No. 04-1687

United States Court of Appeals
for the Seventh Circuit

MAKOR ISSUES & RIGHTS, LTD.,
CHRIS BROHOLM, RICHARD LEBRUN, et al.,

Plaintiffs-Appellants,

v.

TELLABS, INCORPORATED,
MICHAEL J. BIRCK, RICHARD C. NOTEBAERT, et al.,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois,
Eastern Division, No. 02-C-4356, The Honorable **Amy J. St. Eve,** Presiding.

BRIEF OF DEFENDANTS-APPELLEES

David F. Graham
Kathleen L. Roach
Kyle D. Rettberg
SIDLEY AUSTIN BROWN
& WOOD LLP
10 S. Dearborn Street
Chicago, Illinois 60603
(312) 853-7000

Attorneys for Defendants-Appellees

ORAL ARGUMENT REQUESTED

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No. 04-1687

Short Caption: Makor Issues and Rights, Ltd., et al. v Tellabs, Inc.

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

The Court prefers that the disclosure statement be filed immediately following docketing; but, the disclosure statement must be filed within 21 days of docketing or upon the filing of a motion, response, petition, or answer in this court, whichever occurs first. Attorneys are required to file an amended statement to reflect any material changes in the required information. The text of the statement must also be included in front of the table of contents of the party's main brief. **Counsel is required to complete the entire statement and to use N/A/ for any information that is not applicable if this form is use.**

(1) The name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P. 26.1 by completing item #):

Tellabs, Inc., Michael J. Birck, Brian Jackman, John C. Kohler, Richard C. Notebaert, Robert W. Pullen, and Joan E. Ryan

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Sidley Austin Brown & Wood LLP

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

N/A/

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

See explanation attached hereto.

Attorney's Signature: _____ Date: July 2, 2004

Attorney's Printed Name: David F. Graham

Please indicate if you are *Counsel of Record* for the above-listed parties pursuant to Circuit Rule 3(d). Yes X No___

Address: Sidley Austin Brown & Wood LLP
10 South Dearborn Street
Chicago, IL 60603
Phone Number: (312) 853-7000 Fax Number: (312) 853-7036
E-Mail Address: dgraham@sidley.com

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT
RESPONSE TO QUESTION (3) ii)

AXA is a publicly held company whose ordinary share is listed and trades on Paris Stock Exchange and on the SEAQ International in London. In the United States, the AXA American Depository Share is listed on the New York Stock Exchange. AXA has included itself in a Schedule 13G filing that was submitted to the Securities and Exchange Commission (the "SEC") relating to Tellabs, Inc. common stock. A copy of that filing, downloaded from the SEC's Internet website, is attached hereto. The Schedule 13G states that the aggregate amount of Tellabs, Inc. common stock beneficially owned by AXA is 58,486,110 shares, or 14% of Tellabs, Inc. common stock. The Schedule 13G further states that, "AXA expressly declares that the filing of this Schedule 13G shall not be construed as an admission that it is, for purposes of Section 13(d) of the Exchange Act, the beneficial owner of any securities covered by this Schedule 13G."

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JURISDICTIONAL STATEMENT

The appellants' jurisdictional statement is complete and correct.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Did the District Court correctly determine that plaintiffs failed to plead particularized facts giving rise to a "strong inference" of scienter on the part of any of the defendants?

2. Is the dismissal alternatively entitled to affirmance because plaintiffs failed to plead facts adequate to support their claims of falsity?

3. Did the District Court properly dismiss plaintiffs' claims regarding projections that were accompanied by meaningful cautionary statements?

4. Did the District Court properly dismiss certain alleged misstatements as being inactionable "puffery"?

STATEMENT OF FACTS

I. Tellabs' Financial Performance and Guidance

Tellabs, Inc. ("Tellabs" or the "Company") designs, manufactures and markets highly specialized optical networks and broadband access equipment. (JA105, ¶ 2).[1] Because plaintiffs assert that certain of Tellabs' officers and/or directors engaged in a scheme to inflate the Company's stock price between December 11, 2000 and June 19,

[1] Documents will be cited as follows: Record on Appeal (R.___); Joint Appendix (JA___.); Brief Appendix (BA___.); Plaintiffs/Appellants' Opening Brief (Pl. Br. ___.)

2001 (JA105, ¶1), the sequence of events regarding Tellabs' financial guidance and performance during that period is relevant.

During 2000, Tellabs had record sales over $3.3 billion, a 43.3% increase over 1999. (R.74, Tab 4, p. 12).[2] Sales of its optical networking products (the key one of which was the TITAN 5500), increased by 54.1% compared to 1999. (*Id.*, p. 12-13). Anticipating continued strong growth, at a December 11, 2000 analysts conference, Tellabs projected an overall 30% growth in sales during 2001. (JA 126, ¶¶ 75-76).

On January 23, 2001, Tellabs announced record-setting sales for the fourth quarter 2000 of over $1 billion. (JA129, ¶ 81). Sales of optical networking products amounted to $641 million, a 49% increase over the fourth quarter 1999. (R.74, Tab 1). Later that day, Tellabs reiterated its revenue guidance for 2001. (JA121, ¶ 85).

On March 7, 2001, Tellabs updated its guidance for the first quarter and full year 2001, reducing its projections of first quarter sales. (JA138, ¶ 99). The release announcing the updated guidance noted that the revision "stemmed from below-trend growth in Tellabs' CABLESPAN business." (*Id.*). Tellabs' separate CABLESPAN business is not the subject of any allegations by plaintiffs, and there is no claim that this statement about unanticipated reduced CABLESPAN sales was inaccurate.

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[2] Documents that are referred to in a complaint may be considered on a motion to dismiss. *Venture Assocs. Corp. v. Zenith Data Sys. Corp.*, 987 F.2d 429, 431 (7th Cir. 1993). This includes SEC filings, analysts' reports and statements that are integral to the complaint. *Bovee v. Coopers & Lybrand C.P.A.*, 272 F.3d 356, 360-61 (6th Cir. 2001). Such documents were cited to the Court below. (*See* R.49, 74).

On April 6, 2001, Tellabs again lowered its first quarter 2001 revenue guidance. (JA144, ¶ 113), stating "[t]he revised guidance stems from reduced and deferred spending by major communications carriers late in the quarter." (*Id.*). During a call with analysts that same day, Tellabs' CEO, Notebaert, explained that in the last two and a half weeks of the quarter, certain customers had pushed some TITAN 5500 orders into the next quarter (but had *not* cancelled the orders). (JA144-45, ¶ 116). He further stated that, "[c]learly, the environment has resulted in near term caution on the pace at which customers are deploying equipment. Our customers are exercising a high degree of prudence over every dollar spent." (R.74, Tab 3, p. 2).

On April 18, 2001, Tellabs announced its first quarter financial results. (JA147, ¶ 121). Although below original expectations of 30% year to year growth, the results showed that the Company was still experiencing very significant growth – sales in the quarter represented a 21% increase over the first quarter 2000. (R.49, Tab 18). Plaintiffs have never challenged the accuracy of these results. (BA79).

On April 18, 2001, the Company also reduced its full year revenue projections from approximately $4.4 billion to a range of $3.6 to $3.7 billion. (R.49, Tab 18; R.74, Tab 6, p.7). The Company's press release stated, "[i]n light of reduced and deferred spending by major communications carriers, Tellabs will realign its cost structure with its current expectations for lower revenue growth." (JA146, ¶ 121). As part of that belt-tightening, Tellabs announced that it would be reducing its workforce and also

terminating its SALIX product line. (JA147, ¶ 121; R.49, Tab 18). During an analysts call that day, Notebaert stated:

> Declining business trends we experienced late in the quarter indicates *[sic]* that we are operating in a very different environment than we were just a few short months ago. In fact, a very different environment than it was just a few weeks ago. Our customers are reviewing, and in some cases, reducing capital plans …

(R.49, Tab 19).

Between April 18, 2001 and June 19, 2001, the Company did not provide any guidance. During the second quarter 2001, the Company experienced a fall-off in orders for its core TITAN 5500 product, as telecommunications companies reduced capital expenditures. Accordingly, part-way through the quarter, on June 19, 2001, Tellabs announced substantial reductions in its prior guidance for the second quarter and for the remainder of 2001. (JA150, ¶ 131; R. 49, Tabs 3 & 4). As plaintiffs allege, the revenue shortfall was "due almost entirely" to a reduction in sales of "the TITAN 5500 series." (JA150, ¶ 132).

II. The Proceedings Below

A. The Complaint

The Consolidated Class Action Complaint (the "Complaint") alleged that Tellabs and ten of its officers or directors engaged in a scheme to inflate the Company's stock price. (*See* JA21-24, 27-28, ¶¶ 6-14, 21). In general, the Complaint alleged that the Tellabs' reported financial results for the fourth quarter of 2000 were inaccurate, and that revenue projections issued by the Company during the class period were false.

Plaintiffs' claims regarding the alleged falsity of the Company's fourth quarter 2000 results included allegations that the Company artificially inflated revenues through a variety of so-called "channel stuffing" activities, including: (a) offering customers discounts and incentives; (b) providing excess product to customers with a pre-arranged understanding that the product could be returned; and (c) improperly booking revenue on consignment sales. (*See* JA49-50, ¶ 64(a)).

Defendants moved to dismiss the Complaint. The District Court granted defendants' motion, with leave to amend, finding, *inter alia*: (a) all but one of Tellabs' projections were accompanied by meaningful cautionary language, and thus within the scope of the "safe harbor" provisions of the Private Securities Litigation Reform Act ("PSLRA") (BA28-30); (b) plaintiffs had failed to offer particularized facts to support their claim that the Company's fourth quarter 2000 financial results were false (BA18-24); and (c) plaintiffs had failed to adequately allege a strong inference of scienter as to any of the defendants (BA30-38).

B. The Second Amended Complaint

On July 11, 2003, plaintiffs filed their Second Consolidated Amended Class Action Complaint (the "SAC"), which repeated plaintiffs' claims that Tellabs' fourth quarter 2000 financial results were overstated, and that revenue projections between December 2000 and April 2001 were false. The SAC, however, abandoned certain earlier claims. It made no mention of consignment transactions or providing customers

with product for which there was some pre-arranged right of return. Plaintiffs also dropped their claims against four individuals.

The SAC added entirely new allegations of financial wrongdoing, however. It asserted that unnamed Tellabs personnel wrote fictitious orders and backdated sales. (*See*, *e.g.*, JA132, 137, ¶¶ 86(a), 95). The SAC, however, provided no factual details as to these new assertions.

The SAC also purported to describe 27 confidential sources for its allegations. (JA103-05). The SAC's description of these sources consisted largely of a vague characterization of each alleged former employee's position (*e.g.*, "high-level executive"), with no further description of the source's actual job duties or involvement in the matters referenced. (*Id.*).

