NOTES

STRUCTURAL SCIENTER: OPTIMIZING FRAUD DETERRENCE BY LOCATING CORPORATE SCIENTER IN CORPORATE DESIGN

*Emily M. Erickson**

In the context of section 10(b) securities fraud class actions, conceptualizing corporate intent is both an unnatural and a necessary exercise. Circuit courts apply a variety of different approaches to analyze the question of corporate scienter, but they typically start with agency law and impute the intentions of corporate employees to the corporation itself.

Recognizing the fraud-deterrence purpose of these class actions suggests that when corporate liability is on the table, courts should focus more on the ideal of optimal deterrence, which requires consideration of the corporation's capacity to deter fraud. This Note applies optimal deterrence reasoning and argues that courts should consider higher-order decisionmaking related to corporate structure and compliance efforts when evaluating a corporation's intent to defraud investors. Importing consideration of structural design into the corporate scienter analysis will help courts better calibrate the corporation's incentives to deter fraud and avoid the problems that come with too much or too little corporate liability for securities fraud under section 10(b).

* J.D. Candidate 2024, Columbia Law School. The author would like to thank Professor Joshua Mitts for his invaluable guidance and enduring enthusiasm for securities law, Eileen Li for her feedback and support, and the staff of the *Columbia Law Review* for their excellent editorial assistance. This Note is dedicated to Thomas Victor Erickson, whose steadfastness and work ethic inspired all who knew him.

INTRODUCTION

Securities fraud class actions are big business. More than fifty percent of federal class actions filed are securities class actions,[1] and over $114 billion has changed hands through securities class action settlements since 1996.[2] While the total number of filings has decreased significantly since 2017,[3] the magnitude of potential losses to be claimed continues to increase.[4] And there is little reason to believe this trend will slow down:

1. James C. Spindler, Optimal Deterrence When Shareholders Desire Fraud 4 (Univ. of Tex. Sch. of L., Law & Econ. Rsch. Paper No. 595, 2021) [hereinafter Spindler, Optimal Deterrence].

2. Stanford L. Sch. & Cornerstone Rsch., Box Scores or Key Statistics From 1996 to YTD, Sec. Class Action Clearinghouse, https://securities.stanford.edu/stats.html [https://perma.cc/28XY-DMZ7] (last visited Feb. 14, 2024).

3. See Stanford L. Sch. & Cornerstone Rsch., Filings by Year, Sec. Class Action Clearinghouse, https://securities.stanford.edu/charts.html [https://perma.cc/SQX6-2T36] (last visited Feb. 14, 2024).

4. Two measures of market capitalization losses, "disclosure dollar loss" (DDL) and "maximum dollar loss" (MDL), reached "historically high levels" in the first six months of 2022. Cornerstone Rsch., Securities Class Action Filings: 2022 Midyear Assessment 1 (2022), https://securities.stanford.edu/research-reports/1996-2022/Securities-Class-Action-Filings-2022-Midyear-Assessment.pdf [https://perma.cc/LXK7-2F3H]. In 2023, DDL decreased to pre-pandemic levels while MDL again increased. Cornerstone Rsch., Securities Class Action Filings: 2023 Year in Review 1 (2024), https://www.cornerstone.com/wp-content/uploads/2024/01/Securities-Class-Action-Filings-2023-Year-in-Review.pdf [https://perma.cc/6VXN-UYCB].

Many have predicted that a recession is on the horizon,[5] and recessions are often correlated with fraud in financial markets.[6] By the numbers, legal standards in securities fraud litigation have a significant impact on corporations and the millions of Americans whose wealth is invested in the stock market.[7] And they may become even more salient in the coming years.

One of the most-argued elements in section 10(b) securities fraud class actions is the defendant's scienter. Scienter refers to fraudulent intent; it is what separates fraud from negligent or accidental misstatements.[8] The concept of scienter is straightforward as applied to natural persons: What it means for an individual to intend or know something is clear, notwithstanding that intent and knowledge can be difficult to prove.[9] For corporate defendants, however, an additional layer of conceptual difficulty emerges. A corporation is a fictional person, by definition distinct from the natural persons who are its owners and take actions on its behalf.[10] This feature of the corporate form means that to determine whether a corporation has scienter, courts must first develop a theory of the corporate mind that accommodates this separation.

Even though corporations are regularly defendants in securities fraud class actions, and plaintiffs must plead scienter to establish claims against

---

5. See, e.g., Aruni Soni, No Soft Landing: The US Economy Is Going to Fall Into Recession in the Middle of 2024, Citi's Chief Economist Says, Bus. Insider (Feb. 15, 2024), https://www.businessinsider.com/recession-outlook-us-economy-job-market-unemployment-soft-landing-citi-2024-2 (on file with the *Columbia Law Review*) (quoting Andrew Hollenhorst, chief U.S. economist for Citi, and other economists predicting a possible recession in 2024 despite rosy economic indicators).

6. See Jean Eaglesham, SEC Accountant Warns of Heightened Fraud Risk Amid Recession Fears, Market Selloff, Wall St. J. (Nov. 3, 2022), https://www.wsj.com/articles/sec-accountant-warns-of-heightened-fraud-risk-amid-recession-fears-market-selloff-11667427464 (on file with the *Columbia Law Review*).

7. See Katie Kolchin, SIFMA, SIFMA Insights: Q: Who Owns Stock in America? A: Individual Investors 14–15 (2019), https://www.sifma.org/wp-content/uploads/2019/10/SIFMA-Insights-Who-Owns-Stocks-in-America.pdf [https://perma.cc/3WEK-73XD] (noting that fifty-two percent of U.S. households own stocks and that households own a plurality of all equities in the United States).

8. See Scienter, Black's Law Dictionary (11th ed. 2019).

9. See PAMCAH-UA Loc. 675 Pension Fund v. BT Grp. PLC, No. 20-2106, 2021 WL 3415060, at *1 (3d Cir. Aug. 5, 2021) (explaining that securities fraud, including scienter, "is not easy to allege"); see also Steven Shavell, Liability and the Incentive to Obtain Information About Risk, 21 J. Legal Stud. 259, 269 (1992) ("[E]xactly what a defendant knew about risk may be hard to establish even when what he should have known and his level of care can be fairly well determined.").

10. See 15 U.S.C. § 7 (2018) (defining "person" to include corporations); Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property 3–9 (1933) (discussing the implications of separation of ownership from control in the modern corporation); Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 310–11 & n.12 (1976) (explaining the concept of legal fiction as applied to organizations and defining "corporation").

them,[11] organizational scienter remains "one of the greatly under-theorized subjects in all of securities litigation."[12] This theoretical gap could be explained by the fact that imputation of intent through respondeat superior is deeply ingrained as a method for ascribing intent to corporations in the tort context.[13] But securities fraud is unlike other torts in its singular focus on deterrence[14]—specifically, this Note argues, optimal deterrence.[15] Respondeat superior liability is not suited to this goal.[16] Most circuits recognize the shortcomings of respondeat superior and deviate from it, sometimes without acknowledging the deviation.[17] Circuit court approaches to corporate scienter[18] can be sorted into three major groups: adherence to respondeat superior and variations,[19] collective scienter,[20] and the high managerial agent approach.[21] But analyzed under the framework of optimal deterrence, these alternative approaches each fall short.[22]

This Note argues that courts should consider corporate institutional features in the definition of corporate scienter to better meet the ideal of

---

11. See Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 175–78, 191 (1994) (holding there is no aiding and abetting liability under section 10(b)); infra note 35.

12. Donald C. Langevoort, Lies Without Liars? *Janus Capital* and Conservative Securities Jurisprudence, 90 Wash. U. L. Rev. 933, 959 (2013).

13. See infra notes 64–67 and accompanying text.

14. See Stuart M. Speiser, Charles F. Krause & Alfred W. Gans, 1 American Law of Torts § 1.3 & n.1, Westlaw (Monique C.M. Leahy, ed., database updated Feb. 2024) ("The fundamental policy purposes of the tort compensation system are compensation of innocent parties, shifting the loss to responsible parties or distributing it among appropriate entities, and deterrence of wrongful conduct."); infra notes 42–46 and accompanying text.

15. See Amanda M. Rose, Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5, 108 Colum. L. Rev. 1301, 1322 (2008) [hereinafter Rose, Reforming Securities Litigation Reform] (defining optimal deterrence as being achieved when defendants internalize the social costs of their behavior); infra section I.B.

16. See infra section II.C.1.

17. Professor Ann Lipton has argued that courts already deviate from respondeat superior in section 10(b) cases even while they claim to apply it. See Ann M. Lipton, Slouching Towards *Monell*: The Disappearance of Vicarious Liability Under Section 10(b), 92 Wash. U. L. Rev. 1261, 1276–80 (2015). She argues courts surreptitiously apply principles of organizational fault in section 10(b) cases. See id.

18. Some courts have used "corporate scienter" to refer only to scienter that cannot be established by imputation. See, e.g., Rahman v. Kid Brands, Inc., 736 F.3d 237, 246 (3d Cir. 2013) (indicating that "corporate scienter" and "collective scienter" are synonymous). This Note uses the phrase "corporate scienter" to refer generally to scienter attributed to corporations, whether by imputation or otherwise.

19. The Fourth, Fifth, Seventh, and Eleventh Circuits fall into this group. See infra section II.B.1.

20. The Second and Ninth Circuits have each indicated openness to collective scienter, although neither has relied on it in denying a motion to dismiss. See infra section II.B.2.

21. The Sixth Circuit is associated with this approach, although its popularity in other circuits is growing. See infra section II.B.3.

22. See infra sections II.C.2–.3.

optimal fraud deterrence. The concept of optimal deterrence is well adapted to the securities fraud context, where maintaining market efficiency is a primary goal.[23] Moreover, since optimal deterrence reflects a balancing of the arguments for and against private section 10(b) litigation against corporations, it is the key goal that should orient corporate scienter analysis. The optimal deterrence framework suggests that courts are right to move away from the pure application of respondeat superior, but they should consider adding a category of corporate scienter that looks to corporate structure and compliance efforts as proxies for organizational "intent" to defraud. The U.S. Sentencing Commission incorporates similar considerations in its Organizational Sentencing Guidelines,[24] and these guidelines provide helpful examples of corporate actions that could be factored in to the scienter analysis. Injecting these principles into the corporate scienter analysis in securities fraud cases will better calibrate corporations' deterrence-related incentives. Corporate structure may determine who becomes aware of what information and when, and structures that prevent or inhibit the flow of information both prevent scienter from attaching to any corporate speaker and encourage fraud.[25] Consequently, structure and compliance measures reflect both the corporation's intention and ability to prevent fraud, or not.

Part I summarizes the law of federal securities fraud class actions and explores the building blocks of corporate scienter. It also introduces the optimal deterrence goal that guides the remainder of the argument. Part II explains the ongoing circuit split and argues that each of the currently prevailing approaches is systematically either over- or underdeterrent. Part III proposes a new category of corporate scienter oriented to the idea of organizational fault. Inspired in part by the Organizational Sentencing Guidelines, this new category would allow courts to consider corporate structure and compliance alongside the traditional imputation analysis. Part III concludes by reviewing two hypothetical case studies that show how the proposed scienter concept is better equipped than predecessors to handle certain sets of facts that can arise in securities class actions.

---

23. See Frank H. Easterbrook & Daniel R. Fischel, Optimal Damages in Securities Cases, 52 U. Chi. L. Rev. 611, 613 (1985); see also H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.) (indicating one of the purposes of securities law is to "maintain confidence in the securities markets").

24. See U.S. Sent'g Guidelines Manual § 8A1.1–.2 (U.S. Sent'g Comm'n 2023) (considering an organization's "compliance and ethics program" to calculate a "culpability score"); Paula Desio, Deputy General Counsel, U.S. Sent'g Comm'n, An Overview of the Organizational Guidelines, https://www.ussc.gov/sites/default/files/pdf/training/organizational-guidelines/ORGOVERVIEW.pdf [https://perma.cc/CLQ4-WGHA] (last visited Feb. 10, 2024).

25. See Shavell, supra note 9, at 261, 268–69.

I. CORPORATE SCIENTER AND SECURITIES FRAUD DETERRENCE

To understand the corporate scienter mess,[26] it is necessary to contextualize the concept of corporate scienter within the history and purposes of private section 10(b) litigation, scienter standards, and the corporate liability. Section I.A focuses on the textual basis and doctrine of each and their purposes in modern securities fraud class actions. Section I.B introduces the goal of optimal deterrence and explains how it is uniquely suited to the corporate scienter problem.

A. *Building Blocks of Corporate Scienter*

1. *Section 10(b) and Private Class Action Enforcement.* — Congress passed the Securities Exchange Act of 1934 (1934 Act)[27] in the aftermath of the Great Depression to encourage transparency and disclosure in financial markets.[28] Section 10(b) of the 1934 Act gave the newly created SEC[29] near-plenary authority to design a securities fraud regulation scheme.[30] Rule 10b-5 was promulgated under this power and has since evolved into the primary regulatory authority for private securities fraud litigation.[31]

The judiciary inferred a right to private civil remedies under section 10(b) and shaped the private cause of action. Neither the text of section

---

26. This "mess" characterization is borrowed from Samuel W. Buell, What Is Securities Fraud?, 61 Duke L.J. 511, 548 (2011) (entitling the discussion of scienter doctrine "The Scienter Mess").

27. Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–qq (2018)).

28. See Knurr v. Orbital ATK Inc., 294 F. Supp. 3d 498, 513 (E.D. Va. 2018) ("[T]he Exchange Act seeks to 'substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.'" (quoting Sec. Exch. Comm'n v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 186 (1963))).

29. 15 U.S.C. § 78d(a).

30. See id. § 78j(b) (prohibiting the use of "any manipulative or deceptive device" in connection with securities transactions); Rose, Reforming Securities Litigation Reform, supra note 15, at 1308–09 ("Congress granted the Commission broad authority to enact regulations banning manipulation or deception in connection with the purchase or sale of securities.").

31. See 17 C.F.R. § 240.10b-5 (2024). This rule makes it unlawful for "any person" to do any of the following in interstate commerce "in connection with the purchase or sale of any security":

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . .

