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Securities Class Actions: Current and Emerging Issues

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Securities Class Acts: Current and Emerging Issues
By Thomas O. Gorman[1]

I. Introduction

A. Congress and the courts have sought to circumscribe securities class actions in recent years.

1. Congress passed the Private Securities Litigation Reform Act ("PSLRA") in 1995 to eliminate baseless securities class actions.

a. During the hearings, testimony focused on abuses and perceived abuses.

b. Many argued that the merits do not matter in these cases and that hastily, ill-conceived complaints have often resulted in settlements all out of proportion to the merits of the case. *See, e.g.*, H.R. Conf. Rep. No. 369, 104th Cong., 1st Sess. 31 (1995); S. Rep. No. 98, 104th Cong., 1st Sess. 8 (1995); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 516-17 (1991). Many believe this theme permeates the PSLRA.

c. In the PSLRA, Congress imposed a number of substantive and procedural limitations on securities class actions to eliminate strike suits while permitting meritorious actions to proceed. 15 U.S.C. § 78u-4.[2]

2. The courts have long sought to limit securities class actions.

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[2] Three years later, Congress passed the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") in response to claims that plaintiffs were evading the requirements of the PSLRA by bringing their suits in state court. Essentially, SLUSA required that securities class actions be filed in federal rather than state court. Under SLUSA, a case brought in state court can be removed to federal court even if plaintiff fails to plead a cause of action under Section 10(b). *Merrill Lynch, Pierce, Fenner, & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006). The SLUSA does not impact derivative suits. 15 U.S.C. § 77p(f)(2)(B). It also does not prevent plaintiffs from brining a state law cause of action under a state securities law. 15 U.S.C. § 77p(d)(2)(A). *See* Section III. J. *infra*.

a. As early as 1975, the Supreme Court characterized securities class actions as "most vexatious." *Blue Chip Stamps v. Manor Drugstores*, 421 U.S. 723 (1975).

b. Recently, the Supreme Court handed down a series of cases which have redefined who can be liable in securities fraud actions and the requirements for bringing and maintaining securities class actions.

i. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007) ("*Tellabs*"), which defined the meaning of "strong inference" of scienter under Section 21D(b)(2) of the PSLRA;

ii. *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005) ("*Dura*"), which defined the loss causation element of a private action for damages under Section 10(b);

iii. *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., et al.*, 128 S. Ct. 761 (Jan. 15, 2008) ("*Stoneridge"),* which followed up on the Court's 1994 decision in *Central Bank of Denver N.A. v. First Interstate Bank of Denver*, 511 U.S. 164 (1994) (concluding there is no aiding and abetting under Section 10(b)), rejecting "scheme liability."

c. In other cases, the High Court has moved to tighten pleading standards, making it more difficult for a plaintiff to plead a cause of action. *Bell Atlantic Corp. v. Twombley*, 137 S. Ct. 1955 (2007) ("*Twombley*").

d. The lower federal courts have heeded the message from the Supreme Court, stiffening the pleading and proof requirements on key issues such as the use of the "group pleading" doctrine and the circumstances under which confidential sources can be used by plaintiffs to plead a complaint.

B. At the same time, both the courts and Congress have reaffirmed the market policing activities of the SEC. *See, e.g.,* Section 21(e), Exchange Act, added to the statute in 1995 as a part of the PSLRA to restore the SEC's ability to bring cases based on an aiding and abetting theory. *See also SEC v. Zandford*, 535 U.S. 813 (2002) (broadly interpreting the authority of the SEC).

C. The SEC has long insisted that private securities class actions are a necessary adjunct to the enforcement program. Brief for the United States as *Amicus Curae* Supporting Petitioners, *Tellabs, Inc., et al., v. Makor Issues & Rights, Inc., et al.*, No. 06-484 (7th Cir. 2007) ("Meritorious private actions are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by DOJ and the SEC.").

D. In recent years, the number of securities class actions filed each year has generally decreased. Some, such as Stanford law professor and former SEC Commissioner Joseph Grundfest, contend that this means there is less fraud. *Cornerstone Research*, Securities Class Action Case Filings 2007: A Year in Review, at 4 (2008) (hereinafter "Cornerstone"). Others dispute this point and note that while the number of cases filed each year is declining, the settlement value is going up.

E. To examine trends in securities class actions and the impact of the PSLRA and key court decisions three points will be considered:

1. The statistics – the number and type of cases being brought;

2. The impact of key Supreme Court decisions; and

3. Trends in circuit court decisions on key pleading issues regarding the use of confidential witnesses and the group pleading doctrine.

F. Based on an evaluation of these critical points, we will analyze key trends regarding securities class actions.

II. The Statistics

A. The number of cases

1. In 2007 there were 163 cases filed, compared to 109 in 2006, an increase of nearly 50%. *PriceWaterhouseCoopers*, 2007 Sec. Litig. Study, at 7 (2008)(hereinafter "PWC").

2. In part, the increase is from the subprime crisis.

a. 37 of the cases filed or 29% are subprime related. PWC at 7; *see also* Cornerstone at 2.

b. In 2006, some commentators thought that the number of cases declined because of the options backdating scandal, where many of the cases were brought as derivative suits rather than class actions (110 derivative suits vs. 21 federal class actions). PWC at 7.

3. The number of cases filed last year is slightly below the post-PSLRA average of 191 per year. PWC at 8.[3]

    a. Since the passage of the PSLRA, the highest number of cases filed in one year is 487 in 2001; that number, however, includes 309 IPO cases.

    b. The lowest number of cases filed in any year after the passage of the PSLRA was 147 in 1996.

4. The number of cases filed in 2007 is consistent with the post-Sarbanes Oxley averages of 164 cases per year. PWC at 8.

5. One explanation for the variations in the number of filings each year may be market volatility. Cornerstone reports that "stock market volatility is important in explaining the number of filings. For example, a 10 point increase in the quarterly average VIX index [a measure of volatility] was associated with 12 more filings per quarter, on average. Stock market return had no explanatory power for the number of filings." Cornerstone at 6. The report goes on to note that starting in the third quarter of 2005 there are 9 fewer lawsuits per quarter on average. Cornerstone concludes "the results are consistent with both the 'lower volatility" hypothesis and the 'less fraud" hypotheses" of Professor Grundfest which, respectively, argue that lower volatility equals less filings and that overall there may be less fraud and therefore fewer cases. *Id.*

B. Case resolution

1. 81% of the cases filed since the passage of the PSLRA have been concluded. Cornerstone at 14. Of those cases:

    a. 41% were dismissed, of which 73% were dismissed after the first ruling on a motion to dismiss.

    b. 59% were settled, of which 60% of were resolved at the motion to dismiss stage.

2. Trials: 11 post-PSLRA cases have gone to trial. Five resulted in defense verdicts. Four were settled during the trial. Two resulted

[3] Cornerstone reports that the average number of cases filed for the period 1997 to 2008 is 194. Cornerstone at 2. The two services use different data bases. PWC uses a proprietary data base. Cornerstone uses the data base at Stanford University Law School.

in verdicts for the plaintiffs. Cornerstone at 19. In 2007, one case went to trial. It ended with a defense verdict. *Id*.

C. Settlements

1. The number of settlements in 2007 remained about the same as in 2006. PWC at 26.

   a. In 2007 there were 113 settlements.

   b. In 2006 there were 112 settlements.

2. The dollar amount of the settlements in 2007 was also about the same as in 2006. PWC at 26.

   a. 2007: $6.37 billion; average of $56.3 million; the largest settlements were:

      1. Tyco: $3.2 billion
      2. Cardinal Health: $600 million
      3. Delphi Corp.: $333.4 million
      4. CMS Energy: $200 million
      5. Motorola: $190 million

   b. 2006: $6.44 billion; average of $57.5 million.

   c. In 2007, there was one settlement over $1 billion, while in 2006, there were three settlements over $1 billion. PWC at 26.

   d. Excluding the outliers, the average settlement amount in 2006 is larger than the average for 2007. However, the average for 2007 is larger than for any other post-PSLRA year than 2006. Cornerstone at 2.

   e. The median settlement for 2007 was higher than other years. This is due to the large number of settlements in the $10-20 million range. Cornerstone at 2.

3. The largest settlements were in accounting cases which, in 2007, averaged approximately $75 million, compared to about $68.6 million in 2006. PWC at 26.

   a. If the Tyco settlement is excluded, in 2007 the number drops to $35 million.

b. The average non-account settlement in 2007 was $12.8 million, compared to $19.2 million in 2006.[4]

D. Types of cases and defendants

1. Technology cases are the industry group most frequently named as a defendant in a class action. In 2007, 25% of the cases were against technology companies, compared to 30% in 2006. PWC at 6; *see also* Cornerstone at 16. Others include:

a. Banking, brokerage, financial services and insurance: 21%.

b. Pharmaceutical: 13%.

c. Business services: 5%. PWC at 16.

2. Senior officers of companies were named as defendants in a majority of cases in 2007, although at a less frequent rate than in prior years. PWC at 19.