Defendants moved to dismiss the SAC, and the District Court granted that motion with prejudice. (BA93). The Court reaffirmed its prior ruling that all but one of the revenue projections were protected by the PSLRA's "safe harbor." (BA59). It also ruled that plaintiffs had failed to plead particularized facts demonstrating the falsity of certain statements in the first instance, and that certain other statements constituted inactionable puffery. (BA62-73). Finally, after examining plaintiffs' allegations on a defendant-by-defendant basis, the District Court concluded that plaintiffs had failed to

allege particularized facts sufficient to establish the requisite "strong inference" of scienter. (BA32-48). This appeal followed.[3]

SUMMARY OF THE ARGUMENT

This case involves a groundless attempt to transform a downturn in sales encountered by Tellabs in 2001, as part of the well-known telecommunications industry crash at that time, into a case of fraud by its CEO and Board Chairman. The District Court correctly rejected that attempt, finding that plaintiffs had failed to satisfy the PSLRA's requirement of pleading particularized facts sufficient to create a "strong inference" of scienter.

Although plaintiffs' brief eschews a defendant-by-defendant analysis of the issues, that is what the PSLRA requires. As to Mr. Notebaert, Tellabs' CEO, far from creating a "strong inference" of scienter, the SAC did not even attempt to present a plausible motive for his engaging in fraud, and none exists. Moreover, plaintiffs' attempts to suggest that Notebaert had some actual knowledge of wrongdoing are based on allegations that the District Court correctly labeled conclusory, and which fall far short of creating a "strong inference." For example, while conclusorily accusing Notebaert of involvement in "channel stuffing," plaintiffs studiously avoided alleging

[3] Following entry of judgment, the defendants filed a Rule 59(e) motion to alter or amend the judgment in order to clarify that the District Court's finding of a lack of scienter applied to Tellabs as well as each individual defendant. The District Court granted that motion. (BA96-97).

what the nature of that "channel stuffing" was or what Notebaert himself did. Plaintiffs have simply ignored these deficiencie.

The claim of scienter against Mr. Birck is equally weak. Other than conclusory assertions, such as that Birck was "hands on" in his approach, the sole support for the charge that Birck was participant in a fraud is that he sold less than 1% of his Tellabs' stock holdings during the class period. This is patently insufficient. Finally, in the absence of any adequate allegations of scienter with respect to any individual involved in the making of the statements at issue, Tellabs itself cannot be liable. For corporate liability to attach, there must be an individual involved in the representation process that possesses the requisite fraudulent mental state.

The District Court also correctly concluded that Tellabs' projections were accompanied by meaningful cautionary statements, and thereby protected by the PSLRA's "safe harbor" for forward-looking statements. And, the few statements that were found to be vague "puffery" were of the sort that this Court itself has held are inactionable.

Finally, while these deficiencies amply suffice for affirmance, an alternative ground also exists. When examined closely, it is clear that even plaintiffs' claims of falsity were the product of unacceptably conclusory allegations.

ARGUMENT

I. THE DISTRICT COURT PROPERLY APPLIED THE PSLRA'S PLEADING STANDARDS.

A. The PSLRA's Heightened Pleading Standards

The PSLRA was designed to significantly heighten the threshold pleading requirements for securities fraud cases "because of significant evidence of abuse in private securities litigation, particularly the filing of frivolous suits alleging securities violations designed solely to coerce companies to settle quickly and avoid the expense of litigation." *EP Medsystems, Inc. v. EchoCath, Inc.*, 235 F.3d 865, 872 (3rd Cir. 2000).

Even pre-PSLRA, this Court recognized that securities fraud complaints should be subject to rigorous scrutiny, requiring plaintiffs to plead the circumstances surrounding the alleged fraud with particularity, *i.e.*, "the who, what, when, where, and how" of the alleged fraud. *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990). Numerous decisions rejected claims of "fraud by hindsight." *See, e.g., id.* at 628; *Eisenstadt v. Centel Corp.*, 113 F.3d 738, 746 (7th Cir. 1997); *Arazie v. Mullane*, 2 F.3d 1456, 1468 (7th Cir. 1993). This Court held that even though Rule 9(b) allowed state of mind to be pleaded generally, conclusory allegations of scienter were insufficient. *See DiLeo*, 901 F.2d at 629; *Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1127 (7th Cir. 1990) (rejecting "rote conclusions" of scienter). And, it cautioned that in considering whether a plaintiff had adequately pled scienter, courts should not "indulg[e] ready inferences of irrationality." *DiLeo*, 901 F.2d at 629.

The PSLRA increased these significant pleading burdens in several ways. With respect to falsity, the PSLRA requires a complaint to "specify each statement alleged to have been misleading" and "the reason or reasons why the statement is misleading…" 15 U.S.C. § 78u-4(b)(1). It further provides that "if an allegation regarding the statement is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." *Id.* The Court below found, and plaintiffs do not challenge, that virtually all of the SAC's allegations are subject to this latter requirement. (BA58)

The PSLRA also heightened the requirements for pleading scienter. In particular, the PSLRA provides that a plaintiff must "with respect to *each* act or omission alleged to violate this chapter, 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). The PSLRA thus mandates a defendant-by-defendant, statement-by-statement analysis of scienter allegations. *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 364-65 (5th Cir. 2004) ("These PSLRA references to 'the defendant' may only reasonably be understood to mean 'each defendant' in multiple defendant cases…"); *In re Humphrey Hospitality Trust, Inc. Sec. Litig.*, 219 F. Supp. 2d 675, 682 (D. Md. 2002)[4]

[4] Prior to the PSLRA, some courts permitted "group pleading," which allowed plaintiffs to collectivize defendants for pleading purposes. Even before the PSLRA, however, this Court made clear that "[a] complaint that attributes misrepresentations to all defendants, lumped together for pleading purposes, generally is insufficient." *Sears v. Likens*, 912 F.2d 889, 893 (7th Cir. 1990). Because the PSLRA clearly requires a separate analysis as to each defendant, any "group pleading" doctrine does not survive the PSLRA. *Southland*, 365 F.3d at 365.

Finally, in addition to heightening the standards for pleading falsity and scienter, the PSLRA also altered the substantive state of mind requirement as to "forward-looking statements," including projections. *See* 15 U.S.C. § 78u-5. As to natural persons, forward-looking statements are only actionable if "made with actual knowledge by that person that the statement was false or misleading." 15 U.S.C. § 78u-5(c)(1)(B)(i). As to business entities, a forward-looking statement is only actionable if made or approved by an executive officer "with actual knowledge by that officer that the statement was false or misleading." 15 U.S.C. § 78u-5(c)(1)(B)(ii)(II).

Most of the Circuits have addressed the PSLRA's heightened pleading requirements, and in particular the contours of the "strong inference" requirement. A majority have held that whether a complaint adequately pleads a strong inference of scienter is a case-specific inquiry, with no particular pattern of facts is necessarily being determinative.[5] *See Ottmann v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 345 (4th Cir. 2003); *Florida State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 659-60 (8th Cir. 2001).[6]

[5] The Second and Third Circuits, on the other hand, allow a plaintiff to establish the requisite "strong inference" by alleging facts which either (a) show that defendants had both "motive and opportunity to commit fraud," or (b) "constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999). *Accord In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534-35 (3d Cir. 1999).

[6] *See also Nathenson v. Zonagen Inc.*, 267 F.3d 400, 411-12 (5th Cir. 2001); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 551-52 (6th Cir. 2001); *City of Philadelphia v. Fleming Cos. Inc.*, 264 F.3d 1245, 1263 (10th Cir. 2001).

Thus, for example, while allegations of "motive and opportunity" are relevant they cannot automatically be said to create a strong inference of scienter. *See Greebel v. FTP Softward, Inc.,* 194 F.3d 185 at 197 (1st Cir. 1999); *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1285 (11th Cir. 1999); *In re Comshare Inc. Sec. Litig.*, 183 F.3d 542, 551 (6th Cir. 1999). Facts relating to motive do play a crucial role in many cases, though, because where a complaint does not adequately demonstrate a plausible motive, facts tending to show scienter "would have to be *particularly strong* in order to meet the [PSLRA] standard." *Green Tree Fin. Corp.*, 270 F.3d at 660 (emphasis added).

The Circuits have also differed over what precisely it means for an inference to be a "strong" one. The Sixth Circuit has held that, the "strong inference" requirement means "that plaintiffs are entitled only to the *most plausible* of competing inferences." *Helwig*, 251 F.3d at 553 (emphasis added). *Accord Gompper v. VISX, Inc.*, 298 F.3d 893, 897-98 (9th Cir. 2002). The First Circuit has held that inferences of scienter survive a motion to dismiss merely if they are not only reasonable but "strong" inferences. *Greebel*, 194 F.3d at 195-96. The Tenth Circuit has rejected the "most plausible" standard, but acknowledges that "negative inferences that may be drawn against the plaintiff" must also be considered. *Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1187-88 (10th Cir. 2003).

Defendants respectfully submit that the appropriate method for evaluating whether a plaintiff has pled facts sufficient to establish a "strong inference" of scienter is that which has been applied by the majority of Circuits, *i.e.*, a fact-specific inquiry that is

not wedded to any particular formula, and which considers allegations of motive but does not deem them to be mechanically determinative. Plaintiffs appear to agree, as did the District Court. Defendants also submit that the "strong inference" standard can only be met where the inference of scienter is strong even when competing inferences negative to the plaintiff are considered. As demonstrated below, however, regardless of the standard applied, the District Court correctly determined that plaintiffs have failed to allege particularized facts giving rise to a strong inference of scienter on the part of any of the defendants.

B. The District Court Applied Proper Pleading Standards

Plaintiffs argue that the District Court did not apply the correct pleading standards in finding that plaintiffs failed to allege facts creating a "strong inference" of scienter. (Pl. Br. 23-30). Plaintiffs' contentions are unfounded.

Plaintiffs' attack on the District Court is largely rhetorical, and virtually devoid of specific citation to the District Court's opinion. For example, while plaintiffs assert that the District Court failed to accept as true all well-pleaded factual allegations (Pl. Br. 29), they do not identify a single particularized fact that the District Court failed to credit.