Id. The Supreme Court has stated that "[t]he scope of Rule 10b-5 is coextensive with the coverage of § 10(b); therefore, [the Court] use[s] § 10(b) to refer to both the statutory provision and the Rule." Sec. Exch. Comm'n v. Zandford, 535 U.S. 813, 816 n.1 (2002) (citations omitted) (citing United States v. O'Hagan, 521 U.S. 642, 651 (1997); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976)). This Note follows that referential tradition.

10(b) nor Rule 10b-5 explicitly provides for private remedies. The court in *Kardon v. National Gypsum Co.*, the first private action under section 10(b), reasoned from the common law maxim of *ubi jus ibi remedium* and concluded "in view of the general purpose of the act, the mere omission of an express provision for civil liability is not sufficient to negative what the general law implies."[32] The Supreme Court ratified this inference without ceremony in 1971.[33] The elements of common law fraud were thus transposed to the private section 10(b) cause of action:[34] To prevail, plaintiffs must prove "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[35]

While these elements remain the standard for proving section 10(b) violations, the fraud-on-the-market doctrine simplifies the inquiry in practice. The fraud-on-the-market theory recognizes that many investors do not carefully follow or rely on corporate disclosures when deciding whether to buy or sell stock but may still be harmed by fraud that affects market prices and overall market efficiency.[36] Fraud on the market thus

---

32. 69 F. Supp. 512, 513–14 (E.D. Pa. 1946). The court perceived a "broad purpose" of the 1934 Act to "regulate securities transactions of all kinds and . . . provide[] for the elimination of all manipulative or deceptive methods in such transactions." Id.

33. See Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 (1971) (reversing the dismissal of a private plaintiff's section 10(b) complaint and remanding the case for trial). The private right of action has remained settled law ever since, but commentators have continued to question its wisdom. See John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation, 106 Colum. L. Rev. 1534, 1536–37 (2006) [hereinafter Coffee, Reforming the Securities Class Action] (arguing that securities fraud class actions inequitably burden the victims of fraud); Joseph A. Grundfest, Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority, 107 Harv. L. Rev. 961, 1023 (1994) (arguing that the SEC should take action to address concerns about private fraud litigation that had "gotten out of hand" (citation omitted)).

34. See James Cameron Spindler, We Have a Consensus on Fraud on the Market—And It's Wrong, 7 Harv. Bus. L. Rev. 67, 73–74 (2017) [hereinafter Spindler, Consensus on Fraud on the Market] (listing the elements of a common law fraud claim and drawing an analogy to the elements of section 10(b) claims). Despite these parallel elements, section 10(b) is not understood as a codification of common law fraud. See Lipton, supra note 17, at 1280 (explaining one way section 10(b) deviates from common law fraud).

35. Stoneridge Inv. Partners, LLC v. Sci.–Atlanta, 552 U.S. 148, 157 (2008) (citing Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005)). Corporations can be held liable under section 10(b) only if they are found to have satisfied each element: Since 1994, there is no liability for aiding and abetting section 10(b) violations. See Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 175–78, 191 (1994). Even absent direct liability, however, corporations may nevertheless pay for individual section 10(b) violations through indemnification or director-and-officer (D&O) insurance. See infra note 74 and accompanying text.

36. See Spindler, Consensus on Fraud on the Market, supra note 34, at 74–75. For a summary of the theoretical backing of the fraud-on-the-market theory and discussion of its evolution in the lower courts, see generally Daniel R. Fischel, Use of Modern Finance

comports with the "overriding purpose" of the U.S. securities law regime "to protect investors and to maintain confidence in the securities markets."[37] It operates as a rebuttable presumption of reliance that also provides a means of proving materiality, causation, and damages.[38] When plaintiffs invoke fraud on the market, they must only prove a public misrepresentation, establish scienter, and connect a decrease in the stock price to the revelation of fraud.[39] This simplifying presumption enables section 10(b) class actions by collapsing individual questions of reliance and causation, which would otherwise predominate over common questions, into a single inquiry about changes in the stock price.[40] Fraud on the market also adds complexity to the question of corporate scienter by raising the possibility that fraud allegations will be based on the collective action of corporate agents.[41]

One significant attribute of fraud-on-the-market class actions is that they are much more readily justified on deterrence grounds than compensation grounds. Most scholars agree that compensation is not a credible rationale for these class actions because typical investors are diversified and effectively pay themselves damages.[42] Further, the median

---

Theory in Securities Fraud Cases Involving Actively Traded Securities, 38 Bus. Law. 1 (1982) ("The cases adopting the fraud on the market theory are noteworthy because of their explicit recognition of the market model of the investment decision and the concept of efficient capital markets on which the model is based.").

37. H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.).

38. See James C. Spindler, Why Shareholders Want Their CEOs to Lie More After *Dura Pharmaceuticals*, 95 Geo. L.J. 653, 661 & n.35 (2007) [hereinafter Spindler, Why Shareholders Want Their CEOs to Lie]. The Supreme Court confirmed the theory's validity in *Basic, Inc. v. Levinson*. 485 U.S. 224, 250 (1988); see also Spindler, Consensus on Fraud on the Market, supra note 34, at 74.

39. See Spindler, Consensus on Fraud on the Market, supra note 34, at 74–75.

40. The Federal Rules of Civil Procedure require issues common to the class to "predominate over any questions affecting only individual members." Fed. R. Civ. P. 23; see also *Basic*, 485 U.S. at 242 (discussing the predominance requirement). Because causation and reliance on the misrepresentation are generally fact-intensive inquiries unique to each claimant, they would likely predominate if assessed individually, meaning section 10(b) class actions would be impossible without the fraud-on-the-market presumption. See *Basic*, 485 U.S. at 242.

41. Lipton, supra note 17, at 1264 (explaining fraud on the market raises the possibility that scienter could exist in a different agent than the one who makes the misstatement).

42. This phenomenon is known as circularity or pocket-shifting. See, e.g., Coffee, Reforming the Securities Class Action, supra note 33, at 1558 (arguing that compensation is impossible for diversified investors because they will come out even at best as a result of securities class actions); see also Lipton, supra note 17, 1265 & n.10 (arguing that compensation is not "a realistic or achievable goal" of fraud-on-the-market class actions and collecting sources that support this point). For a slightly weaker version of the circularity argument that does not depend on diversification, see James D. Cox, Making Securities Fraud Class Actions Virtuous, 39 Ariz. L. Rev. 497, 509–10 (1997) (arguing the typical securities fraud settlement is functionally a wealth transfer from one innocent group (shareholders outside the class) to another (class members)). For an argument that compensation remains possible despite circularity, see Spindler, Consensus on Fraud on the Market, supra note 34, at 101.

ratio of investor losses to settlement dollars is consistently less than three percent, indicating that compensation is rare in practice, even setting aside circularity concerns.[43]

On the other hand, the prospect of massive class action damages means this private litigation has the potential to function as a powerful fraud deterrent and serve the public good.[44] While the compensatory potential of section 10(b) class actions is controversial,[45] this deterrent potential is not.[46] But some argue the class action is a too-powerful deterrent. This argument relies on the idea that plaintiff counsel can extract settlements from corporations for almost any decrease in their

---

43. Edward Flores & Svetlana Starykh, NERA Econ. Consulting, Recent Trends in Securities Class Action Litigation: 2023 Full-Year Review 26 fig.22 (2024), https://www.nera.com/content/dam/nera/publications/2024/PUB_2023_Full-Year_Sec_Trends_0123.pdf [https://perma.cc/QGU6-4SKA] (showing the maximum median ratio of settlement to investor losses since 2014 was 2.5%). Professor John Coffee originally made this point in his 2006 article using the then-most-recent NERA data, see Coffee, Reforming the Securities Class Action, supra note 33, at 1545, and it has remained true for almost twenty years. Professors James Cox and Randall Thomas have also used empirical data to question the compensation rationale, showing that institutional investors' beneficiaries are almost never directly compensated for securities fraud losses because of the way those investors handle settlement funds. See James D. Cox & Randall S. Thomas, Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements, 58 Stan. L. Rev. 411, 449–53 (2005) (explaining that institutional investors often do not claim settlement funds to which they are entitled, and, when they do, they do not distribute those funds to beneficial owners). Given the significant costs involved in securities litigation, see Coffee, Reforming the Securities Class Action, supra note 33, at 1558, these data suggest that compensation alone cannot justify fraud-on-the-market class actions.

44. See, e.g., Coffee, Reforming the Securities Class Action, supra note 33, at 1547–48 (arguing that the damages threatened in securities class actions outweigh the potential benefits to fraudsters and that "class actions . . . constitute a deterrent threat for most public corporations"); Lipton, supra note 17, at 1265–66 ("Shareholder lawsuits . . . act as a quasi-public mechanism for enforcement of societal norms.").

45. See supra notes 42–43 and accompanying text.

46. See Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310 (1985) ("[W]e repeatedly have emphasized that implied private actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'" (quoting J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964))); Jennifer H. Arlen & William J. Carney, Vicarious Liability for Fraud on Securities Markets: Theory and Evidence, 1992 U. Ill. L. Rev. 691, 704–05, 704 n.69 (1992) ("The central aim of the securities laws is to deter fraud."); Easterbrook & Fischel, supra note 23, at 614–15 (arguing the role of contract damages is to deter inefficient breaches and that it is not obvious that breaches are ever efficient in the securities context); Lipton, supra note 17, at 1265 ("[Section 10(b) actions] are now justified as a deterrent mechanism to protect the integrity of corporate communications."); Rose, Reforming Securities Class Action Reform, supra note 15, at 1314 ("[T]he purpose served by securities class actions today is more akin to the purpose served by qui tam actions than traditional private civil litigation." (footnote omitted)); Spindler, Optimal Deterrence, supra note 1, at 4 ("The main deterrence mechanism for corporate fraud in the United States is private securities litigation under Rule 10b-5 . . . .").

stock price, regardless of whether there was any indication of fraud.[47] These frivolous "strike suits" are thought to be socially detrimental to the extent they chill desirable corporate disclosures, burden courts with meritless litigation, and impose financial costs on corporations that have not committed fraud.[48]

Congress undertook legislative reform in the 1990s to calibrate the deterrent benefits of the section 10(b) class action in response to these overdeterrence concerns.[49] The resulting law, the Private Securities Litigation Reform Act (PSLRA), increased burdens on would-be private section 10(b) plaintiffs and imposed higher standards for pleading certain elements of section 10(b) claims, including scienter.[50] By leaving the private right of action and the fraud-on-the-market presumption intact, these reforms preserved the deterrent benefits of the class action while discouraging strike suits and other questionable litigation.[51] Since the PSLRA came into effect, the vast majority of securities class actions end

---

47. See, e.g., Grundfest, supra note 33, at 969–70 (arguing that private plaintiffs have an incentive to pursue questionable claims to extract settlements); Spindler, Why Shareholders Want Their CEOs to Lie, supra note 38, at 659 n.25 (explaining that firms are "very often sued after disappointing results" even when there is no indication of fraud). For an argument that these concerns are overblown and that strike suits are likely uncommon in practice, see Coffee, Reforming the Securities Class Action, supra note 33, at 1536 n.5 ("The true 'strike suit' nuisance action, filed only because it was too expensive to defend, is, in this author's judgment, a beast like the unicorn, more discussed than directly observed.").

48. See Arlen & Carney, supra note 46, at 705 n.72 (noting the disclosure chilling argument); Spindler, Why Shareholders Want Their CEOs to Lie, supra note 38, at 659 & n.26 (discussing the negative impacts of too much fraud liability).

49. Amanda M. Rose, The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis, 158 U. Pa. L. Rev. 2173, 2174 (2010) [hereinafter Rose, The Multienforcer Approach].

50. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.); see also infra note 58 and accompanying text. Soon after, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA) to prevent class action lawyers from avoiding PSLRA restrictions by filing securities class actions under state law. Pub. L. No. 105-353, 112 Stat. 3227 (codified as amended in scattered sections of 15 U.S.C.); see § 2, 112 Stat. at 3227 (stating congressional findings regarding abusive litigation practices).

51. See Novak v. Kasaks, 216 F.3d 300, 306 (2d Cir. 2000) (citing H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.)) (discussing the legislative history of the PSLRA and the motivation to combat strike suits). Congress could have abrogated the private right of action or the fraud-on-the-market presumption entirely but chose to retain the deterrent benefits they enable. See H.R. Rep. No. 104-369, at 31 (Conf. Rep.) ("Private securities litigation is an indispensable tool . . . . [P]rivate lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing . . . ."). Some have argued that the PSLRA went too far, making it overly difficult for plaintiffs to bring meritorious fraud claims or otherwise encouraging bad behavior. See, e.g., Charles W. Murdock, Sarbanes-Oxley, Corporate Corruption, and Complicity of Courts and Legislatures 46–50 (Sept. 7, 2006) (unpublished manuscript), https://ssrn.com/abstract=1012970 [https://perma.cc/B62E-TXYA]; see also John C. Coffee, Jr., Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms, 84 B.U. L. Rev. 301, 318–20 (2004) (arguing the PSLRA encouraged increased auditor acquiescence in aggressive accounting practices).

with either a successful motion to dismiss or settlement following an unsuccessful one.[52] As a result, standards at the pleading stage are of primary practical importance. Plaintiffs must plead scienter sufficiently to survive a motion to dismiss without the benefit of discovery;[53] if they are successful, they are likely to win a settlement without the risks and costs involved in trial.

2. *Scienter.* — Scienter is defined in general as "[a] degree of knowledge that makes a person legally responsible for the consequences of his or her act or omission."[54] Because a "congressional intent to proscribe a type of conduct quite different from negligence" was "unmistakable" from the text of the 1934 Act, the Supreme Court held that a section 10(b) claim could not stand without an allegation of scienter.[55] The Court defined scienter in this context as a "mental state embracing intent to deceive, manipulate, or defraud."[56] While state of mind may be pled generally for most claims,[57] the PSLRA imposed a higher standard: Securities fraud plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," that is, scienter.[58] In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the Supreme Court held that a "strong" inference under the PSLRA must be "more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."[59]

In economic terms, state of mind requirements like scienter distinguish certain civil and criminal offenses, including fraud, from those involving mere negligence. Judge Richard Posner's influential article discussing the economics of criminal law addressed the legal need to distinguish intentional from unintentional conduct.[60] Judge Posner

52. See Stanford L. Sch. & Cornerstone Rsch., Heat Maps & Related Filings: Litigation Status, Sec. Class Action Clearinghouse, https://securities.stanford.edu/litigation.html [https://perma.cc/MRP3-AL5F] (last visited Feb. 11, 2024) (cataloguing 6,550 securities class actions filed since 1996; while 5,980 have either settled or been dismissed, just nine have been tried to verdict).

