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Case Note: Why Plaintiffs Should Learn to Love the Strong-inference Standard for Pleading a Securities Fraud Claim—Tellabs, Inc. v. Makor Issues & Rights, Ltd

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CASE NOTE: WHY PLAINTIFFS SHOULD LEARN TO LOVE THE STRONG-INFERENCE STANDARD FOR PLEADING A SECURITIES FRAUD CLAIM— *TELLABS, INC. v. MAKOR ISSUES & RIGHTS, LTD.*

Devona L. Wells[†]

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I. INTRODUCTION

Under Chief Justice John G. Roberts, Jr., the U.S Supreme Court is widely thought to be a pro-business Court that rewards big companies at the expense of the little guy.¹ *Tellabs v. Makor* set the stage in 2007 for yet another decision favoring a corporate defendant when the Court considered a securities fraud claim brought by shareholders against fiber optics equipment maker Tellabs, Inc.² Instead, the Court outlined a pleading standard for plaintiffs that remains tough but attainable.

The Supreme Court granted certiorari to resolve a circuit split and interpret two words in the Private Securities Litigation Reform

1. “[T]here is little doubt that the Roberts Court is, broadly speaking, a business-friendly Court.” David L. Franklin, *What Kind of Business-Friendly Court? Explaining the Chamber of Commerce’s Success at the Roberts Court*, 49 SANTA CLARA L. REV. 1019, 1020 (2009). The article notes that the Court’s pro-business decisions can be attributed more to a skepticism for “litigation as a mode of regulation” rather than “a bias in favor of business per se.” *Id.* at 1021; *see also* Jeffrey Toobin, *No More Mr. Nice Guy*, THE NEW YORKER, May 25, 2009, at 42 (“In every major case since he became the nation’s seventeenth Chief Justice, Roberts has sided with the . . . corporate defendant over the individual plaintiff.”); Posting of Peter Lattman to the Wall Street Journal Law Blog, <http://blogs.wsj.com/law/2007/06/22/plaintiffs-bar-losing-at-supremes-winning-one-in-beantown/> (June 22, 2007, 9:16 EST) (“I always thought that the Rehnquist court was really quite a good forum for business,” said Maureen Mahoney of Latham & Watkins to the [*Washington Post*]. “But I think we now know that the Roberts court is even better.”).

2. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). *Tellabs* began in the U.S. District Court for the Northern District in 2003 and was appealed to the U.S. Court of Appeals for the Seventh Circuit. *Johnson v. Tellabs, Inc.* (*Johnson II*), 303 F. Supp. 2d 941 (N.D. Ill. 2004) *overruled by* *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588 (7th Cir. 2004). The case was further appealed to the U.S. Supreme Court, which remanded it to the Seventh Circuit. *Tellabs*, 551 U.S. 308, *vacating*, *Makor Issues*, 437 F.3d 588. The Seventh Circuit then remanded the case to the district court. *Makor Issues & Rights Ltd. v. Tellabs, Inc.*, 513 F.3d 702 (7th Cir. 2008). The most recent judgment in the case came from the same U.S. District Court in Illinois that granted defendants’ motion to dismiss in 2004. *Makor Issues & Rights Ltd. v. Tellabs, Inc.*, 256 F.R.D. 586 (N.D. Ill. 2009). *Tellabs, Inc.*, based in Lisle, Ill., manufactures equipment used in fiber optic cable networks. *Makor Issues*, 513 F.3d at 706.

Act of 1995 (the Act), which governs securities fraud pleading.³ These two words—“strong inference”—had divided the U.S. Circuit Courts of Appeals since the Act’s passage.⁴ Ultimately, the “strong inference” language led to division at the Supreme Court, which issued an 8–1 opinion that contained two concurrences and a dissent.⁵ The majority held that plaintiffs must demonstrate a cogent inference of scienter at least as strong as any opposing inference from the defendant.⁶ In other words, a tie goes to the plaintiff.⁷

This note first addresses passage of the Act as the catalyst that prompted the Supreme Court to lay out a strong-inference standard for securities fraud claims.⁸ Second, this note explains how the Supreme Court arrived at the strong-inference standard and, in doing so, attempted to resolve a circuit split.⁹ Third, this note examines the fallout from *Tellabs* and how plaintiffs can use the standard in their favor.¹⁰ Finally, this note concludes that even though the Supreme Court upheld a heightened pleading standard for securities fraud plaintiffs, it “dropped the bar as low as it could without eviscerating the [Act].”¹¹

3. In 2005, the Court considered parts of the Act related to loss causation in *Dura Pharmaceuticals v. Broudo*. *Dura Pharm. v. Broudo*, 544 U.S. 336 (2005); 3C HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES & FEDERAL CORPORATION LAW* § 16:64 (2d ed. 2009). But *Tellabs v. Makor* was the Court’s first look at the strong inference standard adopted in the Private Securities Litigation Reform Act of 1995. BLOOMENTHAL & WOLFF, *supra* note 3, at § 16:64; 15 U.S.C. § 78u-4(b)(2) (1995).

4. 15 U.S.C. § 78u-4(b)(2) (1995).

5. The majority opinion was written by Justice Ruth Bader Ginsburg and joined by Chief Justice John G. Roberts, Jr. and Justices Anthony M. Kennedy, David H. Souter, Clarence Thomas, and Stephen G. Breyer. *Tellabs*, 551 U.S. 308. Separate concurrences came from Justices Antonin Scalia and Samuel A. Alito, Jr. *Id.* at 329, 333. Justice John Paul Stevens dissented. *Id.* at 335.

6. *Id.* at 324. In *Ernst & Ernst v. Hochfelder*, the Supreme Court defined scienter as “a mental state embracing intent to deceive, manipulate, or defraud.” 425 U.S. 185, 193 n.12 (1976).

7. *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 254 (5th Cir. 2009) (“[A] tie favors the plaintiff.”); *N.J. Carpenters Pension & Annuity Funds v. Biogen IDEC, Inc.*, 537 F.3d 35, 45 (1st Cir. 2008) (“[W]here there are equally strong inferences for and against scienter, *Tellabs* now awards the draw to the plaintiff.”) (quoting *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 59 (2008) (citing *Tellabs*, 551 U.S. at 324)); see also Brett Deforest Maxfield, *Ethics, Politics and Securities Law: How Unethical People Are Using Politics to Undermine the Integrity of our Courts and Financial Markets*, 35 OHIO N.U. L. REV. 243, 286 (2009) (asserting that the Seventh Circuit misinterpreted the Court’s strong inference standard, which requires giving “the tie to the plaintiff,” in *Higginbotham v. Baxter Int’l, Inc.*, 495 F.3d 752 (7th Cir. 2007)).

8. See *infra* Part II.

9. See *infra* Part III.

10. See *infra* Part IV.

11. Christopher J. Keller & Michael W. Stocker, *Tellabs: PSLRA Pleading Test*

II. HISTORY

A. Congress Heightens the Pleading Standard for Securities Fraud Claims

Without the Private Securities Litigation Reform Act, *Tellabs* would not exist.¹² Congress passed the Act in 1995, three days before Christmas, in a vote that overrode the veto of President Bill Clinton.¹³ Proponents of the legislation argued that it would ease the burden on companies overwhelmed by class actions.¹⁴ Critics claimed that, if passed, the Act would shield those who engage in securities fraud from legitimate lawsuits.¹⁵

Under the Federal Rules of Civil Procedure, a complaint must contain a short and plain statement of the claim alleging why the plaintiff is entitled to relief.¹⁶ Securities fraud lawsuits before passage of the Act already were subjected to additional pleading requirements

Comparative, Not Absolute, 238 N.Y. L. J. 4 (2007); see also *infra* Part V.

12. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (“As a check against abusive litigation in private securities fraud actions, the Private Securities Litigation Reform Act of 1995 (PSLRA) includes exact pleading requirements.”).

13. H.R. DOC. NO. 104-150 (1995). The Act was the first comprehensive revision of national securities laws since they were enacted sixty years earlier. Erin E. Rhinehart, Column, *Diluting the Strong Inference Standard*, 55 FED. LAW., 20, 20 (May 2008). The veto override was the first of the Clinton administration. Joshua Mills, N.Y. TIMES, Dec. 24, 1995, at Diary 3. In his veto message to Congress, President Clinton stated that he was not willing to sign a bill that would close “the courthouse door on investors who have legitimate claims.” H.R. DOC. NO. 104-150, at 1 (1995). He gave three reasons for issuing the veto, the first of which addressed the bill’s strengthening of the pleading standard for securities fraud claims. *Id.* President Clinton wrote that fraud victims should have judicial recourse, which the bill would remove. *Id.* He worried that the new heightened pleading standard would erect a barrier “so high that even the most aggrieved investors with the most painful losses may get tossed out of court before they have a chance to prove their case.” *Id.* The House voted 319-100 to override the veto, followed by the Senate, which voted 68-30. MITCHEL A. SOLLENBERGER, CRS REPORT FOR CONGRESS 3 (2004), <http://www.rules.house.gov/archives/98-147.pdf>.