Similarly deficient is plaintiffs' claim that the District Court failed to draw all reasonable inferences in plaintiffs' favor. As an initial matter, inferences that are merely "reasonable" are insufficient to satisfy the "strong inference" requirement of the PSLRA. *See Greebel*, 194 F.3d at 195-96 ("inferences of scienter do not survive if they are

merely reasonable"). Plaintiffs' assertion that it is improper to "weigh" inferences (Pl. Br. 24) similarly ignores the fact that the PSLRA's "strong inference" requirement necessarily includes the consideration of competing inferences. As the Fifth Circuit has stated:

> Although plaintiffs complain the district court improperly weighed the facts, the PSLRA's pleading standards explicitly contemplate such weighing by requiring the district court to determine whether or not the facts support a "*strong* inference" of scienter. That is, the district court must engage in some weighing of the allegations to determine whether the inferences toward scienter are strong or weak.

Rosenzweig v. Azurix Corp., 332 F.3d 854, 867 (5th Cir. 2003). *Accord Gompper*, 298 F.3d at 897-98; *Helwig*, 251 F.3d at 553. Indeed, even the Tenth Circuit decision relied upon by plaintiffs (Pl. Br. 24) makes clear that "potentially negative inferences" need to be considered. *See Pirraglia*, 339 F.3d at 1187-88. The "weighing" rejected by the Tenth Circuit was not the consideration of inferences negative to the plaintiffs, but rather the practice of selecting an inference more favorable to the defendants where the inference advanced by the plaintiff was "equally strong." *Id.* Here, plaintiffs have failed to identify *any* reasonable inferences that were improperly rejected by the District Court, much less any inferences that were at least "equally strong" as the inferences weighing against scienter.

Plaintiffs' claim that the District Court failed to consider the SAC's scienter allegations in their "totality" is also groundless. (Pl. Br. 30 & n. 20) . The District Court expressly noted that it was considering plaintiffs' scienter allegations in their totality.

(*See* JA235 ("Weiss: …[T]he facts alleged in the complaint must be judged cumulatively in their totality'….The Court: I agree."). (*See also*, *e.g.*, BA86 ("these allegations in their totality fall short of providing a strong inference of scienter"); BA44. This is fatal to plaintiffs' contention. *See Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1093 (10th Cir. 2003) ("In light of the district court's express statement that it considered the pleadings in their entirety, we have no reason to conclude otherwise.") But viewing scienter allegations in their "totality" does not eliminate the need to engage in the required defendant-by-defendant analysis. *See Pirraglia*, 339 F.3d at 1190 n.11. Nor does it not mean that plaintiffs can establish scienter by heaping conclusory allegation on top of conclusory allegation. As detailed below, the conclusory allegations of scienter offered by the plaintiffs fail to support a strong inference of scienter, regardless whether they are considered separately or in their "totality."

Finally, plaintiffs' accusation that the District Court required them "at the pleading stage to prove their case with evidence," (Pl. Br. 30) is similarly groundless. The District Court specifically affirmed that, "The PSLRA does not require Plaintiffs to plead all of their evidence of try the case at the pleading stage." (BA57). But while plaintiffs are not required to prove their case at the pleading stage, the PSLRA does require them to plead *specific facts* supporting a strong inference of scienter. That is all the District Court required here. [7]

[7] Plaintiffs' argument that the District Court "demand[ed] evidentiary detail amounting to proof" when it faulted plaintiffs for failing to provide basic information about documents that

II. THE DISTRICT COURT PROPERLY FOUND THE SCIENTER ALLEGATIONS AGAINST NOTEBAERT INSUFFICIENT.

As discussed above, the PSLRA requires plaintiffs to plead scienter on a defendant-by-defendant basis. In this appeal, plaintiffs have abandoned their Section 10(b) claims against Kohler, Pullen, Ryan, and Jackman, each of whom was named in the SAC. (Pl. Br. 4 n. 3). Given that plaintiffs' allegations center on financial matters, plaintiffs' abandonment of these claims against Ryan, Tellabs' CFO, is particularly telling.

Rather than analyzing scienter with particularity as to the remaining defendants – Notebaert, Birck, and the Company – plaintiffs proffer a hodgepodge list of generalized scienter allegations that does not meaningfully distinguish among the various defendants or link the allegations to particular misstatements. (Pl. Br. 31-45). The reason plaintiffs take this tack is clear: the defendant-by-defendant analysis required by the PSLRA conclusively demonstrates that plaintiffs have not alleged the requisite strong inference of scienter for Notebaert or the other remaining defendants.

A. Plaintiffs Did Not Allege Any Motive For Notebaert To Commit Fraud.

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supposedly supported their scienter allegations – such as who prepared them, what information they contained, or how that information rendered the Company's public statements false (*see* Pl. Br. 35 n. 26) -- ignores the fact that even before the PSLRA's "strong inference" requirement, this Court required plaintiffs to plead such facts regarding documents that they claimed supported an inference of scienter. *See Arazie*, 2 F.3d at 1467 (rejecting scienter allegations based on "references to unreleased or internal information that allegedly contradict[s] the public statement[s]" where plaintiffs failed to allege "who prepared the projected figures, when they were prepared, how firm the numbers were, or which [company] officers reviewed them.").

Allegations of motive – or the absence thereof – can play a significant role in determining whether a plaintiff has adequately alleged a strong inference of scienter. **(***See* p. 12, *supra*). Because motives are easily rhetorically invented, however, for motive allegations to be meaningful they must show that the defendant "benefitted in some concrete and personal way from the purported fraud." *Novak v. Kasaks*, 216 F.3d 300, 307-08 (2d Cir. 2000). General motives possessed by virtually all corporate insiders are insufficient. *Id.*

Here, plaintiffs failed to identify any plausible motive for Notebaert – Tellabs' CEO, and the person to whom many of the statements in the SAC are attributed – to have committed fraud. *First*, the SAC does not even attempt to identify any "concrete and personal" benefit to Notebaert from the purported fraud. For example, it does not allege that Notebaert engaged in any sales of the Company's stock during the class period. Nor does it identify any other way that he would have personally benefited from the alleged fraud.

In the absence of a concrete motive for Notebaert, the inference that plaintiffs seek to have this Court draw is that Notebaert risked his job, reputation, and jail in order to engage in a "scheme" that would not benefit himself in any way. That suggestion defies common sense, and is precisely the type of "ready inference of irrationality" that this Court has cautioned against indulging. *DiLeo*, 901 F.2d at 629.

Second, the patent irrationality of the purported fraud here is underscored by the fact that it not only produced no alleged benefit to Notebaert, it is not even alleged to

have been of benefit to Tellabs. The "fraud" alleged here was time-limited in its nature. According to plaintiffs, the "truth" was revealed when Tellabs publicly revised its 2001 guidance on June 19, 2001. (JA150, ¶ 131). Even the alleged financial wrongdoing was limited in duration, affecting only the financials for the fourth quarter of 2000. As the District Court pointed out, and plaintiffs affirmed in oral argument (JA223-25), no claim was made of similar wrongdoing in the first quarter of 2001.

Consequently, in order for Tellabs to have attempted to benefit in some way from the purported fraud, it would have had to do so between December 11, 2000 and June 19, 2001. Yet plaintiffs do not allege that there were *any* Company activities during this period somehow to be facilitated by artificially inflating its stock price – no Company offerings, exchanges, etc.

In short, plaintiffs propose that Notebaert undertook to defraud investors for no apparent reason. And, further undermining any "strong inference" of scienter, plaintiffs also offer no explanation why, if Notebaert was supposedly engaged in a scheme to inflate the stock price during this period by creating unrealistic expectations, he had the Company itself announce downward revisions in its quarterly or yearly guidance on each of March 7, April 6, and April 18, 2001 (*see* pp. 2-4, *supra*), as well as on June 19, 2001 – conduct inconsistent with the purported scheme.

Third, as noted earlier, plaintiffs have abandoned their claims that other Tellabs executives previously named as defendants participated in a fraudulent "scheme" with Notebaert. Plaintiffs make no effort to explain how Notebaert could plausibly hope to

perpetrate such a "scheme" without the involvement or knowledge of the CFO or other high-level executives of the Company.

B. Plaintiffs Failed To Allege Facts Giving Rise To A Strong Inference That Notebaert Acted With Scienter.

As noted earlier, the failure to identify a plausible motive for a defendant to commit fraud means that other allegations of scienter on the part of that defendant must be "particularly strong." *Florida State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 659-60 (8th Cir. 2001). The District Court found that plaintiffs had adequately alleged the falsity of a limited number of statements. The District Court correctly concluded, however, that plaintiffs failed to allege particularized facts supporting a strong inference that Notebaert acted with scienter in connection with any of those statements.

1. Tellabs' Fourth Quarter 2000 Financial Results.

The alleged falsity of Tellabs' fourth quarter 2000 financial results is central to the SAC. In particular, allegations that persons at Tellabs engaged in questionable practices during the fourth quarter 2000 are the basis not only for plaintiffs' claim that Tellabs' reported results for that quarter were false, but also for their claim that the Company was experiencing a substantial decline in demand for its core products (supposedly masked by the alleged misreporting). (*See, e.g.*, JA128, ¶ 80).

The District Court found that plaintiffs had adequately alleged falsity in certain respects as to the Company's fourth quarter 2000 financial results, specifically the

allegations that: (a) the Company had engaged in "channel stuffing" during that quarter by "over-inventorying" some customers; and (b) some sales had been backdated. (BA71-72). But the facts alleged regarding these activities fall well short of supporting a strong inference that *Notebaert himself* was aware of or recklessly disregarded the alleged falsity of Tellabs' reported financial results for the quarter.

a. Channel Stuffing

The SAC is replete with references to the pejorative phrase "channel stuffing." As the District Court observed, however, that phrase is broad enough to encompass a number of activities, including entirely legitimate sales activities. (BA84). This is particularly true when the phase is broadly used to include practices claimed to "induce" purchases earlier than they might otherwise have been made. *See, e.g., Greebel v. FTP Software, Inc.*, 194 F.3d 185, 202 (1st Cir. 1999) ("there is nothing inherently improper in pressing for sales to be made earlier than in the normal course"). The SAC defines "channel stuffing" broadly enough to include a number of such activities, including merely offering major customers discounts and incentives. (*See* JA128-29, ¶ 80(b)(4)) (describing "channel-stuffing" to include offering "unusual and extraordinary discounts and incentives to customers"). As the District Court found, while some forms of "channel stuffing" may be questionable, others, such as offering discounts and incentives, are entirely legitimate. (BA73)

Here, the range of activities lumped together in the phrase "channel stuffing" is critical because, rather than detailing the "channel stuffing" activities Notebaert was

allegedly personally aware of or participated in, the SAC intentionally obscured the issue. Thus, plaintiffs attempted to link Notebaert to awareness of alleged "channel stuffing" through two, conclusory allegations: (a) an allegation attributed to CS-6 that Notebaert "worked directly with Tellabs' sales personnel to channel stuff SBC;" (JA122-23, ¶ 67; Pl. Br. 41); and (b) an allegation attributed to CS-3 that Notebaert "unquestionably knew about channel stuffing activity" (JA161, ¶ 157). These allegations are fatally deficient, however, because they say *nothing* about what Notebaert is alleged to have "worked directly" to do, or about what specific activities Notebaert "unquestionably knew." It would, for example, be entirely unremarkable for a company's CEO to "work directly" with sales staff to offer a major customer discounts and incentives, or to be aware of such offers. As the District Court recognized:

> Plaintiffs do not provide details of any specific actions taken by Notebaert to further the channel stuffing. They do not identify what channel stuffing activities he worked on. Such allegations are critical because the Court has concluded that there is nothing inherently wrong with several of Plaintiffs' channel stuffing allegations.