53. Under the PSLRA, discovery is always stayed pending a motion to dismiss. 15 U.S.C. § 78u-4(b)(3)(B)(iv) (2018).

54. Scienter, Black's Law Dictionary (11th ed. 2019).

55. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

56. Id. at 193 n.12. This is the general definition of scienter in section 10(b) actions, although different standards apply to forward-looking statements and claims involving "soft" information. See 15 U.S.C. § 78u-5(c) (imposing an actual knowledge requirement for scienter with respect to forward-looking statements); Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 470 (6th Cir. 2014) (holding that statements of "soft information" are actionable only if they were made with "knowledge of [their] falsity"); Kushner v. Beverly Enters., Inc., 317 F.3d 820, 831 (8th Cir. 2003) (same).

57. Fed. R. Civ. P. 9(b).

58. 15 U.S.C. § 78u-4(b)(2)(A).

59. 551 U.S. 308, 314 (2007).

60. Richard A. Posner, An Economic Theory of the Criminal Law, 85 Colum. L. Rev. 1193, 1221–25 (1985).

argued that intent requirements help prevent excessive punishment for accidental conduct, which involves social costs in the form of overdeterrence of lawful activity (among other evils).[61] In the context of securities fraud, punishing any ultimately incorrect statement would likely have a chilling effect on corporate disclosures that would be detrimental to stockholders and others.[62] The scienter requirement mitigates this effect by preventing liability for corporate misstatements that are the product of negligent failure to discover information rather than intentional deception.[63]

3. *Corporate Liability.* — Corporate liability for fraud comes from agency law. The idea that principals may be liable for their agent's torts has ancient roots.[64] By the late seventeenth century, the principle of imputation had been extended to impersonal principal–agent relationships much like those that exist in the modern business corporation: those between shipowners and crewmen.[65] While the notion that a corporation could be held directly liable for crimes of intent is much more recent, it rests on the same basic agency law principles.[66] For this type

---

61. See id. at 1221; see also Arlen & Carney, supra note 46, at 705 n.72 (arguing that the solution to overdeterrence concerns is to strengthen scienter requirements). Relatedly, Professor V.S. Khanna argues that mens rea requirements facilitate optimal targeting of higher-than-optimal sanctions. See V.S. Khanna, Is the Notion of Corporate Fault a Faulty Notion?: The Case of Corporate Mens Rea, 79 B.U. L. Rev. 355, 391–95 (1999) [hereinafter Khanna, Notion of Corporate Fault] (arguing that when the optimal level of an activity is zero, there tend to be upwardly biased penalties, and mens rea requirements serve an important optimizing function).

62. See Lipton, supra note 17, at 1288–89 (discussing the social importance of corporate disclosure).

63. See Arlen & Carney, supra note 46, at 705 n.72 (arguing that strengthened scienter requirements are the solution to the perceived chilling problem). Recklessness, on the other hand, is typically sufficient to prove scienter in a section 10(b) case. See *Tellabs*, 551 U.S. at 319 n.3 (noting that while the Supreme Court has never spoken to the recklessness question, "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly" (citing Ottmann v. Hanger Orthopedic Grp., Inc., 353 F.3d 338, 343 (4th Cir. 2003))).

64. See John H. Wigmore, Responsibility for Tortious Acts: Its History, 7 Harv. L. Rev. 315, 317–18 (1894) (noting a master's liability for the actions of his servants under primitive Germanic law).

65. Rory Van Loo, The Revival of Respondeat Superior and Evolution of Gatekeeper Liability, 109 Geo. L.J. 141, 148 (2020) (citing Boson v. Sandford (1689) 91 Eng. Rep. 382 (KB)). "Imputation" here means "ascrib[ing] or attribut[ing]" from an individual. Impute, Black's Law Dictionary (11th ed. 2019).

66. The Supreme Court first clearly held a corporation liable for a crime of intent in New York Central & Hudson River Railroad Co. v. United States, 212 U.S. 481 (1909). V.S. Khanna, Corporate Criminal Liability: What Purpose Does It Serve?, 109 Harv. L. Rev. 1477, 1482 (1996) [hereinafter Khanna, Corporate Criminal Liability].

of wrongdoing, the agent's intent—in addition to their actions—is typically imputed to the corporation-principal.[67]

In general, corporate liability is justified to the extent that "individual liability alone . . . cannot adequately deter corporate wrongdoing."[68] This is the case whenever individual agents are judgment proof or available individual sanctions involve too much social cost.[69] Further, the deterrent effect of individual sanctions depends on the extent to which the individuals are able to rationally weigh the potential costs of their conduct. The corporate form itself can inspire systematic deviation from perfectly rational behavior.[70] And given that potential fraudsters are not perfectly rational, enhanced internal monitoring spurred by the prospect of corporate liability may be a more effective deterrent than the prospect of individual liability alone, even if the actual expected penalty is the same.[71] The central justification for corporate liability, then, especially in the context of financially driven, marketized litigation like securities fraud, is efficient deterrence of the culpable conduct.[72]

The idea that corporations should be held liable for securities fraud remains controversial. Some have argued that corporations and their shareholders are the true victims of securities fraud, making corporate liability a perverse, inefficient device that works a double injury.[73] Another

---

67. Lipton, supra note 17, at 1268; see also id. at 1268 n.20 (collecting cases in which courts imputed mens rea).

68. Jennifer Arlen & Reinier Kraakman, Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes, 72 N.Y.U. L. Rev. 687, 695 (1997).

69. See id. at 695–96 & n.21.

70. See Donald C. Langevoort, Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (And Cause Other Social Harms), 146 U. Pa. L. Rev. 101, 131–34 (1997) [hereinafter Langevoort, Organized Illusions] (arguing that corporate culture can encourage managers to adopt certain biases).

71. See Arlen & Kraakman, supra note 68, at 696 & n.23 ("[H]olding the expected sanction constant, individuals are deterred more by a high probability of paying a relatively low fine than the relatively low probability of paying a high fine."). This is especially notable in the securities fraud context since there is reason to believe the individual's expected sanction is zero in any case. See id. at 695 n.20 (noting that company managers are typically indemnified by the firm); Coffee, Reforming the Securities Class Action, supra note 33, at 1553 (discussing the impact of D&O insurance on corporate agents' incentives).

72. To be sure, there are other arguments in favor of corporate liability in general. A significant strand argues that "moral condemnation" and retribution are properly aimed at corporate defendants in certain cases. See, e.g., Lawrence Friedman, In Defense of Corporate Criminal Liability, 23 Harv. J.L. & Pub. Pol'y 833, 834 (2000); Gregory M. Gilchrist, Individual Accountability for Corporate Crime, 34 Ga. St. U. L. Rev. 335, 342, 348–49 (2018) (arguing that corporate criminal liability is important to avoid "the dangerous message that corporations may price criminal conduct"). But in the context of fraud-on-the-market class actions, the moral valence of each case is usually not clear-cut. See supra notes 42–48 and accompanying text. Given that the goal is market efficiency, optimizing deterrence is the best justification for corporate liability in this context. See infra section I.B.

73. See Coffee, Reforming the Securities Class Action, supra note 33, at 1537 ("To punish the corporation and its shareholders in such a [typical stock drop] case is much like

line of criticism is more pragmatic: Given the ubiquity of indemnity provisions and director-and-officer (D&O) insurance, the corporation and its insurers pay settlements in connection to directors' and officers' bad conduct, making any direct finding of corporate liability redundant.[74] But there could be cases in which there is no culpable individual, or that individual's identity is not obvious.[75] From a deterrence perspective, it may still be beneficial to impose liability on the corporation in these circumstances.[76] Moreover, when corporations create incentives for their agents to violate the law (e.g., through their structure or lenient compliance practices), those violations are best deterred by addressing the undesirable incentive structure directly.[77] Accomplishing these goals in the securities class action context requires a theory of corporate scienter that deviates from traditional principles of respondeat superior.[78]

B. *Optimal Deterrence Should Be the Goal*

As used in the law and economics tradition, efficiency and optimization refer to the balancing of social benefits against social costs, usually in the service of maximizing some net good.[79] While there are

---

seeking to deter burglary by imposing penalties on the victim for having suffered a burglary."); see also Gilchrist, supra note 72, at 344 ("The line between ownership and control of the corporation is the fundamental challenge . . . . Control violated the law, and ownership pays for that violation."). But see Spindler, Optimal Deterrence, supra note 1, at 7–12 (arguing owners do desire fraud and providing a supporting model); id. at 15–19 (arguing that there is fraud at the equilibrium of ownership and control incentives).

74. See Coffee, Reforming the Securities Class Action, supra note 33, at 1550–52 ("The strangest aspect of this pattern involves corporate insiders . . . . Although they are regularly sued, . . . the corporate defendant and its insurer typically advance the entire settlement amount."); see also Arlen & Kraakman, supra note 68, at 695 n.20.

75. See, e.g., Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 710 (7th Cir. 2008) (arguing a hypothetical case where GM commits blatant fraud but there is no identifiable individual wrongdoer); City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 684–90 (6th Cir. 2005) (finding the corporation's public statements evinced fraud even though they could not be connected to any particular individual with scienter).

76. See Arlen & Kraakman, supra note 68, at 695 n.20 (arguing in favor of corporate liability for collective torts).

77. See Deborah A. DeMott, Organizational Incentives to Care About the Law, 60 Law & Contemp. Probs. 39, 44–52 (1997) (arguing that vicarious liability makes sense when agents "act as a consequence of pressures created by the organization's incentive and control systems"); Langevoort, Organized Illusions, supra note 70, at 158 (arguing the law should "create incentives . . . to force the 'debiasing' of corporate inference"); see also Donald C. Langevoort, Capping Damages for Open-Market Securities Fraud, 38 Ariz. L. Rev. 639, 653 (1996) (arguing that corporate fraudsters' "thought processes will be affected by the organizational setting in which their actions are embedded").

78. See infra note 122 and accompanying text (explaining that the pure respondeat superior approach requires plaintiffs to identify a single misfeasant agent whose intent can be imputed to the corporation).

79. Guido Calabresi, Transaction Costs, Resource Allocation and Liability Rules—A Comment, 11 J.L. & Econ. 67, 69–70 (1968) (conceptualizing efficiency and optimization in structural design using law and economics analysis).

obvious social costs associated with fraud,[80] it is arguably impossible (or at least prohibitively costly) to completely eliminate.[81] Consequently, there is an "optimal" level of fraud enforcement at which the net social benefits of fraud deterrence are maximized;[82] fraud should be reduced until the marginal benefit of preventing additional fraud equals the marginal cost of preventing additional fraud. If corporations can prevent certain frauds through relatively low-cost monitoring and control measures or other specific structuring decisions, the securities fraud litigation regime should encourage these measures by holding them liable for preventable frauds specifically.[83]

Section I.A emphasized that calibrating deterrence is the key goal of corporate liability under section 10(b), and the scienter requirement is a key aspect of that goal. Economic analysis is well suited to the question of corporate scienter because this area of law is built on "fundamentally economic concepts."[84] Securities fraud is a notably market-driven area of the law—as one commentator has observed, in securities litigation, "all we care about is money"[85] and, one might add, market efficiency.[86] As a result, principles of efficiency and optimization fit more comfortably here than they do elsewhere in the law, where the popularity of law and economics has been rightfully questioned.[87]

---

80. For example, Professor Amanda Rose has argued the social costs of securities fraud include overinvestment in information gathering, disguising governance issues, and inefficient allocation of resources. Rose, The Multienforcer Approach, supra note 49, at 2179–80.

81. The social costs of fraud enforcement include both the direct costs of detection and prosecution and the indirect costs associated with overdeterrence. Id. at 2184. "Perfect" enforcement (leading to the complete elimination of all fraud) would seem to involve infinite detection costs.

82. According to standard economic assumptions, this should occur at the level at which the marginal social benefit is equal to marginal social cost. See Arlen & Kraakman, supra note 68, at 704 n.39 (defining wrongdoing as any activity where the marginal social cost exceeds the marginal social benefit).

83. See infra section II.C.

84. Easterbrook & Fischel, supra note 23, at 613.

85. Spindler, Why Shareholders Want Their CEOs to Lie, supra note 38, at 656.

86. See Rose, The Multienforcer Approach, supra note 49, at 2179–80 (identifying the negative impacts on market efficiency as the primary costs of securities fraud); supra note 79 and accompanying text; see also Easterbrook & Fischel, supra note 23, at 613 (arguing that economic analysis of securities law is appropriate because markets are well-functioning and participants on both sides tend to be sophisticated).

87. See, e.g., Elliott Ash, Daniel L. Chen & Suresh Naidu, Ideas Have Consequences: The Impact of Law and Economics on American Justice 50–52 (Nat'l Bureau of Econ. Rsch., Working Paper 29788, 2022), https://www.nber.org/system/files/working_papers/w29788/w29788.pdf [https://perma.cc/BX2L-CTGM] (cataloguing the impact of the law and economics movement on judicial decisionmaking). One persuasive critique of the law and economics school is that it undervalues distributive justice goals. See Lee Anne Fennell & Richard H. McAdams, The Distributive Deficit in Law and Economics, 100 Minn. L. Rev. 1051, 1053–54 (2016) ("Systematic neglect of these distributive shortfalls has led to a scholarly deficit in the economic analysis of law."); Daniel Hemel, Regulation

The application of economic principles to securities fraud is not innovative, but the concept of optimal deterrence is notably absent as a principle guiding discussions of corporate scienter.[88] Most commentators who write about securities fraud incorporate economic analysis into their work but do not apply it directly to scienter.[89] Even when the Second Circuit recognized an inherent "difficulty" in applying PSLRA scienter pleading standards stemming from the "'inevitable tension' between the interests in deterring securities fraud and deterring strike suits," it moved on without engaging with the optimization problem.[90] Thus, optimal deterrence analysis is not only uniquely suited to section 10(b) and the corporate scienter problem, but it is a relatively untapped resource. Optimal deterrence is the ideal that should guide corporate scienter standards.

