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Ninth Circuit Holds That Scienter May Be Established Through An Objective Evaluation Of A Defendant's Deliberate Recklessness

In *Securities & Exchange Commission v. Platforms Wireless Int'l Corp.*, No. 07-56542, 2010 U.S. App. LEXIS 15328 (9th Cir. July 27, 2010), the United States Court of Appeals for the Ninth Circuit held that under Section 10(b) of Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, a showing that a statement is so obviously misleading to a reasonable person that the defendant who made the statement must have known of its misleading nature is sufficient on summary judgment to prove defendant's scienter. The Court held further that a defendant cannot defeat summary judgment merely by denying subjective knowledge of the risk that a statement could be misleading. This decision clarifies two points of law in the Ninth Circuit: first, that the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 ("Reform Act"), did not alter the substantive requirement for pleading scienter for claims under Section 10(b) and Rule 10b-5, and second, that deliberate recklessness, for purposes of demonstrating scienter, may be proved by an objective, not subjective, evaluation of a defendant's mental state.

Between 1998 and January 2000, William Martin provided consulting services to Platforms Wireless International Corporation ("Platforms") as an employee of Intermedia Video Marketing Company ("Intermedia"). In exchange for those services, Intermedia earned at least 17.45 million unregistered shares of Platforms stock. In March 2000, Martin became the Chairman and CEO of Platforms. Subsequently, in August 2000, Platforms issued a press release purportedly unveiling new airborne wireless communications technology despite the fact that at that time, Platforms had only a description of how the technology would operate and did not have prototypes built or the money to build them. Later in 2000 and 2001, Platforms issued Intermedia's stocks to entities and individuals associated with Intermedia, who then sold those shares to the public.

In October 2004, the Securities and Exchange Commission ("SEC" filed a civil enforcement action against Platforms, Martin and several other Platforms officers and directors alleging, among other things, that Martin and Platforms violated various federal statutes by selling unregistered securities to the public and issuing a fraudulent press release in August 2000. The United States District Court for the Southern District of California granted summary judgment in favor of the SEC on its claim under Section 5 of the 1934 Act for selling unregistered securities and on its Section 10(b) claim based on the August 2000 press release. The

district court ordered Platforms and Martin jointly and severally to disgorge about $1.75 million in proceeds and pay almost $1 million in prejudgment interest. Defendants appealed.

The Ninth Circuit affirmed the district court's decision. The import of the Ninth Circuit's holding derives from its discussion regarding the Section 10(b) violation in connection with Platforms' August 2007 press release. A violation of Section 10(b) and Rule 10b-5 requires, among other things, a showing of the defendant's mental state or scienter, which can be established by the defendant's intent, knowledge or deliberate recklessness in connection with the making of a materially misleading statement.

The Ninth Circuit focused first on the substantive level of scienter required for liability under Section 10(b) and the Reform Act. In *In re Silicon Graphics, Inc. Securities Litigation*, 183 F.3d 970 (9th Cir. 1999), the Court held that a securities fraud plaintiff must at a minimum plead and prove "deliberate recklessness" to support liability under Section 10(b) and Rule 10b-5. In defining "deliberate recklessness," the *Silicon Graphics* Court relied upon pre-Reform Act decision in *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990) (*en banc*), which in turn quoted from *Sundstrand Corp. v. Sun Chem. Corp.*, 533 F.2d 1033 (7th Cir. 1977). The *Platforms* Court confirmed that under Ninth Circuit precedent the Reform Act did not require a higher level of recklessness than existed previously, affirming what was previously only *dicta* from *Howard v. Everex Systems, Inc.*, 228 F.3d 1057, 1064 (9th Cir. 2000).

The Court then turned to the SEC's arguement that scienter could be established conclusively through an objective showing that a reasonable person would see the statement as so obviously misleading that the defendant must have known it was so, rather than only through a showing that the defendant subjectively appreciated that the statement was misleading. The Ninth Circuit agreed, explaining that in *Hollinger* a showing of scienter can be satisfied if a statement is so objectively misleading that any reasonable person must have known of its misleading nature.

The Court held further that a defendant cannot defeat summary judgment by merely denying subjective knowledge of the risk that a statement could be misleading. Rather, the standards adopted by *Hollinger* and *Gebhart v. SEC*, 595 F.3d 1034 (9th Cir. 2010), establish that "if no reasonable person could deny that the statement was materially misleading, a defendant with knowledge of the relevant facts cannot manufacture a genuine issue of material fact merely by denying (or intentionally disregarding) what any reasonable person would have known." Essentially, the standard requires the defendant to show that the statement was objectively not misleading. As applied to the facts of the case, the court held the scienter requirement was satisfied primarily because the August 2007 press release "only permits the conclusion that Platforms was announcing it had actually developed a viable ARC system," but in actuality the system had only been designed without a prototype and lacked sufficient financing. Based on these facts, the Ninth Circuit held Platforms could not reasonably deny that the statement was materially misleading, and the scienter requirement was established.

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