(BA89). The District Court's conclusions in this regard were entirely correct.

Indeed, precisely because "channel stuffing" can encompass both legitimate and potentially illegitimate conduct, numerous courts have recognized that vague allegations of the sort directed at Notebaert do not support a strong inference of scienter. For example, the First Circuit has held that because "there may be any number of legitimate reasons for attempting to achieve sales earlier," allegations of "channel stuffing" have only "weak" probative value as to scienter. *See Greebel*, 194 F.3d at 203.

Accord Broudo v. Dura Pharm., Inc., 339 F.3d 933, 940 (9th Cir. 2003) (concluding that the allegation of channel stuffing was insufficient for scienter."); *In re Ramp Networks, Inc. Sec. Litig.*, 201 F. Supp. 2d 1051, 1077 (N.D. Cal. 2002). The District Court correctly reached the same conclusion. (BA84-85, 88-89).

Plaintiffs' brief does not even acknowledge, much less respond to this line of cases, which was cited and relied upon by the District Court.[8] (BA85-85). Nor does the brief respond to the specific deficiencies that the District Court identified with respect to the vagueness of the "channel stuffing" allegations as they pertained to Notebaert. (BA88-89). Instead, the totality of plaintiffs' attempt to address scienter as it relates to the "channel stuffing" claims consists of a single paragraph which merely repeats the vague allegation that Notebaert worked with sales personnel "to channel stuff SBC." (Pl. Br. 41). Far from demonstrating that the District Court erred, plaintiffs have simply ignored the specifics of the District Court's well-grounded analysis.

[8] Plaintiffs cite *In re Cabletron Sys., Inc.*, 311 F.3d 11, 40 (1st Cir. 2002), in support of their scienter claims against Notebaert. If anything, however, *Cabletron* illustrates the deficiencies of plaintiffs' allegations. For example, the *Cabletron* court deemed allegations against one of the key defendants sufficient because he was "alleged to have directed some of the fraudulent practices surrounding fictitious sales…" *Id.* at 41. And those allegations were supported by specific details, including the name and address of an employee who had held goods at the direction of that defendant as part of the fictitious sales scheme. Id. at 25. Other defendants had engaged in suspicious stock sales, ranging from sales of approximately 1/3 of the holdings of three defendants to sales of over 90% of holdings by the company's CFO. Id. at 27. By contrast, all plaintiffs offer as to Notebaert is a vague description of alleged involvement in activities that may be entirely legitimate.

b. Backdating Sales

The District Court also concluded that plaintiffs had adequately alleged that some sales had been backdated. (BA72). As discussed below (*see* pp. 43-4, *infra*) plaintiffs have failed to offer any factual support for their claim of backdated sales. More fundamentally, however, plaintiffs do not allege *any* facts – not even conclusory ones – that suggest that Notebaert was personally aware of or recklessly disregarded such activity.

2. The March 8 Statement

The District Court concluded that a March 8, 2001 statement by Notebaert – "[w]e're still seeing that product [the TITAN 5500] continue to maintain its growth rate; it's still experiencing strong acceptance" – was adequately alleged to be inaccurate. (BA64-65). Regardless of whether that is so (*but see* p. 44, *infra*), plaintiffs failed to allege particularized facts giving rise to a strong inference that Notebaert acted with scienter in its making.

First, the District Court made clear that its finding that this statement's inaccuracy had been adequately alleged was derivative of its finding that plaintiffs had adequately alleged the inaccuracy of Tellabs' fourth quarter financials. (BA 65) ("Given these allegations regarding the underlying financials, the Court will not dismiss these alleged statements as mere puffery.") However, as discussed above, plaintiffs' allegations regarding "channel stuffing" and backdating of orders fall well short of establishing a strong inference of scienter *with respect to Notebaert*.

Second, in considering Notebaert's alleged scienter with respect to the March 8 statement, Tellabs' actual performance during the first quarter 2001 is significant. In particular, Tellabs' sales *increased* by 21%, based on a year-to-year quarterly comparison. (JA115, ¶ 16). Plaintiffs have never challenged the accuracy of these results. (BA79). The fact that Tellabs indisputably *did* experience a significant increase in sales during the first quarter is fatal to the attempt to create a "strong inference" that Notebaert's statement that the TITAN 5500 was still "experiencing strong acceptance" was made with scienter. And, although performance for the quarter ultimately fell slightly below expectations, the Company disclosed at the time that the lower than projected revenues were due to certain customers deferring orders in the last two and a half weeks of the quarter (*i.e.*, after Notebaert's March 8 statement). (*See* pp. 3-4, *supra*). Nothing about this chronology suggests that the TITAN 5500 was not maintaining its projected growth at the time Notebaert made his statement, or that he did not believe it to being doing so. (JA144-45, ¶ 116).

Third, none of the other facts alleged in the SAC comes close to establishing a strong inference that Notebaert either knew of or recklessly disregard the alleged falsity of his March 8 statement. Plaintiffs point to generalized allegations that Notebaert had "access to information" that contradicted his public statements. (Pl. Br. 34). But such allegations suffice only when they are supported by particularized facts regarding the contents of the supposedly contradictory information, how the defendant supposedly obtained that information or gained access to it, and how the information demonstrated

the falsity of the defendant's public statements. Absent such particulars, generalized allegations of "access to information" are essentially meaningless. As the Sixth Circuit recently stated:

> fraudulent intent cannot be inferred merely from the Individual Defendants' positions in the Company and alleged access to information. As even the authorities which Plaintiffs cite indicate, the Complaint must allege specific facts or circumstances suggestive of their knowledge.

PR Diamonds, Inc. v. Chandler, 364 F.3d 671, 688 (6th Cir. 2004). *See also Abrams v. Baker Hughes Inc.*, 292 F.3d 424, 432 (5th Cir. 2002). Indeed, even pre-PSLRA, this Court rejected such conclusory claims. *See Arazie v. Mullane*, 2 F.3d 1456, 1467 (7th Cir. 1993). Accordingly, plaintiffs' generalized assertion that "Defendants were kept fully informed on an ongoing basis"[9] (Pl. Br. 32) is wholly inadequate. As the District Court stated:

> These general allegations alone – that Defendants received daily, weekly, and monthly reports – are insufficient to create a strong inference of scienter….Mere access to internal data does not meet the dictates of the PSLRA.

(BA78) (internal citations omitted).

[9] Plaintiffs also argue that generalized allegations that Notebaert was a "hands on" manager support a strong inference that he acted with scienter. (Pl. Br. 43). The District Court properly rejected such allegations. (BA77). Allegations of this sort do not say anything about what Notebaert actually knew, nor do they identify any information he had. Accordingly, courts have routinely recognized that such allegations do not support a strong inference of scienter. *See, e.g., Goldstein v. MCI WorldCom*, 340 F.3d 238, 251 (5th Cir. 2003) ("plaintiffs' general allegation that Ebbers was a 'hands-on' CEO and therefore must have been aware…simply lacks the requisite specificity."); *In re Apple Computer, Inc., Sec. Litig.*, 243 F. Supp. 2d 1012, 1026 (N.D. Cal. 2002).

To the limited extent that plaintiffs made any effort to identify specific information that "defendants" supposedly had access to, plaintiffs' allegations in no way support a strong inference that Notebaert acted with scienter in making his March 8 statement. Indeed, the District Court specifically discussed each of plaintiffs' allegations in that regard, and found them wanting. (BA78-80). For example, plaintiffs claim that certain of Tellabs' internal quarterly reports "showed declining demand in the third and fourth quarters of 2000 for a variety of Tellabs' products, including the TITAN 5500…" (Pl. Br. 33; JA116, ¶ 40). As the District Court found, however, plaintiffs failed to allege any of the basic particulars regarding these reports:[10]

> Plaintiffs, however, fail to allege what reports showed a decline in the demand and who received such reports. They also do not particularize what information was reflected in this report, how significant the decline in demand was, or how much of the decline was attributed to the TITAN 5500 as opposed to other products.

(BA78-79). *See also San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 812-13 (2d Cir. 1996) (rejecting "general claim of the existence of confidential company sales reports that revealed the [a] larger decline in sales"); *Osher v. JNI Corp.*, 256 F. Supp. 2d 1144, 1157 (N.D. Cal. 2003). Moreover, apart from the lack of detail regarding the alleged reports themselves, plaintiffs tellingly do not allege that

[10] This is far from being merely a technical failing. As defendants pointed out in the District Court (*see* R. 72, p. 19), it is difficult to comprehend what this supposed "decline" is being measured against, or how it was arrived at. The Company's fourth quarter 2000 sales of optical networking products represented a 49% increase over sales during the same period of the prior year. (R. 74, Tab 1). Indeed, even compared to the third quarter 2000, sales of optical networking products increased during the fourth quarter 2000. (*Compare* R. 74, Tab 5 to Tab 1).

these reports were actually provided to Notebaert, or even that he was even aware of them.[11]

The same deficiencies plague plaintiffs' claim that unspecified quarterly status reports "showed a decline in customer demand for the TITAN 5500 in March 2001." (Pl. Br. 33; JA116, ¶ 40). As an initial matter, plaintiffs do not allege when "in March 2001" this report was prepared (*i.e*, whether it pre-dated March 8), which is significant given Tellabs' announcement in April 2001 that there had been a fall-off during the last few weeks of the quarter. More fundamentally, plaintiffs do not allege if these reports were even provided to Notebaert (much less when). Nor do plaintiffs provide any particulars regarding the actual contents of the documents, or how they supposedly showed a decline in demand for the TITAN 5500.