3. The number of accounting cases fell in 2007 to about 50% from 61% in 2006. PWC at 14. *See also* Cornerstone at 20 (number of cases with allegations of GAAP violations declined in 2007).

a. There is an increasing number of restatements, according to most observers. Yet, the number of cases involving restatements fell in 2007 to 39 from 47 in 2006. PWC at 14.

b. The Public Company Accounting Oversight Board's (PCAOB) Office of Research and Analysis noted in a working paper that despite an increasing number of restatements, market reaction to them is declining. Steven L. Byers & Jana Hranaiova, *Changes in Market Responses to Financial Statement Restatement Announcements in the Sarbanes-Oxley Era*, Public Company Accounting Oversight Board, Working Paper No. 2007-01, 2007; *see also* PWC at 14.

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[4] One study found that cases with small settlements appear to have the characteristics commonly associated with the type of strike suit the PSLRA was intended to weed out. These cases tend to settle more quickly, have shorter class periods, have significantly lower provable loss and result in a smaller recover for investors. Based on these one study suggest that "the law may well have progressed in a direction to reduce further the possibility of strike or long shot suits." James D. Cox, Randall S. Thomas & Lynn Bai, *There are Plaintiffs and . . . There are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, Vanderbilt U. Law Sch. Law & Economics Research Paper Series, at 37, Working Paper No. 07-33, 2007 (hereinafter "Cox, Thomas & Bai").

E. The number of cases that had some form of government involvement continued to decline. PWC at 22.[5]

1. The number with SEC involvement fell to 15% in 2007, compared to about 32% in 2006.

2. The number with DOJ involvement fell in 2007 to 9% compared to 23% in 2006.

3. Only nine cases in 2007 had both DOJ and SEC involvement.

F. Plaintiffs

1. The PSLRA strongly favors institutional investors as lead plaintiffs. *See generally* Securities Exchange Act of 1934, ("Exchange Act") Section 21D(A)(3)(B)(iii)(bb)(presumption that plaintiff with largest financial interest should be appointed lead plaintiff). PWC at 33.[6]

2. Following the passage of the PSLRA, there was a dramatic increase in the number of institutional lead plaintiffs. Between 1996 and 2002, the percentage increased from 8% to 52%.

3. Post-SOX through 2006 on average, 52% of the cases had an institutional investor as lead plaintiff.

4. In 2007, large institutional investors were named as lead plaintiffs in 48% of the cases, down from the 57% in 2006. PWC at 33. 40% of the institutions selected as lead plaintiff in 2007 were pension funds, the same as in the prior year.

5. The settlements tend to be larger in class actions in which the lead plaintiff is an institution. Cox, Thomas & Bai at 28 ("We find that the presence of an institutional lead plaintiff increases settlement size overall . . . ").

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[5] The U.S. Chamber of Commerce's report on the capital markets suggested that where private actions proceed in advance of an SEC enforcement action, the SEC should seek postponement of the private action until after its cases is completed so that it can establish a Fair Fund settlement which would be given credit in the private action. U.S. CHAMBER OF COMMERCE, COMMISSION ON THE REGULATION OF U.S. CAPITAL MARKETS IN THE 21ST CENTURY, REPORT AND RECOMMENDATIONS 90-92 (2007). Since only a small percentage of settlements have a related SEC case this would not seem to have a significant impact. Cox, Thomas & Bai at 8.

[6] This theory is based on an earlier paper. Elliott Weiss & John Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L. J. 2053 (1989).

a. Those in which a labor union fund and public pension is the lead plaintiff tend to be larger than settlements with other institutions serving as lead plaintiff. Cox, Thomas & Bai at 24.

b. Institutions are more likely to intervene as lead plaintiffs in cases with large economic losses and where there is a government enforcement action and large defendants. Cox, Thomas & Bai at 27.

c. In 2007, the 68 cases with institutional lead plaintiffs settled for a total of $6 billion, about the same as the prior year. PWC at 33.

i. This is 60% of the cases which settled.

ii. The total amount of settlement in these cases represents 94% of the settlement dollars for 2007.

iii. Tyco, the largest settlement of the year, had a pension fund as lead plaintiff.

G. The largest cases and settlements tended to be in actions where there was a pension fund as a lead plaintiff and a parallel SEC and derivative case. Cox, Thomas & Bai at 28-29.

III. Liability under Section 10(b): *Stoneridge,* Scheme and Secondary Liability.

A. Most private securities damage actions are based on the cause of action implied under Section 10(b) and Rule 10b-5 thereunder. Thus, a key question is who can be held liable under the Section and Rule.

B. On January 15, 2008, the Supreme Court handed down its much anticipated decision in *Stoneridge Investment Partners, LLC. v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (Jan. 15, 2008). The Court rejected the theory of scheme liability advocated by plaintiffs which would have extended the reach of Section 10(b) liability to third parties to securities transactions. The decision is based on the court-crafted elements of a private damage claim and not the text of Section 10(b). The impact of this decision and its implications for who can be named in a private securities fraud suit is just beginning to emerge.

C. *Stoneridge*, and the controversy over who can be held liable under Section 10(b), traces to the Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver,* 511 U.S. 164 (1994). In that case, the Court held that there is no aiding and abetting liability under Section

10(b). The Court based its decision on the text of the statute and rule. At the same time, the Court noted that any person can be held liable under the Section if all the elements of a cause of action are established. No question of Section 10(b) deception was raised in the case.

D. In the aftermath of *Central Bank*, Congress considered the question of aiding and abetting. In 1995, Congress restored the authority of the SEC to bring suits using an aiding and abetting theory by adding Section 20(e) to the Exchange Act as part of the PSLRA. Congress declined requests to restore aiding and abetting in private actions.

E. Following *Central Bank*, the circuit courts developed two tests to determine who could be held liable under Section 10(b) in a private damage action. While there are variations of these tests, they can be summarized as follows:

1. The "substantial participation" test. This test was developed by the Ninth Circuit. It required that the actor be substantially involved in the fraudulent transaction. There is little discussion of the elements of a private cause of action in these cases. *See, e.g., In re Software Toolworks, Inc.,* 50 F.3d 615 (9th Cir. 1995); *see also Howard v. Everx Systems, Inc.*, 228 F.3d 1057 (9th Cir. 2000).

2. The "bright line" test. This test, developed by the Second and Tenth Circuits, requires the defendant to make a misrepresentation that he knows or should know would reach investors. *See, e.g., Shapiro v. Cantor,* 123 F.3d 717 (2nd Cir. 1997); *Anixter v. Home-State Production Co.*, 77 F.3d 1215 (10th Cir. 1996). Some courts required the statements to be publicly attributed to the defendant. *See,e.g., Ziemba v. Cascade Int., Inc.*, 256 F.3d 1194 (11th Cir. 2001). Others do not. *See, e.g., In re Lemout & Hauspie Sec. Litig.*, 230 F. Supp. 2d 152, 166-67 (D. Mass. 2002).

F. The theory of scheme liability, based on the text of Section 10(b), would permit a suit to be brought against a third party to a securities transaction in certain instances. Under the theory, as set forth in an SEC *amicus* brief filed in *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006) ("*Simpson*" or "*Homestead*"), a person can be held liable under Section 10(b) if: 1) he or she directly or indirectly engaged in deceptive or manipulative conduct as part of a scheme; 2) there is a deceptive act which is one whose principal purpose and effect is to create a false appearance; and 3) the plaintiff relies on a material deception flowing from defendant's deceptive act.

1. The Ninth Circuit adopted a variation of this theory in *Simpson*. The litigation was based on the financial fraud at Homestore.com.

The complaint alleged that the defendant third party vendors engaged in fraudulent "round trip" transactions to permit Homestore to falsify its financial statements and thus defraud its shareholders.

2. The Fifth Circuit rejected scheme liability in *Regents of the Univ. of Calif. v. Credit Suisse,* 482 F.3d 372 (5th Cir. 2007) ("*Enron*"). The complaint there alleged that a number of investment banks participated in sham transactions to help Enron falsify its financial statements.

3. Other courts adopted versions of scheme liability. *See, e.g., In re Global Crossing,* 313 F. Supp. 2d 189 (S.D.N.Y. 2003); *In re Parmalat Sec. Litig.,* 376 F. Supp. 2d 472 (S.D.N.Y. 2005).

G. In *Stoneridge,* the Supreme Court rejected scheme liability. At the time of the decision, both *Simpson* and *Enron* had filed writs of *certiorari* requesting that the Court hear the case.

1. The factual record in *Stoneridge* is similar to *Enron* and *Simpson.* In that case, plaintiffs attempted to hold third party vendors of Charter Communications liable in a damage action under Section 10(b). According to the complaint, the vendors engaged in round trip sham barter transactions with Charter to permit that company to fraudulently inflate its income and thereby defraud its shareholders. The Eighth Circuit rejected plaintiffs' claims. The Supreme Court affirmed.

2. The Supreme Court based its rejection of scheme liability on the element of reliance rather than the text of Section 10(b). Reliance is a key element of a private damage action under Section 10(b). It can be established in one of two ways. First, by a presumption, if there is a material omission under circumstances where there is a duty to disclose. Second, it can be presumed under the fraud on the market theory. Neither applies here, according to the Court.

