No. 06-484

IN THE

Supreme Court of the United States

TELLABS, INC., ET AL.,
Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., ET AL.,
Respondents.

On Writ of Certiorari to the United States Court Appeals for the Seventh Circuit

BRIEF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC., AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

CONSTITUTIONS, STATUTES, AND RULES

LEGISLATIVE HISTORY

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

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INTEREST OF THE *AMICUS CURIAE* [1]

The North American Securities Administrators Association, Inc. ("NASAA"), is the nonprofit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has 67 members, including

[1] Pursuant to SUP. CT. R. 37.6, NASAA represents that no counsel for any party authored this brief in whole or in part, and no person or entity, other than NASAA, its members, or its counsel, made any monetary contribution to the preparation or submission of the brief. Pursuant to SUP. CT. R. 37.3, NASAA further represents that all parties to this appeal have consented to the filing of this brief. Copies of their written consents have been filed with the Court.

the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, it is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

The U.S. members of NASAA are responsible for administering state securities laws and regulations. Their activities include regulatory functions such as licensing broker-dealers, registering local securities offerings, and conducting compliance examinations. Especially important is their enforcement role: protecting the nation's investors by bringing literally thousands of enforcement actions every year against the firms and individuals who have committed fraud and abuse in the sale of securities. In those cases, state securities regulators often seek restitution to help make injured investors whole, although both state and federal regulators recognize that the best hope of recovery for the vast majority of defrauded investors is through the courts in private actions for damages.

NASAA supports the work of its members through training programs, enforcement assistance, and legislative analysis. Another important role of the association is representing the membership's position as *amicus curiae* in significant cases brought by private plaintiffs as well as government regulators involving the interpretation of the securities laws and the rights of investors. *See, e.g.*, Brief of the North American Securities Administrators Association, Inc., as *Amicus Curiae*, in Support of Respondents Broudo *et al.*, in *Dura Pharmaceuticals, Inc. v. Broudo*, Case No. 03-932 (U.S. Nov. 17, 2004) (supporting investors' position on the pleading requirements for loss causation in a private action for securities fraud), *available at* http://www.nasaa.org/content/Files/BroudoBrief.pdf; Brief of *Amicus Curiae* North American Securities Administrators Association, Inc., in Support of the People of the State of California, in *People v. Edward D. Jones & Co.*, Case No. CO53407 (Cal. Ct. App. Feb. 23,

2007), *available at* http://www.nasaa.org/content/Files/ED_JONES_FINAL.pdf.

NASAA and its members have a stake in the outcome of this appeal because it will have a profound impact upon the ability of investors to seek redress in cases where unscrupulous issuers and corporate executives have perpetrated a fraud on the market. The Seventh Circuit correctly ruled that a complaint for securities fraud satisfies the pleading requirements for scienter under the Private Securities Litigation Reform Act of 1995 ("Reform Act" or "Act") if the allegations in the complaint collectively establish a strong inference of scienter. *See Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601 (7th Cir. 2006), *cert. granted*, 127 S.Ct. 853 (2007). The court rightly rejected the far more onerous requirement that courts actually evaluate competing inferences upon a motion to dismiss and afford the plaintiff only those inferences that are most plausible. *Id.* at 602. If this Court were to reverse the lower court and establish the more burdensome standard as the federal rule governing scienter at the pleading stage, many victims of securities fraud with meritorious claims would lose the opportunity to recover their damages. As advocates for the rights of investors to seek redress, NASAA and its members have an interest in supporting affirmance and minimizing this threat.