[11] Plaintiffs claim that by requiring them to provide details regarding internal reports that supposedly showed a decline in demand, the District Court required "evidentiary detail amounting to proof…" (Pl. Br. 35). But what plaintiffs describe as "evidentiary detail," is nothing more than the type of particularized facts that this Court itself required even before the PSLRA. *See Arazie*, 2 F.3d at 1467 (rejecting scienter allegations based on allegedly contrary information where plaintiffs failed to allege "who prepare the projected figures, when they were prepared, how firm the numbers were, or which officers reviewed them.") Moreover, in advancing their argument, plaintiffs misleadingly cite *In re Cabletron Sys., Inc.*, 311 F.3d 11, 40 (1st Cir. 2002). The portion of the case quoted by plaintiffs addressed the sufficiency of plaintiffs' fraud allegations in general, not plaintiffs' description of documents that allegedly contained information contradicting the defendants' public statements. To the limited extent such documents were found to support an inference of scienter in that case, those documents and the defendants' involvement with them were described in detail. *Id.* at 27. For example, the plaintiffs provided detailed descriptions of internal reports that described particular problems with a product line at issue, specifically alleged that those reports were provided directly to several of the defendants, and even alleged that one of the defendants had instructed employees to conceal those reports from others in the company. *Id.*

Nor do plaintiffs' allegations regarding an alleged study by Probe Research and subsequent internal report based on that study support a strong inference that Notebaert was aware of a decline in demand for the TITAN 5500 prior to his March 8, 2001 statement. (Pl. Br. 32). That study was ambiguously alleged to have been completed "in or about early 2001." (JA115, ¶ 39). As the District Court noted:

> Significantly, the SAC does not detail when in 2001 Probe Research completed the study. It also does not state when the marketing strategy department completed and disseminated its report. Moreover, the report does not disclose when Tellabs' revenue would feel the effect of the drop in the T1 circuits and decline.

(BA80). On appeal, plaintiffs simply ignore the District Court's analysis and repeat their inadequate allegations. But, as the District Court recognized, in the absence of specific details regarding when the study and report were completed, to whom they were distributed, and when they predicted the Company would experience a decline in demand, plaintiffs allegations are wholly insufficient to support *any* inference that Notebaert acted with scienter. And this is particularly true in light of the fact that although plaintiffs claim that these materials were "widely circulated to at least 10 executives," they *do not* allege that either was provided to Notebaert.

Finally, plaintiffs resort to claiming that Notebaert "admitted" that he was well aware of a decline in demand by virtue of his statement in a 2002 letter to shareholders contained in Tellabs' 2001 Annual Report that: "[e]arly in 2001, as our customers reduced capital spending and expressed caution about the future, Tellabs began a process of self-examination." (Pl. Br. 39; JA152, ¶ 141). The District Court specifically

addressed this statement too, finding it not to be an "admission" of anything because it is "completely consistent with statements made during the purported Class Period." (BA80-81). The Company *specifically disclosed* customer "caution" and "reduced capital spending," as well as cost reduction measures, to the market in April 2001, a time that is entirely consistent with the "[e]arly 2001" timeframe referenced in the Annual Report. (*See* pp. 3-4, *supra*). Plaintiffs' brief makes no attempt to rebut the District Court's analysis.[12]

3. Statements Regarding The TITAN 6500

The District Court found two statements by Notebaert regarding the TITAN 6500 – a then-new product for the Company – to be potentially actionable: (a) a March 8, 2001 statement that "interest in and demand for TITAN 6500 continues to grow… We continue to ship the…6500 through the first quarter. We are satisfying very strong demand and growing customer demand;" and (b) an April 6, 2001 statement that "we should hit our full manufacturing capacity in May or June to accommodate the demand we are seeing. Everything we can build we are building and shipping. The demand is

[12] Plaintiffs also contend that the "sheer magnitude" of the revenue decline experienced by the Company in the second quarter 2001 somehow "compels a strong inference of scienter." (Pl. Br. 40). But the Company's 1001 first quarter revenues indisputably increased by 21%; the subsequent decline is, therefore, testament to nothing more than that there was a large shift during the second quarter. Moreover, the "truth" that was allegedly revealed by the Company in June 2001 was merely that it would not meet its revenue projections. Unlike the cases cited by plaintiffs (Pl. Br. 40), there was no large write-off or special charge owing to some previously undisclosed problem or improper accounting. Claiming that executives must have committed fraud merely because Company sales fall substantially short of projections is nothing more than an exercise in 20-20 hindsight. "The fact that management's optimism about a prosperous future turned out to be unwarranted is not circumstantial evidence of conscious fraudulent behavior or recklessness." *Rotherman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000).

very strong." (BA67). However, plaintiffs did not allege particularized facts giving rise to a strong inference that Notebaert acted with scienter with respect to either statement.

Plaintiffs' sole attempt to plead that Notebaert was aware of information contradicting his public statements regarding the TITAN 6500 was a wholly conclusory allegation attributed to CS-3 that Notebaert "knew about the TITAN 6500 problems." (JA119, ¶ 53). This is nothing more than the type of purely conclusory allegation that this Court deemed insufficient even pre-PSLRA. *See, e.g,, Robin v. Arthur Young & Co.*, 915 F.2d 1120, 1127 (7th Cir. 1990). Plaintiffs offered no particulars: they did not specify what information regarding problems with the TITAN 6500 was provided to Notebaert, when that information was provided to him, or what the information allegedly showed. Nor did plaintiffs provide any explanation regarding how CS-3 – who was not even with Tellabs during the class period – has any information regarding what Notebaert "knew" in March or April 2001. (BA87) (noting these deficiencies in the CS-3 allegations against Jackman).

Plaintiffs also failed to allege facts supporting a strong inference that Notebaert was aware that the statement "[t]he TITAN 6500 is available now," – which was contained in a December 11, 2000 press release announcing a $100 million contract with Sprint for the TITAN 6500 – was false. As an initial matter, that statement is not attributed to Notebaert, and plaintiffs do not allege any facts demonstrating that he was involved in the preparation of that press release. That alone precludes him from being individually liable for that statement. In the wake of *Central Bank, N.A. v. First Interstate*

Bank, N.A., 511 U.S. 164, 177 (1994), courts have recognized that an individual may only be liable for a misstatement where he makes or is attributed a statement (*see, e.g., Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997)), or, according to some courts, if he has had "substantial participation or intricate involvement" in drafting or preparing the statement (*see, e.g., Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1061 n.5 (9th Cir. 2000)). In any event, plaintiffs did not allege any particularized facts creating a "strong inference" that Notebaert was *aware* that this statement of "availability" was somehow false – particularly since Sprint had just signed a $100 million contract for the TITAN 6500. (JA125, ¶ 73).

4. The December 11, 2000 Revenue Projection

The District Court dismissed plaintiffs' claim regarding the December 11, 2000 projection because plaintiffs had failed to adequately allege that it was made with "actual knowledge" of falsity, as required by the PSLRA. (BA61-62). The District Court's ruling was clearly correct – plaintiffs' scienter allegations regarding the December 11, 2000 projection consisted of nothing more than a rehashing of the scienter allegations shown to be deficient above. In particular, plaintiffs' claim that the December 11 projection was false was based on: (a) plaintiffs' allegations of "channel stuffing" in the fourth quarter 2000; (b) the claim that there was decline in demand for the TITAN 5500; and (c) allegations regarding problems with the TITAN 6500. (BA61; JA125, 128, ¶¶ 74, 80). There is no factual basis for a strong inference that Notebaert acted even recklessly with regard to these matters . *(See* pp. 19-23, *supra).* They are

plainly insufficient to establish a strong inference that Notebaert had actual knowledge that the December 11, 2000 revenue projection was false at the time it was made.

III. THE DISTRICT COURT PROPERLY HELD THAT PLAINTIFFS DID NOT ALLEGE FACTS GIVING RISE TO A STRONG INFERENCE THAT BIRCK ACTED WITH SCIENTER.

Other than Notebaert, the only individual defendant against whom plaintiffs are still pursuing a Section 10(b) claim is Birck, the Company's Board Chairman during the relevant period. (*See* Pl. Br. 4 n. 3; JA109, ¶ 17). Almost *none* of the false statements alleged in the SAC is claimed to have been "made" by Birck, either personally or with his substantial participation.[13] (*See*, pp. 30-31, *supra*). In light of that, it is not surprising that plaintiffs do not even attempt to link their allegations regarding scienter on the part of Birck to any particular misstatements. Instead, the only allegations in the SAC relating to Birck are generalized ones that do not come close to creating a "strong inference" that he acted with scienter.

A. The District Court Correctly Deemed Plaintiffs' Motive Allegations Inadequate.

Plaintiffs attempted to show that Birck had a motive to commit fraud through allegations that he sold some Tellabs stock during the class period. Insider stock sales may, at times, contribute to a "strong inference" of scienter, but only when the trading activity is "unusual or suspicious." *In re K-tel Int'l, Inc. Sec. Litig.*, 300 F.3d 881, 895 (8th Cir. 2002); *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 368 (5th Cir.

[13] The one exception that the SAC alleges was that Birck was among those signing Tellabs' 2000 Annual Report, which contained the fourth quarter 2000 financial results. (JA141, ¶ 107).

2004). Only stock sales that are substantial to the individual's holdings, and are "dramatically out of line with…prior trading practices," support an inference of scienter. *In re Navarre Corp. Sec. Litig.*, 299 F.3d 735, 747 (8th Cir. 2002); *Abrams v. Baker Hughes Inc.*, 292 F.3d 424, 435 (5th Cir. 2002). Accordingly, a plaintiff seeking to support an inference of scienter through stock sales must allege contextual details. *K-tel*, 300 F.3d at 895. Moreover, any claimed inference of scienter is severely undermined when other key insiders alleged to be part of the "scheme" retained their shares. *Id. 887*; *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995) (claim of scienter undermined by "fact that the other defendants did not sell shares during the relevant class period."); *Southland*, 365 F.3d at 369.

In accordance with these principles, the District Court twice rejected plaintiffs' contention that Birck's stock sales supported a "strong inference" that he acted with scienter. In dismissing plaintiffs' initial Complaint, the District Court recognized the basic principles set forth above, and then noted plaintiffs' failure to provide critical information:

> The Complaint, however, fails to allege the prior history of stock sales for these Defendants, the number of shares held by each Defendant or the percentage of each Defendant sold of his or her stock. These bare-bones allegations do not amount to anything unusual or suspicious.

(BA32-33). In the SAC, plaintiffs merely repeated their "bare-bones" allegations as to Birck. (JA153, ¶ 144).

Plaintiffs' failure to provide this information was no accident. For although plaintiffs make much of the fact that Birck "sold 80,000 shares for about $5.2 million" during the class period (Pl. Br. 43-44), as the District Court noted:

> at the time Defendant Birck sold 80,000 shares of common stock, he was the beneficial owner of over 37 *million* shares of Tellabs common stock. Birck's sales during the Class Period thus amount to less than 1% of his holdings.