3. The Court based its conclusion in part on policy issues.

   a. If the petitioner's theory of scheme liability is adopted "the implied cause of action would reach the whole market-place … and there is no authority for this rule." *Id.* at 766;

   b. The acts of the defendants in this case are simply too remote;

c. The transactions at issue are outside the securities laws and in a realm that is governed by state law, intrusion into that area would raise separation of powers concerns;

d. Traditionally business transactions are regulated by state law; and

e. Restraint must be exercised when interpreting a Section 10(b) cause of action because it was implied by the courts and not created by Congress.

H. *Stoneridge* narrows the potential scope of liability in securities damage actions. At the same time, since it is based on the reliance element of a private cause of action and not the statutory text of Section 10(b), it did not impact SEC enforcement actions. To the contrary, the Court reaffirmed the broad reach of the antifraud provision and the market policing obligations of the SEC.

I. The immediate impact of *Stoneridge* is evident from the results in the *Enron* and *Simpson/Homestore* cases:

1. On January 22, 2008, the Supreme Court entered an order denying the petition for certiorari in the *Enron* class action litigation. This action had been widely viewed as potentially one of the largest cases of all time. *Regents of Univ. of California v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.3d 372 (5th Cir. 2007), *cert. denied*, 128 S. Ct. 1120 (2008). This left standing the decision of the Fifth Circuit reversing the district court's class certificate order.

2. On January 22, 2008 the Supreme Court granted the petition for certiorari in *Simpson/Homestore* and then reversed and remanded the case to the Ninth Circuit for further proceedings in *Avis Budget Group, Inc., et al., v. CA State Teachers' Retirement Systems*, 452 F.3d 1040 (9th Cir. 2006), *cert. granted*, 128 S. Ct. 1119 (Jan. 22, 2008). The Ninth Circuit subsequently vacated its prior opinion and that of the district court and remanded to the district court for further proceedings consistent with the Supreme Court's opinion. *Simpson v. Homestore.com, Inc.*, No. 04-55665 (9th Cir. filed Mar. 26, 2008). This will, in probability, end this huge class action.

J. In *Grossman v. Merrill Lynch & Co.*, Civ. Action No. 2:03-cv-05336 (E.D. Pa. filed Sep. 23, 2003), a law firm alleged to have participated in the fraud of a client company obtained dismissal of the suit filed against it based on *Stoneridge*. *Grossman* is a suit brought by the shareholders of DVI Inc., a health care finance company against its former counsel Clifford Chance and others. The law firm represented the company up to

the time of its bankruptcy filing. The complaint alleges that the law firm participated in a scheme with DVI's executives to engage in sham transactions designed to conceal the company's true financial health. The district court entered an order dismissing the case against Clifford Chance based on *Stoneridge. But see, Huston v. Seward & Kissel, LLP*, Civ. Action No. 07-cv-6305 (S.D.N.Y. filed Jul. 10, 2007). This is a suit by investors against a New York law firm for aiding and abetting the unlawful sale of unregistered securities in violation of Oregon's securities laws. The court declined to dismiss the action as pre-empted and noted that *Stoneridge* only applies to the federal securities laws and does not impact a cause of action under state law in an opinion issued March 27, 2008.

IV. Pleading a cause of action: Rule 8(a), basic pleading standards

A. Many securities class actions are resolved at or shortly after the motion to dismiss stage. Pleading issues can thus be key.

B. The basic pleading standards for a complaint are set forth in Federal Civil Rule 8(a). Under that Rule, a plaintiff need only set forth a short, plain statement demonstrating that he or she is entitled to relief and giving notice of the claim to the defendant.

C. In *Bell Atlantic Corp. v. Twombly*, 137 S. Ct. 1955 (2007), the Supreme Court recast the Rule 8(a) standards:

1. Previously, the standard under this Rule had been interpreted by many in view of the Court's frequently quoted statement from *Conley v. Gibson*, which noted that it is "the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." 355 U.S. 41, 45-46 (1957).

2. Justice Souter, writing for the Court in *Twombly*, noted that in *Conley* the passage quoted above followed a detailed recitation of the facts of the case which demonstrated the merits of the claim before the Court at that time. *Conley* must be read against that backdrop, according to the Court.

3. When *Conley* is read in this context, the proper standard the Court held, is not to require any heightened fact pleading standard "but only enough facts [in the complaint] to state a claim to relief that is plausible on its face. Because plaintiffs here have not nudged their claims across the line from conceivable to plausible, their complaint must be dismissed." *Twombly*, 137 S. Ct. at 1955. This

"plausibility" standard comports with the Rule and will ensure that meritorious claims proceed while at the same time weeding out those which lack merit. When the case is meritless, parties should not be put to the burdens and cost of discovery.

4. While *Twombly* is an antitrust case, the Court noted that "[w]e alluded to the practical significance of the Rule 8 entitlement requirement in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), when we explained that something beyond the mere possibility of loss causation must be alleged, lest a plaintiff with a 'largely groundless claim' be allowed to 'take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value.'" *Id*. at 347 (quoting *Blue Chip Stamps v. Manor Drug Stores*, 411 U.S. 723 (1975)).

5. The citations to *Dura*, a securities class action, as part of the origin of the "plausibility" standard and *Blue Chip Stamps*, another securities damage action, for the abusive impact of discovery in meritless cases, clearly suggest that *Twombly* should to apply in securities damage actions as a primary pleading standard.

D. Subsequently *Twombly* has been applied in securities damage cases.

1. In *Atsi Communications, Inc. v. The Shaar Fund, Ltd.*, the Second Circuit applied *Twombly* in a securities fraud suit. 493 F.3d 87 (2nd Cir. 2007). In doing so, the Court noted: "We have declined to read *Twombly's* flexible 'plausibility standard' as relating only to antitrust cases." *Id*. at 98. Citing *Iqbal v. Hasty*, 490 F.3d 143, 157 (2nd Cir. 2007). The court went on to affirm the dismissal of the complaint for failing to properly plead a securities claim. In part, the court relied on the fact that the manipulation claim asserted by plaintiff did not meet the *Twombly* plausibility standard. *See also In re Openwave Systems Sec. Litig.*, 97 Civ. 1309 (S.D.N.Y. Oct. 31, 2007).

2. The First Circuit also applied *Twombly* in a securities fraud suit, noting that "[t]he Supreme Court has recently altered the Rule 12(b)(6) standard in a manner which gives it more heft. In order to survive a motion to dismiss, a complaint must allege a plausible entitlement to relief." *ACA Financial Guaranty Corp. v. Advest, Inc.*, 512 F.3d 46, 58 (1st Cir. 2008), citing *Twombly*. Here, the court affirmed the dismissal of the complaint based on a failure to meet the PSLRA standards.

3. In *Mississippi Public Employees' Retirement System v. Boston Scientific Corp.*, 2008 WL 1735390 (9th Cir. Apr. 16, 2008), the

Ninth Circuit, in a securities case, cited *Twombly* as the standard applicable on a Rule 12(b)(6) motion to dismiss. *See also Foster v. Wilson,* 504 F.3d 1046, 1051 (9th Cir. 2007) (affirming the dismissal of a securities class action noting that "here the flaw in the federal fraud claim is not a failure to allege sufficient facts, but a failure to state a tenable theory upon which the claim could be established" without citing *Twombly*).

V. PSLRA Pleading Standards: A Strong Inference of Scienter -- *Tellabs*

A. In 1995, Congress passed the PSLRA in response to what was perceived to be growing abuse in bringing securities class actions. Prior standards under Federal Civil Rules 8 (discussed above) and 9(b)(which required that fraud, but not state of mind, be pled with particularity) were deemed insufficient to curb abusive filings. As the Conference Report notes:

> The routine filing of lawsuits against issuers of securities . . . whenever there is a significant change in the issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action.
>
> H.R. Conf. Rep. No. 369, 104th Cong., 1st Sess. 31 (1995).

B. To curb these abuses, Congress imposed a number of limitations and restraints on private securities actions. As the Supreme Court later noted: "Exacting pleading requirements are among the control measures Congress included in the PSLRA. The Act requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter . . . " *Tellabs,* 1275 S. Ct. at 2504. Under the PSLRA, a securities law plaintiff:

1. Must "specify each statement alleged to have been misleading, the reason or reason or reasons the statement is misleading. . . " Section 21D(b)(9)(1).

2. For any statement made on information and belief "the complaint shall state with particularity all facts on which that belief is formed." *Id.*

C. The pleading standards for the required state of mind is incorporated in Section 21(D)(b)(2) of the Act which specified in part that in "any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of

mind, the complaint shall, with respect to each act or omission alleged to violate this title, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."

1. The "strong inference" standard evolved out of the pre-PSLRA case law.

2. Prior to the passage of the PSLRA, the pleading standard of the Second Circuit Court of Appeals was generally deemed to be the most stringent, regarding state of mind. Under that standard, a securities plaintiff was required to plead facts giving rise to a "strong inference" of fraudulent intent. That requirement could be met in two ways: "By alleging facts establishing motive and opportunity to commit fraud, or by alleging facts constituting circumstantial evidence of either reckless or conscious behavior." *In re Time Warner, Inc., Sec. Litig.* 9 F.3d 259 (2nd Cir. 1993); *IUE AFL-CIO Pension Fund v. Hermann,* 9 F.3d 1049 (2nd Cir. 1993); *see generally,* 5A Wright & Miller, Federal Practice and Procedure, Section 1301.1 at 300. *Compare In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541 (9th Cir. 1994)(*en banc*)(holding that state of mind need not be pled with particularity in securities fraud cases). Other courts took an intermediate position. *See, e.g., In re HealthCare Compare Corp., Sec. Litig.*, 75 F.3d 276 (7th Cir. 1996).