14. 141 CONG. REC. 19,146 (1995) (statement of Sen. D’Amato). “The system no longer recovers damages for investors who are actually wronged and it unfairly focuses the enormous costs of litigation on reputable public companies and not upon those who engage in fraud.” *Id.*; see also Patrick Berarducci & Larry J. Obhof, *Supreme Court Clarifies Scierter Pleadings*, 17 BUS. L. TODAY 10, 10 (2007) (asserting that private securities litigation play an important role in deterring fraud but too many pre-Act actions frustrated business activities and imposed a burdensome discovery process, which led to settlement if even meritless cases survived a motion to dismiss).

15. 141 CONG. REC. 19,146 (1995) (statement of Sen. Sarbanes). Senator Paul Sarbanes stated that the bill’s major provisions would go “well beyond curbing frivolous lawsuits and will work to shield some of the most egregious wrongdoers from legitimate lawsuits brought by defrauded investors.” *Id.*

16. FED. R. CIV. P. 8.

under Rule 9(b), which requires that pleadings state fraud allegations with factual particularity.¹⁷

According to some in Congress, Rule 9(b)'s additional pleading requirements did not do enough to prevent private litigants from abusing securities laws.¹⁸ Therefore, the Act heightened the threshold pleading rules for a federal securities fraud claim initiated under section 10(b) of the Securities and Exchange Act of 1934 and SEC Rule 10b-5.¹⁹ The Act requires that such a complaint (1) state facts with particularity and (2) state facts that give rise to a strong inference of scienter.²⁰

Tellabs originated in the U.S. District Court for the Northern District of Illinois, which noted that Congress enacted the Act's heightened pleading standard to limit meritless lawsuits and to create a uniform pleading standard.²¹ While Congress succeeded in the enactment of a more stringent pleading standard, it failed to create a

17. *In re* Rockefeller Ctr. Props., Inc. Sec. Litig., 311 F.3d 198, 216 (3d Cir. 2002); see FED. R. CIV. P. 9(b).

18. *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 580, 600 (2006) (quoting H.R. REP. NO. 104-369 at 41 (1995) (Conf. Rep.), reprinted in U.S.C.C.A.N. 730, 740).

19. 15 U.S.C. § 78j(b) (2000).

It shall be unlawful for any person . . . to use or employ, in connection with the sale of any security . . . any manipulative or deceptive device or contrivance of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.; 17 C.F.R. § 240.10b-5 (2006).

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (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, in connection with the purchase or sale of any security.

Id.

20. 15 U.S.C. § 78u-4(b)(2) (2000). As was the case before the Act, plaintiffs still must meet the Federal Rule 9(b) requirements. *Johnson v. Tellabs, Inc. (Johnson II)*, 303 F. Supp. 2d 941, 951 (N.D. Ill. 2004) (noting that securities fraud allegations must meet Rule 9(b)'s heightened pleading requirements, as well as the Act's additional pleading requirements); see also *supra* note 17 and accompanying text.

21. *Johnson II*, 303 F. Supp. 2d at 952 (quoting *Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 343 (4th Cir. 2003) (quoting H.R. REP. NO. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 740)).

uniform pleading standard among the circuits.²²

B. Circuits Disagree on What Makes a Strong Inference of Scienter

Lacking a definition of strong inference from Congress, the circuits diverged in their application of the Act's heightened pleading standard.²³ On one end of the spectrum, the Seventh Circuit applied a reasonable person standard that allowed a plaintiff to survive a motion to dismiss "if it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent."²⁴ On the other end of the spectrum, the First, Fourth, Sixth, and Ninth circuits required a direct comparison of plausible inferences and would find a strong inference if the plaintiff's allegation was the most plausible.²⁵

In the middle sat the Eighth and Tenth circuits, which considered all inferences, both of a culpable and innocent state of mind, to test if the culpable inference was a strong inference.²⁶ The Second and Third circuits also were near the spectrum's midpoint, employing tests that equated a plaintiff's allegations of either motive and opportunity or knowing or reckless conduct with a strong inference.²⁷

22. *Makor Issues*, 437 F.3d at 601 (noting three different approaches among the courts of appeals in finding that a plaintiff demonstrated a strong inference of scienter).

23. See *infra* notes 24–26 and accompanying text.

24. *Makor Issues*, 437 F.3d at 602.

25. *Ottmann*, 353 F.3d at 345–46 (holding that all allegations should be examined to determine if they collectively establish a strong inference of scienter); *In re Cabletron Sys.*, 311 F.3d 11, 40 (1st Cir. 2002) ("Each individual fact . . . may provide only a brushstroke, but the resulting portrait satisfies the requirement for a strong inference of scienter under the PSLRA."); *Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir. 2002) (holding that courts should consider all allegations and their inferences in concluding whether the plaintiff has pleaded the requisite scienter inference); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001) ("[T]he 'strong inference' requirement means that plaintiffs are entitled only to the most plausible of competing inferences."); see also Maxfield, *supra* note 7, at 282.

26. *Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1188 (10th Cir. 2003) ("If a plaintiff pleads facts with particularity that, in the overall context of the pleadings, including potentially negative inferences, give rise to a strong inference of scienter, the scienter requirement of the Reform Act is satisfied."); *In re K-tel Int'l, Inc. Sec. Litig.*, 300 F.3d 881, 889 n.6 (8th Cir. 2002) (rejecting Sixth Circuit's "most plausible" pleading standard); see also Maxfield, *supra* note 7, at 282.

27. *Kalnit v. Eichler*, 264 F.3d 131, 138–39 (2d Cir. 2001) (concluding that the circuit's pre-Act pleading standard survived the Act); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 535–36 (3d Cir. 1999) (holding that plaintiffs may plead scienter by alleging a motive and opportunity to commit fraud or through evidence of reckless or

C. Tellabs Shareholders Are Twice Rejected By the Trial Court for Not Meeting the Act's Pleading Standards

On December 11, 2000, Tellabs, Inc. pitched the promise of its newest product to shareholders and analysts while selling the strength of its established product.²⁸ In the following months, CEO Richard Notebaert painted a rosy picture for analysts and shareholders of customer demand and sales growth.²⁹ Meanwhile, the company reduced sales projections for the first quarter of 2001 and again for the second quarter.³⁰ On June 19, 2001, the company announced that second quarter sales had plummeted.³¹ The next day, the stock closed at \$16.04 per share, far below a high just months earlier of \$67.13.³²

On December 3, 2002, Tellabs investors filed a putative class action against Tellabs and ten executives, including Notebaert, alleging a scheme to deceive and defraud investors as to the true value of the company's stock.³³ The lawsuit set the stage for years of still-pending litigation and for the Supreme Court to resolve an unsettled facet of securities fraud pleading.³⁴

conscious behavior) (quotation and citation omitted); *see also* Maxfield, *supra* note 7, at 282.

28. *Makor Issues & Rights Ltd. v. Tellabs, Inc.*, 256 F.R.D. 586, 591 (N.D. Ill. 2009). The class period began Dec. 11, 2000, and ended June 19, 2001. *Id.* at 591. Sales of the Titan 5500, despite being described as the company's "best seller," substantially slowed with excess stored in warehouses. *Id.* at 592. By the start of the class period, the Titan 5500 (a digital cross-connect product) was not well received because it was inferior to competitors' offerings. Complaint of Plaintiff-Appellee, *Johnson v. Tellabs, Inc. (Johnson I)*, 262 F. Supp. 2d 937 (N.D. Ill. 2003) (No. 02-CV-4356). Meanwhile, the new product, the Titan 6500, was not selling, was behind schedule, and failed customer lab evaluations. *Makor Issues*, 256 F.R.D. at 591-92.

29. In February 2001, Notebaert issued a letter to stockholders describing "robust" demand for the Titan 5500, including accelerating growth and that "customers are embracing" the Titan 6500. *Johnson v. Tellabs, Inc. (Johnson II)*, 303 F. Supp.2d 941, 948 (N.D. Ill. 2004) (citing Complaint of Plaintiff at ¶¶ 90-91, *Johnson I*, 262 F. Supp. 2d 937 (N.D. Ill. 2003) (No. 02-CV-4356)). Less than a month later, the numbers began to reveal another story as Tellabs decreased its revenue and earnings-per-share expectations for the first quarter while maintaining that demand for the Titan 6500 continued to grow. *Id.*

30. *Johnson II*, 303 F. Supp. 2d at 948-49.

31. *Id.* at 949-50.

32. *Makor Issues*, 256 F.R.D. at 593 (noting that the \$67.13 share price was the highest purchased by shareholders during the nearly eight-month class period).

33. *Johnson II*, 303 F. Supp. 2d at 944.