This Court's decision will also affect the role of private actions as a deterrent against securities fraud. Private actions by defrauded investors are an enormously important complement to regulatory enforcement actions as a means of policing the securities marketplace. State and federal securities regulators work tirelessly to detect, enjoin, and punish financial fraud. However, private actions not only provide the principal means of redress for victims of securities fraud, they also play a vitally important role in protecting the integrity of the marketplace through deterrence. Congress and the courts alike have recognized this fact. The Senate Report accom-

panying the Reform Act described the importance of private rights of action as follows:

> The SEC enforcement program and the availability of private rights of action together provide a means for defrauded investors to recover damages and a powerful deterrent against violations of the securities laws. As noted by SEC Chairman Levitt, "private rights of action are not only fundamental to the success of our securities markets, they are an essential complement to the SEC's own enforcement program." (citation omitted)

See S. REP. NO. 104-98, at 8 (1995) ("Senate Report"), *reprinted in* 1995 U.S.C.C.A.N. 679, 687; *see also Basic Inc. v. Levinson*, 485 U.S. 224, 230-31 (1988) (observing that the private cause of action for violations of Section 10(b) and Rule 10b-5 constitutes an "essential tool for enforcement of the 1934 Act's requirements"). To the extent that the Court erects unwarranted barriers to recovery in private actions, such as the pleading requirements for scienter advanced by the Petitioners, the Court will undermine an important deterrent that benefits the marketplace as a whole. For this additional reason, NASAA and its members support affirmance of the circuit court's decision.

SUMMARY OF THE ARGUMENT

The Seventh Circuit correctly held that a complaint for securities fraud satisfies the pleading requirements for scienter under the Reform Act if the allegations in the complaint collectively establish a strong inference of scienter. This formulation is precisely what the Reform Act says and what Congress intended the courts to apply. Moreover, the Seventh Circuit's rule advances the Congressional policy of discouraging meritless lawsuits, while minimizing restrictions on access to the courts by the ever-increasing number of investors who are genuine victims of securities fraud. The rule advanced by Petitioners and their *amici*, suggesting that courts must instead evaluate competing inferences upon a

motion to dismiss and afford the plaintiff only those inferences that are most plausible, should be rejected. It has no support in the language or legislative history of the Reform Act. Moreover, by calling upon courts to weigh competing evidentiary claims, it violates the universally accepted interpretation of Rule 12(b)(6), as well as the Seventh Amendment guarantee of trial by jury. And the Petitioners' rule would severely limit access to the courts for injured investors, at a time when the need to address rampant financial fraud far outweighs the need to protect companies and their executives from strike suits.

ARGUMENT

I. THE SEVENTH CIRCUIT CORRECTLY FORMULATED AND APPLIED THE PLEADING STANDARD FOR SCIENTER UNDER THE REFORM ACT

The Seventh Circuit held that when evaluating the adequacy of scienter allegations on a motion to dismiss under the Reform Act, courts should examine all of the allegations in the complaint and decide whether collectively they establish a strong inference of scienter. *Makor*, 437 F.3d at 601. This simple test faithfully adheres to the actual language of the Reform Act, it comports with the Act's legislative history, and it strikes the right balance between the two policies underlying the Act: eliminating meritless strike suits while preserving the right of investors to seek damages for securities fraud. The circuit court's interpretation of the Reform Act was therefore correct and should be affirmed.

A. The Seventh Circuit's Test Follows The Plain Language Of The Reform Act

"[T]he starting point in any case involving the meaning of a statute is the language of the statute itself." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 210 (1979); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 533 (3rd Cir.

1999) (focusing attention on the Reform Act's plain language, "which is the customary starting point in statutory interpretation"). With respect to allegations of scienter, the Reform Act simply provides that a complaint alleging securities fraud must "state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (emphasis added). This is precisely the test that the Seventh Circuit adopted in its opinion. *See, e.g., Makor*, 437 F.3d at 603 ("We can now assess whether the complaint states, with respect to each of these actionable statements, facts that give rise to a *strong inference* of scienter.") (emphasis added); *id.* at 605 ("[W]e find that the complaint contains enough detail to establish a *strong inference* that Notebaert knew of the channel stuffing and therefore knew Tellabs had exaggerated its fourth quarter 2000 revenues.") (emphasis added); *id.* at 604 ("We conclude that the plaintiffs have pleaded sufficient facts to 'giv[e] rise to a *strong inference*,' 15 U.S.C. § 78u-4(b)(2), that Notebaert knowingly lied . . . .") (emphasis added).[2] The Seventh Circuit clearly based its analysis on an accurate reading of the Reform Act.