3. Congress adopted the Second Circuit's "strong inference test in an effort to create a national pleading standard and "more stringent pleading requirements to curtail the filing of meritless lawsuit." H.R. Conf. Rep. No. 104-369, at 37 (1995). While the legislative history is less than clear, the committee reports note that the Second Circuit case law was not adopted, but should be reviewed as "instructive." *Id*. at 15.

D. Following the passage of the PSLRA, the circuit courts split over two key issues concerning Section 21D(b)(2). The first concerned what constitutes a "strong" inference, while the second dealt with how to assess the inference.[7]

E. The circuits split over the question of what constitutes a strong inference:

[7] While the section does not specify the "required state of mind," virtually every circuit agreed that it is scienter, the same as prior to the passage of the Act. *Ottmann v. Hanger Orthopedic Group,* 353 F.3d 338, 343 n. 3 (4th Cir. 2003) (collecting cases); *but see In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 974 (1999) (holding that there must at a minimum be "deliberate recklessness"). Prior to the passage of the PSLRA, the Ninth Circuit had been in agreement with other circuits that scienter was the applicable standard. *See, e.g., Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990)(*en banc*); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 46 (2nd Cir. 1978).

1. The Second and Third Circuits adopted the pre-PSLRA Second Circuit test. *Press v. Chem. Inv. Serv. Corp.,* 166 F.3d 529 (2nd Cir. 1999); *In re Advanta Corp., Sec. Litig.,* 180 F.3d 525 (3rd Cir. 1999).

2. The Ninth Circuit adopted a heightened standard of "deliberate recklessness." *Silicon Graphics,* 183 F.3d at 979.

3. The First, Fourth, Sixth, Eighth, Tenth and Eleventh Circuit took an intermediate position. Some circuits found that motive and opportunity evidence may be sufficient while others concluded it was only some evidence and that the totality of the facts need to be considered. *See, e.g., Greebel v. FTP Software, Inc.,* 194 F.3d 185 (1st Cir. 1999); *Bryant v. Avado Brands, Inc.,* 187 F.3d 1271 (11th Cir. 1999); *Helwig v. Vencor, Inc.,* 251 F.3d 540 (6th Cir. 2001)(*en banc)* (PSLRA is concerned with quantum of evidence and not necessarily motive and opportunity); *City of Philadelphia v. Fleming Co., Inc.* 265 F.3d 1245 (10th Cir. 2001); *Florida State Board of Admin. v Green Tree Fin. Corp.,* 270 F.3d 646 (8th Cir. 2001); *Ottmann v. Hanger Orthopedic Group,* 353 F.3d 338 (4th Cir. 2003).

F. The circuits also split on how to deal with the question of competing inferences.

1. The First Circuit concluded that there is no change from standard Rule 12(b)(6) practice under which all inferences are drawn in favor of plaintiff. *Aldridge v. A.T. Cross Corp.,* 284 F.3d 72 (1st Cir. 2002); *but see Greebel v. FTP Software, Inc.,* 194 F.3d 185 (1st Cir. 1999) ("Congress has effectively mandated a special standard for measuring whether allegations of scienter survive a motion to dismiss.").

2. The Ninth Circuit adopted a similar approach to that of the First, but concluded that there is a "tension" between the Rule and the PSLRA and that the latter required the court to consider all facts in the complaint. Subsequently, the Fifth Circuit adopted essentially the same approach, but without commenting on the impact of the PSLRA on Rule 12(b)(6). *Gompper v. VISX, Inc.,* 298 F.3d 893 (9th Cir. 2002); *see also In Re Credit Suisse First Boston Corp.,* 431 F.3d 36 (1st Cir. 2005).

3. The Tenth Circuit concluded that all inferences must be considered if they are drawn from facts pled with particularity. *Pirraglia v. Novell, Inc.,* 339 F.3d 1182 (10th Cir. 2003).

4. The Sixth Circuit, sitting *en banc*, adopted a rule which varied from standard Rule 12(b)(6) practice, concluding that plaintiffs are entitled only to the most plausible of competing inferences. *Helwig*, 252 F.3d at 540. A variation of this rule was adopted by the Eighth Circuit in *Green Tree Fin. Corp.*, 270 F.3d at 645, under which "catch-all" and "blanket" assertions that do not meet the particularity requirements are discarded.

G. The Supreme Court resolved the question of what constitutes a strong inference of scienter under Section 21D(b)(2) and how to consider competing inferences in *Tellabs.* 127 S. Ct. 2499 (2007).

1. The Court held: "A plaintiff alleging fraud in a Section 10(b) action, we hold today, must plead facts rendering an inference of scienter *at least as likely* as any plausible opposing inference. *Id.* at 2512.

2. The PSLRA was designed as a "check" on meritless suits. Section 21D(b)(2) is one of those checks. Under that section, plaintiff must plead a "strong inference" of scienter. "To qualify as strong within the intendment of Section 21D(b)(2), we hold, an inference of scienter must be more than merely plausible or reasonable –it must be cogent and at least as compelling as any opposing inference of nonfradulent intent." *Id.* at 2504-2505.

3. Inn the PSLRA, Congress sought to craft a uniform standard for pleading. Congress imposed substantive and procedural limits to make sure that only proper actions were brought. *Id.* at 2508. The "strong inference" standard raised the bar for pleading scienter. While Congress did not specifically define the standard, it is clear that it adopted the language of the Second Circuit while not codifying its case law defining that language.

4. In applying the standard, the court must do three things: First, under Rule 12(b)(6) the factual allegations in the complaint must be accepted as true. Second, the complaint in its entirety must be considered, which is the traditional Rule 12(b)(6) standard. Third, "in determining whether the pleaded facts give rise to a 'strong' inference of scienter, the court must take into account plausible opposing inferences." *Id.* at 2509.

5. "Strong" means "powerful or cogent." Alternate definitions include "'[p]owerful to demonstrate or convince'" (quoting the Oxford English Dictionary 949 (2d ed. 1989). *Id.* at 2510. The strength of that inference can not be tested in a vacuum. Rather, it must be considered in the context of the entire complaint. Thus "[a] complaint will survive, we hold, only if a reasonable person

would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* The court went on to note that motive can be a relevant consideration, but its absence is not necessarily fatal. On the other hand, omissions and ambiguities "count against inferring scienter." *Id.* at 2511. "In sum, the reviewing court must ask: When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?" *Id.*

6. A plaintiff alleging fraud in a Section 10(b) action, we hold today, must plead facts rendering an inference of scienter *at least as likely* as any plausible opposing inference. At trial, she must prove her case by a 'preponderance of the evidence.' Stated otherwise, she must demonstrate that it is *more likely* than not that the defendant acted with scienter." *Id.* at 2513 (emphasis original). In making the determination, the court must consider all the facts in the complaint, those in exhibits incorporated by reference into the complaint and those in documents of which the court may properly take judicial notice.

H. While *Tellabs* rewrote standard Rule 12(b)(6) practice, its impact is difficult to assess. Following *Tellabs*, the Seventh Circuit on remand from the Supreme Court carefully assessed the competing inference and concluded that the complaint adequately plead scienter. This is the same conclusion it had reached under its prior test. Other courts, such as the Fifth Circuit, also examined the question by assessing all of the competing inferences. Some courts, such as the Second Circuit used its prior standards to assess the facts pled and the *Tellabs* "all inferences" approach. Others, such as the Third Circuit used the Second Circuit approach at times. Only the First and Ninth Circuits stated that *Tellabs* altered their prior standards.

1. No obvious impact: The Seventh, Third and Fifth circuits

a. On remand from the Supreme Court, the Seventh Circuit again considered the sufficiency of the allegations as to whether a strong inference of scienter had been pled. Again the court concluded that the complaint was sufficient. *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702 (7th Cir. Jan. 17, 2008) ("*Makor Issues & Rights II*").

i. In its initial decision the court reviewed the allegations regarding scienter using a variation of the intermediate position: "we will allow the complaint to survive if it alleges facts from which,

if true, a reasonable person could infer that the defendant acted with the required intent." *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 602 (7th Cir. 2005), *rev'd*, 127 S. Ct. 2499 (2007) ("*Makor Issues & Rights I*"). The court specifically declined to weigh the inferences, viewing that task as reserved for the jury. Under this approach the court concluded that the allegations in the complaint are sufficient.

ii. On remand, the circuit court applied the teachings of the Supreme Court. Essentially, the court viewed the facts as presenting two competing inferences. Under one theory, erroneous statements were made by senior corporate officials but as a result of errors by lower employees that were not detected. Under this theory, the plaintiff's complaint would fail. Under the alternative, the senior officials who made the false statements were responsible. The court considered the inference of corporate scienter more likely than the opposing inference because of the importance of the statements and the products to the company. Thus, the court concluded: "So the inference of corporate scienter is not only as likely as its opposite, but more likely. And is it cogent? Well, if there are only two possible inferences, and one is *much* more likely than the other, it must be cogent." *Makor Issues & Rights II*, 513 F.3d at 710. The allegations in the complaint are sufficient the court concluded.