34. *See supra* note 2 and accompanying text. In February 2009, Judge Amy J. St. Eve certified the class, allowing plaintiffs to continue moving forward with their securities fraud claims. *Makor Issues*, 256 F.R.D. at 586.

The plaintiffs' allegations were brought under section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5.³⁵ On May 19, 2003, the district court dismissed the shareholder complaint on multiple grounds, including a lack of specificity in the plaintiffs' allegations and a failure to properly allege scienter.³⁶

The shareholders then amended their complaint, identifying twenty-seven confidential sources to further support their securities fraud allegations.³⁷ On February 19, 2004, the district court again dismissed the plaintiffs' claims, this time with prejudice.³⁸ The court concluded that even though shareholders had sufficiently pleaded numerous allegations with specificity as required by the Act, the allegations did not support a strong inference of scienter.³⁹ The plaintiffs then appealed to the Seventh Circuit, alleging that the district court erred on three issues, including whether the complaint pleaded a strong inference of scienter.⁴⁰

D. The Seventh Circuit Adopts a Reasonable Person Standard for Finding a Strong Inference of Scienter

Makor Issues & Rights, Ltd. v. Tellabs, Inc. presented the Seventh Circuit its first opportunity to address the Act's heightened pleading requirement.⁴¹ In doing so, the Seventh Circuit reversed the trial court in relevant part.⁴² Like the district court, the Seventh Circuit found that the plaintiffs had pleaded securities fraud allegations with sufficient particularity, satisfying the first of the two elements of the Act's heightened pleading standard.⁴³ However, in writing for the

35. *Johnson I*, 262 F. Supp. 2d 937, 944 (N.D. Ill. 2003).

36. *Id.* at 937 (concluding also that plaintiffs' "claims regarding future success were nonactionable puffery" and that "revenue projections were covered by safe harbor provision").

37. *Johnson II*, 303 F. Supp. 2d at 945.

38. *Id.* at 970.

39. *Id.* at 960–61.

40. *Makor Issues & Rights, Ltd. & Tellabs Inc.*, 437 F.3d 588, 594 (7th Cir. 2006). Plaintiffs also argued that the court dismissed as puffery statements that were legally actionable and that Tellabs, Inc. could not rely on the Act's safe harbor provision. *Id.*

41. *Id.* at 591.

42. *Id.* The Seventh Circuit affirmed the district court's decision to dismiss allegations against another Tellabs executive, which is not relevant to the heightened pleading standard issue. *Id.* at 605.

43. *Id.* at 599–600. The Seventh Circuit also agreed with the district court that some statements by Notebaert, such as "we feel very, very good about the robust growth we're experiencing," amounted to no more than puffery. *Id.* at 597. Mere

Seventh Circuit, Judge Harlington Wood, Jr. noted that whether the plaintiffs adequately alleged scienter is the “even more arduous[] hurdle” presented by the Act’s pleading requirements.⁴⁴ Additionally, Judge Wood acknowledged that it was this strong-inference standard that had generated a split among the circuits.⁴⁵ He wrote that most of the disagreement centered on the level of factual detail needed in a pleading to create a strong inference of scienter.⁴⁶ Judge Wood also lamented that Congress, in creating the strong-inference standard, “did not, unfortunately, throw much light on what facts will suffice to create such an inference.”⁴⁷

In reversing the district court’s order to dismiss the lawsuit, the Seventh Circuit found that the plaintiffs sufficiently alleged that Notebaert acted with the requisite state of mind.⁴⁸ Therefore, the plaintiffs were found to have met the Act’s strong-inference standard in their allegations against Notebaert and Tellabs.⁴⁹ The Seventh Circuit held that a complaint survives if it pleads facts from which “a reasonable person could infer that the defendant acted with the required intent.”⁵⁰

In its holding, the Seventh Circuit rejected interpretations of the Act’s strong-inference pleading standard by the Second, Third, Sixth,

sales puffery is not actionable under Rule 10b-5. *Id.* at 596 (quoting *Eisenstadt v. Centel Corp.*, 113 F.3d 738, 746 (7th Cir. 1997) (quotations omitted)).

44. *Id.* at 600.

45. *Id.* at 595.

46. *Id.*

47. *Id.* at 601.

48. *Id.* at 603. The Seventh Circuit rejected the Ninth Circuit’s definition of scienter, which called for a plaintiff to allege facts that “create a strong inference of ‘deliberate or conscious recklessness’ or a ‘degree of recklessness that strongly suggests actual intent.’” *Id.* at 600 (quoting *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 979 (9th Cir. 1999)). The Seventh Circuit stated that if Congress had wanted to impose a more stringent scienter standard it would have done so explicitly, as it did when changing the pleading requirements. *Id.* The court, therefore, applied the same scienter standard as it did prior to the Act: “an extreme departure from the standards of ordinary care, [] which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” *Id.* (citing *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (internal quotation removed)).

49. *Id.* at 603 (concluding that Notebaert’s statements were actionable against Tellabs because, as CEO, “his alleged knowledge of the falsity of his statements can be imputed to . . . Tellabs”).

50. *Id.* at 602.

Ninth, and Eleventh circuits.⁵¹ On January 5, 2007, the Supreme Court granted certiorari.⁵²

III. THE CASE: *TELLABS, INC V. MAKOR ISSUES & RIGHTS, LTD.*

A. *The Stage is Set For Resolution of a Circuit Split*

The Supreme Court stated that it granted certiorari to “resolve the disagreement among the Circuits on whether, and to what extent, a court must consider competing inferences in determining whether a securities fraud complaint gives rise to a ‘strong inference’ of scienter.”⁵³ In its 8–1 opinion, the Court laid out two requirements for a complaint to satisfy the Act’s strong-inference standard and, therefore, survive a motion to dismiss.⁵⁴ First, the Court held that all facts alleged must be evaluated holistically and not in isolation.⁵⁵ Second, a court evaluating allegations under section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 must take into account plausible opposing inferences as part of a comparative inquiry to determine if the facts pleaded give rise to a strong inference.⁵⁶

The Supreme Court remanded *Tellabs* to the Seventh Circuit for a reexamination of the case in accordance with the Court’s construc-

51. *Id.* at 601–02. Judge Wood observed that the Second and Third circuits operated as if Congress had adopted their pre-Act pleading standards, which required plaintiffs to plead “either motive and opportunity or strong circumstantial evidence of recklessness or conscious misbehavior.” *Id.* at 601 (citing *Novak v. Kasaks*, 216 F.3d 300, 309–10 (2d Cir. 2000); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 530–35 (3d Cir. 1999)). The Ninth and Eleventh circuits “opted for a more onerous burden,” rejected the approach of the Second and Third circuits, and believed that Congress intended a stricter standard in its aim to curb abusive securities litigation. *Id.* at 601 (citing *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999); *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1286 (11th Cir. 1999)). The Seventh Circuit aligned itself with the remaining six circuits, a position that was characterized as a “middle ground” because Congress did not adopt or reject particular methods of pleading. *Id.* (citing *Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 345 (4th Cir. 2003); *accord Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 659–60 (8th Cir. 2001); *Nathenson v. Zonagon, Inc.*, 267 F.3d 400, 411–12 (5th Cir. 2001); *City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1261–63 (10th Cir. 2001); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 550–52 (6th Cir. 2001) (en banc); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195–97 (1st Cir. 1999)).

52. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 549 U.S. 1105 (2007).

53. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 317–18 (2007).

54. *Id.* at 322–23.

55. *Id.*

56. *Id.* at 323.

tion of the Act's strong-inference standard.⁵⁷

B. The Court Requires a Holistic Evaluation

The Court emphasized that the evaluation of a motion to dismiss a securities fraud complaint begins with a "holistic" inquiry.⁵⁸ Such an inquiry must take into account all facts rather than examining whether each individual allegation satisfies the strong-inference standard.⁵⁹ The Court stated that the key question is: "When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?"⁶⁰

C. The Court Requires a Comparative Evaluation of Plausible Opposing Inferences

To begin laying out its comparative evaluation requirement the Court turned to the American Heritage and Oxford English dictionaries to define "strong."⁶¹ The Court determined that when Congress adopted the strong-inference requirement in the Act, it equated a strong inference with "a powerful or cogent inference."⁶² But the strength of an inference is not merely its power or potency as it stands

57. *Id.* at 329. The Seventh Circuit was directed by the Supreme Court "to dismiss the complaint unless '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.'" *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 705 (2008) (citing *Tellabs*, 551 U.S. at 323 (footnote omitted)). On remand from the Supreme Court, the Seventh Circuit held that the investors' complaint met the new strong-inference standard for scienter by "pleading scienter in conformity with the requirements of the Private Securities Litigation Reform Act." *Id.*

58. *Tellabs*, 551 U.S. at 326 (citing *Id.* at 323–24; *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601 (7th Cir. 2006)).

