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TELLABS PROVES TO BE NO DETERRENT TO SECURITIES CLASS ACTION FILINGS

When the United States Supreme Court decided *Tellabs v. Makor Issues and Rights, Ltd.*, 127 S. Ct. 2499 (2007), in June 2007 and, in so doing, set the standard for pleading the requisite "strong inference" of scienter in securities fraud class actions, commentators offered differing views on the impact of the decision. Some suggested that *Tellabs* was a major victory for the defense bar. Others suggested that the Court's decision was at best a draw and would have little impact on future securities class action filings. Filings data from the second half of 2007 suggests that the latter individuals were the better prognosticators.

According to Cornerstone Research, the number of securities class action filings increased by 43 percent in 2007. Cornerstone Research, *Securities Class Action Case Filings - 2007: A Year in Review*, at 2 (available at http://securities.cornerstone.com/). Eighty percent of the 166 filings in 2007 asserted Rule 10b-5 fraud claims, which are subject to the *Tellabs* pleading standard. *Id.* at 21. Moreover, "litigation activity jumped in the second half of the year [post-*Tellabs*]." *Id*. at 2. While some of that additional litigation activity can be attributed to the subprime mortgage crisis and its fallout, only 23 of the 100 filings in the second half of 2007 were related to subprime issues. *Id*. at 2.

So why has *Tellabs* not deterred securities class action filings? A recent decision from the First Circuit suggests one explanation. In *Mississippi Public Employees' Retirement System v. Boston Scientific Corporation*, the First Circuit reversed the dismissal of a securities fraud class action lawsuit and noted that "the district court did not have the benefit of the *Tellabs* opinion, which reversed a higher standard for scienter imposed by prior law in the circuit." No. 07-1794, 2008 WL 1735390, at *12 (1st Cir. April 16, 2008) (emphasis added). Prior to *Tellabs*, in the First Circuit, when there existed equally convincing inferences for and against scienter based on the pleaded facts, the complaint was subject to dismissal because the plaintiff was entitled to only the more likely of competing inferences. Other Circuits, including the Fourth, Sixth, and Ninth, similarly applied a "more likely than not"

pleading standard. However, under *Tellabs*, a complaint will survive a motion to dismiss where "[a] plaintiff . . . plead[s] facts rendering an inference of scienter at least as likely as any plausible opposing inference." *Tellabs, Inc.*, 127 S.Ct. at 2513. As explained by the First Circuit, "where there are equally strong inferences for and against scienter, *Tellabs* now awards the draw to the plaintiff." *ACA Financial Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 59 (1st Cir. 2008). In sum, in the previously more demanding Circuit Courts of Appeal, cases are actually more likely to survive a motion to dismiss after *Tellabs* than before.

On the flip side, as the filings data confirms, even in formerly less demanding circuits, *Tellabs* did not set the pleading bar at a level that deters filings. Indeed, in *Tellabs* itself, on remand, the Seventh Circuit reaffirmed its reversal of the district court's dismissal of the case and held that plaintiffs adequately pleaded scienter under even the more stringent pleading standard established by the Supreme Court. As one plaintiffs' lawyer has explained, "[w]e don't bring cases that would not [already] meet this standard." Tony Mauro, "High Court Raises the Bar for Investors Alleging Securities Fraud," *Legal Times*, June 22, 2007.

Under these circumstances, it is not surprising that *Tellabs* has not significantly reduced the number of securities class action lawsuits that are filed. In the end, a "more likely than not" standard—*i.e.*, an inference of scienter that is more likely than a competing inference of innocence, as was endorsed by Justices Scalia and Alito—might have provided a greater deterrent. However, the *Tellabs* majority expressly rejected that standard in its effort to balance the competing interests of curbing frivolous, lawyer-driven litigation and preserving meritorious investor claims. The majority held that "a plaintiff is not forced to plead more than she would be required to prove at trial," despite the defense bar's plea that Congress had intended the pleading standard to be higher. *Tellabs*, 127 S.Ct. at 2513. Right or wrong, *Tellabs* plainly has not operated to deter securities class action filings. To the contrary, the data confirms that filing opportunities remain wide open for plaintiffs and their counsel in the post-*Tellabs* world.

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