b. Prior to the remand of *Tellabs*, the Seventh Circuit upheld the dismissal of a securities fraud complaint based on a review of the totality of the inferences. *Higginbotham v. Baxter International, Inc.*, 495 F.3d 753 (7th Cir. 2007). The Supreme Court decided *Tellabs* after argument, but before decision.

i. There, Baxter International announced that it would restate the preceding three years' earnings to correct errors resulting from fraud in its Brazilian subsidiary. The managers in the subsidiary created the illusion of growth by at first prematurely recognizing sales and later recording fictitious sales. When the problem was announced the stock dropped about 4.6%. Later, the stock price

corrected when the restatement showed that the impact was not as large as initially thought. Plaintiffs claim that by March 12 or May 10 Baxter's senior managers knew the Brazilian data to be false, that the controls were inadequate and they should not have waited until July 22 to disclose the problem.

ii. The district court's order of dismissal was affirmed. Citing the Supreme Court's decision in *Tellabs*, the Court noted that a complaint can only survive this standard if "a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* at 756. The standard is higher than probable cause, but, less than the more-likely-than-not threshold used a trial.

iii. Essentially, the court reviewed each arguments raised by plaintiffs. The fact that on April 29 Brazil's government accused Baxter's subsidiary of raising prices by participating in a cartel did not alert the defendants to the fraud as plaintiff's claim. Accusations differ from proof and executives do not necessarily know what government officials know. More importantly, cartels improve profits through antitrust violations. That differs from reporting non-existent sales.

iv. The fact that the reporting systems turned out to be weak does not support the complaint as plaintiffs argue. "That's no news; by definition, *all* fraud demonstrates the 'inadequacy' of existing controls, just as all bank robberies demonstrate the failure of bank security . . ." *Id.* at 760.

v. The court also rejected the claim that the fraud should have been disclosed in June or early July rather than in the first quarter at the end of July: "What rule of law requires 10-Q reports to be updated on any cycle other than quarterly? That is what the 'Q' means. Firms regularly learn financial information between quarterly reports, and they keep it under their hats until the time arrives for disclosure. Silence is not 'fraud' without a duty to disclose . . . Taking the time necessary to get things

right is both proper and lawful. Managers cannot tell lies but are entitled to investigate for a reasonable time, until they have a full story . . . After all, delay in correcting a misstatement does not create the loss; the injury to investors comes from the fraud, not from a decision to take the time necessary to endure that the corrective statement is accurate. Delay may affect which investors bear the loss but does not change the need for some investors to bear it, or increase its amount." *Id.* at 761.

c. The Third Circuit has decided two post-*Tellabs* cases. In one, it relied in part on its prior standards, while in the other it did not. In *The Winer Family Trust v. Queen*, the court did not cite its prior standards in analyzing whether there was a strong inference of scienter. 503 F.3d 319 (3rd Cir. Sep. 24, 2007). Using the *Tellabs* standard, the circuit court affirmed the dismissal of the complaint.

i. Winer claims that Pennex, Smithfield Foods, and executives and officers of both companies inflated the price of the stock through public statements and earning reports that omitted material facts. Many of the allegations focus on a deal in which Pennex purchased and renovated a facility and equipments and the related values and costs. Plaintiffs argued that a press release announcing the deal is false and misleading because it fails to disclose the facility needs a major overhaul costing over $18 million and expert supervision. Defendants did not disclose that Smithfield Foods, not Pennex, controlled the renovation.

ii. Under *Tellabs* the district court correctly considered inferences which point in each direction as well as documents attached to the complaint.

iii. The court rejected the arguments that the press release supported an inference of scienter because the costs were disclosed after it was issued. The court also rejected the plaintiff's claim that the failure to disclose the fact that Smithfield controlled the renovation supported a strong inference of

scienter because there was no duty to disclose the fact.[8]

d. In *Key Equity Investors Inc., v. Sel-Leb Marketing Inc.*, No. 06-1052, 2007 WL 2510385 (3rd Cir. Sep. 6, 2007), the court used a different approach. Here, the court cited its prior standards for determining whether there was a strong inference of scienter and the *Tellabs* standard. The court's prior standards followed the "motive and opportunity" test of the Second Circuit (discussed above). A review of the majority opinion and the dissent illustrates the different views that can be taken of the same facts and the different results that can be achieved.

i. The complaint alleges that the defendant company and its officers failed to disclose that the pretax earnings for 2001 were materially overstated; that it had a pre-tax loss for 2002; that it was in default under the terms of its credit facility; and that its financial statements had not been prepared in accord with GAAP. The stock is now virtually worthless.

ii. The circuit court affirmed the dismissal of the complaint.

iii. To plead a strong inference of scienter the court held that plaintiff may allege: 1) facts show that the defendants had both motive and opportunity to commit fraud or 2) facts constituting strong circumstantial evidence of conscious misbehavior or recklessness. Under *Tellabs*, the complaint only presents a strong inference of scienter if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference. Plaintiffs may not benefit from an inference "flowing from vague or unspecific allegations-inferences that may arguably have been

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[8] *See also Globis Capital Partners v. Stonepath Group, Inc.*, 241 Fed. Appx. 832 (3rd Cir. Jul. 10, 2007). Here, the plaintiffs brought a financial fraud complaint following a large share price drop after a third restatement. In affirming the dismissal of the complaint, the circuit court simply reviewed the factual arguments offered in support of a strong inference of scienter by plaintiffs and rejected them. The court did not cite its prior scienter pleading standards. In a footnote at the end of the opinion the court cited the recently decided *Tellabs* decision, noting that it "removes any doubt that the PSLRA's scienter pleading requirement is a significant bar to litigation that *Globis* has failed to meet." *Id.* at 837, fn. 1.

justified under a traditional Rule 12(b)(6) analysis." *Id.* at *4.

iv. The dissent argues that in view of the fact that the overstatement of earnings is 400% and in the midst of the crisis, Merrill Lynch tightened the terms of the credit line, inferences of scienter are sufficient. First, Merrill Lynch repeatedly tightened the terms of the credit facility, thus demonstrating its concern about the financial condition of the company. This was not properly disclosed and what was disclosed was buried. Second, the magnitude of the overstatements is significant and bolsters the inference of scienter. Together these facts demonstrate conscious behavior of wrongdoing.

e. Fifth Circuit: In *Central Laborers' Pension Fund v. Integrated Electrical Services, Inc.*, No. 06-20135, 2007 WL 236776 (5th Cir. Aug. 21, 2007) the court relied only on *Tellabs* and not its prior cases.

i. In August 2004, IES announced it would not be able to file its quarterly financial statements on time. The company was conducting an on-going evaluation of accounting issues at two subsidiaries and its auditors had identified two material weaknesses in the internal controls. Later, IES announced a restatement covering two and one half years. Plaintiffs brought a financial fraud securities suit.

ii. The circuit court affirmed the dismissal with prejudice of the case.

iii. After restating the holding of *Tellabs,* the court assessed all of the inferences raised by the complaint by considering each argument advanced to support scienter.

iv. GAAP violations, without more, do not establish scienter. A restatement based on GAAP violations does provide some basis on which to infer scienter.

v. The court rejected claims that the resignation during the period and trading by the CFO of less than 5% of his holdings supported a strong inference of

scienter. The court noted that the fact that he did not insulate his trading by using a Rule 1065-1 plan provided some support for finding scienter.

vi. Over the objection of plaintiffs, the court considered innocent explanations about the trading based on the fact that the CFO was in the midst of a divorce and need to cash to make payments to his former wife.

vii. The court refused to draw an inference of scienter from the fact that the officer signed a SOX certification. Following the lead of the Eleventh Circuit in *Garfield v. NDC Health Corp.*, 466 F.3d 1255, 1266 (11th Cir. 2006), the court held that such an inference would only be proper if the person knew or should have suspected due to glaring accounting irregularities or other red flags that the financial statements were false. Here there were no such red flags.

2. The Second and Eighth Circuits continue to follow their prior decision, in addition to the teachings of the Supreme Court in *Tellabs* to assess the adequacy of facts pled and the resulting inference regarding scienter.

a. Second Circuit: In *ATSI Communications, Inc. v. The Shaar Fund, Ltd.*, No. 05-5132-cv, 2007 WL 1989336 (2nd Cir. Jul. 11, 2007), the court used the "motive and opportunity" test it developed prior to the passage of the PSLRA, along with the holding of *Tellabs*, to evaluate the adequacy of the facts pled regarding scienter.

i. This is a suit by an issuer of "floorless preferred" against the purchasers. Essentially ATSI Communications alleged that defendants, who purchased the floorless preferred in private placements, later manipulated the stock by selling short and driving the price down, sending the company into a death spiral. The circuit court affirmed the dismissal of the complaint.

ii. To plead scienter under the Section 21D(b)(2), the plaintiff must state with particularity facts giving rise to a strong inference of scienter. Plaintiff can meet this burden "by alleging facts (1) showing that

the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness." *Id* at *17. This is the court's pre-*Tellabs* case law.

iii. The court went on to note that in determining whether the facts pled give rise to a "strong" inference of scienter the court must take into account plausible opposing inferences and it must be such that "a reasonable person [must] deem [it] cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'" *Id* at *18, quoting *Tellabs* at 10.

b. The Eighth Circuit took a similar approach in *Crowell v. Possis Medical, Inc.*, No. 07-1840 (8th Cir. Mar. 21, 2008).

i. The circuit court affirmed the dismissal of a securities damage case. The complaint alleged that defendants had repeatedly made false statements about a key new medical device and its potentially favorable impact on company revenues. When the truth was disclosed, the stock price dropped significantly.

ii. Citing its pre-*Tellabs* decision in *In re K-Tel Int'l, Inc. Sec. Litig.*, 300 F.3d 991 (8th Cir. 2002), the court held that "Scienter can be established in three ways: (1) from facts demonstrating a mental state embracing an intent to deceive, manipulate, or defraud; (2) from conduct which rises to the level of severe recklessness; or (3) from allegations of motive and opportunity."

iii. The relevant inquiry under *Tellabs* in assessing the evidence regarding scienter is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter. Here, allegations from anonymous sources, plus a study which suggests that company executives were aware of potentially negative results from the product and stock sales, are not sufficient.

