the Supreme Court's decision in *Tellabs*. After establishing that courts can and should sustain Rule 10b–5 lawsuits against corporations solely based on dramatically false statements, this Part contends that the PSLRA's "strong inference" requirement does not limit the Speech Approach to misstatements about a company's core operations. Rather, courts can, consistent with the PSLRA, evaluate the degree to which any dramatic misstatement raises a strong inference of corporate scienter on a case-by-case basis. The rationale of the Speech Approach, that high-level agents likely know the truth when they issue

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the Speech Approach is that it may allow plaintiffs to "circumvent the heightened pleading standard" established by the PSLRA).

138. *See, e.g.*, Jackson v. Abernathy, 960 F.3d 94, 99 (2d Cir. 2020) (stating that the Speech Approach applies only in "exceedingly rare instances").

139. *See infra* Part III.

140. *See, e.g.*, Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 710 (7th Cir. 2008); *Jackson*, 960 F.3d at 99.

dramatically false statements about the company's core operations, applies with equal force when the statement concerns any subject that substantially impacts the company's financial condition and future prospects.

A. THE SPEECH APPROACH CORRECTLY APPLIES THE PSLRA

1. The Speech Approach Comports with the Text of the PSLRA

The Speech Approach adheres to the PSLRA's mandate that plaintiffs plead "facts giving rise to a *strong* inference that the *defendant* acted with the required state of mind."[141] Generally, the simplest way that a plaintiff can establish a strong inference of corporate scienter is to allege that a particular individual knew that a statement was false.[142] But the PSLRA does not require that the complaint identify an individual who acted knowingly; rather, it requires that the plaintiff raise a strong inference that the defendant-corporation acted knowingly.[143] Identifying an individual who possessed knowledge is not the sole means by which a litigant can establish a strong inference of corporate scienter. The Speech Approach recognizes that when the challenged statement is dramatically false, the plaintiff's argument that corporate agents knew that it was false is not only plausible, but strong.[144] Because the extreme incongruence between the misstatement and the truth creates an inference of scienter that is at least as strong as nonculpable explanations, the Speech Approach comports with the PSLRA.

2. The Speech Approach Comports with the History and Purpose of the PSLRA

The Speech Approach is consistent with the PSLRA's twin goals of eliminating strike suits against public corporations while reinforcing investors' private right of action to recover losses from public companies who intentionally deceive them.[145] In most 10b–5 cases, plaintiffs must identify a speaker who acted with knowledge or intent because the Speech Approach only applies in egregious situations where the inference that the

141. 15 U.S.C. § 78u-4(b)(2)(A) (emphasis added).

142. *See, e.g.*, Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap Inc., 531 F.3d 190, 195 (2d Cir. 2008).

143. 15 U.S.C. § 78u-4(b)(2)(A).

144. *See Tellabs II*, 513 F.3d at 710.

145. *See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.).

makers of the statement must have known it was false is particularly strong.[146] But in those situations where the misstatement is dramatically false, the Speech Approach allows the plaintiff's claim to proceed to discovery, serving the PSLRA's purpose of holding public corporations accountable to investors in cases where the allegations are compelling.[147]

3. The Speech Approach Comports with the Supreme Court's Decision in Tellabs I

The Speech Approach follows *Tellabs I*'s instruction to consider allegations holistically in determining whether the plaintiff has satisfied its burden of raising a strong inference of scienter.[148] *Tellabs I* emphasizes that the proper inquiry is whether all of the facts alleged, taken collectively, raise a strong inference of scienter, not whether any one scienter allegation alone is sufficient to defeat a motion to dismiss.[149] That is precisely what the Speech Approach does. Rather than focusing on whether any one speaker possessed scienter—an unnecessary and extra-statutory limitation on pleading 10b–5 claims—the Speech Approach evaluates the strength of the plaintiff's inference based on all allegations, including the incongruity between the statement and "the circumstances under which it was made."[150] Therefore, the Speech Approach aligns with *Tellabs I*'s tripartite process for determining whether the plaintiff has raised a strong inference of fraudulent intent.[151]

146. *See* Jackson v. Abernathy, 960 F.3d 94, 99 (2d Cir. 2020) (noting that the Speech Approach only applies "in exceedingly rare instances").