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[2] These excerpts from the Seventh Circuit's opinion refute any suggestion that the court's test for pleading scienter *after* adoption of the Reform Act is no more stringent than the test applicable *before* adoption of the Reform Act. *See also Makor*, 437 F.3d at 601 (the Reform Act "did unequivocally raise the bar for pleading scienter"); *id.* at 600 (adequately pleading scienter under the Reform Act requires plaintiffs to clear "another, even more arduous hurdle"). Nor does the Seventh Circuit's reference to a "reasonable person" standard support the Petitioners' contention on this issue. The court used that phrase not to dilute the "strong inference" requirement, but as an alternative to the Sixth Circuit's unacceptable suggestion that courts must weigh competing inferences and afford plaintiffs only those that are most reasonable. *Id.* at 602. Rather than balancing inferences, the court's role under the Seventh Circuit's analysis is simply to determine if a "reasonable person" could arrive at the requisite *strong* inference.

B. The Seventh Circuit's Test Comports With The Legislative History

The Seventh Circuit also considered the legislative history of the Reform Act. Although generally regarded as "contradictory and inconclusive," *see Makor,* 437 F.3d at 601 (quoting *In re Advanta Corp.*, 180 F.3d at 533), the legislative history is clear at least on this point: Congress deliberately chose to fashion a strong but simple test, unencumbered with embellishments derived from the case law. The Conference Report confirms that the standard was intended to be precisely what the statute says: the plaintiff's facts, stated with particularity, "must give rise to a 'strong inference' of the defendant's fraudulent intent." H.R. CONF. REP. NO. 104-369, at 41 (1995) ("Conference Report"), *reprinted in* 1995 U.S.C.C.A.N. 730, 740. While acknowledging that the standard was derived in part from the test in the Second Circuit, the Report expressly disavows any intention "to codify the Second Circuit's case law interpreting this pleading standard." *Id.* The report further explains that "for this reason, the Conference Report chose not to include in the pleading standard certain language relating to motive, opportunity, or recklessness." Conference Report at n.23. The legislative history thus supports the Seventh Circuit's observation, shared by the majority of the federal circuit courts, that "Congress chose neither to adopt nor reject particular methods of pleading scienter—such as alleging facts showing motive and opportunity—but instead only required plaintiffs to plead facts that together establish a strong inference of scienter." *See Makor,* 437 F. 3d at 601 (quoting *Ottman v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 345 (4th Cir. 2003)).

C. The Seventh Circuit's Test Advances The Goal Of Limiting Groundless Class Action Lawsuits, While Minimizing The Adverse Impact On Meritorious Claims By Injured Investors

In the Reform Act, Congress sought to "strike the right balance between protecting the rights of victims of securities fraud and the rights of public companies to avoid costly and meritless litigation." *See* Senate Report at 10. Congress clearly wanted to inhibit abusive lawsuits, but at the same time it recognized that "[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action." *See* Conference Report at 31. Moreover, Congress recognized that "[s]uch private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs." *Id*. The Conference Report begins with the affirmation that "[t]he *overriding* purpose of our nation's securities laws is to protect investors and to maintain confidence in our capital markets . . . ." (emphasis added). *See* Conference Report at 31; *see also Makor*, 437 F.3d at 595 (establishing, as a backdrop to its analysis, that "the modern securities laws were designed . . . to 'substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry") (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)).

The Seventh Circuit's interpretation of the Reform Act's heightened pleading standard for allegations of scienter accommodates both of these Congressional policy goals. The circuit court's analysis obviously recognizes that allegations of scienter in a securities fraud action must be subjected to more "arduous" scrutiny under the Reform Act. *See Makor*, 437 F.3d at 600. The court's holding thus serves the purpose

of deterring unfounded lawsuits. At the same time, however, the court refused to graft onto the statute's plain language the vastly more repressive balancing-of-inferences test advocated by the Petitioners. The court's holding thus also advances Congress's goal of preserving meaningful recourse for bona fide victims of securities fraud.[3]

The need to ensure that investors have meaningful private remedies in federal court has become starkly apparent since the passage of the Reform Act. Over the last several years, there has been a marked rise in the incidence of corporate accounting fraud and securities law violations affecting large classes of investors. *See, e.g.,* Press Release, No. 2002-179, SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators Announce Historic Agreement to Reform Investment Practices (SEC, Dec. 20, 2002), *available at* http://www.sec.gov/news/press/2002-179.htm; *see also* Press Release, State Investigation Reveals Mutual Fund Fraud (Office of New York Attorney General, Sept. 3, 2003), *available at* http://www.oag.state.ny.us/press/2003/sep/sep03a_03.html.