(BA76) (emphasis in original) (*see also* R.49, Tab 70). A sale of less than 1% of holding is not the type of unusual stock sale that supports an inference of scienter.[14] *See, e.g.*, *Navarre*, 299 F.3d at 747 (8th Cir. 2002) ("the sale of ten percent or even thirty-two percent of an individual's stock during a class period fails to substantiate a strong inference of scienter.") Indeed, the proposition advanced by plaintiffs – that Birck engaged in a scheme to inflate his Company's stock price so that he could sell far less than 1% of his shares, while holding on to more than 99% of his shares and thus suffering large losses when, as plaintiffs claim, "the truth" was revealed (*see* JA150-51, ¶¶ 131, 135) – is precisely the type of "ready inferences of irrationality" that this Court has cautioned against. *DiLeo*, 901 F.2d at 629.

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[14] Plaintiffs contend that the timing of sales by various insiders was "suspicious and coordinated." The SAC, however, only alleges stock sales by five insiders other than Birck. (JA153-55, ¶ 144). The largest of these other sales was made by an outside director , on May 3, 2001 – *i.e.*, more than three months *after* Birck's sales. (*Id.*) The next largest sale, by another director, was made on April 20, 2001 – more than two and a half months after Birck's trades. Moreover, that three Company executives sold within two weeks of Birck is hardly suspicious, particularly in light of the fact that public companies routinely restrict their insiders to trading only during certain "trading windows," which typically begin within days after the announcement of quarterly results and end several weeks before the announcement of the next quarter's results. *See In re Homestore.com, Inc. Sec. Litig.*, 252 F. Supp. 2d 1018, 1030 (C.D. Cal. 2003).

In their brief, plaintiffs make no effort to show that the District Court's reliance on cases requiring stock sales to be "unusual or suspicious" was somehow erroneous, nor do they challenge the District Court's ruling regarding contextual information. They also do not challenge the Court's analysis that Birck's sale of less than 1% of his stock does not qualify as being "unusual or suspicious." Instead, they ignore the District Court's analysis altogether, and merely reiterate their allegations of insider sales, lumping Birck's sales together with those of other non-defendant insiders in the process, and nakedly asserting that those collective sales were "suspicious and coordinated." (Pl. Br. 43-44).

Plaintiffs' conclusory assertions are simply insufficient to demonstrate any error by the District Court. As an initial matter, plaintiffs provide no explanation why sales by other persons who were not, or are not any longer, accused of having participated in any fraudulent "scheme" have any bearing on Birck's scienter.[15] As the District Court stated, "It would be a stretch, at best, to conclude…that the Individual Defendants engaged in the alleged scheme in order to financially benefit other insiders who were not part of the scheme." (BA77). Moreover, plaintiffs have failed to allege any facts suggesting that those sales by others were themselves in any way "unusual or

[15] Plaintiffs cite *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1224 (1st Cir. 1996) for the proposition that non-defendant sales are somehow relevant. (Pl. Br. 43 n. 35). In that pre-PSLRA case, the First Circuit noted plaintiffs' allegations of stock sales by two non-defendants, but did so *after* it had already concluded that plaintiffs' other allegations supported a "reasonable inference" of defendants' scienter. *Id.* at 1224. In addressing the sales by non-defendants, the court noted, "the level of suspicion warranted by the alleged insider stock sales is marginal" *Id.*

suspicious."[16] Indeed, in dismissing plaintiffs' original Complaint, the District Court specifically considered and deemed insufficient plaintiffs' allegations regarding stock sales by others who, at the time, were named as defendants. (BA33).

Finally, plaintiffs' attempt to rely on stock sales by others to mask the deficiency in their allegations against Birck ignores the very most significant insiders – the Company's CEO and CFO. They are *not* alleged to have made any sales during the class period. As the District Court correctly noted, this severely undermines any inference of scienter. (BA34, 76). *See also K-tel*, 300 F.3d at 895; *Acito*, 47 F.3d at 54; *In re First Union Corp. Sec. Litig.*, 128 F. Supp. 2d 871, 899 (W.D. N.C. 2001) ("many key First Union executives… including the company's Chief Financial Officer – did not sell a single share. This fact alone is fatal to Plaintiffs' effort to establish scienter through stock sales.") Plaintiffs attempt to dodge the issue by citing *In re Cabletron Sys., Inc.*, 311 F.3d 11, 40 (1st Cir. 2002), for the proposition that "insider trading may support scienter even when not every defendant sold stock." (Pl. Br 43 n. 35). Plaintiffs' purported reliance of *Cabletron*, however, is misplaced. In that case 5 of the 7 individual defendants, *including the company's CEO and CFO*, were alleged to have sold stock during the class period. *Cabletron*, 311 F.3d at 27. Indeed, the CEO was alleged to have sold over 30% of his holdings in the company, and the CFO was alleged to have sold *over 90%* of his shares. *Id.*

[16] For example, Gruenwald's January 31, 2001 sale represented just 1.8% of his Tellabs holdings (R. 49, Tab 21); and Kohler's February 2, 2001 sale represented a sale of just 13% of his holdings in the Company. (*Id.*, Tab 22).

B. Plaintiffs Remaining Scienter Allegations Regarding Birck Are Also Insufficient.

Unable to support any inference of scienter through Birck's stock sales, plaintiffs resort to generalized allegations regarding his involvement in the Company. For example, plaintiffs claim that Birck, like Notebaert, was a "hands on" manager. (Pl. Br. 43). The District Court correctly held that such allegations simply do not support a strong inference of scienter. *See* p. 25 n.9, *supra.* Similarly inadequate is plaintiffs' allegation that Tellabs' mergers and acquisition group "fed" Birck unidentified "market data." (Pl. Br. 32). Plaintiffs fail to provide any specifics whatsoever about what this data allegedly showed, much less particular facts demonstrating that the data somehow contradicted any public statements in which Birck participated. Finally, plaintiffs' claim that Birck (with Notebaert) "admitted" in the Company's 2001 Annual Report his earlier awareness of a decline in demand is wholly unfounded. *See* pp. 28-29, *supra***.** In short, plaintiffs fail to point to a single fact suggesting that Birck acted with scienter, much less particularized facts sufficient to show the requisite strong inference.

IV. THE DISTRICT COURT CORRECTLY HELD THAT PLAINTIFFS' ALLEGATIONS FAILED TO CREATE THE REQUISITE STRONG INFERENCE THAT TELLABS ACTED WITH SCIENTER.

The District Court held that, having failed to adequately allege that any of the individual defendants acted with the requisite scienter – and having failed to identify any other person participating in the making of an alleged misstatement that supposedly acted with scienter – plaintiffs "did not sufficiently allege scienter on the part of Tellabs." (BA97). This determination was entirely correct.

The Fifth Circuit recently addressed this precise issue in *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 366 (5th Cir. 2004):

> For purposes of determining whether a statement made by the corporation was made by it with the requisite Rule 10(b) scienter we believe it appropriate to look to the state of mind of the individual corporate official or officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like) rather than generally to the collective knowledge of all the corporation's officers and employees acquired in the course of their employment."

The Ninth Circuit has reached a similar conclusion. *See Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1435 (9th Cir. 1995) ("there is no evidence in this case to support 'collective scienter' without a concurrent finding that a defendant director or officer also had the requisite intent"). As the Fifth Circuit has pointed out, this rule is consistent with the general common law rule in fraud cases. *Southland*, 365 F.3d at 366. Indeed, the intent requirement for fraud would effectively become meaningless if corporate liability could be imposed without the required state of mind "actually exist[ing] in the individual making (or being a cause of the making of) the misrepresentation." *Id.* Moreover, this rule is consistent with *Central Bank*'s emphatic reminder that Section 10(b) "prohibits only the making of a material misstatement…" 511 U.S. at 177. To allow persons not involved in the "making" (and therefore not subject to primary liability) to somehow supply an otherwise missing mental state would be to create a critical disconnect in the statutory scheme. Finally, the PSLRA itself embraces this same principle, albeit in even more restrictive form, allowing corporate liability as to

projections only if an *executive* officer made the statement with actual knowledge that it was false. 15 U.S.C. 78u-5(c)(1)(B)(ii).

Plaintiffs rely primarily upon two treatises for the proposition that the knowledge of disparate corporate employees can be combined to form some "collective scienter" sufficient to state a claim against a corporate defendant. (Pl. Br. 45-46). But as *Nordstrom* noted, "there is no case law supporting an independent 'collective scienter' theory." 54 F.3d at 1435. Indeed, in *Nordstrom* the Ninth Circuit specifically quoted and discussed the same two treatises relied upon by plaintiffs before rejecting the concept of "collective scienter" and ruling that it saw "no way" to show "that the corporation, but not any individual defendants, had the requisite intent to defraud." *Id.* at 1436. *In re Apple Computer, Inc. Securities Litigation*, 243 F. Supp. 2d 1012, 1023 (N.D. Cal. 2002); *Gutter v. E.I. DuPont de Nemours*, 124 F. Supp. 2d 1291, 1311 (S.D. Fla. 2000).

Plaintiffs also rely (Pl. Br. 46) on this Court's opinion in *Caterpillar, Inc. v. Great American Ins. Co.*, 62 F.3d 955 (7th Cir. 1995), which noted in *dicta* that "there are conceivable situations where the individual actors would not be liable but their corporate employer would be." 62 F.3d at 962. However, *Caterpillar* recognized that "there is little case law supporting an independent corporate scienter theory," and affirmed that "a corporation still must act through its agents." (*Id.* at 963). Moreover, *Caterpillar* did not disagree with *Nordstrom's* rejection of the possibility of finding corporate scienter without finding scienter on the part of any particular officer or

director, finding that *Nordstrom* "differs from this case in its particulars, not in its analysis." (*Id.* at 963 n.9).[17]

Finally, plaintiffs argue that "there is no requirement that the person with such culpable knowledge must be a named defendant." (Pl. Br. 47). But the SAC failed to identify any individual other than the named defendants who plaintiffs contended acted with the requisite intent while participating in the making of an alleged misstatement. Plaintiffs essentially admit this, but claim that they should not be required to identify the individuals who supposedly acted with scienter. (Pl. Br. 47, n.39). Requiring plaintiffs to identify who they claim acted with scienter, however, is an essential and unremarkable element of their pleading burden.

V. ALTERNATIVELY, THE DISMISSAL SHOULD BE AFFIRMED BECAUSE PLAINTIFFS FAILED TO ALLEGE MISSTATEMENTS ADEQUATELY.

The SAC could and should have been dismissed on the additional basis that plaintiffs failed to allege particularized facts supporting their claims that the statements the District Court deemed actionable were false. This is a sufficient alternative basis for affirming the judgment below. *See*, *e.g.*, *Slaney v. The Int'l Amateur Athletic Fed'n*, 244 F.3d 580, 597 (7th Cir. 2001).