147. *See* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.) (stating that private securities litigation is an "indispensable tool" that deters corporate wrongdoing and helps defrauded investors recover their losses without having to rely on government action").

148. *See* Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 322–24 (2007).

149. *See id.*

150. *See* 17 C.F.R. § 240.10b-5; *see also* Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 709–11 (7th Cir. 2008).

151. *See Tellabs I*, 551 U.S. at 322–24.

B. A Dramatically False Statement About a Company's Financial Prospects Should Raise a Strong Inference of Corporate Scienter

1. The Strong Inference Requirement Should Not Limit the Speech Approach Solely to Statements About Core Operations

In *Tellabs II*, Judge Posner wrote that the officials who made or approved the corporate misstatements must have known they were false because they concerned the company's "most important products"—"[t]hey were to Tellabs as Windows XP and Vista [were] to Microsoft."[152] Other Circuits adopting the Speech Approach have also embraced the Seventh Circuit's core operations requirement. In *In re NVIDIA*, the Ninth Circuit held that the plaintiff can establish a strong inference of corporate scienter without pointing to any particular individual when the statement is both "so important" to the company and "so dramatically false."[153]

In *Jackson v. Abernathy,* the Second Circuit arrived at the same conclusion, holding that plaintiffs can establish a strong inference of corporate scienter without identifying any officers who acted with scienter when the false statements are about a key product that is "of [such] core importance" to the company.[154] In each of these cases, the success of the Speech Approach is tied to the statement's connection to a single product (or two closely related products) that is vital to the company's existing revenues.[155] But this restriction is an unnecessary limitation of liability.

First, large corporations typically offer many products that significantly affect their balance sheet.[156] In many cases, the company may not have one core, revenue-generating product.[157] For example, in *Jackson*, the plaintiff could not provide any evidence that the MicroCool gown was the company's core product where the defendant-corporation marketed many healthcare products.[158] Determining which product is a

152. *See id.* at 709.

153. *In re* NVIDIA Corp., 768 F.3d 1046, 1063 (9th Cir. 2014).

154. Jackson v. Abernathy, 960 F.3d 94, 99 (2d Cir. 2020).

155. *See id.*; *Tellabs II*, 513 F.3d at 709–10; *In re NVIDIA Corp.*, 768 F.3d at 1063–64.

156. *See, e.g.*, Jackson v. Halyard Health, Inc., No. 16-CV-05093, 2018 WL 1621539, at *2 (S.D.N.Y. March 30, 2018), *aff'd sub nom.*, Jackson v. Abernathy, 960 F.3d 94 (2d. Cir. 2020).

157. *See Jackson*, 960 F.3d at 99.

158. *See id.*; *Halyard Health, Inc*., 2018 WL 1621539, at *2.

"core" product, as shorthand for assessing whether it is likely that high-level agents knew detailed information about that product, is an improper extra-statutory inquiry. Instead, courts should evaluate on a case-by-case basis whether the allegations raise a strong inference of scienter. Typically, a dramatically false statement about any subject that substantially impacts the company's financial performance will create such an inference.

Second, inferring corporate scienter only from a statement about a company's key product presents an artificial obstacle when the statement is about a new or emerging product. When companies develop new products or enter new areas of business, high-level officials are frequently involved on an intimate, day-to-day level.[159] In such cases, although the officials who made or approved dramatic misstatements about a new product launch likely knew of their falsity, the current construction of the Speech Approach would reject this reasoning merely because the product is not yet "core" to the corporation's existing revenues.[160] Investors depend on corporate officers to provide accurate information about a company's new products and future prospects.[161] Because of these consequences, the strong inference requirement should not limit the Speech Approach solely to statements about a company's core operations.