II. DISAGREEMENT PERSISTS AS TO HOW TO CAPTURE CORPORATE FAULT IN CORPORATE SCIENTER

The building blocks of corporate scienter all point to the need to balance the fraud deterrence goals of section 10(b) with the risks of overdeterrence, and the definition of corporate scienter is the ideal nexus for this balancing. Scienter is typically a major issue in the section 10(b) class actions this Note is focused on.[91] Further, the lack of clear statutory limitations and Supreme Court precedents gives lower courts flexibility to reason out the best standard of corporate scienter that comports with the goals of the modern fraud-on-the-market class action. But without the explicit ideal of optimal deterrence to guide the analysis, circuit courts

---

and Redistribution With Lives in the Balance, 89 U. Chi. L. Rev. 649, 651–53 (2022) (arguing for the injection of distributive considerations into the favorite tool of law and economics scholars: cost-benefit analysis). But there is reason to question whether distributive justice is achievable in the modern section 10(b) class action given the general failure of compensation. See supra notes 42–43 and accompanying text. If the true goal of securities litigation is market efficiency, the distributive justice critique is less salient. See supra note 23 and accompanying text.

88. See, e.g., Patricia S. Abril & Ann Morales Olazábal, The Locus of Corporate Scienter, 2006 Colum. Bus. L. Rev. 81, 101 (using deterrence to justify comparison to criminal law but otherwise not engaging with the concept); Arlen & Carney, supra note 46, at 705 n.72 (arguing that strengthened scienter requirements are the solution to overdeterrence in the form of chilling, but relegating this argument to a lone footnote); Kevin M. O'Riordan, Note, Clear Support of Cause for Suspicion? A Critique of Collective Scienter in Securities Litigation, 91 Minn. L. Rev. 1596, 1623 (2007) (noting that making it easier to plead scienter might deter wrongdoing but pursuing the argument no further).

89. See, e.g., Rose, The Multienforcer Approach, supra note 49, at 2178 (framing an argument regarding securities fraud enforcement using optimal deterrence concepts); Spindler, Optimal Deterrence, supra note 1, at 4 (same).

90. Novak v. Kasaks, 216 F.3d 300, 307 (2d Cir. 2000) (quoting In re Time Warner Inc. Sec. Litig., 9 F.3d 259, 263 (2d Cir. 1993)).

91. See supra notes 36–41 and accompanying text.

have balanced the relevant concepts inconsistently, leading to a variety of suboptimal approaches.

Circuit courts follow one of three approaches to corporate scienter: respondeat superior, collective scienter, or the high managerial agent approach. Under the pure version of respondeat superior, a corporation commits fraud if and only if one of its agents makes a material misstatement with an intent to defraud investors *and* an intent to benefit the corporation.[92] Respondeat superior is the orthodox approach to corporate scienter, but courts regularly deviate from its pure application, applying variations or entirely different approaches.[93] At the other end of the spectrum is the expansive collective scienter approach, which allows for a finding of corporate scienter based on the aggregate knowledge of multiple agents or the knowledge of one agent combined with the actions of another.[94] A third approach allows for imputing scienter either from the speaker or from certain "high managerial agents," borrowing this concept from the organizational mens rea teachings of the Model Penal Code.[95] This high managerial agent approach has been characterized as a "middle ground" in conceptualizing corporate scienter.[96]

This Part argues that the collective concern about respondeat superior in the circuit courts has yet to be resolved because courts have not applied optimal deterrence reasoning to home in directly on the shortcomings of the current approaches and the policy implications of the relevant legal authorities. Section II.A reviews the Supreme Court doctrine that touches on corporate scienter. Section II.B discusses the varying approaches taken by the circuit courts. Section II.C analyzes the shortcomings of each of these approaches from the optimal deterrence perspective.

A. *The Supreme Court Accepts Imputation but Has Not Addressed Corporate Scienter*

The Supreme Court has never spoken directly to the issue of corporate scienter, although the facts of two of its cases raised the issue

92. See infra section II.C.1.

93. See Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 477 (6th Cir 2014); In re Cognizant Tech. Sols. Corp. Sec. Litig., No. CV-16-6509 (ES) (CLW), 2020 WL 3026564, at *24 (D.N.J. June 5, 2020) (explaining another judge rejected the respondeat superior approach due to concerns that it would be underinclusive); Abril & Olazábal, supra note 88, at 120 ("[S]ome scholars and courts have proposed that the proper way to apply the collective knowledge doctrine is in conjunction with other considerations that may more accurately point to culpability, most notably the presence of willful blindness."); Lipton, supra note 17, at 1276–80; see also infra section II.B.1.

94. See Khanna, Notion of Corporate Fault, supra note 61, at 372.

95. See *Omnicare*, 769 F.3d at 476 (citing Abril & Olazábal, supra note 88, at 135).

96. Id.

obliquely.[97] In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the Court considered what is required for allegations to raise a "strong inference" of scienter under the PSLRA.[98] While there was a corporate defendant in that case, the question presented was about pleading standards under the PSLRA, not the requirements of corporate scienter.[99] After announcing the new prevailing pleading standard,[100] the Court remanded to the Seventh Circuit for further proceedings without analyzing the corporate defendant's scienter.[101] A few years later, in *Matrixx Initiatives, Inc. v. Siracusano*, the Court took up the question of what bearing statistical significance has on materiality and scienter.[102] It did not analyze the corporate defendant's scienter separately from the individual defendants'.[103] Apart from these cases, the Court has also cautioned in general that "the § 10(b) private right should not be expanded beyond its present boundaries."[104]

Matrixx Initiatives was somewhat more on point for the issue of corporate scienter than *Tellabs*, especially as analyzed by the Ninth Circuit. The plaintiffs alleged that several people within Matrixx's corporate ranks were aware that the company's key product, Zicam, had been connected to anosmia (loss of smell) in certain patients.[105] Timothy Clarot, Matrixx's Vice President and Director of Research and Development, had corresponded with research scientists treating anosmia patients who had taken Zicam.[106] Anosmia-related lawsuits were also filed against Matrixx.[107] Nevertheless, Matrixx stated publicly that Zicam was "poised for growth"

---

97. Professor Lipton argued that Janus Capital Group, Inc. v. First Derivative Traders, 564 U.S. 135 (2011), and Stoneridge Investment Partners, LLC v. Scientific–Atlanta, Inc., 552 U.S. 148 (2008), undermine imputation of scienter from low-ranking individuals because they limit the concepts of reliance and attribution. See Lipton, supra note 17, at 1281–86. But neither case engaged directly with corporate scienter. See *Janus*, 564 U.S. at 142–44 (refusing to hold a parent company liable for its subsidiary's misstatements because liability should not be expanded "beyond the person *or entity* that ultimately has authority over a false statement" (emphasis added)); *Stoneridge*, 552 U.S. at 164–66 (refusing to expand the concept of reliance in part because the private right of action is not explicitly authorized by statutory text).

98. 551 U.S. 308, 314 (2007) (quoting 15 U.S.C. § 78u-4(b)(2) (2006)).

99. Id.

100. Following *Tellabs*, an inference of scienter is sufficiently "strong" if it is "cogent and at least as compelling as any opposing inference of nonfraudulent intent." Id.

101. Id. at 329. The Court did note, however, that the corporate defendant's scienter would need to be proven "by imputation" at trial. Id. at 328.

102. 563 U.S. 27, 30 (2011).

103. Id. at 48–49.

104. Stoneridge Inv. Partners, LLC v. Sci.–Atlanta, Inc., 552 U.S. 148, 165 (2008); see also Lipton, supra note 17, at 1281–86 (summarizing the Court's scienter jurisprudence).

105. *Matrixx Initiatives*, 563 U.S. at 31–32; see also Siracusano v. Matrixx Initiatives, Inc., 585 F.3d 1167, 1181–83 (9th Cir. 2009), aff'd, 563 U.S. 27 (2011).

106. *Siracusano*, 585 F.3d at 1170.

107. Id. at 1172, 1174.

and that the company's financial prospects were good.[108] SEC filings failed to disclose the pending lawsuits and minimized relevant risks.[109] The Supreme Court was not attentive to the intricacies of corporate scienter in its analysis, treating all the defendants as one unit for purposes of the question presented.[110] But the Ninth Circuit implied that Clarot was sufficiently high-ranking for his intent to be imputed to the corporation in connection with public statements attributed to the corporation.[111] With respect to the omission of the lawsuits from the SEC filings, it reasoned that "the inference that high-level executives such as [the CEO, the CFO], and Clarot would know that the company was being sued in a product liability action is sufficiently strong to survive a motion to dismiss."[112] In short, the Ninth Circuit determined Clarot's intent could be imputed based on the presumption that corporate speech can be attributed in general to corporate officers,[113] and the Supreme Court affirmed. But the Supreme Court's decision did not specifically endorse this corporate scienter analysis.

To the extent these two cases can be interpreted to reflect the Court's implicit corporate scienter positions, they authorize a variety of approaches. In *Tellabs*, the Court indicated the corporate defendant's scienter must be shown "by imputation" from a specific individual;[114] this language suggests the respondeat superior approach, which relies on imputing intent from individuals. But in *Matrixx Initiatives*, the Court did not systematically engage with what each individual knew when they made each statement, as is probably required under the pure respondeat superior approach.[115] To be sure, the Court was not specifically attuned to corporate scienter in either case, since the questions presented were about

---

108. Id. at 1170–76.

109. Id. at 1172, 1774.

110. See *Matrixx Initiatives*, 563 U.S. at 30 (defining "Matrixx" to include the corporation and individual defendants and referring to the defendants collectively throughout the opinion). The question presented in this case was whether it is possible to state a claim under § 10(b) "based on a pharmaceutical company's failure to disclose reports of adverse events associated with a product if the reports do not disclose a statistically significant number of adverse events." Id.

111. See *Siracusano*, 585 F.3d at 1181 (referencing Clarot's awareness of the anosmia problem and grouping him with the CEO and CFO as "high-level executives"). Under the pure respondeat superior approach, this imputation would only be allowed if Clarot made or approved the relevant misstatements. Attributing statements in SEC filings and general press releases to management at large is a hallmark of the high managerial agent approach, see infra section II.B.3, but it also makes sense in the context of collective scienter, see infra section II.B.2.

112. *Siracusano*, 585 F.3d at 1181.

113. See infra note 111.

114. Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 328 (2007).

115. See *Matrixx Initiatives*, 563 U.S. at 30; infra section II.B.1. The Ninth Circuit's approach, which the Supreme Court affirmed, relied on a more expansive view that excuses plaintiffs from having to connect to corporate speech to specific speakers. See supra note 111 and accompanying text.

other, related issues.[116] But these cases allow for any concept of corporate scienter that does not entirely eschew the possibility of imputing intent from individuals.

B. *The Circuit Split*

Given the lack of concrete Supreme Court guidance and the complexity of balancing the issues and values involved, it is not surprising that there is a long-existing circuit split regarding the proper approach to corporate scienter. The circuits that have ascribed scienter to corporations appear to be moving toward consensus in practice, but their doctrines remain inconsistent. Other circuits, notably the Third,[117] have declined to wade into the split at all.[118] This section reviews each of the three major approaches that circuit courts take to corporate scienter: respondeat superior, collective scienter, and the high managerial agent approach.

1. *Respondeat Superior.* — Respondeat superior is the traditional approach to imputing intent to corporations and is the default adopted by courts in section 10(b) cases.[119] It is also the strictest way to define corporate scienter. In theory, any agent's state of mind may be imputed to their corporate principal; if that state of mind involves fraudulent intent,

---

116. See *Tellabs*, 551 U.S. at 314 (addressing the PSLRA's "strong inference" requirement); *Matrixx Initiatives*, 563 U.S. at 30 (considering whether a risk can be material if the risk is not statistically significant).

117. The Third Circuit is "notable" because it has been repeatedly explicit in its refusal to decide the corporate scienter issue. See In re Hertz Glob. Holdings Inc., 905 F.3d 106, 121 n.6 (3d Cir. 2018) ("We have neither accepted nor rejected that doctrine [of collective scienter] and decline to do so here . . . ."); see also PAMCAH-UA Loc. 675 Pension Fund v. BT Grp. PLC, No. 20-2106, 2021 WL 3415060, at *2 (3d Cir. Aug. 5, 2021) (declining to address whether the collective scienter theory is viable because it could not support the allegations at hand); Rahman v. Kid Brands, Inc., 736 F.3d 237, 246 (3d Cir. 2013) (same). Other circuits have signaled acceptance of the doctrine regardless of its application in particular cases. See, e.g., Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.), 768 F.3d 1046, 1063 (9th Cir. 2014) (citing Glazer Cap. Mgmt., LP v. Magistri, 549 F.3d 736, 743–44 (9th Cir. 2008)); Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap. Inc., 531 F.3d 190, 195–96 (2d Cir. 2008) ("[W]e do not believe [Congress has] imposed the rule . . . that in no case can corporate scienter be pleaded in the absence of successfully pleading scienter as to an expressly named officer.").

118. See Smallen v. W. Union Co., 950 F.3d 1297, 1314–15 (10th Cir. 2020) ("We have neither accepted nor rejected [the collective scienter] theory of corporate scienter, and we need not do so now."); Metzler Asset Mgmt. GmbH v. Kingsley, 928 F.3d 151, 162–63 (1st Cir. 2019) (declining to determine whether collective scienter is viable because plaintiffs' scienter allegations could not be sustained even if it were); *In re Hertz*, 905 F.3d, at 121 n.6; Horizon Asset Mgmt. Inc. v. H&R Block, Inc., 580 F.3d 755, 767 (8th Cir. 2009) (noting the appropriate standard for pleading corporate scienter under the PSLRA is an "open question" in the circuit).