[17] Plaintiffs also cite *United States v. Bank of New England*, N.A., 821 F.2d 844 (1st Cir. 1987) (Pl. Br. 46), which approved the use of a jury instruction allowing a jury to impute to a corporate defendant the collective knowledge of each of its employees. (*Id.* at 856). Knowledge is a different concept than intent, however. Indeed, with respect to the separate issue of intent, the instruction at issue in *Bank of England* provided that "[t]he bank is deemed to have acted willfully if one of its employees acted willfully." (*Id.*).

A. The District Court Erred In Concluding That Plaintiffs Had Adequately Alleged Falsity As To The Company's Fourth Quarter Financials

1. Plaintiffs' Allegations Of Channel Stuffing Were Inadequate

In dismissing plaintiffs' original Complaint, the District Court correctly recognized that allegations of "channel stuffing" are inadequate absent particulars such as "the particular terms of the 'channel stuffing'…the individuals involved in the practice, or the documents exchanged in connection with it." (BA20). The District Court nonetheless deemed the SAC's over-inventorying claims to be actionable, apparently in large part because plaintiffs' allegations were now "supported" by eight "confidential sources." (*See* BA71).

The confidential sources cited, however, added almost nothing in terms of providing particularized facts necessary to sustain allegations of improper activity. *First,* in many instances plaintiffs did little more than attach conclusory, perjorative characterizations to these "sources," without making any attempt to provide the rudimentary "who, what, when, where and how" details. For example, CS-8 is claimed to have stated that Tellabs "definitely channel-stuffed and loaded up distributors 'big and fat'…." (JA122, ¶ 66). But this allegation provides no clue as to what exactly it is that Tellabs allegedly did, or provide any way of assessing whether it was improper – an especially significant concern given that, as the District Court recognized, plaintiffs described channel-stuffing broadly. *See* pp. 20-21, *supra.* Particularity pleading requirements cannot so easily be circumvented by attributing to an unnamed source an allegation which, if made directly by plaintiffs themselves, would be deemed

unacceptably conclusory. Similarly unenlightening and conclusory statements about "channel stuffing" were attributed to other "sources" as well. (*See, e.g.*, JA122, ¶ 64). Having multiple sources repeat the same deficient vagaries does not somehow cure this defect, however.

Second, several of the "sources" referred to by the District Court clearly did nothing more than negatively describe innocuous activity. For example, CS-21 notes that sales "reached a peak" in 2000 "when Tellabs shipped off premises absolutely everything it could get out" – without alleging that the Company did anything improper. (JA122, ¶ 66). Similarly, CS-5 merely is cited as "confirming" that Tellabs sent out "a tremendous amount of product during the last 6 weeks of the fourth quarter." (JA124, ¶ 72). And, CS-1 states that Tellabs got "creative" by "offering customers discounts" – a practice that the District Court recognized is legitimate. (JA123, ¶69).

Third, in the few instances where the SAC provided even the barest of details, by naming three allegedly victimized customers – Verizon, Lexcom and Telcobuy – the allegations remained woefully insufficient. The SAC alleges that the Lexcom sales occurred in 2001 (JA123, ¶ 69); they therefore could not have affected the 2000 fourth quarter financials. In any event, even the District Court found the Lexcom allegations entirely conclusory because "they do not particularize any details about the alleged channel stuffing…." (BA71, ¶ 14). The allegations as to Verizon are no different in this respect, however. While the SAC claims that "Tellabs' Verizon team used channel

stuffing as a strategy" (JA122, ¶63), no details as to what this alleged strategy entailed, or why it was allegedly improper, were pleaded.[18]

That leaves only Telcobuy, a reseller to SBC. But the only allegations relating to Telcobuy are that Tellabs provided it with incentives. (JA122-24, ¶¶ 67, 71). While the SAC alleges that some returns from Telcobuy were later accepted in 2001,[19] absent particularized facts that Tellabs made these sales in the fourth quarter knowing that they would be returned – and no such facts were alleged – "Plaintiffs are doing nothing more than playing Monday morning quarterbacks." (BA21). None of these allegations come close to providing an adequate basis for the claim that the fourth quarter financials were misstated.

2. Plaintiffs' Allegations Of Backdated Sales Were Deficient

The SAC similarly failed to offer any particularized facts supporting the claim of "backdated orders." It did not describe this purported activity with any specificity, or identify *any* specific sales or orders that were backdated, *any* individuals allegedly involved in the backdating, or provide any information (even approximately) regarding

[18] Similarly contentless is the allegation from CS-3 (not even employed by Tellabs during the relevant period), that Verizon's chairman called to complain "about channel stuffing." (JA124, ¶ 71). And the fact that "Verizon *unsuccessfully* tried to return a lot of product" (*id.),* if anything underscores the absence of any impropriety in Tellabs' fourth quarter financials.

[19] Plaintiffs attempted to bolster their channel stuffing allegations by alleging that "returns in January, February and March 2001 were in the millions of dollars." (JA123, ¶ 68). Plaintiffs do not allege that product was sold with a *right* of return, however, and these numbers must be considered in the context of Tellabs' fourth quarter 2000 sales, which were in excess of *$1 billion*. (JA121, ¶ 58). As the District Court noted in dismissing the initial Complaint, it is not clear that these alleged product returns are material in amount. (BA21 n.12).

the number, frequency, or size of the allegedly backdated orders. Moreover, the sole source for the SAC's allegations of "backdated orders" is CS-1 (JA124, ¶70), and plaintiffs provided no corroborating details to support the assertion attributed to this "former Tellabs marketing manager." (JA103). *See Novak v. Kasaks*, 216 F.3d 300, 314 (2nd Cir. 2000) ("where plaintiffs rely on confidential personal sources *but also on other facts*, they need not name their sources *as long as the latter facts provide an adequate basis* for believing that the defendants statements were false.") (emphasis added). They do not even allege that CS-1 has personal knowledge of backdated sales, or describe his involvement in such activities. In short, there is a complete absence of *any* factual details to support the claim of back-dating.

B. Plaintiffs Did Not Adequately Allege The Falsity Of Notebaert's March 8, 2001 Statement

The District Court concluded that Notebaert's March 8, 2001 statement about the TITAN 5500's continued growth and strong acceptance was actionable. That conclusion was based entirely on plaintiffs' allegations of "channel stuffing" and backdated orders. (BA65). As just discussed, those allegations are themselves insufficient. Moreover, plaintiffs did not provide any other particularized facts demonstrating that Notebaert's statement was false. **(***See* pp. 23-29, *supra*). The vaguely described internal reports alleged by plaintiffs are simply insufficient to do so. (*Id.*). And that insufficiency is underscored by the undisputed fact that in the first quarter 2001 Tellabs' sales increased by 21% based on a year-to-year quarterly comparison. (*See* p. 3, *supra*).

C. Plaintiffs Did Not Adequately Plead The Falsity Of The Statements Regarding The TITAN 6500

Plaintiffs similarly failed to offer particularized facts sufficient to show the falsity of statements regarding the TITAN 6500. The District Court deemed actionable Notebaert's March 8, 2001 statement that "interest in and demand for TITAN 6500 continues to grow… We continue to ship the…6500 through the first quarter. We are satisfying very strong demand and growing customer demand." (BA67). But plaintiffs failed to allege with particularity anything false about that statement. *In particular, the SAC did not contain any allegations that the TITAN 6500 was* not *being shipped to customers at that time at their request.* In fact, plaintiffs themselves alleged that "Pullen made numerous visits to TITAN 6500 customers in connection with failed evaluation problems. " (JA119, ¶ 50). Regardless whether customers were encountering some "evaluation" problems, the very fact that there were "numerous" customers for the TITAN 6500 who were going through the process of installation and on-site testing in and of itself demonstrates that there was "interest in and demand for" the product. That conclusion is further bolstered by the fact that Sprint had entered into a $100 million contract for the product. (JA125, ¶ 73).

Plaintiffs similarly failed to allege any particularized facts demonstrating the falsity of Notebaert's April 6, 2001 statement that "we should hit our full manufacturing capacity in May or June to accommodate the demand we are seeing. Everything we can build we are building and shipping. The demand is very strong." Plaintiffs did not allege any facts suggesting that Notebaert did not expect Tellabs to be at full

manufacturing capacity for the TITAN 6500 by May or June. And, again, plaintiffs did not challenge the fact that the product was, in fact, being built, shipped and installed at customers.

Finally, plaintiffs failed to allege any facts sufficient to show that the Company's December 11, 2000 statement that "[t]he TITAN 6500 is available now," was false. The District Court viewed the meaning of "available now" as being potentially ambiguous, and thus declined to dismiss that statement. (BA66). It erred in that regard, however, because plaintiffs did not allege any *facts* demonstrating that the TITAN 6500 was, in any normal usage, "not available" in December 2000. Plaintiffs attempted to do so through the allegation that the TITAN 6500 was not "a released, saleable product even two months after the Class Period," (JA117-18, ¶ 48), but plaintiffs provided no explanation of what it means to be a "released, saleable product." And this failure is telling in light of the facts that plaintiffs do not challenge. On appeal, plaintiffs do not challenge the fact that Sprint entered into a purchase contract. (JA125, ¶ 73). Nor do they allege that the product was not actually being built and shipped to customers for installation and testing during the class period. Those facts fatally undermine any strained suggestion that the product was "not available."

VI. THE DISTRICT COURT PROPERLY DISMISSED PLAINTIFFS' CLAIMS REGARDING TELLABS' REVENUE PROJECTIONS

A. The Projections Were Protected By The PSLRA's "Safe Harbor."

In dismissing plaintiffs' Complaint, the District Court concluded that the projections issued by the Company between January and April 2001 were protected by

that prong of the PSLRA's "safe harbor" which prohibits liability for forward-looking statements "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." (BA27-30; *see also* 15 U.S.C. § 78u-5(c)(1)(A)(i)). The District Court reaffirmed this ruling when it dismissed the SAC. (BA59). On appeal, plaintiffs offer two arguments challenging the District Court's ruling, each of which is deficient.

First, plaintiffs argue that Tellabs' cautionary statements – which were indisputably present (BA28-29) were not sufficiently "meaningful." (Pl. Br. 48). A cautionary statement need not identify *all* risk factors that might cause actual results to vary from projections in order to qualify as "meaningful." *Miller v. Champion Enterprises, Inc.*, 346 F.3d 660, 678 (6th Cir. 2003) (company "is not required to detail every facet or extent of that risk to have adequately disclosed the nature of the risk"); *Harris v. Ivax Corp.*, 182 F.3d 799, 807 (11th Cir. 1999). Instead, cautionary language is sufficient so long as an investor has been warned of "risks of a significance similar to that actually realized." *Harris* at 183 F.3d at 807. Here, Tellabs' cautionary statements warned of the specific risks on which plaintiffs rely – a "downturn in the telecommunications industry" and "risks associated with new products." (*See*, *e.g.*, BA29). Accordingly, as the District Court concluded, the cautionary statements are sufficiently "meaningful" under the PSLRA, and immunize Tellabs' revenue projections from liability. *Miller*, 346 F.3d at 678; *Ehlert v. Singer*, 245 F.3d 1313, 1319, 1320 (11th Cir. 2001).