Congress recognized the seriousness of the problem, and the need for at least a partial legislative response, when it enacted the Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201-7266. The House Report accompanying the House bill aptly describes the problem of deceptive corporate practices that harm investors:

> The collapse of the Enron Corporation provided irrefutable evidence of serious, systemic problems in our

[3] On its face, at least, the Seventh Circuit's disposition of the Petitioners' specific challenges to the complaint suggests that the "strong inference" standard is a rigorous screening mechanism for fraud claims. Although the court sustained a number of fraud allegations against one of the two individual defendants, it dismissed all of the complaint's allegations against the other individual defendant, finding that "the plaintiffs did not meet the strict PSLRA standards for pleading Birck's scienter." *See Makor*, 437 F.3d at 603-04.

> financial reporting system and our capital markets. Far from being an isolated instance, Enron was only the most spectacular example of what has become a common phenomenon—earnings manipulation and deceptive accounting by our largest companies. Before Enron, company after company—Waste Management, Sunbeam, Cendant, W.R. Grace, and many others—were found to have manipulated their accounting to present a picture to investors that did not match reality. As evidenced by the record number of investigations opened by the SEC thus far this year [2002], the problem has only become more acute.

See H.R. REP. NO. 107-414 (2002), 2002 WL 661614, *47 (Minority Views).[4]

This corporate fraud has harmed millions of investors nationwide, inflicting huge personal losses. Yet the number of securities fraud class action lawsuits filed in the federal courts has declined, and dismissal rates have increased, since the Reform Act was passed. *See generally Hearing on H.R. 5491, Before the House Committee on Financial Services, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises,* 109th Cong. (2006) (Statement of James D. Cox), *available at* http://www.law.duke.edu/features/pdf/ coxtestimony.pdf; Ronald I. Miller, Todd Foster, and Elaine Buckberg, *Recent Trends in Shareholder Class Action Litigation: Beyond the Mega-Settlements, is Stabilization Ahead?* Apr. 2006, *available at* http://www.nera.

[4] For the most part, the laudable provisions of Sarbanes-Oxley are focused on enhancing the regulatory oversight of corporate accounting practices and toughening the penalties for violations of the securities laws. *See, e.g.*, Title I, 15 U.S.C. §§ 7211-19 (establishing an accounting oversight board for public companies); Title VIII, Section 807, 18 U.S.C. § 1348 (increasing criminal penalties for defrauding shareholders of publicly traded companies). It remains for the courts to interpret the securities laws in a manner that affords investors an adequate means of redress for corporate malfeasance.

com/image/BRO_RecentTrends2006_SEC979_PPB-FINAL.pdf (National Economic Research Associates, Inc.). These conflicting trends have prompted experts in the securities field to surmise that because of the Reform Act, "the balance has been tipped too far in favor of preventing claims (some of which would, after discovery, turn out to have merit) rather than protecting investors who have suffered losses. That is, Congress swung the pendulum too far in protecting defendants." Kevin S. Schmelzer, *The Door Slammed Shut Needs to be Reopened: Examining the Pleading Requirements Under the Private Securities Litigation Reform Act*, 78 Temp. L. Rev. 405, 426 (2005); *see also* Joel Seligman, *Rethinking Private Securities Litigation*, 73 U. Cin. L. Rev. 95, 113 (2004) ("the diminution in the effectiveness of private federal securities litigation was one of the several facts that contributed to a reduction in fraud deterrence."). The Seventh Circuit's ruling at least minimizes this regulatory imbalance that favors defendants at the expense of investors.