59. *Id.* at 326 (citing *id.* at 323–24; *Makor Issues*, 437 F.3d at 601 (holding that, given the lack of congressional direction on how to evaluate a strong inference pleaded under the Act, the best approach is to examine the allegations and decide collectively if they establish a strong inference)).

60. *Id.* at 326.

61. *Id.* at 323 (citing AM. HERITAGE DICTIONARY 1717 (4th ed. 2000); 16 OXFORD ENGLISH DICTIONARY 949 (2d ed. 1989)). The American Heritage Dictionary defined "strong" as "[p]ersuasive, effective and cogent," while the Oxford English Dictionary defined "strong" as "[p]owerful to demonstrate or convince." *Id.* at 323. The Oxford English Dictionary defined "inference" as "a conclusion [drawn] from known or assumed facts or statements"; "reasoning from something known or assumed to something else which follows from it." *Id.* (quoting OXFORD ENGLISH DICTIONARY).

62. *Id.* at 323.

on its own.⁶³ The Court reasoned that the strength of such an inference is drawn from opposing inferences and “must be more than merely ‘reasonable’ or ‘permissible’—it must be cogent and compelling, thus strong in light of other explanations.”⁶⁴

Therefore, the comparative evaluation of plausible opposing inferences is essential to determining whether a plaintiff’s complaint gives rise to a strong inference of scienter.⁶⁵ To determine if a securities fraud complaint raises a strong inference, the *Tellabs* majority held that competing inferences must be considered.⁶⁶ The Supreme Court stated that such a comparative evaluation includes inferences from the plaintiff, as well as competing inferences drawn from the facts alleged.⁶⁷ The Court reasoned that because the strength of such competing inferences cannot be evaluated in a vacuum, the inquiry is inherently comparative.⁶⁸ The question to be asked is: “How likely is it that one conclusion, as compared to others, follows from the underlying facts?”⁶⁹

Writing for the majority, Justice Ruth Bader Ginsburg noted that the Seventh Circuit declined to conduct a comparative inquiry and instead opted to apply a reasonable person standard.⁷⁰ The majority reasoned that Congress required plaintiffs to plead with particularity facts that give rise to a strong inference, which can only be determined by weighing the plaintiff’s inferences against the defendant’s.⁷¹ The Court ruled that a complaint will survive when a reasonable person would deem the inference of scienter cogent and at least as

63. *Id.* at 323–24.

64. *Id.* at 324.

65. *Id.* at 323–24.

66. *Id.* at 328.

67. *Id.* at 314.

68. *Id.* at 323.

69. *Id.* at 323.

70. *Id.* The majority discounted Seventh Circuit concerns that finding a strong inference through a comparative evaluation impinges upon the Seventh Amendment right to a jury trial. *Id.* at 326–27. First, the Court noted that the issue was not raised on appeal by plaintiffs. *Id.* at 326 n.7. Second, the Court pointed to other “gatekeeping, judicial determinations” that prevent submission of a claim to a jury without violating the Seventh Amendment. *Id.* at 327 n.8 (citing *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 589 (1993) (expert testimony can be excluded based on judicial determination of reliability); *Neely v. Martin K. Eby Constr. Co.*, 386 U.S. 317, 321 (1967) (judgment as a matter of law); *Pease v. Rathbun-Jones Eng’g Co.*, 243 U.S. 273, 278 (1917) (summary judgment)). Finally, the Court concluded that Congress may shape the pleading requirements for private securities fraud claims as it sees fit. *See id.* at 327.

71. *Id.* at 328

compelling as any opposing inference.⁷²

The majority's insistence on a comparative evaluation that awards a tie to the plaintiff sits at the core of the discord between the two concurrences and dissent that follow.

D. Concurrence I: Justice Scalia Proposes a Stronger Strong-Inference Standard

The first concurrence came from Justice Antonin Scalia, who agreed with the majority that the Act does not require a strong inference be irrefutable.⁷³ But he asserted that the majority's definition went beyond what Congress intended.⁷⁴ In fact, Justice Scalia believed it to be "inconceivable" that Congress meant to give plaintiffs the edge in close cases when it enacted the Act's heightened pleading standard.⁷⁵ Instead, Justice Scalia proposed his own strong-inference test: "whether an inference of scienter (if any) is *more plausible* than the inference of innocence."⁷⁶

To bolster his point, Justice Scalia employed an example involving the hypothetical theft of a jade falcon.⁷⁷ He wrote that should the falcon be stolen from a room accessed only by *A* and *B*, it could not be strongly inferred that *B* was the thief.⁷⁸ Justice Scalia concluded that a strong possibility that *B* was responsible did not equate to a strong inference that *B* was responsible, reasoning that to form a strong inference one must strongly believe.⁷⁹

The majority disagreed with Justice Scalia that it could not be strongly inferred that either *A* or *B* stole the jade falcon from a room populated only by *A* and *B*.⁸⁰ Writing for the majority, Justice Ginsburg contended that law enforcement officials, along with the

72. *Id.* at 324.

73. *Id.* at 330 (Scalia, J., concurring). The majority stated that "the inference that the defendant acted with scienter need not be irrefutable, i.e., of the 'smoking-gun' genre." *Id.* at 324.

74. *See id.* at 330 (Scalia, J., concurring). Justice Scalia asserted that his interpretation of the "strong inference" language in the Act was not the only or normal reading but "the natural reading of the statute." *Id.* at 331–32.

75. *Id.* at 330 (Scalia, J., concurring).

76. *Id.* at 329 (Scalia, J., concurring) (arguing that he could not "see how an inference that is merely 'at least as compelling as any opposing inference[]' . . . can conceivably be called what the statute here at issue requires: a 'strong inference'").

77. *Id.* (Scalia, J., concurring).

78. *Id.* (Scalia, J., concurring).

79. *Id.* at 329 n.* (Scalia, J., concurring).

80. *Id.* at 324 n.5.

falcon's owner, would find the inference of guilt as to *B* quite strong — “certainly strong enough to warrant further investigation.”⁸¹ In defense of its strong-inference standard, the majority turned to the famous torts case *Summers v. Tice*⁸² to demonstrate that “an inference at least as likely as competing inferences can, in some cases, warrant recovery.”⁸³

Justice Scalia countered that any fame bestowed on *Summers v. Tice* is owed to the case sticking “out of the ordinary body of tort law like a sore thumb.”⁸⁴ The case, he stated, represents a relaxation of the proof ordinarily required in a negligence action.⁸⁵ Justice Scalia added, “[t]here is no indication that the statute at issue here was meant to relax the ordinary rule under which a tie goes to the defendant. To the contrary, it explicitly strengthens that rule by extending it to the pleading stage of a case.”⁸⁶

E. Concurrence II: Justice Alito Believes Congress Wanted a Known Quantity in Its Strong-Inference Standard

Justice Samuel A. Alito, Jr., in his concurrence, gave a tempered endorsement of Justice Scalia's view while criticizing the majority for laying out an unknown standard.⁸⁷ Justice Alito endorsed the view that a strong inference should be one, as Justice Scalia argued, that is more likely than not correct as opposed to the majority's holding that the inference of scienter is at least as strong as the inference of no

81. *Id.*

82. *Summers v. Tice*, 199 P.2d 1, 2–5 (Cal. 1948) (en banc) (establishing doctrine of alternative liability); *see also* RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL HARM § 28, cmt. f (noting only two jurisdictions have rejected the concept of alternative liability since the Second Restatement [of Torts] adopted it: Minnesota and Oregon).

83. *Tellabs*, 551 U.S. at 324 n.5 (citing *Summers*, 199 P.2d at 2–3 (concluding that plaintiff wounded by gunshot could recover from two defendants, even though the most he could prove was that each defendant was at least as likely to have injured him as the other); RESTATEMENT (THIRD) OF TORTS § 28(b), cmt. f (“Since the publication of the Second Restatement in 1965, courts have generally accepted the alternative-liability principle of [*Summers v. Tice*, adopted in] § 433B(3), while fleshing out its limits.”)).

84. *Tellabs*, 551 U.S. at 330 (Scalia, J., concurring).

85. *Id.* (Scalia, J., concurring) (citing *Summers*, 199 P.2d at 3–5 (internal quotations omitted)).

86. *Id.* (Scalia, J., concurring).