119. See supra notes 64–67 and accompanying text. To the extent courts deviate from pure respondeat superior, they tend to expand, not contract, the scope of liability. See infra sections II.B.2–.3.

that intent may be imputed as well.[120] Because the required state of mind is the "intent to deceive, manipulate, or defraud" via a misstatement, omission, or other scheme,[121] courts applying pure respondeat superior require plaintiffs to identify a single corporate agent who made the misstatement and acted with this intent.[122] Often, this identified agent will also be named as an individual defendant.[123]

The Fifth and Eleventh Circuits have each largely declined to extend corporate scienter beyond the traditional principles of respondeat superior, although neither adheres to the pure version. In *Southland Securities Corp. v. INSpire Insurance Solutions,* the Fifth Circuit relied on a Restatement to hold "the required state of mind must actually exist in the individual making (or being a cause of the making of) the misrepresentation, and may not simply be imputed to that individual on general principles of agency."[124] While this language could be read as a strong statement in favor of pure respondeat superior, it also indicates that the "required state of mind" could be imputed from someone who was only "a cause of the making of" the misstatement.[125] Other language in the opinion clarifies that there are cases in which scienter might be imputed from corporate agents who did not make any public misstatements:

> For purposes of determining whether a statement made by the corporation was made by it with the requisite Rule 10(b) scienter[,] we believe it appropriate to 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) . . . .[126]

This language supports the idea that fraudulent intent could be imputed from any corporate "official" who could be connected to the

120. See Developments in the Law—Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions, 92 Harv. L. Rev. 1227, 1247–48 (1979) ("[U]nder respondeat superior, the intent of the offending agent is imputed directly to the corporation."); see also supra note 67 and accompanying text.

121. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976).

122. See Southland Sec. Corp. v. INSpire Ins. Sols., Inc., 365 F.3d 353, 366 (5th Cir. 2004) (citing Restatement (Second) of Agency §§ 268 cmt. d, 275 cmt. b (Am. L. Inst. 1958)). For a general description of the respondeat superior approach to imputing states of mind, see Khanna, Notion of Corporate Fault, supra note 61, at 369–71.

123. See, e.g., *Southland*, 365 F.3d at 385 (imputing scienter from the defendant CEO); see also Matrix Cap. Mgmt. Fund, LP v. BearingPoint, Inc., 576 F.3d 172, 189 (4th Cir. 2009) ("Most often, the complaint and documents incorporated into the complaint by reference will identify a corporate agent who acted with scienter.").

124. 365 F.3d at 366 (citing Restatement (Second) of Agency §§ 268 cmt. d, 275 cmt. b).

125. Id.

126. Id.

misstatement.[127] The Eleventh Circuit adopted a similar approach in *Mizzaro v. Home Depot*, citing *Southland* with approval.[128]

In a 2016 case, the Fifth Circuit decided that it would even consider the state of mind of officials whom plaintiffs could not directly connect to the misstatement at the pleading stage, but only in case of "special circumstances" that urge deviation from respondeat superior.[129] When "some combination of" these circumstances obtain, the Fifth Circuit may find a strong inference of scienter from an officer who has a sufficiently high position in the company.[130] This approach expands the universe of agents eligible to have their knowledge imputed to the corporation as compared to *Southland*, edging closer to the high managerial agent approach.[131] But the requirement that scienter be imputed directly from an individual who can be connected to the misstatement remains in most cases.

One common variation on pure respondeat superior is the "anonymous fraudster" version. Under this approach, the rules of respondeat superior apply, but courts do not require plaintiffs to identify the specific individual with scienter at the pleading stage.[132] The Fourth

---

127. For a discussion of the different possible readings of *Southland*, see Ashley S. Kircher, Note, Corporate Criminal Liability Versus Corporate Securities Fraud Liability: Analyzing the Divergence in Standards of Culpability, 46 Am. Crim. L. Rev. 157, 162 (2009).

128. 544 F.3d 1230, 1254 (11th Cir. 2008) (citing *Southland*, 365 F.3d at 366). The *Mizzaro* court indicated openness to the anonymous fraudster version of respondeat superior pleading as well: "Even though it failed to plead scienter adequately for any of the individual defendants, the amended complaint could, in theory, still create a strong inference that the corporate defendant . . . acted with the requisite state of mind." Id.; see also infra notes 132–133 and accompanying text. The court declined to pursue this argument since the plaintiff did not raise it. *Mizzaro*, 544 F.3d at 1254. Since *Mizzaro*, the Eleventh Circuit has limited itself to the pure respondeat superior approach despite reaffirming its openness to go further in the right circumstances. See Thompson v. RelationServe Media, Inc., 610 F.3d 628, 635 (11th Cir. 2010).

129. Loc. 731 I.B. of T. Excavators & Pavers Pension Tr. Fund v. Diodes, Inc., 810 F.3d 951, 958–59 (5th Cir. 2016). The considerations identified as "special circumstances" included the size of the company (because an executive is more likely to be familiar with day-to-day operations in a smaller company), the importance of the transaction to the company's continued vitality, whether the misrepresented information would have been readily apparent to the speaker, and whether the defendant's statements were internally inconsistent. Id. at 959.

130. Id.

131. See infra section II.B.3.

132. See Matrix Cap. Mgmt. Fund, LP v. BearingPoint, Inc., 576 F.3d 172, 189–90 (4th Cir. 2009) ("A complaint that alleges facts giving rise to a strong inference that at least one corporate agent acted with the required state of mind satisfies the PSLRA even if the complaint does not name the corporate agent as an individual defendant or otherwise identify the agent."). Most courts adopting this approach couch their decisions in the language of the PSLRA's strong inference standard. See id. But since cases that survive a motion to dismiss typically settle, pleading standards are of special significance. See supra note 52 and accompanying text.

and Seventh Circuits have explicitly adopted this more-permissive variation,[133] and it can also apply in the collective scienter circuits.[134]

The Seventh Circuit addressed a version of the anonymous fraudster theory in *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*[135] In an oft-cited hypothetical, the court explained:

> 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.[136]

Makor quoted and adopted the "order or approve" language from *Southland*,[137] and, in *Pugh v. Tribune Co.*, the Seventh Circuit confirmed *Makor* was intended as an endorsement of the anonymous fraudster pleading theory.[138] Nevertheless, both the Second and Ninth Circuits have quoted this hypothetical to justify collective scienter.[139] Confusion between anonymous fraudster and collective scienter makes sense because the two may be functionally equivalent,[140] and it can be difficult to distinguish them based on some of the verbal formulations courts employ. In fact, the formulation the Second Circuit adopted in *Dynex Capital*[141] has been framed as an endorsement of collective scienter, though it is arguably an

---

133. See *Matrix Cap.*, 576 F.3d at 189–90 (explaining plaintiffs do not need to identify the agent with scienter in the complaint to survive a motion to dismiss); Pugh v. Trib. Co., 521 F.3d 686, 697 & n.5 (7th Cir. 2008) (stating the Seventh Circuit rejects the collective scienter doctrine but indicating openness to the anonymous fraudster approach (quoting Makor Issues & Rts., Ltd. v. Tellabs, Inc., 513 F.3d 702, 708 (7th Cir. 2008))).

134. See infra notes 139–143 and accompanying text.

135. 513 F.3d 702.

136. Id. at 710.

137. Id. at 708; see supra note 126 and accompanying text.

138. See *Pugh*, 521 F.3d at 697 (quoting *Makor*, 513 F.3d at 708, for the proposition that the Seventh Circuit rejects the collective scienter doctrine); see also id. at 697 n.5 (declining to assess the anonymous fraudster argument because plaintiffs did not pursue it).

139. See Glazer Cap. Mgmt., LP v. Magistri, 549 F.3d 736, 744 (9th Cir. 2008) ("[T]here could be circumstances in which a company's public statements were so important and so dramatically false that they would create a strong inference that at least some corporate officials knew of the falsity upon publication."); Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap. Inc., 531 F.3d 190, 195–96 (2d Cir. 2008) (quoting and adopting the GM hypothetical).

140. If plaintiffs need not identify a specific individual with the requisite scienter, nothing would prevent them from inventing an anonymous fraudster who was tipped off by each of the individuals whose combined knowledge or intent would make up the collective scienter. See supra note 94 and accompanying text. If this hypothetical fraudster enabled them to get past the pleading stage, it is unlikely the plaintiffs would be forced to identify the fraudster before the case settled. See supra note 52 and accompanying text.

141. *Dynex Cap.*, 531 F.3d at 196.

anonymous fraudster rule.[142] In theory, true collective scienter probably remains more permissive, at least when the relevant knowledge is dispersed and seems insignificant.[143]

2. *Collective Scienter.* — Collective scienter is the most expansive approach to corporate scienter. Under collective scienter, unlike under respondeat superior, a corporation may have scienter even if there is no single culpable individual.[144] A collective scienter allegation typically comes in one of two forms: (1) those in which one agent's state of mind is combined with another agent's conduct to establish corporate scienter;[145] or (2) those in which multiple agents' states of mind are aggregated and ascribed in full to the corporation.[146] The Second and Ninth Circuits are associated with this approach, although neither typically applies it in practice.[147]

The Second Circuit may accept collective scienter in limited circumstances. In *Dynex Capital*, the Second Circuit endorsed a version of collective scienter as a pleading theory while simultaneously indicating the plaintiff would need to identify a specific agent from whom intent could be imputed to prevail on scienter at trial.[148] In *Jackson v. Abernathy*, the court clarified *Dynex Capital* by discussing a number of ways to show corporate scienter: by showing that a "dramatic" misstatement was "the product of collective fraudulent conduct" and "not a case of mere

---

142. See Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 474–75 (6th Cir. 2014) (citing *Dynex Capital* as an endorsement of collective scienter); infra notes 148–151 and accompanying text.

143. See United States v. Bank of New Eng., N.A., 821 F.2d 844, 855–56 (1st Cir. 1987) (finding a bank willfully failed to report a reportable withdrawal under a collective scienter standard when the transaction was only reportable based on the cumulative total of multiple withdrawals involving different tellers). In such a case, it would be difficult to argue each teller tipped off the same anonymous individual, but liability would attach via collective scienter.

144. See Khanna, Notion of Corporate Fault, supra note 61, at 372.

145. See, e.g., Metzler Asset Mgmt. GmbH v. Kingsley, 928 F.3d 151, 162 (1st Cir. 2019) (securities fraud example); *Bank of New Eng.*, 821 F.2d at 854–57 (1st Cir. 1987) (non-securities fraud example).

146. See, e.g., United States v. T.I.M.E.-D.C., Inc., 381 F. Supp. 730, 732–33, 738 (W.D. Va. 1974) ("[T]he corporation is considered to have acquired the collective knowledge of its employees and is held responsible for their failure to act accordingly."), vacated sub nom Int'l Bhd. of Teamsters v. United States, 431 U.S. 324 (1977).

147. See, e.g., Jackson v. Abernathy, 960 F.3d 94, 99 (2d Cir. 2020) (indicating "collective corporate scienter may be inferred" in "exceedingly rare instances" but finding the "proposed amended complaint sets forth no such allegations"); Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.), 768 F.3d 1046, 1063 (9th Cir. 2014) (noting the court has "opined that the doctrine [of collective scienter] might be appropriate in some cases" but that it has never used that theory to justify its holding).

148. *Dynex Cap.*, 531 F.3d 190, 196 (2d Cir. 2008); see also Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 474–75 (6th Cir. 2014) (citing *Dynex Capital* as an endorsement of collective scienter).

mismanagement;"[149] by "imput[ing] [scienter] from an individual defendant who made the challenged misstatement;"[150] or by imputing scienter from "other officers and directors who were involved in the dissemination of the fraud."[151] Under the *Jackson* standard, then, a plaintiff can establish collective scienter in certain unique circumstances, but otherwise the Second Circuit's approach is similar to the *Southland* version of respondeat superior.[152]

The Ninth Circuit is more permissive than the Second Circuit but similarly hesitant to make a finding of collective corporate scienter. In *Glazer Capital Management v. Magistri*, the Ninth Circuit indicated openness to the collective scienter theory based on a dramatic false statement but held the theory was not appropriate for the facts of that case.[153] The court has subsequently reaffirmed its openness to collective scienter pleading;[154] it has yet to apply the theory.[155] In a recent case, the court acknowledged that collective scienter had only been endorsed in dicta in the Ninth Circuit and questioned whether it is a "viable theory."[156] But, to the extent this dicta is persuasive to the court in future cases where collective scienter would be viable, it remains undisturbed. If the Ninth Circuit rejects collective scienter, *Siracusano* suggests it would follow the high managerial agent approach.[157]

3. *High Managerial Agents*. — The high managerial agent approach endorses imputing scienter either from any of the agents responsible for the statement or from certain corporate officials termed "high managerial agents," even if they cannot be connected to the misstatement.[158] The Sixth Circuit adopted this approach in *Omnicare*, presenting it as a new, "middle ground" approach inspired by an article written by Professors Patricia Abril and Ann Morales Olazábal.[159] Despite being an imputation theory much like respondeat superior, this approach does not require the

149. 960 F.3d at 96; see also id. at 99 ("In exceedingly rare instances, a statement may be so 'dramatic' that collective corporate scienter may be inferred." (quoting *Dynex Cap.*, 531 F.3d at 195–96)).

150. Id. at 98.

151. Id.

152. See supra notes 129–131 and accompanying text.

153. 549 F.3d 736, 744 (9th Cir. 2008).

154. See, e.g., Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.), 768 F.3d 1046, 1063 (9th Cir. 2014).

155. Id. (finding the false statement was not sufficiently dramatic); see also supra note 153 and accompanying text.

156. Loc. 353, IBEW Pension Fund v. Zendesk, Inc., No. 21-15785, 2022 WL 614235, at *2 (9th Cir. Mar. 2, 2022).

157. Siracusano v. Matrixx Initiatives, Inc., 585 F.3d 1167, 1181 (9th Cir. 2009) (finding an inference of scienter viable based on the knowledge of "high-level executives"), aff'd, 563 U.S. 27 (2011); see also infra section II.B.3.

158. See Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 476 (6th Cir. 2014) (quoting Abril & Olazábal, supra note 88, at 135).