Another factor supporting the Seventh Circuit's interpretation of the Reform Act is the limited availability of alternative recourse for the victims of securities fraud in the state courts. This Court has observed that the disadvantages posed by a restrictive interpretation of federal securities law can be "attenuated" where adequate remedies are available under state law. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 738 n.9 (1975) (standing to bring private cause of action under Rule 10b-5 limited to actual purchasers or sellers). Conversely, where state courts do not offer an adequate alternative forum for plaintiffs' claims, federal courts have a correspondingly greater justification for providing relief.

In this case, state law offers limited recourse for investors in the Respondents' position. Congress has expressly limited the use of class action suits seeking recovery for securities fraud under state law. In 1998, Congress enacted the Securi-

ties Litigation Uniform Standards Act ("SLUSA") to address the concern that "securities class action lawsuits [had] shifted from Federal to state courts" as a means of circumventing the Reform Act. *See* Pub. L. No. 105-353, § 2(1), (2), 112 Stat. 3227. With certain exceptions, SLUSA provides that no class action based upon state law may be maintained in any state court on behalf of more than 50 class members. *See* 15 U.S.C. § 77p(b). Moreover, state courts generally have not recognized the doctrine of fraud-on-the-market in cases seeking relief under state common law, further limiting the state courts as an alternative forum for investors aggrieved by large-scale market manipulation of the sort alleged in this case. *See, e.g., Kaufman v. i-Stat Corp.*, 754 A.2d 1188, 1193-94 (N.J. 2000); *Mirkin v. Wasserman*, 858 P.2d 568, 584 (Cal. 1993).

Precisely because of the massive corporate frauds that have surfaced in recent years, some state courts have recognized the need to reevaluate barriers to civil actions alleging securities fraud. The California Supreme Court, for example, has cited the troubling increase in corporate fraud as a reason to recalibrate the balance between the interests of investors and the interests of corporations, in favor of providing greater judicial recourse to victims of fraud:

> When Congress enacted the Private Securities Litigation Reform Act of 1995 and the Uniform Standards Act of 1998, it was almost entirely concerned with preventing nonmeritorious suits. (Stout, supra, 38 Ariz. L. Rev. 711). But events since 1998 have changed the perspective. The last few years have seen repeated reports of false financial statements and accounting fraud, demonstrating that many charges of corporate fraud were neither speculative nor attempts to extort settlement money, but were based on actual misconduct. "To open the newspaper today is to receive a daily dose of scandal, from Adelphia to Enron and beyond. Sadly, each of us knows that these newly publicized instances of accounting-related securities fraud are no longer out of

> the ordinary, save perhaps in scale alone." (Schulman, et al., The Sarbanes-Oxley Act: The Impact on Civil Litigation under the Federal Securities Laws from the Plaintiff's Perspective (2002 ALI-ABA Cont. Legal Ed. p.1.) The victims of the reported frauds, moreover, are often persons who were induced to hold corporate stock by rosy but false financial reports, while others who knew the true state of affairs exercised stock options and sold at inflated prices. (See Purcell, The Enron Bankruptcy and Employer Stock in Retirement Plans, Congressional Research Service (Mar. 11, 2002)). Eliminating barriers that deny redress to actual victims of fraud now assumes an importance equal to that of deterring nonmeritorious suits.

See Small v. Fritz Companies, Inc., 65 P.3d 1255, 1263-64 (Cal. 2003) (a person wrongfully induced to hold stock may bring an action for fraud under state common law). However, unless and until this shift in state law gains currency, investors must depend upon the federal courts to afford complete relief where corporate executives and others have perpetrated a fraud on the market. As financial crimes abound and as alternative forums for aggrieved investors remain limited, it is especially important that the federal courts interpret federal law in a way that, to the extent possible, affords meaningful remedies to victims of securities fraud. The Seventh Circuit's ruling accomplishes this objective and should be affirmed.