3. In contrast, the First and Ninth Circuits have specifically acknowledged that *Tellabs* lowered the standard for pleading scienter in their circuit.

   a. In *ACA Financial Guaranty Corp., v. Advest, Inc.*, 512 F.3d 46 (1st Cir. 2008), the First Circuit affirmed the dismissal of a suit by bond holders following default on those bonds based on claims that they had been misled at the time of purchase.

      i. In affirming the dismissal of the complaint, the court stated that *Tellabs* affirmed in part its prior case law: "*Tellabs* affirms our case law that plaintiffs' inferences of scienter should be weighed against competing inferences of non-culpable behavior." *See, e.g.*, *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 203 (1st Cir. 1999). *Tellabs* also affirms our rule that the complaint is considered as a whole rather than piecemeal." *ACA Financial*, 512 F.3d at 52.

      ii. At the same time, the circuit court acknowledged that *Tellabs* altered it prior case law in favor of plaintiffs: "However, *Tellabs* has overruled one aspect of the rule this court stated in *Credit Suisse. Credit Suisse* held that where there were equally strong inferences for and against scienter, this resulted in a win for the defendant. … This is no longer the law." *Id*. at 59. Thus, *Tellabs* lowered the standard in this circuit.

   b. In *Mississippi Public Employees' Retirement System v. Boston Scientific Corp.*, 2008 WL 173590 (9th Cir. Apr. 16, 2008), the Ninth Circuit reversed under *Tellabs* the dismissal of a securities complaint which was based on allegations involving the launch of a new product and its eventual recall. In reaching its conclusion, the court carefully reviewed all of the allegations in the complaint. The reason for reversing the district court is that *Tellabs* lowered the scienter pleading standard: "The district court did not have the benefit of the *Tellabs* opinion, which reversed a higher standard for scienter imposed by the prior law of this circuit. We apply *Tellabs* and that leads us to a different result. While there is support for defendants' inferences, we think, at this stage, that plaintiff's inferences are at least equally strong." *Id*. at 12. In reversing the

district court, the Ninth Circuit was careful to note that it was not indicating that the complaint had merit. Previously, the Ninth Circuit had adopted the highest post-PLSRA scienter pleading standard of "conscious recklessness."

IV. The Group Pleading Doctrine

A. Another key pleading issue under the PSLRA involves the application of the "group pleading" doctrine. Prior to the PSLRA, some circuit courts permitted fraudulent statements in corporate documents such as periodic filings to be attributed to directors and officers. Thus, for example, the Ninth Circuit in *Wool v. Tanden Computers, Inc.* 818 F.2d 1433, 1330 (9th Cir. 1987) held that "[i]n cases of corporate fraud where the false or misleading information is conveyed in prospectuses, registration statements, annual reports, press releases, or other 'group-published information,' it is reasonable to presume that those are the collective actions of the officers." *See also Serabian v. Amoskeag Bank Shares, Inc.*, 24 F.3d 357, 367-68 (1st Cir. 1994); *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246 (10th Cir. 1997); *see generally*, 3 Thomas Lee Hazen, Treatise on the Law of Securities Regulation, Section 12.13 (5th ed. 2006)(citing cases).

B. The PSLRA requires that plaintiffs pleading fraud in a private suit for damages specify each statement alleged to be misleading and the reasons the statement is misleading. 15 U.S.C. § 78u-4(b)(1). For allegations based on information or belief, the PSLRA requires plaintiffs to "state with particularity all facts" forming the basis of the belief. *Id.* Each untrue statement or omission must be set forth with particularity as to "the defendant" and scienter must be pled in regards to "each act or omission" sufficient to support a strong inference that "the defendant" acted with the required state of mind. 15 U.S.C. § 78u-4(b)(2). The PSLRA does not mention the group pleading doctrine.

1. The Fifth and Seventh Circuits and some district courts have concluded that the doctrine is no longer viable following the passage of the PSLRA. *See, e.g., Southland Secs. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353 (5th Cir. 2004); *Makor Issues & Rights I*, 437 F.3d at 602-03, 127 S. Ct. 2499 (2007); *Gurfein v. Ameritrade, Inc.*, 411 F. Supp. 2d 416 (S.D.N.Y. 2006)*; In re Bio-Technology Gen. Corp. Sec. Litig.*, 380 F. Supp. 2d 574 (D.N.J. 2005); *In re Cable & Wireless, PLC*, 321 F. Supp. 2d 749 (E.D. Va. 2004); *Allison v. Brooktree Corp.*, 999 F. Supp. 1342; *see also Phillips v. Scientific-Atlanta, Inc.*, 374 F.3d 1015, 1018 (11th Cir. 2004)(suggesting the doctrine may not survive the PSLRA, but not deciding the issue).

2. The Ninth and Tenth Circuits have continued to permit the doctrine to be used following the passage of the PSLRA, although the opinions do not specifically discuss the question. *See, e.g, Howard v. Everex Sys., Inc.,* 228 F.3d 1057, 1061-63 (9th Cir. 2000); *Schwartz v. Celestial Seasoning, Inc.* 124 F.3d 1246 (10th Cir. 1997). A number of district courts have also concluded that the doctrine survives the passage of the PSLRA. *See, e.g., In re Van Der Moolen Holding N.V. Sec. Litig.,* 405 F. Supp. 2d 388 (S.D.N.Y. 2005); *In re Rent-Way,* 209 F. Supp. 2d 493 (W.D. Pa. 2002); *In re Raytheon Sec Litig.,* 157 F. Supp. 2d 131, 153 (D. Mass. 2001); *In re SmarTalk Teleservices, Inc. Sec. Litig.,* 124 F. Supp. 2d 527, 545 (S.D. Ohio 2000).

C. In *Tellabs,* the Supreme Court referenced the doctrine. The Seventh Circuit had held that the doctrine did not survive the PSLRA. Since that issue was not before the Supreme Court, it did not rule on it. The only post-*Tellabs* circuit court decision to address the issue held that the group pleading doctrine did not survive the PSLRA. *The Winer Family Trust v. Queen*, 503 F.3d 319 (3rd Cir. Sep. 24, 2007). That decision is consistent with pre-*Tellabs* decisions in the circuit.

V. Confidential witnesses

A. Another key pleading issue involves the use of confidential witnesses as sources for the factual allegations in the complaint and whether the use of those sources is consistent with the pleading requirements of the PSLRA. Some early cases concluded that "all facts" be pled provisions of the PSLRA required that all sources be identified. *See, e.g., In re Silicon Graphics, Inc. Sec. Litig.,* 970 F. Supp. 746, 764 (N.D. Cal. 1997); *In re Nice Sys., Ltd. Sec. Litig.,* 135 F. Supp. 2d 551 (D.N.J. 2001).

B. However, in the leading case of *Novak v. Kasaks,* 216 F.3d 300, 314 (2nd Cir. 2000) *cert. denied.,* 531 U.S. 1012 (2000), the court concluded that "our reading of the PSLRA rejects any notion that confidential sources must be named as a general matter." The court concluded that naming informants could have a chilling effect.

C. Other circuits agree with the Second Circuit that confidential sources need not typically be disclosed at the pleading stage. *In re Cabletron Sys., Inc.,* 311 F.3d 11, 28-30 (1st Cir. 2002); *Cal Pub. Employees' Ret. Sys. V. Chubb Corp.,* 394 F.3d 126, 146-47 (3d Cir. 2004); *ABC Arbitrage Plaintiffs Group v. Tchuruk,* 291 F.3d 336, 351-52 (5th Cir. 2002); *Fla. State Bd. of Admin. v. Green Tree Fin. Corp.,* 270 F.3d 645, 667-68 (8th Cir. 2001); *In re Daou Sys., Inc. Sec. Litg.,* 411 F.3d 1006, 1015 (9th Cir. 2005); *Adams v. Kinder-Morgan, Inc.,* 340 F.3d 1083, 1101 (10th Cir.

2003). The Seventh Circuit noted that a "bright line rule obliging the plaintiffs to reveal their sources has the potential to deter informants from exposing malfeasance. Such a rule might also invite retaliation. *Makor Issues & Rights I,* 437 F.3d at 596.