159. Id.

managers' imputed scienter to be connected directly to the misstatement.[160] It also introduces new complexity in the need to decide who qualifies as a "high managerial agent." The Sixth Circuit did not engage with this issue in *Omnicare*, determining only that a vice president who conducted audits was "potentially" a high managerial agent.[161]

The high managerial agent approach envisioned by the Sixth Circuit is similar to the anonymous fraudster approach in its improvements on pure respondeat superior. The *Omnicare* court set out to reinterpret and revise its then-operative precedent, which had the potential to be read "too broadly" and to enable corporate liability "for a statement made regarding a product so long as a low-level employee, perhaps in another country, knew something to the contrary."[162] This new approach precluded that possibility while allowing a corporation to be found liable for securities fraud even when no identifiable speaker possessed the requisite scienter. And it goes further than the anonymous fraudster approach, allowing a finding of corporate liability even when it can be *proven* that no one involved in the statement had scienter, as long as some manager did.

The Sixth Circuit is the only circuit court to explicitly adopt this high managerial agent approach, but through modifications to other leading approaches, many circuits are moving in the same direction. No matter

---

160. Specifically, the *Omnicare* court declared:

> The state(s) of mind of any of the following are probative for purposes of determining whether a misrepresentation made by a corporation was made by it with the requisite scienter under Section 10(b): . . .
>
> a. The individual agent who uttered or issued the misrepresentation;
>
> b. Any individual agent who authorized, requested, commanded, furnished information for, prepared (including suggesting or contributing language for inclusion therein or omission therefrom), reviewed, or approved the statement in which the misrepresentation was made before its utterance or issuance;
>
> c. Any high managerial agent or member of the board of directors who ratified, recklessly disregarded, or tolerated the misrepresentation after its utterance or issuance . . . .

Id. (quoting Abril & Olazábal, supra note 88, at 135). This approach differs from the Fifth Circuit's in that scienter can be imputed from these officials without regard to "special circumstances." See Loc. 731 I.B. of T. Excavators and Pavers Pension Tr. Fund v. Diodes, Inc., 810 F.3d 951, 957–59 (5th Cir. 2016).

161. *Omnicare*, 769 F.3d at 483.

162. Id. at 475–76 (citing City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 688 (6th Cir. 2005)). *Bridgestone* had held "knowledge of a corporate officer *or agent* acting within the scope of [his] authority is attributable to the corporation," *Bridgestone*, 399 F.3d at 688 (alteration in original) (emphasis added) (internal quotation marks omitted) (quoting 2 Thomas Lee Hazen, Treatise on the Law of Securities Regulation 444 (4th ed. 2002)), which was read as an endorsement of collective scienter, see *Omnicare*, 769 F.3d at 475–76; Abril & Olazábal, supra note 88, at 91–95 (noting *Bridgestone* did not invoke collective scienter explicitly but "presuppose[d] that corporations may have the requisite mental state to be held liable as primary violators of Section 10(b) without imputing scienter from a particular individual corporate agent").

where they stood in the immediate aftermath of the PSLRA, today each circuit to address corporate scienter has moved toward the high managerial agent approach.[163]

C. *Current Approaches Do Not Encourage Optimal Deterrence*

None of these standards is particularly attuned to the goal of optimal deterrence. An optimal corporate securities fraud liability regime would cause corporations to efficiently internalize the social costs of fraud.[164] Efficient internalization would mean that corporations are held responsible for frauds they were competent to prevent.[165] When corporations are held responsible for frauds they could not have

---

163. The Second Circuit backed away from an earlier endorsement of collective scienter and toward a more manager-centric approach in a 2020 opinion. Compare Jackson v. Abernathy, 960 F.3d 94, 98 (2d Cir. 2020) (indicating corporate scienter may be imputed from "officers or directors who were involved in the dissemination of the fraud . . . even if they themselves were not the actual speaker" or inferred collectively), with Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap. Inc., 531 F.3d 190, 196 (2d Cir. 2008) (indicating openness to collective scienter). The Fifth Circuit softened its initial commitment to respondeat superior. Compare *Diodes*, 810 F.3d at 958–59 (allowing imputation from management in case of "special circumstances"), with Southland Sec. Corp. v. INSpire Ins. Sols., Inc., 365 F.3d 353, 366 (5th Cir. 2004) (limiting corporate scienter to respondeat superior principles). A district court in the Seventh Circuit recently indicated that the potential knowledge of management, rather than any anonymous fraudster, was key in the imputation analysis. Compare In re Boeing Co. Aircraft Sec. Litig., No. 19-cv-02394, 2022 WL 3595058, at *11 (N.D. Ill., Aug. 23, 2022) (considering the argument that "widespread knowledge" within the company could support a collective scienter allegation but finding that the problem at issue would not necessarily have been known by senior management), with Pugh v. Trib. Co., 521 F.3d 686, 697 (7th Cir. 2008) (adopting the anonymous fraudster approach). The Ninth Circuit, which initially limited itself to imputation of scienter from individual defendants, began considering the knowledge of executive managers more broadly. Compare Siracusano v. Matrixx Initiatives, Inc., 585 F.3d 1167, 1181 (9th Cir. 2009) (allowing scienter to be imputed from "high-level executives"), aff'd, 563 U.S. 27 (2011), with Nordstrom, Inc. v. Chubb & Son, Inc., 54 F.3d 1424, 1436 (9th Cir. 1995) (requiring scienter to be imputed from individual defendants). And the Eleventh Circuit adopted a more permissive version of respondeat superior. Compare Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1254 (11th Cir. 2008) (indicating plaintiffs could prove scienter without identifying a specific individual who acted with scienter), with Phillips v. Sci.–Atlanta, Inc., 374 F.3d 1015, 1018 (11th Cir. 2004) (requiring imputation from specific, identified defendants).

164. See Rose, Reforming Securities Litigation Reform, supra note 15, at 1322 ("[O]ptimal deterrence is achieved when the defendant is made to internalize the net social costs of the contemplated misbehavior . . . ."); Shavell, supra note 9, at 260 (noting that parties make socially optimal decisions when they internalize the social costs of their actions).

165. Holding corporations responsible for frauds they could not prevent could hardly be argued to have deterrent benefits. Because this Note contemplates corporate liability in addition to, not instead of, individual liability, corporate liability is justified as long as it would provide additional deterrent benefits at the same or lower cost than individual liability.

prevented, the deterrence justification evaporates;[166] it follows that the liability scheme should hold corporations accountable only for preventable frauds to encourage efficient fraud deterrence.[167] Whether the corporation can prevent or discourage fraud at acceptable cost depends on the specific nature of the fraud and its relationship to reasonable corporate structure and compliance mechanisms.[168]

This section analyzes each of the circuit court approaches from the perspective of optimal deterrence. Each captures some unpreventable frauds (i.e., is overinclusive) with some—like collective scienter—capturing conduct that strains the very concept of fraud. Some are also underinclusive, precluding corporate liability for frauds that corporations can efficiently deter. Ultimately, none is optimal because none involves consideration of corporate structuring decisions that may enable willful ignorance or otherwise intentionally obscure misleading disclosures.

1. *Respondeat Superior.* — The pure respondeat superior approach is both over- and underinclusive; while variations help remedy some of the issues, more progress is possible with respect to optimizing deterrence. Pure respondeat superior is a blunt instrument, imposing liability on corporations even when they act reasonably.[169] And there may be good reason to hold a corporation liable even though there is no specific individual who can be alleged to have the requisite imputable intent.[170] Respondeat superior does catch the clearest cases of fraud: those driven by an individual bad actor who acts on the corporation's behalf to trick the investing public. But there is an argument that corporate liability is less important in these circumstances because individual liability is likely to

---

166. Many of the criticisms of corporate liability for securities fraud sound in the concept of agency costs, arguing that the corporation (meaning, ultimately, its shareholders) is unjustly held responsible for the ultra vires actions of its agents. See Spindler, Optimal Deterrence, supra note 1, at 6–7 (collecting arguments relying on the agency costs critique). Professor James Spindler argues that shareholders do benefit from (and thus desire) fraud in some cases. See id. at 7–12. But the idea that shareholders may encourage fraud in certain circumstances does not imply that the corporation can *always* prevent fraud at reasonable cost even if properly incentivized.

167. Corporations can often efficiently deter fraud because they are better positioned to identify potential fraud internally than external investigators are, thus increasing the probability that fraud will be prevented or discovered and remedied quickly. See Arlen & Kraakman, supra note 68, at 699.

168. A corporation is very likely to be able to prevent fraud committed by a rogue, high-level manager because it can require important decisions and disclosures to be made by multiple managers who are unlikely to have influence over each other. See id. at 702. By contrast, a corporation is very unlikely to be able to prevent so-called fraud premised on pieces of seemingly insignificant knowledge possessed by different employees. See infra section II.C.2.

169. See Khanna, Notion of Corporate Fault, supra note 61, at 370–71; see also United States v. Twentieth Century Fox Film Corp., 882 F.2d 656, 660 (2d Cir. 1989) (finding Fox liable for its employee's violation of a consent decree and refusing to consider evidence of Fox's "reasonable diligence" in ensuring compliance).

170. See supra notes 75–78 and accompanying text.

have a sufficient deterrent effect[171] without the additional costs involved in corporate liability.[172] Perhaps recognizing these issues, no circuit court adheres strictly to pure respondeat superior.[173] While respondeat superior remains the baseline, most courts have loosened the traditional rules to allow imputation from agents, especially managers, who did not directly make the misstatement.

Basic practical flaws in the pure version of respondeat superior make it underinclusive from the optimal deterrence perspective. If the person actually making the statement was strictly required to have scienter to support any fraud liability, corporations could always avoid liability by making public statements through walled-off representatives. These representatives would never have the intent (or the capacity) to defraud because they would never have any inside information about the corporation or its business. Further, at the pre-discovery pleading stage, plaintiffs are unlikely to have specific evidence regarding who knew what and when.[174] So the *Southland* variation allowing imputation of scienter from agents who "order or approve" or "furnish information or language for" the misstatement[175] is a wise expansion, but it does not go far enough. Any form of respondeat superior encourages inefficient management and works against optimal deterrence to the extent it encourages corporations to keep information as dispersed as possible. The Seventh Circuit's GM hypothetical illustrates a scenario that leaves the reader with a strong conviction that the corporation should be held liable for fraud but without a clear path to impute scienter.[176] While the Seventh Circuit was focused on the limitations of proof at the pleading stage,[177] holding GM liable for the fraud in this context even if an anonymous fraudster could never be identified would have deterrent benefits. If there were no specific culpable individual causing this gross misreporting, such misreporting could only be a result of intentionality or recklessness on the part of the corporation as a whole reflected in its deficient structure and compliance apparatus.[178] Because no individual would face liability in this circumstance, corporate liability is essential for deterrence.[179]

---

171. See Coffee, Reforming the Securities Class Action, supra note 33, at 1563 (arguing that individual liability is typically a stronger deterrent than corporate liability). But see Arlen & Kraakman, supra note 68, at 695–96 (arguing that corporate liability is an important supplement to individual liability when agents are judgment proof or not perfectly rational).

172. See supra note 81.

173. See supra section II.B.1.

174. Recall that the key action in securities litigation typically occurs at the pleading stage. See supra notes 52–53 and accompanying text.

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

176. Makor Issues & Rts., Ltd. v. Tellabs Inc., 513 F.3d 702, 710 (7th Cir. 2008).

177. See id. (indicating "it is possible to draw a *strong inference* of corporate scienter" without identifying an individual fraudster (emphasis added)).

178. See infra section III.B.2.

179. See Arlen & Kraakman, supra note 68, at 695–96.

Respondeat superior is also overinclusive to the extent it leads to corporate liability for unpreventable frauds. When a rogue employee circumvents legitimate and generally effective fraud deterrence mechanisms and falsifies records for their own personal gain, the agency costs argument against corporate liability for securities fraud is most salient.[180] In these cases, the corporation could still be liable under respondeat superior if a purpose to benefit the corporation even partially animated the rogue fraudster,[181] but corporate liability would have no deterrent benefit.

2. *Collective Scienter.* — The collective scienter approach corrects some of the underdeterrence problems of respondeat superior, but it casts a very wide net, creating the potential for corporate liability that does not track the corporation's capacity to deter fraud. It discourages willful blindness but causes other problems associated with broad overdeterrence, including chilling disclosures.[182] As such, its advocates typically endorse it as a pleading theory rather than a true definition of corporate scienter.[183] But an overinclusive pleading theory is arguably as bad as an overinclusive trial standard in the section 10(b) context, where the vast majority of cases are dismissed or settled.[184] If too many cases survive a motion to dismiss based on a questionable pleading theory, there may be an overdeterrence problem even if these cases probably could not be proven at trial.

The strong form of collective scienter has yet to gain widespread acceptance in the circuit courts, and the optimal deterrence analysis confirms that hesitations are well placed. In *Omnicare*, the Sixth Circuit explained that it was not comfortable with the possible collective scienter implications of its previous leading case, *Bridgestone*, which was interpreted as the high-water mark of collective scienter at the time.[185] Collective scienter flouts the spirit of the PSLRA and the broader goal of optimal deterrence by holding corporations liable for so-called fraud that is not clearly recognizable as any kind of intentional wrongdoing.[186] No one could know whether some widespread group of employees had bits of

180. See supra note 73 and accompanying text.

181. Lipton, supra note 17, at 1296. Professor Lipton argued that discomfort with the implications of corporate liability for this type of fraud has pushed courts to modify traditional respondeat superior doctrine in the section 10(b) context. See id. at 1266.

182. See supra note 48 and accompanying text.

183. See, e.g., Heather F. Crow, Comment, Riding the Fence on Collective Scienter: Allowing Plaintiffs to Clear the PSLRA Pleading Hurdle, 71 La. L. Rev. 313, 341–43 (2010); see also Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.), 768 F.3d 1046, 1063 (9th Cir. 2014) (discussing the possibility that a collective scienter theory could raise an *inference* of corporate scienter); Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap. Inc., 531 F.3d 190, 195–96 (2d Cir. 2008) (same).

184. See supra note 52 and accompanying text.

185. See Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 475–76 (6th Cir. 2014); Abril & Olazábal, supra note 88, at 91–95 (referencing *Bridgestone* as the key example of collective scienter principles in securities litigation).