II. THE TEST ADVANCED BY THE PETITIONERS FINDS NO SUPPORT IN THE REFORM ACT; IT CONFLICTS WITH RULE 12(b)(6) AS WELL AS THE SEVENTH AMENDMENT; AND IT AGGRAVATES RATHER THAN AMELIORATES THE ALREADY EXCESSIVE BURDENS FACING INJURED INVESTORS SEEKING REDRESS IN THE COURTS

The Petitioners argue that the "strong inference" standard requires courts to apply a host of additional tests to determine

if a complaint adequately pleads scienter under the Reform Act. At the heart of the Petitioners' argument is the notion that a court must exclude the possibility of innocence by entertaining inferences that favor the *defendant* as well as the plaintiff, and balancing those inferences to determine which are more plausible—those that indicate innocence or those that support culpability. *See, e.g.*, Brief of Petitioners, No. 06-484, 2007 WL 432763 at *25-26 (S.Ct. Feb. 9, 2007) ("Reform Act requires the complaint to paint a detailed picture of the facts that meaningfully tends to exclude the possibility of innocence. . . . "); *id.* at 35 (inference cannot be strong if claimed culpable inference appears no more plausible than alternative, innocent inferences). This standard, however, finds no support in the language or the legislative history of the Reform Act. Moreover, it conflicts with the time-honored principle that on a motion to dismiss, *all* reasonable inferences are to be drawn in favor of the plaintiff. It also violates the right to trial by jury by asking courts to choose between competing factual interpretations. Finally, and perhaps most important, the Petitioners' harsh formula undermines the policies that the Reform Act and the securities laws more generally were intended to serve: it will routinely extinguish meritorious fraud claims at the pleading stage without significantly enhancing the goal of discouraging frivolous suits.

A. The Language And The Legislative History Of The Reform Act Do Not Support The Petitioners' Interpretation Of The Pleading Standard

Nowhere does the Reform Act make any reference to drawing inferences that favor the defendant, balancing competing inferences regarding scienter, or excluding the possibility of innocence. As discussed above, a complaint satisfies the Act if it pleads facts giving rise to a strong inference of scienter. The legislative history also contains no hint that Congress intended to incorporate the Petitioners'

burdensome standard into the Reform Act. On the contrary, as discussed *supra*, the Conference Report disavows any Congressional intent to incorporate specific requirements other than the "strong inference" test.

B. The Pleading Standard Advanced By The Petitioners Conflicts With The Judicially Established Procedures For Applying Rule 12(b)(6)

An enormous body of case law developed under Rule 12(b)(6) of the Federal Rules of Civil Procedure, FED. R. CIV. P. 12(b)(6), has established three core principles that apply whenever a court entertains a motion to dismiss for failure to state a claim upon which relief can be granted. First, the complaint is construed in the light most favorable to the plaintiff. Second, the allegations as pled in the complaint are taken as true. Third, and most important for the purposes of this appeal, all reasonable inferences that can be drawn from the pleading are drawn in favor of the pleader. 5B CHARLES ALLEN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE §1357 (3d ed. 2004). When considering a motion to dismiss pursuant to Rule 12(b)(6), a court is bound to "assume the truth of all well-pleaded facts and indulge all reasonable inferences that fit the plaintiff's stated theory of liability." *See In re Colonial Mortg. Bankers Corp.*, 324 F.3d 12, 15 (1st Cir. 2003). The rationale for this doctrine is that, on a motion to dismiss, the court is not weighing evidence, but only testing the legal sufficiency of the plaintiff's claim to determine if relief may be granted. *See Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1187 (10th Cir. 2003). This Court has instructed that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). This instruction leaves no room for

the trial judge to consider the inferences that cast a defendant in the best light.

Congress evinced no intent to amend Rule 12(b)(6) or overturn its judicial underpinnings when it adopted the Reform Act. "[T]he Reform Act did not reverse the polarity of securities pleading." *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001), *cert. dismissed*, 536 U.S. 935 (2002). In the absence of such an amendment, federal courts are bound to follow the dictates of Rule 12(b)(6). *See Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163 (1993). Accordingly, its requirements apply no less to allegations of scienter in a securities fraud case than they do to any other case. The Petitioners' assertion that on a motion to dismiss, courts must entertain inferences in favor of the defendant directly conflicts with the canons of Rule 12(b)(6). The Seventh Circuit's interpretation of the pleading standard for scienter creates no such conflict, and for this reason, the court's ruling should be affirmed.