D. The key question is what must be disclosed regarding confidential witnesses.

1. *Novak* concluded that the sources must be "described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged. 216 F.3d at 314. The Fifth and Seventh Circuits agree with this approach. *Makor Issues & Rights I,* 437 F.3d at 596; *Tchuruk,* 291 F.3d at 353.

2. The First Circuit developed an alternative approach in *Cabletron*, 311 F.3d at 29-30. There the court concluded that the test should be an "evaluation, *inter alia,* of the level of detail provided by the confidential sources, the corroborative nature of the other facts alleged (including from other sources), the coherence and plausibility of the allegations, the number of sources, the reliability of the sources, and similar indicia." 311 F.3d at 29-30. The Third and Ninth Circuits have adopted a similar approach. *Chubb,* 394 F.3d at 147; *In re Daou Sys., Inc.,* 411 F.3d 1006, 1015 (9th Cir. 2005).

3. A third approach has been developed by the Tenth Circuit in *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1101 (10th Cir. 2003). The court rejected a "per se rule that a plaintiff's complaint must always identify the source." "Rather, source information is more important for allegations that are difficult to confirm than for claims that "may be objectively verifiable" such as contract terms, financial results and similar information.

E. The Supreme Court in *Tellabs* did not consider the question of confidential witness because the issue was not presented although the Seventh Circuit had ruled on the issue.

1. Immediately following *Tellabs*, however, the Seventh Circuit seemed to reverse its position on confidential witness. In *Higginbotham* the court noted that: "One upshot of the approach that *Tellabs* announced is that we must discount allegations that the complaint attributes to five 'confidential witnesses'—one ex-employee of the Brazilian subsidiary, two ex-employees of Baxter's headquarters, and two consultants. It is hard to see how information from anonymous sources could be deemed

'compelling' or how we could take account of plausible opposing inferences. Perhaps these confidential sources have axes to grind. Perhaps they are lying. Perhaps they don't even exist." 495 F.3d at 756-757. This conclusion is based on Section 21D(b)(2) which deals with pleading the applicable state of mind. In contrast, earlier decisions on this issue had focused on the PSLRA requirements that "all facts" be pled.

2. When the Seventh Circuit considered *Tellabs* on remand however, the court revised its opinion.

a. There the Court explained *Higginbotham*, noting that "[t]here was no basis other than the confidential sources, described merely as three ex-employees of Baxter and two consultants, for a strong inference that the subsidiary had failed to conceal the fraud, from its parent and thus that the management of the parent had been aware of the fraud during the period covered by the complaint." *Makor Issues & Rights II*, 513 F.3d at 712.

b. In contrast, in *Makor Issues & Rights II*, the court did not discount the confidential witness because they "are numerous and consist of persons who from the description of their jobs were in a position to know first hand the facts…" *Id*. In addition, the material from the confidential informants "is set forth in convincing detail" and in some cases "corroborated by multiple sources." *Id.* While "it would be better were the informants named . . . the absence of proper names does not invalidate the drawing of a strong inference from informants' assertions." *Id.*

VI. *Dura* and Loss Causation

A. *Dura Pharmaceuticals, Inc. v. Broudo* imposes another key pleading and proof requirement on securities damage suits. 544 U.S. 336 (2005). *Dura* however does not deal with the PSLRA. Rather, the case concerns one of the elements of a cause of action crafted by the court-loss causation. While that element has been incorporated into the PSLRA, it is not defined in the statute. Essentially, *Dura* requires that the securities law plaintiff plead and prove a causal link between the alleged fraud and the loss, that is loss causation. Loss causation is one of six elements of a Section 10(b) cause of action for damages.

1. Prior to *Dura*, the circuits split over the question of loss causation.

2. The Second, Third and Eleventh Circuits required more than price inflation to establish a link between the misrepresentation or omission and injury. *See, e.g., Emergent Capital Inv. v. Stonepath Group,* 343 F.3d 189 (2nd Cir. 2003).

3. The Eighth and Ninth Circuits held that the fraud on the market theory of *Basic v. Levinson*, 485 U.S. 224 (1988)(holding that, where there is an efficient market there is a presumption of reliance on the integrity of the market), permitted the presumption that when stock prices were inflated, it made sense to conclude that plaintiffs were harmed by paying too much for the shares. *See, e.g., Gebhardt v. ConAgra Foods*, 335 F.3d 824 (8th Cir. 2003).

B. The Decision in *Dura.*

1. Plaintiffs brought a securities class action against Dura Pharmaceuticals and some of its officers and directors. The complaint alleged that Dura made false statements about its drug profits and future FDA approval of a new asthmatic spray device. Subsequently, the company announced that its earnings would be lower than expected, principally due to slow drug sales. The next day its share price fell almost 50%. Eight months later, the company announced that the FDA would not approve its new asthmatic spray device. The share price fell temporarily, but almost fully recovered within one week. Plaintiffs claimed that their economic loss resulted from paying artificially inflated prices for Dura securities.

2. The district court dismissed the complaint, holding that it failed to adequately allege scienter as to the drug-profitability claim. On the claim concerning the spray device, the court held that plaintiffs failed to adequately allege loss causation. The Ninth Circuit reversed as to loss causation holding that price inflation was sufficient because loss causation is established on the date of purchase.

3. The Supreme Court reversed, holding that an inflated price alone is not sufficient to establish loss causation. The Court's opinion contains six key points.

   a. The elements of a private cause of action under Section 10(b) are based in part on common law principles and in part on those added by Congress. Those are: (a) a material misrepresentation or omission; (b) scienter or a wrongful state of mind; (c) a connection with the purchase or sale of a security; (d) reliance which is sometimes referred to as

transaction causation; (e) economic loss; and (f) loss causation, that is "a causal connection between the material misrepresentation and the loss. . . " *Id*. at 342; *Dura,* 544 U.S. at 342.

b. As a matter of logic, an inflated priced is insufficient because:

i. It does not mean there is a loss. An artificially inflated purchase price *might* mean there is a loss.

ii. The longer the time between purchase and sale, the more likely it is that other factors caused the loss.

iii. The fact that the complaint fails to state that the share price fell after the truth came out suggests that plaintiff thought the artificial price was sufficient.

c. The PSLRA.

i. An inflated price might touch upon a loss, but under the PSLRA (which requires loss causation) that is not enough.

ii. Loss causation is consistent with a key goal of the PSLRA of maintaining confidence in the markets, but not insuring against loss.

d. Common law.

i. The holding of the Ninth Circuit lacks precedent.

ii. Securities fraud has common law roots. Basic tort theory and most courts require reliance.

e. Pleading requirements.

i. Rule 8 pleading which is applicable here, only requires a short plain statement to give "fair notice" to the defendant of the claim.[9]

ii. According to the court, "it should not prove burdensome for a plaintiff who has suffered an

[9] The Supreme Court later interpreted this discussion to be the origin of its "plausibility" test in *Twombley*. 137 S. Ct. 1955 (3007); *see* Fed. R. Civ. P. 8(a). See Section 21D(b)(2) *supra*.

economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff had in mind." *Id.* at 582.

f. Policy: Absent a loss causation requirement, baseless claims could go forward.

C. On remand, the district court found that the complaint adequately pled loss causation since plaintiffs "explained how the misrepresentations . . . caused economic loss. . . " *Id*. at 1022. This conclusion is based on the fact that the plaintiffs amended the complaint regarding their medical device claim to allege that the misrepresentations inflated the stock price and that the share price dropped following corrective disclosures made on three different dates. *Id*.

D. The impact of *Dura.*

1. The precise impact of *Dura* is controversial. While most commentators agree that *Dura* has had an impact on securities litigation, some argue that it left open a number of issues which must resolved. Under these circumstances, its precise impact is difficult to determine. *See, e.g.,* Tom Baker and Sean J. Griffith, *How The Merits Matter: D&O Insurance and Securities Settlements* 13, forthcoming, available at http://ssrn.com/abstract=1101068 (March 2, 2008)("What exactly plaintiffs must plead to establish loss causation after *Dura*, however, remains unclear . . . Our participants regularly noted the importance of *Dura*, but also acknowledged that it remains to be seen what effect *Dura* and its progeny will ultimately have on securities settlements." *See also* Merritt B. Fox, After *Dura*, *Causation in Fraud-on-the-Market Actions*, 31 J. CORP. L. 829 (2006).

2. *Dura* has had a impact in pleading and proof standards. It is also beginning to have an impact on class certification.[10]

3. One area in which *Dura* is having an impact is pleading. The requirements of the decision are in addition to those under the PSLRA.

