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FOURTH CIRCUIT INTERPRETS *TELLABS* FOR FIRST TIME AND DISMISSES SUITS

by
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In 1995, Congress passed the Private Securities Litigation Reform Act, which among other mandates instructed courts to dismiss any securities fraud complaint that does not “state with particularity facts giving rise to a strong inference that the defendant acted with scienter.” 15 U.S.C. § 78u-4(b)(2). The Supreme Court in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007), defined the strong inference standard by holding that the inference of scienter must be “cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” *Id.* at 2510.

Recently, the U.S. Court of Appeals for the Fourth Circuit issued its first two opinions applying the holding in *Tellabs*. See *Pub. Employees’ Ret. Ass’n of Colo. v. Deloitte & Touche LLP*, ___ F.3d ___, No. 07-1704, 2009 WL 19134 (4th Cir. Jan. 5, 2009); *Cozzarelli v. Inspire Pharm. Inc.*, 549 F.3d 618 (4th Cir. 2008). As explained below, in both cases, the Fourth Circuit followed *Tellabs* by weighing the competing inferences of fraudulent and non-fraudulent intent and held that dismissal was proper because the innocent inferences available to the defendants were more compelling than any culpable ones. *Deloitte*, 2009 WL 19134 at *11; *Cozzarelli*, 549 F.3d at 626.

In *Cozzarelli*, plaintiffs alleged that a pharmaceutical company and its directors committed securities fraud by withholding certain details regarding a clinical trial that was being conducted to obtain FDA approval for a new product. 549 F.3d at 625. Defendants asserted that they did not disclose the subject details of the trial because they did not want the company’s competitors to know the FDA’s requirements for approval. *Id.* at 622. Defendants, therefore, urged the court to find the inference of non-fraudulent intent to protect the company’s competitive interests more compelling than plaintiffs’ allegations of a nefarious intent, which included allegations of concealing negative test results to insure the company’s ability to raise capital and to increase executive compensation. *Id.* at 625-26. After noting that the alleged financial motives are common to every company and its officers, the Fourth Circuit dismissed the complaint because “the most persuasive inference is that defendants acted with a lawful intent to protect their competitive interests[,] . . . [a]nd that inference is more compelling than the inference that defendants acted with an intent to mislead or deceive.” *Id.* at 627-28; see also *Fourth Circuit Affirms Dismissal Based on Failure to Raise a Strong Inference of Scienter under Tellabs*, available at <http://securities.litigation.alston.com/blog.aspx?entry=1231>

In *Deloitte*, plaintiffs alleged that the defendant accounting firm committed securities fraud by issuing audit opinions for Ahold, a company that announced it had overstated its income by \$500 million. 2009 WL 19134, at *2, *8. In an attempt to plead a strong inference of scienter, plaintiffs alleged that the accountants were severely reckless in not knowing about the accounting fraud because there were a number of actions the accountants could have taken to discover the fraud earlier. *Id.* at *11. But the facts before the court also

demonstrated that Ahold “went to considerable lengths to conceal the frauds from the accountants,” which supported the inference that the accountants “lacked the requisite scienter and instead were deceived by Ahold.” *Id.* Because this inference of non-fraudulent intent was more compelling than the inference that the accountants knew Ahold was defrauding investors, the Fourth Circuit upheld the complaint’s dismissal. *Id.*

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