87. *See id.* at 333–34 (Alito, J., concurring) (adding that facts not stated by plaintiffs with particularity should not be used to determine whether the plaintiff met the strong-inference standard).

scienter.⁸⁸

However, Justice Alito stated that the two approaches amount to little practical difference because each offers a binary choice: “either the facts give rise to a ‘strong inference’ of scienter or they do not.”⁸⁹ Justice Alito favored Justice Scalia’s view because it aligned the Act’s pleading standard with the test used at summary judgment and judgment as a matter of law, “whereas the Court’s test would introduce a test previously unknown in civil litigation.”⁹⁰ He concluded that it seemed more likely that Congress intended a known quantity.⁹¹

Justice Ginsburg disagreed with Justice Alito that Congress intended to transpose a test from summary judgment and judgment as a matter of law to a point much earlier in the litigation process.⁹² She concluded that, given the absence of such a stated intention from Congress, it is improbable that courts examining a motion to dismiss a securities fraud case are expected to determine whether a genuine issue of material fact exists.⁹³

F. Dissent: Justice Stevens Believes the Strong-Inference Standard Should Look Like Probable Cause

Justice John Paul Stevens, in his dissent, proposed a third strong-inference standard, one that mirrors the probable-cause standard and that would not require the weighing of opposing inferences.⁹⁴ While calling the majority’s strong-inference standard “a perfectly workable definition of the term,” Justice Stevens argued that a probable-cause standard would be easier to apply and more consistent with the Act.⁹⁵

88. *Id.* at 333–35 (Alito, J., concurring).

89. *Id.* at 335 (Alito, J., concurring).

90. *Id.* (Alito, J., concurring).

91. *Id.* (Alito, J., concurring).

92. *Id.* at 324 n.5.

93. *Id.* (arguing, additionally, that judgment as a matter of law, as a post-trial device, turns on “whether a party has produced evidence ‘legally sufficient’ to warrant a jury determination in that party’s favor”).

94. *Id.* at 336 (Stevens, J., dissenting) (arguing that because the Act’s heightened pleading standard is meant to protect defendants from the costs of discovery and trial in unmeritorious cases, the standard can be equated with the probable-cause standard, which does not require defendants “to produce their private effects unless there is probable cause to believe them guilty of misconduct”).

95. *Id.* at 335 (Stevens, J., dissenting) (arguing that “[a]s a matter of normal English usage” the probable-cause and strong-inference standards share “roughly the same” meaning and that a probable cause standard would avoid the “unnecessary conclusion” that determining a strong inference requires a comparative evaluation of plausible opposing inferences).

Justice Stevens wrote that an inference can be deemed strong without comparing inferences.⁹⁶ As an example, he stated that a confirmed drug dealer carrying a suspicious-looking package from a building provides the information necessary to draw a strong inference that the person was involved in a drug transaction without weighing it against other possibilities.⁹⁷

However, not to enlist a comparative evaluation, the majority emphasized, would provide no reference from which to judge whether a pleading rises to a strong inference of scienter.⁹⁸ According to the majority, “[i]n sum, the reviewing court must ask: When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?”⁹⁹

IV. ANALYSIS

A. *Tellabs Publicized as a Pro-Defense Victory from a Pro-Business Court*

Tellabs carried the potential to drastically alter the securities fraud litigation landscape. Anticipation of the Supreme Court’s decision centered on the possibility that leverage could shift at a critical stage in litigation because the risk to defendants tends to increase once a securities fraud complainant survives a motion to dismiss.¹⁰⁰ Immediate reaction to the case revealed that securities defendants liked what they saw.

National media coverage characterized the decision as “another setback for investor’s advocates”¹⁰¹ and now “more difficult for plaintiffs to sue corporations or win substantial damage awards.”¹⁰²

96. *Id.* at 336 (Stevens, J., dissenting).

97. *Id.* at 336–37 (Stevens, J., dissenting).

98. *Id.* at 326 (majority opinion) (citing *id.* at 323–24; *Makor Issues & Rights Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601 (7th Cir. 2006)).

99. *Id.*

100. Allen Ferrell, *The Supreme Court’s 2005-2008 Securities Law Trio: Dura Pharmaceuticals, Tellabs and Stoneridge*, ENGAGE, Oct. 2008, at 32, 34, available at http://www.fed-soc.org/doclib/20090107_FerrellEngage93.pdf.

101. Greg Stohr, *Top U.S. Court Tightens Limits on Shareholder Suits*, BLOOMBERG.COM, June 21, 2007, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a065gqfBaEMQ> (last visited Apr. 11, 2010) (writing that the decision gave “companies a new tool to win early dismissal of shareholder suits and avoid the expense of mounting a full-scale defense.”).

102. Robert Barnes & Carrie Johnson, *Pro-Business Decision Hews to Pattern of Roberts Court*, WASH. POST, June 22, 2007, at D1 (writing that it had been a “resoun-

Additionally, Tellabs, Inc. and the U.S. Chamber of Commerce applauded the Court's stance on the strong-inference standard, even though the position they championed favored the investor plaintiffs on remand.¹⁰³

Rather than make it impossible for plaintiffs to succeed in a securities fraud lawsuit, the Court held that plaintiffs simply must show an inference of scienter at least as strong as any opposing inference.¹⁰⁴ One commentator, notably underwhelmed by the pro-defense spin, stated that *Tellabs* actually "left relatively little changed in the balance of power between defendants and plaintiffs."¹⁰⁵ Another commentator stated that reports of a pro-defense win "got it all wrong."¹⁰⁶ Instead, the Supreme Court liberalized the standard of most circuits to plead a securities fraud class action.¹⁰⁷

B. Defendants Did Not Score the Win They Sought

Tellabs may have appeared pro-business when it was not for several reasons. First, the Court chose to uphold the "strong inference" language as adopted by Congress in the Act rather than strike it down.¹⁰⁸ However, that the Court's definition did not eliminate the

dingly successful year before the nation's highest court" for business, including *Tellabs*, where the Court "made it more difficult for plaintiffs to sue corporations or win substantial damage awards."); see also Linda Greenhouse, *In Steps Big and Small, Supreme Court Moved Right*, N.Y. TIMES, July 1, 2007, at A1 (describing how the decision made it more difficult for investors to sue companies, executives, and underwriters when they suspect securities fraud or unlawful manipulation); David Milstead, *Court Hands Investor Advocates a Setback*, ROCKY MTN. NEWS, June 22, 2007 (explaining how the Court tightened the limits on shareholder-initiated fraud lawsuits).

103. Press Release, Tellabs, Inc., Tellabs Issues Statement on Supreme Court Ruling in *Tellabs v. Makor* (June 21, 2007), available at www.tellabs.com/news/2007/nr062107.shtml (last visited Feb. 13, 2010). Tellabs general counsel James Sheehan provided a statement in the press release that, in part, said, "The Supreme Court has . . . appropriately established a strict standard to be applied in sending the case back for further review. We believe that Congress intended such a rigorous standard when it enacted the Private Securities Litigation Reform Act of 1995 (PSLRA)." *Id.*; see also Press Release, U.S. Chamber of Commerce, Chamber Lauds Supreme Court Decision in Securities Fraud Case (June 21, 2007), available at www.uschamber.com/press/releases/2007/june/07-111.htm (last visited Jan. 28, 2010); *supra* note 72 and accompanying text.

104. See *supra* notes 6–9 and accompanying text.

105. Ferrell, *supra* note 100, at 34.

106. E. Powell Miller, *The Supreme Court's Decision in Tellabs: The Death Knell for Securities Class Actions? Not So Fast*, 86 MICH. B. J. 40 (Oct. 2007).

107. *Id.*

108. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 308 (2007).

language adopted by Congress did not equate to a victory for corporate defendants. Second, the Court criticized the Seventh Circuit and laid out a standard tougher than what came up from the circuit court, which could have contributed to the pro-business sentiment.¹⁰⁹ But the Seventh Circuit was thought to employ the weakest strong-inference standard of all the circuits.¹¹⁰ Therefore, rejecting the weakest of the strong-inference standards did not equate to a loss for securities fraud plaintiffs. Third, the opinion could have appeared to be a blow to private plaintiffs because the Seventh Circuit characterized the Circuit's standard as "a middle ground" and an adoption of the view of six other circuits when it was actually among the lowest of any circuit.¹¹¹

In the wake of *Tellabs*, federal district courts and the circuits took immediate note by referring to the decision more than ninety times in six months.¹¹² If *Tellabs* could be classified as a win at all for defendants, it was only a modest one that would likely result in just as many cases brought by plaintiffs as before *Tellabs*.¹¹³ On multiple fronts, defendants did not score the big win they wanted.¹¹⁴ First, the Court neglected to address the arguably more important scienter issue of defining scienter itself and what must be proven to establish scienter.¹¹⁵ Additionally, *Tellabs* reinforced the deference given to a judge's subjective views on the severity of wrongdoing in fraud cases and did not, therefore, materially change the way judges handle securities fraud cases.¹¹⁶ Finally, the Court did not find what defendants would

109. *Id.* at 310.

110. *Maxfield*, *supra* note 7, at 282 (discussing how the Seventh Circuit's strong inference test, some would argue, provided "an extremely lenient standard.>").

111. BLOOMENTHAL & WOLFF, *supra* note 3, at § 16:64.

112. 26A MICHAEL J. KAUFMAN, SECURITIES LITIGATION: DAMAGES § 24:52 (2009).