186. See supra note 143.

knowledge that could be aggregated to prove the misleading nature of some corporate statement, and thus corporations have little to no power to control these circumstances.[187] Therefore, allowing a complaint premised on such allegations to survive a motion to dismiss undercuts the optimal deterrence goal of the securities fraud enforcement scheme.[188]

3. *High Managerial Agents.* — The high managerial agent approach is the product of careful reasoning, but its original advocates in the securities fraud context were not focused specifically on optimizing deterrence.[189] It improves on the underdeterrence problems of pure respondeat superior by allowing plaintiffs to impute scienter from certain management employees to the corporation even if those managers could not be connected to the fraudulent misrepresentation. Allowing imputation of scienter from management employees regardless of connection to the misstatement makes sense from a deterrence perspective. The executives who are most likely to be defined as "high managerial agents" tend to have incentives more aligned with the corporation's and are more likely to be subject to the supervision of the board of directors.[190] Further, they are likely to be in a position to prevent or correct misstatements, even if they are not involved enough in the original statement to be eligible for imputation under the *Southland* approach.[191]

One shortcoming of the high managerial agent approach is the difficulty in defining "high managerial agent," which the Sixth Circuit did not engage with in *Omnicare*.[192] Following the Model Penal Code, Professors Abril and Olazábal defined the category to include "an officer . . . a partner, or any other agent of a corporation or association 'having duties of such responsibility that his conduct may fairly be assumed to represent the policy of the corporation or association.'"[193] This definition begs the question of *whose* conduct may fairly be assumed to represent the policy of the corporation. In practice, courts in section 10(b) cases may or may not impute scienter from a variety of high-ranking managers.[194] And there is no principled reason to exclude, for example,

187. Cf. Stavros Gadinis & Amelia Miazad, The Hidden Power of Compliance, 103 Minn. L. Rev. 2135, 2139, 2179–80 (2019) (arguing that compliance officers' power lies in their ability to make key players aware of key information that could, in the securities fraud context, contradict public statements and thus create scienter).

188. See supra notes 49–51 and accompanying text.

189. See Abril & Olazábal, supra note 88, at 101–02 (using the similar deterrence goals to justify a comparison to criminal law but otherwise not engaging with the concept).

190. Cf. Rose, The Multienforcer Approach, supra note 49, at 2222 (arguing that private enforcement encourages directors to better control for the risk of "managerial fraud").

191. See supra notes 124–127 and accompanying text.

192. See supra notes 158–161 and accompanying text.

193. Abril & Olazábal, supra note 88, at 146 n.210 (quoting Model Penal Code § 2.07(4)(c) (Am. L. Inst. 1985)).

194. See, e.g., Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 483 (6th Cir. 2014) (indicating that a Vice President who conducted audits is "potentially" a high managerial agent); Siracusano v. Matrixx Initiatives, Inc., 585 F.3d 1167,

regional managers.[195] Unconstrained, this category could expand to encompass anyone with management responsibilities; at the limit, it becomes virtually indistinguishable from the collective scienter approach.[196] Conversely, if "high managerial agent" were defined with a bright-line rule, courts would lose the valuable flexibility to consider the unique circumstances of each corporate structure.

More fundamentally, this approach does not connect to the corporation's capacity to deter fraud nor to calibrate managerial incentives effectively. It may be argued that each "high managerial agent" *should* know the content of every public corporate statement and be positioned to verify the underlying facts, but, given the volume of corporate speech, this level of monitoring may not always be possible. By imputing these managers' knowledge to the corporation with reference to a particular misstatement regardless of their actual knowledge of the statement, the high managerial agent approach is potentially overdeterrent. One manager's knowledge may be contradicted by one public statement even if that manager (and management as a whole) has done everything in their power to deter fraud; this approach does not explicitly leave room for courts to weigh whether corporate scienter has been established in these circumstances.[197] And while it might be argued that the prospect of corporate liability should encourage these managers to do more to deter fraud, their incentives with respect to each potential misstatement may not be aligned with the corporation's.[198] On any given day, a manager may be distracted by other corporate projects or captured by personal goals;[199] they are much more likely to consider the corporation's liability exposure when making big-picture decisions impacting overall corporate structure than they are when making individual, moment-to-moment monitoring decisions.[200] But the high managerial agent approach implicitly focuses on the micro-universe of each potentially fraudulent misstatement rather than the bigger picture of

---

1181 (9th Cir. 2009) (grouping a Vice President with the CEO and CFO as "high-level executives"), aff'd, 563 U.S. 27 (2011).

195. See State v. Cmty. Alts. Mo., Inc., 267 S.W.3d 735, 737, 744 (Mo. Ct. App. 2008) (finding that a "lead staff person" who "supervised subordinate employees in a managerial capacity" is a high managerial agent under the Model Penal Code).

196. As a result, the criticisms of collective scienter could apply to the high managerial agent approach as well. See supra section II.C.2.

197. While Professor Lipton has argued courts already do this surreptitiously, see Lipton, supra note 17, at 1276–80, this reasoning is better made explicit.

198. See supra note 71 and accompanying text.

199. See Reza Dibadj, Reconceiving the Firm, 26 Cardozo L. Rev. 1459, 1493 (2005) (explaining managers' personal goals that might conflict with business objectives include "personal financial rewards, security, power and prestige within the organization, desire to be liked, human sympathy, the urge to create and perhaps occasionally the desire for an easy life" (internal quotation marks omitted) (quoting William L. Baldwin, The Motives of Managers, Environmental Restraints, and the Theory of Managerial Enterprise, 78 Q.J. Econ. 238, 248 (1964))).

200. See supra note 77 and accompanying text.

corporate structure and compliance policies. These structure and compliance decisions represent the corporation's true power to deter fraud, and a definition of corporate scienter can best optimize deterrence by capturing intentions at that level.

III. ORGANIZATIONAL FAULT AND STRUCTURAL CORPORATE SCIENTER

Similar policy concerns animate the varying scienter pleading standards in the circuit courts. These courts regularly discuss the legislative purpose behind the PSLRA, the need to avoid runaway liability for corporations in securities fraud class actions, and whether the corporation can reasonably be said to be at "fault" for the fraud.[201] While the circuit courts have not explicitly applied optimal deterrence analysis, their reasoning sounds in calibrating incentives. But each circuit court approach is imperfect in that it fails to connect corporate liability to the corporation's capacity to deter fraud.[202]

As a result, most circuits have moved or are moving towards the high managerial agent approach,[203] which fares better than other approaches when evaluated under an optimal deterrence lens even though it still fails to capture the corporation's direct role in fraud deterrence.[204] The high managerial agent approach is appealing in that it locates the corporation's mind in the individuals most identifiable with the corporation itself: its high-ranking managers.[205] But these managers may be more or less identifiable with the corporation depending on what type of work they are engaged in on its behalf. Even high-ranking managers may be more "human" with respect to their day-to-day monitoring role and more "corporate" when they are intentionally considering big-picture corporate structure, at least with respect to incentives.[206] Regardless, the high managerial agent approach does not account for the possibilities that a corporation's design intentionally prevents management from becoming aware of relevant information or that its compliance efforts are unreasonably insufficient.[207]

This Part argues that intentions behind corporate structuring and compliance decisions should be factored into the analysis of corporate scienter. Ultimately, a corporation's mind is reflected in its self-determined structure. The Organizational Sentencing Guidelines promulgated by the U.S. Sentencing Commission (Guidelines) provide a

---

201. See Lipton, supra note 17, at 1266, 1276–80.

202. See supra section II.C.

203. See supra note 163.

204. See supra section II.C.3.

205. Although, as discussed above, the current definitions of "high managerial agent" do not limit how deep in the organizational chart courts may look to find high-ranking managers. See supra notes 192–196 and accompanying text.

206. See supra notes 77, 199 and accompanying text; see also supra section II.C.3.

207. See infra notes 221–223 and accompanying text.

model for considering structure and compliance efforts in the corporate crime context that could be applied within the analysis of corporate scienter.[208] Adding consideration of organizational features like structure and compliance to the current approaches would better optimize deterrence by allowing courts to hold corporations directly accountable for deficient structures, reduce or exclude corporate liability in cases of unpreventable frauds, and encourage adoption of effective fraud deterrence structures without deviating from black-letter law. Section III.A explains the teachings of the Guidelines as applied to the corporate scienter problem. Section III.B reviews two hypothetical case studies that illustrate the potential practical benefits of considering structure in section 10(b) class actions.

A. *Corporate Scienter Based on Structuring Decisions*

To calibrate corporations' incentives to deter fraud, courts should be attuned to corporations' actual deterrence capacities and thus should consider the features of the corporation itself more directly in analyzing the corporate scienter. Incorporating principles of organizational liability from criminal law into the definition of corporate scienter can help achieve this goal by facilitating consideration of corporate intent at the level of ex ante structuring decisions, which otherwise would not be reached by scienter doctrine. This section first reviews some principles of organizational liability and incentive creation that are relevant to the corporate scienter inquiry. It then proposes that courts consider these principles as a factor in whichever approach to corporate scienter they currently employ.

1. *Organizational Structure and Liability.* — From the optimal deterrence perspective, corporations should be held liable only for frauds they were competent to prevent.[209] When a corporation knows of a pending fraudulent misstatement through one of its agents, the corporation is competent to prevent the fraud: That knowledgeable agent can take action to prevent the misstatement themselves if they are appropriately positioned within the organization, or otherwise they can notify someone who is.[210] But the reverse does not necessarily follow. Even

---

208. Prior work has advocated incorporating these guidelines in the section 10(b) regime, although not specifically as advocated here. See Abril & Olazábal, supra note 88, at 160–64 (arguing culture as used in the Guidelines is evidence of corporate scienter); David Ian Wishengrad, Comment, Securities, Scienter & Schizophrenia: Should the Efficacy of Compliance Initiatives Within Multi-Service Investment Firms Be Used to Determine Scienter for 10b-5 Violations Under Federal Securities Law?, 25 Pace L. Rev. 383, 402–04 (2005) (pointing to the Guidelines as evidence that efficacy of compliance initiatives is a "valid assessment of 'organizational scienter'").

209. See supra notes 164–165 and accompanying text.

210. This is possible assuming that the corporation established channels that facilitate the flow of relevant information to those agents who are positioned to take appropriate action and that those agents (presumably managers or lawyers) are properly motivated to

when no single agent is aware of the misstatement—and thus, no agent has scienter—the corporation may still have been competent to deter the fraud because its self-determined structure influences its agents' conduct with respect to reporting potentially relevant information to management.[211] Said differently, corporate structure determines who becomes aware of which information and when, and structures that inhibit fraud detection both prevent scienter from attaching to any individual agent and encourage fraud.[212] Considering corporate structure as an element of corporate scienter would mitigate these potentially inefficient incentives.

The current corporate criminal sentencing regime incorporates general principles of "corporate good citizenship" and corporate culture that reflect the organization's structural efforts to reduce misconduct within its ranks.[213] Corporate liability in both the criminal and civil contexts is typically based on agency principles, so a corporation can be held liable for its agent's crimes or torts even if the agent's actions directly conflicted with specific corporate directions[214] or the agent did not act with an obvious motive to benefit the corporation.[215] These categories of liability may be disconnected from the corporation's ability to deter wrongdoing, and the Guidelines recognize this by allowing corporations to mitigate the punishment imposed on them through "[c]ompliance standards and procedures reasonably capable of reducing the prospect of criminal activity."[216] These "effective compliance programs" might involve appropriate oversight and monitoring systems, effective channels of communication, and consistent enforcement of compliance policies and related sanctions.[217] Overall, efforts like these both contribute to an honest corporate culture and enable the corporation to prevent, detect, and

---

respond to the information. See DeMott, supra note 77, at 45, 55–56. Even if they do not respond by preventing the fraud, they are likely to have imputable scienter. See Gadinis & Miazad, supra note 187, at 2180.

211. See DeMott, supra note 77, at 45–46.

212. In fact, a liability system that depends on the information the party (or its agent) actually possesses creates a perverse incentive to intentionally avoid obtaining information that might expand the scope of liability. See Shavell, supra note 9, at 261. Professor Shavell's model shows that this kind of liability arrangement is suboptimal. Id. at 268–69.

213. See Symposium, Corporate Crime in America: Strengthening the "Good Citizen" Corporation, U.S. Sent'g Comm'n 119, 261 (1995), https://www.ussc.gov/sites/default/files/pdf/research-and-publications/research-projects-and-surveys/economic-crimes/19950907-symposium/WCSYMPO_opt.pdf [https://perma.cc/ECC9-BVW2].

214. Desio, supra note 24; see also supra note 169 and accompanying text.

215. See Ira S. Bushey & Sons v. United States, 398 F.2d 167, 170–72 (2d Cir. 1968) (finding the government vicariously liable when its sailor returned drunk to his ship at night and caused damage by "turn[ing] some valves" because "it was foreseeable that crew members crossing the drydock might do damage").

216. Desio, supra note 24.

217. Id.

respond to potential fraud.[218] To encourage corporations to make such efforts, the Guidelines allow for a "mitigation credit" for firms that have adopted effective compliance measures but are nevertheless convicted of corporate criminal conduct. This credit can reduce corporate criminal fines by up to ninety-five percent and gives courts leeway to tailor punishment based on the corporation's efforts to prevent wrongdoing from happening in the first place.[219]

While connecting corporate fraud liability to the corporation's structure and compliance efforts is likely to help optimize deterrence,[220] it is less clear that the concept of corporate structure can be reconciled with a state of mind requirement like scienter. But to say that a corporation's structure itself rises to the level of state of mind is simply to recognize that corporate structure is the product of intentional choices by corporate actors.[221] Corporations have the capacity to be intentional about the level of direct monitoring required and the way such requirements are enforced, about the lines of communication available for everyday reporting and reporting suspected wrongdoing, and about the prescribed response to possible wrongdoing. These structural features reflect the corporation's intentionality about reducing fraud because they reflect decisions by high-level actors that directly determine corporate action with respect to fraud reduction. Some structures or practices are so clearly deficient that they could raise an inference of recklessness or willfulness with respect to certain misstatements.[222] At least at the pleading stage, plaintiffs could argue that corporate structure is a product of the intent of *some* high-ranking corporate agent, since only directors and high-level managers can influence the corporation's structure. The collective shift toward the high managerial agent approach in the circuit courts supports the idea that scienter could attach from decisions that impact the corporation's structure and thus facilitate—but do not directly connect

---

218. See Barry D. Baysinger, Organization Theory and the Criminal Liability of Organizations, 71 B.U. L. Rev. 341, 341–42 (1991) (arguing these control systems "force low-level managers and other employees to internalize the organizational costs of their opportunistic actions" and the result is "a relatively effective system of deterrence"); see also Arlen & Kraakman, supra note 68, at 712 (arguing that the possibility of duty-based corporate liability makes the threat of internal sanctions more credible, which has its own deterrence benefits). Professor Donald Langevoort identifies these reputational deterrent mechanisms as elements of corporate culture. See Langevoort, Organized Illusions, supra note 70, at 132.

