SUPREME COURT TELLABS RULING CONFIRMS HEIGHTENED PLEADING REQUIREMENTS UNDER FEDERAL LAW

This newsletter provides an overview of the recent decision of the U.S. Supreme Court in Tellabs, Inc. v. Makor Issues & Rights, Ltd., No. 06-484, 127 S.Ct. 2499 (June 21, 2007). In Tellabs, the Supreme Court for the first time addressed the heightened requirements for pleading scienter enacted in the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Federal courts have for many years construed an antifraud provision of federal law Section 10(b) of the Securities Exchange Act of 1934 to afford a private right of action to purchasers or sellers of securities injured by its violation. To establish liability under §10(b) and Rule 10b–5, a private plaintiff must prove that the defendant acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud" known as "scienter." See Ernst & Ernst v. Hochfelder, 425 U. S. 185, 193-94 (1976). Prior to the enactment of the Reform Act, plaintiffs needed only to plead scienter generally under applicable federal pleading rules.

Congress, in enacting the Reform Act, intended to enact more stringent pleading standards for private plaintiffs. Under the Reform Act, a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." See 15 U.S.C. § 78u-4(b)(2). In so doing, Congress recognized that private securities fraud actions, if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law. Since 1995, lower federal courts have been divided over the meaning of the Reform Acts' "strong inference" standard.

In Tellabs, the Supreme Court, by a vote of 8-1, rejected a relaxed "reasonable inference" approach that had been previously adopted by the Seventh Circuit. In the majority opinion by Justice Ginsburg, the Supreme Court held that a securities fraud complaint will survive dismissal only if, based upon its factual allegations, the inference of defendant's 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." The Supreme Court also held that courts must consider at the pleadings stage plausible, nonculpable explanations for the defendant's conduct, as well as inferences favoring the

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The Securities Law Practice Group at Murtha Cullina LLP is pleased to provide its clients and friends with information about topics of interest in the securities regulation area.

If you have questions about the issues addressed in this newsletter, or any other matters involving securities regulation issues, please feel free to contact the following attorneys:

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plaintiff. Justices Scalia and Alito wrote separate concurring opinions, and would have required a higher standard whereby to survive dismissal the inference of scienter must be more "likely than not correct." Justice Stevens dissented from the majority's decision, arguing that the Supreme Court should have applied a "probable cause" standard for judging the sufficiency of plaintiffs' pleadings of fraudulent intent. Widely viewed as pro-defendants, the Tellabs decision demonstrates that the Supreme Court is favorably inclined to use the Reform Act's heightened pleading standards to protect public companies, their directors and officers, from meritless private securities litigation brought by the class action bar. For a copy of the Tellabs decision, see: http://www.supremecourtus.gov/opinions/06pdf/06-484.pdf.

Since the Tellabs decision, a number of federal appeals courts have begun to apply its new heightened pleading standards, and have each affirmed dismissals of securities fraud actions. See Globis Capital Partners, L.P. v. Stonepath Group, Inc., 2007 U.S. App. LEXIS 16353 (July 10, 2007) (Third Circuit affirms dismissal of complaint under Tellabs); ATSI Communications, Inc. v. The Shaar Fund, Ltd., 2007 U.S. App. LEXIS 16382 (July 11, 2007) (Second Circuit affirms dismissal of complaint on Tellabs grounds); Higginbotham. v. Baxter International Inc., 2007 U.S. App. LEXIS 17918 (July 27, 2007) (Seventh Circuit affirms dismissal of complaint under Tellabs). These decisions demonstrate the impact of the newly articulated Tellabs standards in carrying out the goals of the Reform Act.

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The foregoing summary is intended to provide only an overview of the Tellabs decision. If you have questions concerning the scope, application or implications of the Tellabs decision, please contact any member of the Murtha Cullina LLP Securities Law Practice Group.

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