113. Dan A. Bailey, *The U.S. Supreme Court Decision in Tellabs: Major Victory or Minor Benefit for Defendants in Securities Class Actions?*, RISKVUE, (July 2007), www.riskvue.com/articles/fs/fs0707b.htm.

114. *Id.*

115. *Id.* While U.S. Circuit Courts of Appeals agree that a plaintiff can meet the scienter requirement by showing a defendant acted recklessly, they disagree on the degree of recklessness required—a question not at issue here. *Id.*; see also *Tellabs v. Makor*, 551 U.S. 308, 319 n.3 (2007).

116. Bailey, *supra* note 113; see also HAROLD S. BLOOMENTHAL AND SAMUEL WOLFF, *Securities Fraud Actions and the Private Securities Litigation Reform Act*, 1C GOING PUBLIC AND THE PUBLIC CORP. § 16:18 (noting that the degree of deference maintained for judges could prove difficult for defendants post-*Tellabs* as they must accept plaintiff's well-pled facts and guess at what the court will deem as plausible and more compelling than any reasonable inferences drawn from the allegations made by the plaintiff).

have considered a resounding victory: a pleading standard so high that it would discourage plaintiffs from filing lawsuits.¹¹⁷

Another commentator wrote that in not providing a bright-line test in its strong-inference standard the Court's opinion did "not appear to have the stringent dictates necessary to send the death-knell to private securities suits."¹¹⁸ *Tellabs* may actually have made it easier in certain jurisdictions for a plaintiff to survive a motion to dismiss.¹¹⁹ In fact, securities class actions likely will cause corporate director and officer defendants the same disruption as before *Tellabs*.¹²⁰

C. *Why Tellabs is Good for Plaintiffs*

While one commentator stated that *Tellabs* has resulted in greater risk of dismissal, he also recognized that "plaintiffs can take solace in the fact that generally, courts accept the interpretation of *Tellabs* that awards a tie to the plaintiff."¹²¹ Since *Tellabs*, in fact, district courts have readily awarded the tie in close cases to plaintiffs.¹²²

By establishing a comparative standard that takes into account the plaintiff's pleadings as well as the defendant's, the Supreme Court dropped the Act's strong-inference bar as low as it could without eviscerating the standard adopted by Congress.¹²³ Further, the test enunciated by *Tellabs* acknowledged an important role for well-pled securities fraud lawsuits.¹²⁴ By allowing a standard that favors plaintiffs

117. Bailey, *supra* note 113.

118. VINCENT G. CARACCILO, INTEGRO USA, INC., TELLABS: THE SUPREME COURT DECISION: HOW HIGH A HURDLE? 2 (2007), http://www.integrogroup.com/portal/serverpt/AllFiles/tellabs_supreme_court_decision_july_2007.pdf.

119. *Id.* at 1.

120. *Id.* at 2.

121. KAUFMAN, *supra* note 112; *see also* Lormand v. US Unwired, Inc., 565 F.3d 228, 254 (5th Cir. 2009) ("[A] tie favors the plaintiff.").

122. Akerman v. Arotech Corp., 608 F. Supp. 2d 372, 382 (E.D.N.Y. 2009) ("When the competing inferences rest in equipoise, the 'tie . . . goes to the plaintiff.'") (quoting City of Brockton Ret. Sys. v. Shaw Group Inc., 540 F. Supp. 2d 464, 472 (S.D.N.Y. 2008) (internal quotation omitted)); Teamsters Local 617 Pension & Welfare Funds v. Apollo Group, Inc., 633 F. Supp. 2d 763, 792 (D. Ariz. 2009) ("[T]he court endorses this tie-breaking approach."); *In re* Amaranth Natural Gas Commodities Litig., 587 F. Supp. 2d 513, 543 n.199 (S.D.N.Y. 2008) ("In other words, in close cases, tie goes to the plaintiff."); Sloman v. Presstek, Inc., No. 06-cv-377-JD, 2007 WL 2740047, at *7 (D. N.H. 2007) ("[A] tie now goes to the plaintiff.").

123. Keller & Stocker, *supra* note 11, at 4.

124. "Plaintiffs benefitted to the extent *Tellabs* supports the 10b-5 private right of action[,] which has been greatly expanded and restricted by caselaw and legislation."

when the holistic evaluation finds evenly matched inferences, the Supreme Court demonstrated an understanding that the Act's heightened pleading standard places plaintiffs at enough of a disadvantage by requiring allegations that contain strong inferences early in a case and without the benefit of discovery.¹²⁵

The Court demonstrated this understanding by acknowledging that fraud evidence tends to be subtle and difficult to locate when it held that plaintiff's evidence of fraud at a motion to dismiss need not be the equivalent of a smoking gun.¹²⁶

The tone of the decision favored plaintiffs, as well.¹²⁷ For instance, the first sentence of the opinion praised private securities litigation as an essential supplement to criminal antifraud prosecutions and civil actions.¹²⁸ The Court also wrote, "Nothing in the PSLRA Act, we have previously noted, casts doubt on the conclusion 'that private securities litigation [i]s an indispensable tool with which defrauded investors can recover their losses'—a matter crucial to the integrity of domestic capital markets."¹²⁹

5 ALAN R. BROMBERG AND LEWIS D. LOWENFELS, BROMBERG & LOWENFELS ON SECURITIES FRAUD § 10:114.20 (2d ed. 2009).

125. 15 U.S.C. § 78u-4(b)(3)(B) (2006). The mandated discovery stay results in a delay of most discovery until dismissal motions are ruled upon, which "does not give plaintiffs access to discovery which might fortify their allegations." BROMBERG & LOWENFELS, *supra* note 124; *see also*, Barbara Black, *Eliminating Securities Fraud Class Actions Under the Radar*, 2009 COLUM. BUS. L. REV. 802, 816–17 (2009) (asserting that the Act's discovery stay, combined with the tightened pleading standards and a short statute of limitations, means that plaintiffs' attorneys "may lack sufficient time to uncover enough evidence to persuade a court that fraud has occurred."); Geoffrey P. Miller, *Pleading After Tellabs*, 2009 WIS. L. REV. 507, 530 (2009) (noting that the requisite stay "puts the plaintiff in a vise: the pleading rules require particularized allegations and a strong inference of scienter, while the discovery stay deprives the attorney of the conventional means to develop this information").

126. Bailey, *supra* note 113. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 324 (2007) ("The inference that the defendant acted with scienter need not be irrefutable, *i.e.*, of the 'smoking-gun' genre, or even the 'most plausible of competing inferences . . .'" (quoting *Fidel v. Farley*, 392 F.3d 220, 227 (6th Cir. 2004) (quoting *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001) (en banc))).

127. Ferrell, *supra* note 100; *see also* 5 RICHARD M. PHILLIPS, ET AL., BUSINESS AND COMMERCIAL LITIGATION IN FEDERAL COURTS § 62:45.50 (2d ed.) (noting that while the Court rejected the "anomalously pro-plaintiff" strong-inference standard from the Seventh Circuit, "the Supreme Court's holding and other language in the opinion suggest a somewhat more plaintiff-friendly view of securities class actions than had previously prevailed in many circuits.").

128. *Tellabs*, 551 U.S. at 313.

129. *Id.* at 320 n.4. (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006)).

One commentator noted that Supreme Court reforms often “swing the pendulum too far and eliminate meritorious cases,” but avoided such an outcome in *Tellabs*.¹³⁰ In this case, the Supreme Court instead moved the pendulum closer to the middle, when it imposed a more reasonable burden for plaintiffs to meet and enabled plaintiffs to bring meritorious lawsuits.¹³¹

Other commentators argue that *Tellabs* did even more for securities plaintiffs.¹³² One commentator wrote that the Court dropped the ball in allowing plaintiffs too much room to maneuver.¹³³ She contended that the Court weakened the Act’s heightened pleading standard and undercut Congress’s attempt to rein in the significant discretion judges must exercise in evaluating securities fraud allegations during a motion to dismiss.¹³⁴

Additionally, two commentators wrote that the Court’s strong-inference standard means that plaintiffs must demonstrate only that their allegations of scienter are just as likely as any innocent explanation from defendants, rather than reaching some highly abstract level of probability.¹³⁵ They concluded that such a standard “tilts steeply in favor of plaintiffs” because they “can buttress their claims with as many documents and witnesses as they please. In stark contrast, defendants under *Tellabs* may offer competing explanations of innocence based only on the plaintiff’s complaint.”¹³⁶

D. Plaintiffs Prevail Under New Strong-Inference Standard

Since *Tellabs v. Makor*, all U.S. Circuit Courts of Appeals except the Tenth Circuit have addressed the strong-inference standard in light of the Supreme Court’s interpretation of the Act’s heightened pleading standard. The Seventh Circuit was first in the remand of *Tellabs*.¹³⁷ Judge Richard A. Posner, writing for the circuit, noted, “To judges raised on notice pleading, the idea of drawing a ‘strong inference’ from factual allegations is mysterious.”¹³⁸ The Seventh

130. Miller, *supra* note 106, at 42.

131. *Id.*

132. Keller & Stocker, *supra* note 11, at 4.

133. Rhinehart, *supra* note 13, at 21.

134. *Id.*

135. Keller & Stocker, *supra* note 11, at 4.

136. *Id.*

137. *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 705 (2008).