2. Corporate Agents Likely Act with Scienter when a Misstatement Grossly Misrepresents the Truth About the Company's Financial Prospects

While the Speech Approach is consistent with the text and purpose of the Exchange Act and PSLRA, courts should not artificially limit its application solely to statements about a company's most important product. Instead, this Note suggests that the reasoning that high-level officials likely know detailed information about core operations will usually be true regarding any subject that substantially impacts the value

159. *See, e.g.,* Silverman v. Motorola, Inc., No. 07 C 4507, 2008 WL 4360648, at *14 (N.D. Ill. Sept. 23, 2008) ("[I]t is almost inconceivable that [corporate executives] were not aware of the production problems faced by the significant new product launch in the division that accounted for the largest share of sales in the company.").

160. For instance, both the flagship and successor products together in *Tellabs II* were sufficiently core to the company to infer corporate scienter, *see* 513 F.3d at 709, but it is unclear whether the Seventh Circuit would have reached the same conclusion if the statements only concerned the successor TITAN 6500 product.

161. *See supra* notes 18–20 and accompanying text.

of the company, including its earnings, assets, and future prospects.[162] Such metrics are so critical to the company's daily operations that one can expect management to be aware of them.[163]

This principle, rather than the core product limitation, should serve as the starting point when analyzing whether a dramatically false statement raises a strong inference of corporate scienter, because it is more consistent with the PSLRA's strong inference requirement as well as the history and purpose of the Exchange Act. Of course, this expanded approach is still confined to statements from which it reliably can be inferred that high-level employees are sufficiently knowledgeable. But nothing in the text of the PSLRA demands that the inference of scienter must be limited to dramatic statements about core products. When, under the circumstances, common sense and reason support the conclusion that corporate officials likely knew that their dramatically misleading statements were not accurate, the requirements of the PSLRA are met. And, generally, when top officials make statements that dramatically deviate from the truth about any subject that substantially impacts the value of the company and its future prospects, it is reasonable to infer that they did so with scienter.

Moreover, incorporating future prospects into the Speech Approach will allow investors to hold corporations liable for issuing dramatically false statements about new or emerging products that are critical to the company's future. The success of these new products can significantly affect a company's future prospects, which, in turn, affect the company's value.[164] When companies tout emerging products or expand to new areas of business, top executives are frequently involved in the launch of the new product or business.[165] In such cases, a dramatically false statement

162. These financial considerations are used to determine the fair value of a company. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983) (formulating these criteria to determine a fair price for a target company's shares in a merger). Because these metrics are contained in periodic reports, plaintiffs will have access to them before discovery, which alleviates the most substantial barrier to relief imposed by the Speaker Approach. *See supra* note 20 and accompanying text.

163. *See* Kaufman & Wunderlich, *supra* note 62, at 518 (citing Schultz v. Applica, Inc., 488 F. Supp. 2d 1219, 1226 n.3 (S.D. Fla. 2007)).

164. *See Weinberger*, 457 A.2d at 713 (stating that determining the fair price of a target requires consideration of "all relevant factors involving the value of the company" including its "future prospects").

165. *See, e.g.*, Silverman v. Motorola, Inc., No. 07 C 4507, 2008 WL 4360648, at *14 (N.D. Ill. Sept. 23, 2008).

about a new product or business that substantially impacts the company's future prospects will itself raise a strong inference of scienter.

Finally, the presumption that agents act with scienter when they make dramatically false statements that substantially impact the company's value and future prospects is consistent with the history and purpose of the Exchange Act. As noted in Part I, Congress enacted the Exchange Act to provide investors with honest disclosure about the companies in which they invest.[166] Investors depend on a company's reports to present a clear and accurate picture in all material respects of a company's business and financial condition.[167] Lack of such transparency risks erosion of investors' confidence in the securities markets.[168]

To illustrate the way in which this presumption resolves the shortcomings of the Speaker Approach and the Speech Approach, consider again the scenario in the Introduction in which a pharmaceutical manufacturer states: "Our new cancer drug is 100% safe and effective. The subjects in our clinical trials are in remission and have faced no harmful side effects. The FDA has indicated that the drug will be approved." However, prior clinical trials in a foreign subsidiary contradict the statement. In that scenario, lower-level employees in a foreign subsidiary reported their findings to their superiors, but officers of the parent company swear they did not know about the adverse clinical results when the manufacturer made the statement.