Plaintiffs nevertheless contend that the cautionary statements were not sufficiently meaningful because the statements warned of "potential" risks when, allegedly, "actual problems already had materialized…" (Pl. Br. 49-50). At bottom, plaintiffs' argument amounts to nothing more than a claim that the projections should somehow have been known to be false at the time they were made. The PSLRA's meaningful cautionary statement "safe harbor" applies, however, even if a projection is claimed to have been known to have been false at the time.[20] Indeed, the very purpose of this safe harbor was to provide a bright line, protective rule, encouraging companies to disclose projections by enabling them to know that if a forward-looking statement is accompanied by meaningful cautionary language, they will not be subject to the type of fact-specific inquiry into subjective intent (*e.g.*, what was known) that plaintiffs seek. It is for this reason that the "safe harbor" provision of the PSLRA has two *independent* prongs – the other providing the independent requirement of proof of "actual knowledge" of falsity – separated by the disjunctive "or," making clear that the statutory "safe harbor" protections apply if *either* prong of the statute is met. 15 U.S.C. § 78u-5(c)(1); H.R. Conf. Rep. No. 104-369 at 43-44, *reprinted in* 1995 U.S.S.C.A.N. 742-43 (safe harbor designed to be "bifurcated").

Because the statements at issue here were accompanied by sufficient cautionary language, the first prong of the "safe harbor" applies whether or not defendants were allegedly aware that "problems" existed. *See Harris*, 182 F.3d at 803 (if a statement is

[20] It is thus no accident that plaintiffs rely solely on pre-PLSRA cases decided under the slightly

accompanied by meaningful cautionary language, "the defendants' state of mind is irrelevant."); *Miller*, 346 F.3d at 678.

Second, unable to show that Tellabs' cautionary statements were not sufficiently meaningful, plaintiffs resort to suggesting that defendants' safe-harbor arguments raise issues that should not have been resolved on a motion to dismiss. (Pl. Br. 50). That contention, however, is directly contrary to the PSLRA, which explicitly *requires* courts to consider such issues on a motion to dismiss. See 15 U.S.C. § 78u-5(e) ("[o]n any *motion* to *dismiss* … the court *shall consider* any statement cited in the complaint and any cautionary statement accompanying the forward-looking statement…") (emphasis added); *Helwig v. Vencor*, Inc., 251 F.3d 540, 554 (6th Cir. 2001). Not surprisingly, in arguing to the contrary, plaintiffs rely solely on pre-PLSRA cases. (Pl. Br. 50-51).

B. In Any Event, The Projections Are Not Actionable

In light of its ruling regarding meaningful cautionary statements, the District Court never separately analyzed whether the projections issued by the Company between January and April 2001 were otherwise actionable. They are not.

The PSLRA imposes a substantive liability requirement that a projection is only actionable if made or approved by an executive officer with actual knowledge of its falsity. **(***See* p. 11, *supra*)**.** Accordingly, "[t]o avoid the safe harbor, plaintiffs must plead facts demonstrating that the statement was made with actual knowledge of its falsity."

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different, judicially created "bespeaks caution" doctrine.

Southland Sec. Corp. v. INSpire Ins. Solutions, Inc., 365 F.3d 353, 371 (5th Cir. 2004). Here, plaintiffs have abandoned all Section 10(b) claims against executive officers other than Notebaert, and have not appealed the District Court's findings that those other officers lacked scienter. That leaves only Mr. Noebaert and, as previously discussed, the SAC fails to allege with particularity *any* facts establishing that Notebaert had "actual knowledge" that any projections he announced or approved were false.

VII. THE DISTRICT COURT PROPERLY DISMISSED CERTAIN OPTIMISTIC STATEMENTS AS PUFFERY.

This Court has long-recognized that mere "optimistic rhetoric" and "indefinite predictions of growth" are not the stuff of a securities fraud claim. *See*, *e.g.*, *Searls v. Glasser*, 64 F.3d 1061, 1066 (7th Cir. 1995); *Stransky v. Cummins Engine Co., Inc.*, 51 F.3d 1329, 1333 (7th Cir. 1995). Vague, optimistic statements relating to a company or its products are simply not the type of "detailed information upon which a reasonable investor typically relies." *Searls*, 64 F.3d at 1066-67 (statement that company was "recession-resistant" was inactionable "promotional phrase" because it was "devoid of any substantive information"); *see also Raab v. Gen. Physics Corp.*, 4 F.3d 286, 290 (4th Cir. 1993) ("Analysts and arbitrageurs rely on facts in determining the value of a security, not mere expressions of optimism from company spokesmen."). In its opinion, the District Court undertook a careful analysis of the statements alleged in the SAC, and only dismissed as inactionable puffery those which were clearly the type of vague, optimistic statements that this Court has made clear no reasonable investor would rely upon. (*See* BA63-70).

In their brief, plaintiffs identify four specific statements that they claim should not have been dismissed as puffery. (Pl. Br. 51-53). The first two statements by plaintiffs are ones in which the Company's growth or demand for its products were described as "strong." (*Id.* at 51). The phrase "strong," however, is exactly the type of indefinite, subjective characterization that this Court has recognized provides no substantive information to an investor. *See Searls*, 64 F.3d at 1067 ("Portraying disposition gains as 'high' is of no help to an investor…It is simply too vague a description to affect the mix of more detailed information upon which a reasonable investor typically relies."); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854-70 (5th Cir. 2003) (statement that, "'[o]ur fundamentals are strong' is obviously immaterial puffery"); *In re Splash Tech. Holdings Inc. Sec. Litig.*, 160 F. Supp. 2d 1059, 1076 (N.D. Cal. 2001) (statements that demand was "strong" were puffery). Plaintiffs suggest (Pl. Br. 52) that these statements somehow do not constitute puffery because the "market fully understood" that the statements were references to the TITAN 5500. But linking a hopelessly vague characterization to a particular product does not alter its inactionable nature.

The same deficiencies afflict the third statement identified by plaintiffs (Pl. Br. 53): "on [TITAN] 6500, demand for that product is exceeding expectations…Demand is just, is huge for this product." *See In re Allaire Corp. Sec. Litig.*, 224 F. Supp. 2d 319, 331 (D. Mass. 2002) ("It is hard to imagine a more subjective or vague statement than 'exceeded our expectations.'"). And the final statement identified by plaintiffs –

"customers are embracing it" (Pl. Br. 53) – similarly does not contain any substantive information on which a reasonable investor would rely. The District Court did not err in concluding that these statements were inactionable.

VIII. THE DISTRICT COURT PROPERLY DISMISSED PLAINTIFFS' CONTROL PERSON AND INSIDER TRADING CLAIMS.

Plaintiffs do not dispute the District Court's holding (BA90) that in order to state a control person claim under Section 20(a), 15 U.S.C. §78t(a), they must properly allege an underlying securities violation. Plaintiffs also do not contest the District Court's holding (BA92) that in order to state an insider trading claim under Section 20A, 15 U.S.C. 78t-1, they must properly allege a predicate violation of the securities laws. Instead, plaintiffs' claim on appeal is that their section 20(a) claims and their 20A claim[21] should not have been dismissed because they *did* adequately plead the requisite underlying violation. (Pl. Br. 55). Because plaintiffs' claims as to underlying violations were properly dismissed, these claims were too.

[21] In this appeal plaintiffs contest only the dismissal of the section 20(a) claims against Notebaert, Birck, Ryan and Jackman, and pursue a section 20A claim only against Birck. (Pl. Br. 4, n.3).

CONCLUSION

For the foregoing reasons, defendants-appellees respectfully request that the judgment of the District Court be affirmed.

Respectfully submitted,

By:_____
One of the Attorneys for
Defendants-Appellees TELLABS, INC., MICHAEL J. BIRCK, BRIAN JACKMAN, RICHARD C. NOTEBAERT, and JOAN E. RYAN

David F. Graham
Kathleen L. Roach
Kyle D. Rettberg
SIDLEY AUSTIN BROWN & WOOD LLP
Bank One Plaza
10 S. Dearborn Street
Chicago, Illinois 60603
(312) 853-7000

Dated: July 2, 2004

CERTIFICATE OF COMPLIANCE

In accordance with Federal Rule of Appellate Procedure 32(a)(7), counsel for Defendants-Appellees, certifies that this brief complies with the type-volume limitation set forth in Rule 32(a)(7)(B)(i). The word processing system used to prepare this brief, upon which counsel relies in making the certification, indicates that this brief contains 13,938 words, exclusive of the items listed in Rule 32(a)(7)(B)(iii).

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Kyle D. Rettberg

CERTIFICATE OF SERVICE

Kyle D. Rettberg, an attorney, certifies that he caused both paper and digital copies of the foregoing Brief of Defendants-Appellees to be served on the counsel listed in the manner specified on July 2, 2004.

By Messenger
Marvin A. Miller
Jennifer Winter Sprengel
Lori A. Fanning
MILLER FAUCHER & CAFFERTY LLP
30 North LaSalle Street Suite 3200
Chicago, Illinois 60602

By U.S. Mail & Facsimile
Richard H. Weiss
Elizabeth A. Berney
MILBERG WEISS BERSHAD HYNES & LERACH LLP
One Pennsylvania Plaza – 49th Floor
New York, New York 10119

By U.S. Mail
John G. Emerson, Jr.
THE EMERSON FIRM
1509 Louisiana, Suite CD
Little Rock, Arkansas 72202

By U.S. Mail
Mary Jane Edelstein Fait
Adam J. Levitt
WOLF HALDENSTEIN ADLER FREEMAN & HERZ LLP
656 West Randolph Street, Suite 500W
Chicago, Illinois 60661

By U.S. Mail
Gregory M. Nespole
WOLF HALDENSTEIN ADLER FREEMAN & HERZ LLP
270 Madison Avenue
New York, New York 10016

By U.S. Mail
Bruce G. Murphy
LAW OFFICES OF BRUCE G. MURPHY
265 Llywds Lane
Vero Beach, Florida 32963

By U.S. Mail
Nadeem Faruqi
FARUQI & FARUQI, LLP
320 East 39th Street
New York, New York 10016

By U.S. Mail
Guri Ademi
ADEMI & O'REILLY, LLP
3620 East Layton Avenue
Cudahy, Wisconsin 53110

_____
Kyle D. Rettberg