

SECURITIES LITIGATION ALERT

SUPREME COURT RAISES BAR FOR SHAREHOLDERS BRINGING CLASS-ACTION SECURITIES SUITS



On June 21, 2007, the Supreme Court issued an opinion in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* that raises the bar for shareholders bringing class-action securities suits.

In *Tellabs*, the Court considered one of the pleading requirements established by Congress in the Private Securities Litigation Reform Act of 1995 (PSLRA). Among its other requirements, the PSLRA requires plaintiffs to plead “with particularity facts giving rise to a **strong inference** that the defendant acted with the required state of mind,” i.e., scienter, which is the intent to deceive or defraud. 15 U.S.C. § 78u-4(b)(2) (emphasis added). Congress left undefined the “strong inference” required to survive a motion to dismiss. See 15 U.S.C. §78u-4(b)(1), (2), (3)(A). As a result, the courts of appeals split on the issue of the term’s interpretation. While the 7th Circuit held that plaintiffs must merely plead enough facts that “a reasonable person could infer that the defendant acted with the required intent,” the 6th Circuit held plaintiffs to a more exacting standard, requiring that fraudulent intent be “the most plausible of competing inferences” presented by the parties. Compare *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 602 (7th Cir. 2006), with *Fidel v. Farley*, 392 F.3d 220, 227 (6th Cir. 2004) (quoting *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001)).

The Court established a middle ground in its *Tellabs* opinion, holding that, “[t]o qualify as ‘strong’ . . . an inference of scienter must be more than merely plausible or reasonable — it must be cogent and *at least as compelling* as any opposing inference of nonfraudulent intent.” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, No. 06-484, ___ S. Ct. ___, 2007 WL 1773208, at *4 (June 21, 2007) (emphasis added). This inherently comparative analysis, which the 7th Circuit had expressly refused to conduct, is essential to determining whether plaintiffs have sufficiently pled scienter because “[t]he strength of an inference cannot be decided in a vacuum . . . it must be cogent and compelling, thus strong in light of other explanations” *Id.* at *10. The Court concluded that, “[a] complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” *Id.* at *10.

The 7th Circuit had expressed concern that an assessment of competing inferences potentially could infringe upon plaintiffs’ 7th Amendment right to a jury trial. *Id.* at *11. The *Tellabs* Court found that there was no danger that a comparison of plausible inferences would violate the Seventh Amendment, noting that there are many contexts in which Congress establishes pleading requirements and courts make gatekeeping determinations that prevent submission of claims to a jury without impinging on the right to a jury trial. *Id.* at 11 & nn.8-9.

The Court explained further that its construction of the scienter standard does not require plaintiffs to plead more than they are required to prove at trial. Under the *Tellabs* standard, at the pleading stage, plaintiffs must show that it is *at least as likely* as any other plausible scenario that the defendants acted with scienter, but to win at trial, plaintiffs must show that “it is *more likely than not* that the defendant acted with scienter.” *Id.* at *12.

Thus, the *Tellabs* decision reinforces the PSLRA’s purpose by curbing frivolous litigation on the front end, while preserving investors’ ability to recover on meritorious claims. This more stringent standard for pleading a “strong inference” is yet another defensive weapon in the arsenal for companies fighting meritless shareholder lawsuits, and it has the potential to further limit the number of securities fraud class actions filed in the coming years.

CONTACT INFORMATION

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