219. Desio, supra note 24.

220. See Baysinger, supra note 218, at 342; supra notes 164–212 and accompanying text.

221. See DeMott, supra note 77, at 40 (explaining that corporate principals design agents' incentives).

222. For examples, see infra section III.B; see also Abril & Olazábal, supra note 88, at 160–61 (presenting a fraudulent culture hypothetical based on the facts of In re Alpharma, Inc., Sec. Litig., 372 F.3d 137 (3d Cir. 2004)). Under the PSLRA, scienter must be alleged with respect to each alleged misstatement, see 15 U.S.C. § 78u-4(b)(2)(A) (2018), but this approach does not preclude that.

to—the alleged fraud.[223] And this way of considering management decisions is better, from an optimal deterrence perspective, than the Sixth Circuit's high managerial agent approach because it connects more clearly to the corporation's capacity to deter fraud.[224]

2. *Combining Respondeat Superior With Organizational Fault Theory.* — Infusing principles of organizational fault drawn from the Guidelines into the corporate scienter inquiry can help optimize the fraud deterrence potential of section 10(b). But this is not to say that corporate structure should be the only way to ascribe intent to corporations; the principles of organizational fault outlined in section III.A.1 can and should be applied within an existing imputation framework.[225] As originally proposed, the Abril and Olazábal high managerial agent approach included the possibility of locating scienter in "the corporation itself,"[226] and corporate criminal enforcement and organizational theory provide tools to analyze the corporation's scienter independently of direct imputation from an agent.[227] This section envisions organizational fault as an added factor in the respondeat superior analysis, finding that this addition fully addresses the optimal deterrence problems with respondeat superior and that other variations are thus unnecessary. But the idea of structural scienter need not be tied to any particular approach; courts should consider injecting organizational fault as one factor in analyzing corporate scienter within any baseline approach.

Considering organizational fault would require courts to analyze corporate scienter more holistically by weighing allegations and evidence related to corporate structure and compliance measures to either establish or mitigate an inference of corporate scienter. In the section 10(b) context, the most important features of the corporate structure are reporting requirements, effective options for reporting suspected wrongdoing or problems sufficiently likely to affect the corporation as a whole, and oversight by officials with appropriate incentives.[228] The response to fraud is also relevant to a corporation's organizational fault.[229] When these structural factors are so deficient that they did not meet a

223. See supra section II.B.3; see also Lipton, supra note 17, at 1316–17.

224. See supra section II.C.3.

225. In any case, given the current state of the doctrine in the Supreme Court, some imputation theory would remain the baseline for ascribing intent to corporations. See supra section II.A (concluding that Supreme Court doctrine would not permit completely abandoning imputation).

226. See Ansfield v. Omnicare, Inc. (In re Omnicare, Inc. Sec. Litig.), 769 F.3d 455, 476 n.2 (6th Cir. 2014) (explaining this factor and rejecting it as "highly theoretical"); Abril & Olazábal, supra note 88, at 151–64 (indicating scienter in the corporation itself can be established through the corporation's history, common knowledge, or culture).

227. See supra section III.A.1.

228. These might include lawyers, see DeMott, supra note 77, at 55–56, or multiple managers working in tandem as concurrent checks on each other, see Arlen & Kraakman, supra note 68, at 702.

229. See Desio, supra note 24.

minimum threshold of fraud deterrence, or that there is a culture of deception within the firm, this may raise a strong inference that the corporation itself had the intent to defraud.[230] On the other hand, when the corporation is appropriately structured and an agent intentionally circumvents fraud controls, these circumstances would weigh against imputing that agent's scienter to the corporation.[231] And courts might consider allowing corporations to defend allegedly deficient designs by pointing to legitimate business justifications that rebut the inference of "willfully" deficient structure.[232]

Grounding corporate scienter in a corporation's deficient structure would be a deviation from the usual reliance on agency law, but the texts of the relevant laws and regulations do not preclude this framework. The textual underpinnings of section 10(b) class action litigation are sparse.[233] Congress has said plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind" in their complaint and must allege scienter "with respect to each act or omission."[234] Beyond these directives, no legislative text defines what can or cannot be factored in to the already abstract analysis of corporate scienter, and nothing limits courts to a strict imputation analysis. In fact, most courts look beyond strict agency principles to help calibrate their corporate scienter analysis in these cases.[235] And there is a distinct intentionality about corporate structuring.[236] Even though decisions regarding corporate structure typically cannot be connected directly to fraudulent misstatements, they determine the flow of information that comes to define what is or isn't fraud. Thus, considering structure as intention allows courts to close a loophole that has driven the appeal of otherwise questionable doctrines such as collective scienter: Courts want to hold corporations accountable for designing themselves to allow abdication of responsibility. Considering institutional structure as an

230. See supra notes 220–223 and accompanying text.

231. Such a mitigation analysis need not be applied as a bright-line rule. If a corporation had a robust fraud-deterring structure, but half of its officers were complicit in the fraud, the facts could still be found to support a strong inference of corporate scienter. See Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 326 (2007) (directing lower courts to consider plaintiffs' allegations holistically to determine whether they raise a strong inference of scienter).

232. Courts could consider such evidence to combat a rebuttable presumption of corporate scienter created by a plaintiff's deficient-structure evidence or otherwise as an affirmative defense.

233. See supra section I.A.1.

234. 15 U.S.C. § 78u-4(b)(2)(A) (2018).

235. See, e.g., Loc. 731 I.B. of T. Excavators and Pavers Pension Tr. Fund v. Diodes, Inc., 810 F.3d 951, 958–59 (5th Cir. 2016) (conducting a fact-intensive analysis before allowing imputation); see also Abril & Olazábal, supra note 88, at 120 ("[S]ome scholars and courts have proposed that the proper way to apply the collective knowledge doctrine is in conjunction with other considerations that may more accurately point to culpability, most notably the presence of willful blindness.").

236. See supra notes 220–223 and accompanying text.

element of corporate scienter allows intent (and, ultimately, culpability) determinations to implicate these deficient designs directly.

Moreover, considering organizational fault principles helps optimize deterrence and comports with the purpose of the overall statutory enforcement scheme. Optimally calibrating fraud deterrence is the key goal of corporate liability in section 10(b) class actions, and scienter standards facilitate that goal. Considering organizational fault helps courts encourage optimal deterrence by mitigating the over- and underdeterrence problems associated with existing approaches. It would shape corporate scienter to reflect statutory purpose and policy goals by limiting corporate liability for frauds in which the corporation is truly a victim and expanding liability to capture wrongdoing that is within the intended scope of section 10(b) but unaddressed due to current scienter formulations. The uneven evolution of corporate scienter standards in the circuit courts can be explained as an effort to incorporate certain policy goals into the doctrine; structural scienter captures these goals in a cohesive framework motivated by optimal deterrence. Injecting this framework into existing imputation approaches would be far preferable to ad hoc revisions reflected in the trend in the circuit courts toward high managerial agent-style approaches[237] and flirtations with collective scienter.[238]

B. *Hypothetical Case Studies*

The previous section focused on the theoretical benefits of considering structure and compliance principles reflected in the Guidelines as one factor in analyzing corporate scienter. This section reviews two hypothetical case studies to address the practical benefits of adding a structural scienter category.

1. Makor *GM Hypothetical*. — Recall the Seventh Circuit's GM hypothetical from *Makor*.[239] The Seventh Circuit intended to illustrate the need to allow plaintiffs to allege corporate scienter even if they cannot identify a responsible individual[240] and concluded that the anonymous fraudster approach would be sufficient to handle these facts.[241] Other courts have quoted this hypothetical as justification for collective

---

237. See supra note 163 and accompanying text.

238. See supra section II.B.2.

239. The hypothetical is as follows:

> 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.

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

240. Id.

241. See Pugh v. Trib. Co., 521 F.3d 686, 697 & n.5 (7th Cir. 2008).

scienter.[242] But the organizational fault framework is actually best suited to handle at least one version of this hypothetical.

These facts could arise in a few circumstances. In one version, the speaking official or someone else at the management level who advises them knew that the company sold no cars and nevertheless made or supplied the rosy announcement. That person would have scienter that could be imputed to the corporation under the *Southland* version of respondeat superior,[243] and most courts would find scienter had been sufficiently alleged even if the plaintiffs could not identify the fraudster at the pleading stage.[244] But, in another version, the low-level salespeople all come together and agree to do just enough work to keep up appearances but no more. They make no sales. Through some lie or even an error, management receives a report of a million cars sold and immediately passes this news to the public. Here, no one has scienter that can be imputed to the corporation with respect to the false public statement. GM would not be liable under respondeat superior,[245] even though this extreme communication failure could seemingly only occur if the corporation were intentionally designed to prevent relevant information from reaching high-level management. Collective scienter would probably support liability, but commitment to collective scienter is likely ill-advised.[246]

This situation would easily fall into the organizational fault category of scienter. That an entire class of employees could functionally cease working without this being reported to upper management, and that some further error could lead to a grossly inflated sales report, would provide prima facie evidence of a failure to maintain effective communication and oversight. One might argue that this structure could only result from a corporate framer's intention to prevent information from flowing to the top, or else from extreme recklessness. But in any case, the obvious failures in communication and oversight presented here seem to implicate the type of reckless or intentionally deficient structure that should establish corporate scienter under the proposed framework. This version of corporate scienter allows for liability based on the corporation's own

242. See Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap. Inc., 531 F.3d 190, 195–96 (2d Cir. 2008) (quoting and adopting the GM hypothetical); Glazer Cap. Mgmt., LP v. Magistri, 549 F.3d 736, 744 (9th Cir. 2008) ("[T]here could be circumstances in which a company's public statements were so important and so dramatically false that they would create a strong inference that at least *some* corporate officials knew of the falsity upon publication." (citing *Makor*, 513 F.3d at 710)).

243. See supra notes 124–127 and accompanying text.

244. The Second, Fifth, Seventh, Ninth, and Eleventh Circuits have all endorsed the anonymous fraudster pleading theory. See supra sections II.B.1–.2.

245. Plaintiffs could probably still sustain a complaint through a motion to dismiss on these facts by imagining an anonymous fraudster within the managerial ranks. See supra note 140. But presumably, once it was established that no one in management knew about the discrepancy, GM could not be held liable due to a lack of imputable scienter.

246. See supra section II.C.2.

relevant shortcomings without introducing the problems associated with commitment to collective scienter or engage with what managers "must have known."

2. Matrixx Initiatives *Counterfactual*. — While the facts of *Matrixx Initiatives v. Siracusano* supported a finding of scienter by imputation in the Ninth Circuit,[247] one might imagine an alternative version in which a finding of corporate liability would still be warranted even though there is no imputation avenue. Consider a scenario where Clarot is not a Vice President but instead is sufficiently low ranking that he is not presumed to be involved in the formulation of press releases and SEC filings. He has the same information about the anosmia reports but has not reported it to anyone further up the chain of management. Further assume that there is conclusive evidence that the managers were not aware of lawsuits filed against the company—perhaps Clarot is engaged in a massive cover-up, or perhaps communication from the legal department to management is simply failing. If all the other facts were the same as *Matrixx Initiatives*, there might still be a case for corporate liability. The fraud may have been outside the corporation's reasonable ability to control if Clarot actively ignored reporting protocols and prevented the legal department from communicating with management due to some personal vendetta. But if Clarot were just not required (or worse, were unable) to report this information up the chain, and if the legal department were similarly disconnected from upper management, individual liability would make much less sense and corporate liability would become more appealing.

The organizational fault framework has double benefits in this scenario: It would give the corporation the opportunity to mitigate its exposure in the rogue Clarot version and would hold Matrixx responsible if its internal systems were deficient. Assuming Matrixx could show it had reasonably sufficient oversight and communication mechanisms in place, and that it punished Clarot appropriately upon discovering the cover-up, its liability could be greatly reduced or eliminated. By contrast, if the corporation were set up to prevent or discourage reporting such that public communications continued without input from lawyers or research scientists, plaintiffs could allege scienter on that basis even if its deficient systems prevented scienter from attaching to anyone actually responsible for its statements.

CONCLUSION

Given that most section 10(b) cases settle if they make it past a motion to dismiss and that scienter is a frequent battleground issue in fraud-on-the-market class actions, the definition of scienter at the pleading stage is often outcome determinative. It should be supported by sound legal reasoning and informed by the policy objectives captured in optimal

247. See supra notes 105–113 and accompanying text.

deterrence. The optimal deterrence goal suggests that corporate scienter should be conceptually connected to the corporation's capacity to deter fraud, which exists primarily in structure and compliance decisions. The Organizational Sentencing Guidelines provide a starting point to help courts consider these decisions as one factor in the analysis of corporate scienter, and each circuit should inject their teachings into its doctrine.

Incorporating corporate structure into the analysis of corporate states of mind is conceptually and legally justified and practically helpful. The category of structural scienter directly captures the policy decisions underlying the securities litigation regime that have driven both the scienter circuit split and the appeal of the high managerial agent approach. Further, the organizational fault framework advocated herein can be injected into any existing corporate scienter approach to give courts better tools to calibrate corporate incentives with respect to securities fraud no matter how they have historically handled corporate scienter. Corporations may not have literal minds, but they are intentionally designed. Structural decisions can and should be considered to reflect corporate intentions separate from those of any individual agent at any particular time to supplement the analysis of corporate scienter in section 10(b) litigation.