C. The Petitioners' Insistence That Courts Balance Competing Inferences To Resolve A Motion To Dismiss Conflicts With The Seventh Amendment's Right To Trial By Jury

The Seventh Amendment to the Constitution provides that "the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law." U.S. CONST. amend. VII. It is well settled that "when there is a debatable issue of fact in the trial of a suit at common law in a court of the United States, the right to have it determined by a jury is guaranteed by the Seventh Amendment of the Constitution." *See Hunt v. Bradshaw*, 251 F.2d 103, 108 (4th Cir. 1958). The Seventh Amendment ensures "the enjoyment of the right of trial by jury be not obstructed, and that the ultimate determination of issues of fact by the jury be not interfered with." *Ex Parte Peterson*, 253 U.S.

300, 309-310 (1920). "[M]aintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care." *Beacon Theatres, Inc. v. Westover*, 359 U.S. 500, 501 (1959).

The right to trial by jury places limits on the nature of the issues that a judge may decide on a dispositive motion, such as a motion to dismiss or a motion for summary judgment. Courts certainly are empowered to make procedural rulings with a view to formulating the issues. However, when a court weighs competing inferences and "fails to draw all reasonable inferences in favor of [the plaintiff]," it acts as a fact finder and "impermissibly substitute[s] its judgment concerning the weight of the evidence for the jury's." *Reeves v. Sanderson Plumbing Products*, 530 U.S. 133, 153 (2000); *cf. Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986) ("Credibility determinations, the weighing of the evidence and the drawing of legitimate inferences from the facts are jury functions, not those of a judge, whether ruling on a motion for summary judgment or for a directed verdict.").

The Petitioners' interpretation of the Reform Act calls upon courts to engage in just these sorts of factual determinations: considering the relative weight of inferences drawn in favor of both parties, in conflict with the Seventh Amendment. The Seventh Circuit recognized the constitutional implications of the Petitioners' test:

> [W]e think it wiser to adopt an approach that cannot be misunderstood as a usurpation of the jury's role. Instead of accepting only the most plausible of competing inferences as sufficient at the pleading stage, we will allow the complaint to survive if it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent. "Faced with two seemingly equally strong inferences, one favoring the plaintiff

> and one favoring the defendant, it is inappropriate for us to make a determination as to which inference will ultimately prevail, lest we invade the traditional role of the factfinder."

See Makor, 437 F.3d at 602 (quoting *Pirraglia*, 339 F.3d at 1188); s*ee also City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 683 n.25 (6th Cir.), *cert. denied*, 126 S.Ct. 423 (2005) ("One might argue that for cases where a juror could conclude that the facts pleaded show scienter, but that conclusion would not be the most plausible of competing inferences, a Seventh Amendment problem is presented."). Unlike the Petitioners' test, the Seventh Circuit's interpretation of the Reform Act avoids a conflict with the right to trial by jury, and for this reason the court's ruling should be affirmed.

D. If The Seventh Circuit's Ruling Is Reversed, An Increasing Number Of Investors Will Suffer Irretrievable Losses At The Hands Of Those Committing Fraud

While the Seventh Circuit's ruling imposes manageable burdens on investors who have legitimate claims for securities fraud, the Petitioners' formula for pleading scienter under the Reform Act heaps additional, unreasonable requirements on those same investors. Under that formula, meritorious claims involving fraud on the market will be barred in instances where a class of plaintiffs, at the pleading stage and without the benefit of discovery, cannot yet perform the daunting task of disproving all innocent explanations for the defendants' fraudulent conduct. As a result, plaintiffs will be unjustly deprived of the right to recover damages for fraud and abuse that unquestionably caused them injury. Because the Petitioners' interpretation of the pleading requirements for scienter under the Reform Act will so undermine the purposes of the securities laws, and because it is neither compelled nor warranted by the applicable statutory language, it should be

rejected. The Seventh Circuit's ruling avoids this unfairness to investors, without betraying the obligation to fulfill Congress's policy objectives under the Reform Act, and it should therefore be affirmed.

CONCLUSION

For the reasons set forth above, the decision of the Seventh Circuit should be affirmed.

Respectfully submitted,

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