138. *Id.* at 705 (“To draw a ‘strong inference’ in favor of the plaintiff might seem to imply that the defendant had pleaded facts or presented evidence that would, by

Circuit nonetheless proceeded with a careful, thoughtful analysis that considered the plaintiff's allegations against multiple explanations from the defendants.¹³⁹ The circuit court then concluded, "the inference of corporate scienter is not only as likely as its opposite, but more likely. And is it cogent? Well, if there are only two possible inferences, and one is *much* more likely than the other, it must be cogent."¹⁴⁰ The Seventh Circuit finding in favor of plaintiffs so soon after *Tellabs* immediately undermined the widespread notion that *Tellabs* was a pro-defense opinion. In fact, *The Wall Street Journal's* Law Blog admitted upon release of the Seventh Circuit opinion that *Tellabs* was not as bad as it seemed for plaintiffs after the newspaper had been among the early outlets touting *Tellabs* as pro-defense.¹⁴¹

Just months later, a decision from the First Circuit provided additional insight into the potential for plaintiffs who bring post-*Tellabs* securities fraud allegations.¹⁴² The circuit court reversed the district court's grant of the defendant's motion to dismiss, which was issued the same day the Supreme Court released *Tellabs*.¹⁴³ Plaintiff shareholders in *Mississippi Public Employees' v. Boston Scientific* alleged that Boston Scientific omitted material information when it disclosed manufacturing changes to a heart stent that it later recalled.¹⁴⁴ Judge Sandra L. Lynch noted that the district court granted the motion to dismiss under a higher standard than should be imposed under *Tellabs*.¹⁴⁵ She wrote, "While there is support for defendants' infe-

comparison with the plaintiff's allegations, enable a conclusion that the plaintiff had the stronger case; and therefore that a judge could not draw a *strong* inference in the plaintiff's favor before hearing from the defendant. But comparison is not essential, and obviously is not contemplated by the Reform Act, which requires dismissal in advance of the defendant's answer unless the complaint itself gives rise to a strong inference of scienter.").

139. *Id.* at 706–11.

140. *Id.* at 710.

141. See Posting of Peter Lattman to the Wall Street Journal Law Blog, <http://blogs.wsj.com/law/2008/01/17/7th-cir-revisits-tellabs-a-milberg-weiss-win/> (Jan. 17, 2008 16:45 EST) (reporting that its initial post-*Tellabs* headline, "Supremes Deliver Another Blow to Plaintiffs Securities Bar," may not ring as true as it initially appeared); Posting of Peter Lattman to the Wall Street Journal Law Blog, <http://blogs.wsj.com/law/2007/06/21/supremes-deliver-another-blow-to-plaintiffs-securities-bar> (June 21, 2007 10:33 EST).

142. *Miss. Pub. Employees' Ret. Sys. v. Boston Scientific Corp.*, 523 F.3d 75 (1st Cir. 2008).

143. *Id.* at 94.

144. *Id.* at 79–80.

145. *Id.* at 89.

rences . . . plaintiff's inferences are at least as equally strong."¹⁴⁶ The reversal in *Boston Scientific*, alongside the circuit court's recognition that *Tellabs* lowered the threshold pleading requirement for plaintiffs, demonstrates that the Supreme Court's strong-inference standard is far better for plaintiffs than the pro-business spin predicted.¹⁴⁷ As one commentator stated, *Boston Scientific* "highlights that even after *Tellabs*, in certain circumstances, plaintiffs will be able to continue to meet the PSLRA's pleading requirements"¹⁴⁸

The Third Circuit has twice found in favor of plaintiffs since *Tellabs*.¹⁴⁹ In *Institutional Investors Group v. Avaya*, it reversed the trial court's order granting a motion to dismiss on allegations of false or misleading statements regarding earnings growth and pricing.¹⁵⁰ The circuit court concluded that "the totality of facts alleged by Shareholders here establishes a strong inference of scienter."¹⁵¹ The opinion also pointed to the importance of a holistic inquiry as part of a common-sense view of the allegations.¹⁵² The court concluded that the fraud allegations gave rise to a strong inference that the defendant at least acted recklessly, enough to survive a motion to dismiss.¹⁵³

Additionally, the Third Circuit determined in *Alaska Electricians Pension Fund v. Pharmacia Corp.* that the district court correctly denied defendant's motion to dismiss.¹⁵⁴ The plaintiffs alleged that the defendant schemed to mislead *The Journal of the American Medical Association*, as well as the investment community, by submitting

146. *Id.*

147. Kevin M. LaCroix, *First Circuit Applying Tellabs, Reverses Securities Case Dismissal*, THE D&O DIARY, Apr. 17, 2008, <http://www.dandodiary.com/2008/04/articles/securities-litigation/first-circuit-applying-tellabs-reverses-securities-case-dismissal> ("This specific statement is an explicit recognition that, in the First Circuit at least, the Tellabs standard not only did not advance the defendants' interests, but it arguably aids plaintiffs' interests by imposing a lower threshold pleading requirement.").

148. *Id.*

149. See *Institutional Investors Group v. Avaya, Inc.*, 564 F.3d 242, 280 (3d Cir. 2009) (concluding that defendant's motion to dismiss should be denied because fraud allegations by plaintiff showed that the defendant acted consciously or recklessly in making false statements); *Alaska Elec. Pension Fund v. Pharmacia Corp.*, 554 F.3d 342, 352 (3d Cir. 2009) (determining that the defendant's motion to dismiss was correctly denied by the district court).

150. *Avaya*, 564 F.3d at 280.

151. *Id.* at 269.

152. *Id.* at 273. ("[I]nference is not arithmetic. The inferential significance of any single allegation can be determined only by reference to all other allegations.").

153. *Id.* at 269.

154. 554 F.3d 342, 351 (3d Cir. 2009).

incomplete data and using it as a basis for publishing in the national journal.¹⁵⁵ The court stated that even though the scienter allegations were thin, “when examined as a whole . . . the Amended Complaint is replete with allegations that defendants acted with the requisite scienter.”¹⁵⁶ The decision provided an important affirmation that even when a court finds “thin” allegations of scienter, it will conduct the requisite holistic inquiry and, potentially, find for the plaintiff.

Avaya also highlighted that not all is harmonious among the U.S. Circuit Courts of Appeals in the post-*Tellabs* world. The Third Circuit disagreed with the Ninth Circuit’s application of the strong-inference test as a misread of the *Tellabs* standard, asserting that the Ninth Circuit has attempted to graft the requisite “holistic analysis onto the Ninth Circuit’s earlier jurisprudence as an extra layer.”¹⁵⁷ The Ninth Circuit revised its pleading standard post-*Tellabs* to (1) assess whether a plaintiff’s individual allegations are sufficient under the Act and (2) perform a second holistic analysis to determine if the inference of scienter alleged is greater than the sum of its parts.¹⁵⁸ The Third Circuit argued that the dual-inquiry approach undertaken by the Ninth Circuit contradicts the holistic inquiry from *Tellabs*, which “explicitly warrants against scrutiniz[ing] allegations in isolation.”¹⁵⁹ Six months later, the Ninth Circuit stuck with its dual-inquiry approach in *Siracusano v. Matrixx Initiatives, Inc.*¹⁶⁰ The circuit court concluded that allegations that the defendant withheld crucial information regarding the popular cold medicine Zicam was at least as compelling as any plausible non-culpable explanation.¹⁶¹

But the Ninth Circuit has admitted that its previous strong-inference standard was too strong as now viewed under the *Tellabs* lens.¹⁶² In 2008, *South Ferry LP, No. 2 v. Killinger* was remanded to the district court to reconsider the Supreme Court’s new scienter standard after recognizing that, post-*Tellabs*, the Ninth Circuit’s

155. *Id.*

156. *Id.*

157. *Avaya*, 564 F.3d at 273 n.46.

158. 26A MICHAEL J. KAUFMAN, SECURITIES LITIGATION DAMAGES § 24:4 (2009).

159. *Avaya*, 564 F.3d at 273 n.46 (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* 551 U.S. 308, 323 (2007)).

160. 585 F.3d 1167, 1180 (9th Cir. 2009) (stating that the scienter analysis requires, first, a determination of whether plaintiff’s allegations alone create a strong inference of scienter and, if not, then a holistic review of the same allegations).

161. *Id.* at 1183 (reversing trial court order granting motion to dismiss).