Under the Speaker Approach, the plaintiffs cannot establish a strong inference of corporate scienter because the investors will not be able to identify a speaker from whom corporate scienter may be imputed. The Fifth Circuit's Speaker Approach confines imputation solely to individuals who make, issue, order, approve, or furnish information for the statement. The Sixth Circuit's Speaker Approach also allows plaintiffs to support their inference of corporate scienter by identifying a high-level agent with knowledge who ratified, recklessly disregarded, or tolerated a misrepresentation after its issuance.

In this scenario, scienter cannot be imputed from the CEO or any other high-level agent because the investors cannot provide particularized allegations that any of them knew the company's statements about the new drug were misleading. The executives all will claim that they did not know of the adverse side effects, and the CEO swears that he was

166. *See supra* notes 18–20 and accompanying text.
167. *See supra* notes 18–20 and accompanying text.
168. *See supra* note 27 and accompanying text.

informed that the new drug would be approved. The court will not impute scienter from the scientists in the foreign subsidiary who knew the truth because they did not make or approve the statement, nor did they furnish false reports for the misstatement. Therefore, although it is likely that at least one top executive was intimately involved in the development and announcement of the new drug, the Speaker Approach would not capture corporate misconduct in this scenario.

Under the current construction of the Speech Approach, the investors' claim would still likely fail because the novel drug is not yet the company's "core" product. To raise a strong inference that high-level officials acted with scienter under the Speech Approach, the dramatically false statement must concern the company's most important product. Because the new treatment had not yet generated any revenues, the statements would not concern the company's most important product. Although the plaintiffs will argue that the dramatically false statement raises an inference that the CEO and others knew the truth, a court would probably conclude that the misstatement was more likely a disagreement based on scientific data or a negligent mistake by management due to inadequate reporting procedures because the brain cancer treatment was not a core product.

Finally, under the Approach set forth in this Note, even though investors cannot identify a speaker who knew about the drug's adverse side effects, they will successfully state a claim against the corporation because the dramatically false statement concerned an imminent novel cancer treatment. If the revolutionary new drug was released to the market, the company's future prospects and overall value would have invariably increased. Therefore, it is highly likely that at least one high-level executive knew the truth of the lab results detailing the side effects before the statement's issuance. As a result, a court will likely conclude that the statement itself raises a strong inference that corporate insiders knew or were recklessly indifferent to its falsity.

CONCLUSION

The PSLRA had two primary goals to promote the integrity of the U.S. securities market: to mitigate strike suits against public companies and to buttress investors' right of action to recover losses from companies who intentionally deceive them.[169] The PSLRA heightened ordinary pleading requirements by requiring 10b–5 plaintiffs to raise a strong

[169] *See supra* note 32–34 and accompanying text.

inference of corporate scienter in their complaints.[170] But the statute does not limit the ways in which the plaintiff can plead a strong inference of scienter.[171] In some cases, the extreme incongruity between a misstatement and the truth will itself raise a strong inference that those who speak on behalf of a corporation must have known that the misstatement was false.[172] Rejecting this logical inference finds no support in the PSLRA or Supreme Court precedent.[173] However, this theory of scienter should not be artificially cabined to misstatements about core products.[174] Often, it is equally likely that high-level corporate agents are just as familiar with emerging products as they are with current revenue-generating products.[175] Therefore, courts should not ask whether the dramatically false statement concerned a core product, but rather whether the allegations in each case holistically demonstrate a strong inference that high-level agents possessed scienter.[176] This inquiry can be accomplished by considering whether the dramatically false statement concerned any subject that substantially impacted the company's financial prospects.[177]

[170] *See supra* notes 34–38 and accompanying text.
[171] *See supra* notes 142–45 and accompanying text.
[172] *See supra* Part II.B.1.
[173] *See supra* Part III.A.
[174] *See supra* Part III.B.1.
[175] *See supra* Part III.B.2.
[176] *See supra* Part III.B.1.
[177] *See supra* Part III.B.2.