162. *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 784 (9th Cir. 2008).

strong-inference standard was too strong.¹⁶³ Importantly, the circuit court noted that vague allegations must be considered as a part of the holistic analysis to determine if a strong inference of scienter exists.¹⁶⁴ On remand, the district court concluded that plaintiffs pleaded a strong inference of scienter.¹⁶⁵

Most circuits, however, have turned away plaintiffs for not satisfying *Tellabs's* strong-inference standard.¹⁶⁶ For instance, the Eighth Circuit's frequent dismissals of complaints brought by shareholder plaintiffs since *Tellabs* demonstrates that the strong-inference hurdle,

163. *Id.* at 786.

164. *Id.* at 784.

165. *S. Ferry LP, No. 2 v. Killinger, No. C04-1599-JCC*, 2009 WL 3153067, at *12 (W.D. Wash. Oct. 1, 2009); *see also In re Syncor Int'l Corp. Sec. Litig.*, 239 F. App'x 318, 321 (9th Cir. 2007) (reversing grant of motions to dismiss filed by officers and directors of a company because the alleged illegal payment scheme "creates a strong inference that all three defendants believed the illegal payments were driving overseas growth").

166. *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200, 208–12 (5th Cir. 2009) (determining that statements that dividend payments were "under review," as well as interval between end of tender offer period and increase in dividend did not raise strong inference of scienter); *Cozzarelli v. Inspire Pharms. Inc.*, 549 F.3d 618, 625 (4th Cir. 2008) (holding that an argument dependent on stringing together isolated allegations without necessary context fails to satisfy strong-inference standard); *Mizarro v. Home Depot, Inc.*, 544 F.3d 1230, 1249 (11th Cir. 2008) (concluding that generalized allegations that corporation orchestrated an improper chargeback scheme to inflate earnings and failed to advise investors of its effect on earnings did not satisfy strong-inference standard); *Ley v. Visteon Corp.*, 543 F.3d 801, 812 (6th Cir. 2008) (concluding that accounting improprieties did not support strong inference of scienter); *Metzler Inv. GMBH v. Corinthian Colls., Inc.*, 540 F.3d 1049, 1066 (9th Cir. 2008) (concluding that insider trading, access to information, and rejection of alternative accounting methods did not give rise to a strong inference of scienter); *N.J. Carpenters Pension & Annuity Funds v. Biogen IDEC Inc.*, 537 F.3d 35, 55 (1st Cir. 2008) (concluding that plaintiffs failed to raise a plausible inference that defendants knew financial projections made and assertions related to a combination therapy product were misleading); *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 196–97 (2d Cir. 2008) (concluding that plaintiffs failed to support allegations of false statements); *Pugh v. Tribune Co.*, 521 F.3d 686, 694–95 (7th Cir. 2008) (concluding that allegations of boosting newspaper circulation figures failed to satisfy strong-inference standard for relying on fraud by hindsight argument and not supporting allegation of suspicious trades); *Cornelia I. Crowell GST Trust v. Possis Med., Inc.*, 519 F.3d 778, 784 (8th Cir. 2008) (determining that receiving unfavorable data regarding medical device before disclosing the data did not raise a strong inference of scienter); *Winer Family Trust v. Queen*, 503 F.3d 319, 331–32 (3d Cir. 2007) (concluding a post-press release revised cost estimate did not provide evidence needed for strong inference of scienter).

even though far from impossible to clear, remains high.¹⁶⁷ In 2008, the court concluded that multiple allegations, including accusations of insider trading and a falsely sworn Sarbanes-Oxley certification, did not satisfy the strong-inference standard in *In re Ceridian Corp. Securities Litigation*.¹⁶⁸ The court cited Judge Posner's discomfort with the Supreme Court's newly minted strong-inference standard and seemed to commiserate with his hesitation to draw a strong inference from factual allegations when the Seventh Circuit recognized "it is an inquiry that must be made, however awkward or unusual, because it has been mandated by Congress to remedy widespread abuses of the Rule 10b-5 class action device."¹⁶⁹ The opinion discounted the plaintiff's argument that the district court did not engage in the requisite holistic analysis.¹⁷⁰ Judge James B. Loken wrote that simply because a court discusses multiple assertions separately does not mean they were not analyzed collectively.¹⁷¹ The circuit court then methodically turned down each of the plaintiff's allegations for failing to plead a strong inference of scienter.¹⁷²

Several recent district court cases, however, should encourage plaintiffs navigating the post-*Tellabs* world. Courts across the country have demonstrated the ability to reason through competing inferences and find for the plaintiff in close cases.¹⁷³ Such results

167. *Horizon Asset Mgmt. Inc. v. H & R Block, Inc.*, 580 F.3d 755, 762–63 (8th Cir. 2009) (concluding that defendant's decision to outsource tax staffing, failure to maintain tax software, and operating without a chief financial officer for eleven months did not raise a strong inference of scienter); *Elam v. Neidorff*, 544 F.3d 921, 928 (8th Cir. 2008) (concluding that allegations of intentionally false statements regarding medical costs that artificially inflated stock price while officers sold personal stock holdings did not give rise to strong inference); *In re Ceridian Corp. Sec. Litig.*, 542 F.3d 240, 246–49 (8th Cir. 2008) (determining that alleged insider trading, approval of accounting policies, allegedly false sworn Sarbanes-Oxley certification, and ongoing investigation did support strong inference of scienter); *Possis Med.*, 519 F.3d at 784 (concluding that receiving unfavorable data regarding medical device before disclosing the data did not raise strong inference).

168. 542 F.3d at 247–49.

169. *Id.* at 245; *see Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702, 705 (7th Cir. 2008); *supra* note 140 and accompanying text.

170. *In re Ceridian Corp. Sec. Litig.*, 542 F.3d at 246.

171. *Id.*

172. *Id.* (concluding that alleged insider trading, approval of accounting policies, allegedly false sworn Sarbanes-Oxley certification, and ongoing investigation did support strong inference of scienter).

173. *Bacon v. Stiefel Labs., Inc.*, No. 09-21871-CV-KING, 2010 WL 54753, at *10 (S.D. Fla. Jan. 4, 2010) (concluding that the complaint in its entirety contained allegations that "strongly imply" defendants acted with the requisite state of mind);

demonstrate that a tie can and does go to the plaintiff.

V. CONCLUSION

In the less than three years since *Tellabs*, the ability of plaintiffs to bring a securities fraud class action has fared far better than post-*Tellabs* publicity predicted.¹⁷⁴

Rather than a pro-defense interpretation, the Supreme Court's articulation of the Act's strong-inference test preserved the tough standard Congress intended while acknowledging the value of securities fraud actions.¹⁷⁵ Doing so rightfully balanced the interests of plaintiffs against those of defendants. Most importantly, *Tellabs* provided an attainable standard that allows securities fraud lawsuits to fulfill their role as vital tools for plaintiffs to bring their causes of action and recover their losses.¹⁷⁶

Gosselin v. First Trust Advisors L.P., No. 08-C-5213, 2009 WL 5064295, at *6 (N.D. Ill. Dec. 17, 2009) (concluding that plaintiff satisfied the heightened pleading standard); Lefkoe v. Jos. A. Bank Clothiers, No. WMN-06-1892, slip op. 2009 WL 3003247, at *8 (D. Md. May 1, 2009) ("No doubt this is a close case, but the Court remains persuaded that Plaintiff has alleged facts sufficient to support an inference of scienter at least as compelling as these opposing inferences."); Mill Bridge V, Inc. v. Benton, No. 08-2806, 2009 WL 4639641, at *29 (E.D. Pa. Dec. 3, 2009) (concluding that, given the totality of circumstances, plaintiff's final allegation created a strong inference of scienter); Jayhawk Capital Mgmt., LLC v. LSB Inds., Inc., No. 08-2561-EFM, 2009 WL 3766371, at *14 (D. Kan. Nov. 10, 2009) (concluding that plaintiff's allegation supported a fraudulent inference at least as compelling as defendant's legitimate business reason); Middlesex Ret. Sys. v. Quest Software, Inc., No. CV 06-6863, 2008 WL 7084629, at *5-10 (C.D. Cal. July 10, 2008) (concluding that allegations of misleading SEC filings were at least as compelling as the inference that defendant was merely negligent).

174. See *infra* Part IV.C-D.

175. See *infra* Part IV; see also Kenneth A. Kuwayti & Olga A. Tkachenko, *Early Inferences from the Supreme Court's Tellabs Ruling*, 23 No. 15 ANDREWS CORP. OFFICERS & DIRS. LIAB. LITIG. REP. 13 (2008) (arguing that early cases interpreting *Tellabs* raised the bar on pleading securities fraud, "[b]ut the bar is not so high that it will deter legitimate suits from going forward.").

176. *Tellabs*, 551 U.S. at 320 n.4.