[10] *See, e.g., Oscar Private Equity Investments v. Allegronice Telecom, Inc*. 487 F.3d 262 (5th Cir. 2007) (vacating class certification order because plaintiffs had not shown loss causation); *See also, Allen Ferrell and Atanu Saha*, The Loss Causation Request For Rule 10B-5 Cause-Of-Action: The Implication of *Dura Pharmaceuticals v. Brauder*, Discussion paper No. 0812007, Harvard Law School, available at: http://www.Law.Harvard.edu/programs/olin_center/ (discussing open issues following *Dura).*

a. Three positions on pleading emerged in the immediate wake of *Dura.*

i. Some courts held that general allegations were sufficient. Thus, in *In re OmniVision Technologies,* the court held a complaint had adequately pled loss causation where it stated that the plaintiffs "purchased OmniVision securities at artificially inflated prices and suffered damages when revelation of the true facts cause a decline in the value of their shares." 2005 WL 1867717 (N.D. Cal. Jul. 29, 2005).

ii. Other courts held that "some detail" is required. Thus, where the complaint alleged two price dips following disclosure of the true facts the court found that loss causation had been adequately pled because there was "at least some minimal details" from which the possibility of *Dura* causation could be inferred. *In re Unumprovident Corp., Sec. Litig.*, 2005 WL 2206727 (E.D. Tenn. Sep. 12, 2005).

iii. Other courts concluded that loss causation must be pled with sufficient specificity. Thus, in *Teachers' Retirement System of L.A. v. Hunter,* the court held that while "particularity" is not required as under the PSLRA or Rule 9(b), something more than a bare Rule 8(a) allegation should be required since under the PSLRA loss causation is an "averment of fraud." 477 F.3d 162 (4th Cir. 2007). Following this line of reasoning the court concluded a plaintiff must plead it "with sufficient specificity to enable the court to evaluate whether the necessary causal link exists." *Id.* at 186.

4. The Supreme Court's recent decision in *Twombley* cites *Dura* as the predicate for its reinterpretation of Rule 8 as discussed above.

E. Theories of proof for loss causation – overview.

1. Some courts have held that *Dura* did not establish what is sufficient, but only what is not. *See, e.g,. In re Initial Publ. Offering Sec. Litig.,* 2005 WL 1529659 (S.D.N.Y. Jun. 28, 2005); *In re The Warnaco Group, Inc. Sec. Litig.,* 388 F. Supp. 2d 37, 317

(S.D.N.Y. 2005); *In re Coca-Cola Enterprises, Inc. Sec. Litig.*, 2007 WL 472943 (N.D. Ga. Feb. 7, 2007); *Marsden v. Select Medical Corp.*, 2007 WL 1725204 (E.D. Pa. Jun. 12, 2007).

2. Other courts have held that there are theories beyond the price inflation theory discussed in *Dura*. *Ray v. Citigroup Global Markets*, 482 F.3d 991 (7th Cir. 2007).

3. Three basic theories have emerged:

   a. Fraud on the market. This is the standard theory used in *Dura*. It requires proof of an artificial price and a decline in value when the truth is revealed.

   b. Materialization of risk. Under this theory, a plaintiff must prove that it was the very facts about which the defendant lied which caused its injuries.

   c. Representation that the investment is risk free. This theory requires an explicit representation that the investment is risk free.

F. Loss causation: Fraud on the market theory.

1. Under this theory, the specific fraud must be revealed. For example, in *Tricontinental Ind. v. PWC*, 475 F.3d 824 (7th Cir. 2007), the court affirmed the dismissal of the complaint because the specific fraudulent conduct was not revealed. There, plaintiff sold assets to defendant for stock in reliance on the 1997 financial statements. In 2000, the defendant announced an investigation of possible accounting irregularities for the period 1998-1999. Following the announcement the stock price dropped. The court found these allegations to be inadequate: *Dura* "stresses that the complaint must 'specify' each misleading statement … and that there must be a causal connection . . . " *Id.* at 843. A general acknowledgment of "accounting irregularities" is not sufficient.

2. The key to this theory is the disclosure of the truth, not the market's perception of those facts. In *In re Bristol-Myers Squibb Sec. Litig.*, 2005 WL 2007004 (S.D.N.Y. Aug. 17 2005), the complaint claimed fraud from misstatements of a number of independent contractor doctors about a drug. The drug was withdrawn from the market, noting that there were questions about it, but that it would be resubmitted for approval. The share price dropped. Defendants argued that the complaint failed to meet the requirements of *Dura* in part because plaintiffs failed to

demonstrate the actual market impact of the disclosure rather than the disclosure itself. The court rejected this argument noting that "if Defendant's argument prevails, a plaintiff must prove that it was the perception of the alleged corrective disclosure not necessarily the subject of the disclosure that caused the share price to drop. This is an impossible burden to satisfy and cannot be required by *Dura*." *Id*. at *21.

3. The truth must also be disclosed prior to the price drop. Conversely, if the share price declines prior to the time the truth comes out, it is insufficient to plead *Dura* causation. In *Schleider v. Wendt*, 2005 WL 1656871 (SD. Ind. Jul. 14, 2005), the complaint claimed that false statements were made about the operations during the class period. During the period the share price declined. After the class period, the company filed for bankruptcy and later still the truth emerged. The court held that there was a failure to plead loss causation: "The stock had long since hit bottom before these alleged misrepresentations became known." *See also In re Coca-Cola Enterprises, Inc. Sec. Litig.*, 2007 WL 472943 (N.D. Ga. Feb. 7, 2007)(same); *Powell v. Ida Corp., Inc.*, 2007 WL 1498881 (D. Idaho May 21, 2007)(same).

4. Price inflation plus reliance on the integrity of the market is typically not sufficient. *See, e.g., In re Business Objects S.A. Sec. Litig.*, 2005 WL 1787806 (N.D. Cal. Jul. 27, 2005) concluding that a complaint is insufficient because it is not enough to allege that the class "suffered damages in that in reliance on the integrity of the market, [and that] they paid inflated prices for Business Object's publicly traded securities." *See also Reding v. GoldmanSachs & Co.*, 382 F. Supp. 2d 1112, 1126 (E.D. Mo. 2005).

5. A bankruptcy announcement has also been held to be insufficient to reveal the truth. In *D. E & J. Ltd. Partnership v. Conaway*, 133 Fed. Appx. 994, 999-1000 (6th Cir. 2005) the stock price was alleged to have been inflated by concealing the true financial condition of the company. When the company filed for bankruptcy the price of the shares dropped. The court held that "a stock price dropped on a particular day, whether as a result of a bankruptcy or not, is not the same as an allegation that a defendant's fraud caused the loss." *Id*. at 1001.

6. Under this theory, the failure to specifically allege that the stock was sold at a loss will result in dismissal. Thus, in an action where it was alleged that the financial data used to secure the approval of a merger was false, the court concluded that the

complaint was inadequate because although it alleged that the price of the stock dropped there was no allegation that the shares were sold at a loss. *Knollenberg v. Harmonic,* 152 Fed. Appx. 674 (9th Cir. 2005); *see also Glaser v. Enzo Biochem, Inc.*, 464 F.3d 474 (4th Cir. 2006)(same but the case was based on common law fraud).

G. Loss causation: Materialization

1. The court in *Glover v. Deluca,* 2006 WL 2850448 (W.D. Pa. Sep. 29, 2006) defined the requirements for using the materialization theory of loss causation. There, the court noted that "There are two methods of establishing loss causation . . . where the alleged misstatement conceals a condition or event which then occurs and causes the plaintiff's loss, it is the materialization of the undisclosed condition or event that causes the loss." *Id* at *34. To use this theory, the plaintiff must first identify the risk that is concealed. That specific risk must later "materialize" to establish loss causation.

2. In contrast, where the truth leaks out and its impact on the market cannot be distinguished from other market events, the theory fails. Thus the court in *In re Williams Securities Litig.*, 496 F. Supp. 2d 1195 (N.D. Okla. Jul. 6, 2007) held that a plaintiff relying on this theory "must provide proof that the market recognized a relationship between the event disclosed and the fraud." *Id.* at 1266.

3. Where the concealed risk appears, it has been held sufficient to establish loss causation. In *Teamsters Local 445 v. Bombardier,* 2005 WL 218919 (S.D.N.Y. Sep. 6, 2006) the complaint alleged that there were misrepresentations and omissions regarding the integrity of the underwriting standards for securitized interests in a pool of mortgages. Plaintiffs claimed that loss causation was adequately pled because the complaint alleged that the disclosure of an exceedingly high delinquency rate for the mortgage pool caused the price to drop. District Judge Scheindlin held this sufficient, noting that a corrective disclosure was not required where the concealed fact materializes.

4. In *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 510 (S.D.N.Y. 2005), the court also found a complaint using the materialization theory sufficient at the pleading stage. There, the defendants alleged sham transactions undertaken to aid Parmalat in concealing its true financial condition. The scheme involved the use of worthless invoices to concealed the fact Parmalat could not pay its

debt. The scheme emerged or materialized because of the increasing delinquency rate for the invoices. Judge Kaplan held that these allegations were sufficient at the pleading stage.

5. In contrast, where sufficient facts do not materialize to reveal the truth to the markets, loss causation has not adequately been pled. In *In re Initial IPO Sec. Litig.*, 399 F. Supp. 2d 261 (S.D.N.Y. May 6, 2006), the complaint alleged in part that the defendants discounted earnings estimates so that companies could beat estimates. As a result, the share price became inflated. The scheme materialized, according to the complaint, when the companies failed to meet earnings and the financial statements became available. District Judge Scheindlin, who also write the opinion *Bombardier*, rejected the claim holding: "The fact that an event—in this case a failure to meet earnings forecasts or a statement foreshadowing such a failure – disabused the market of the belief does not mean that the event disclosed the alleged scheme to the market." *Id*. at 266. In a subsequent opinion, the court amplified its holding noting: "Because plaintiffs do not allege that the scheme was ever disclosed, they fail to allege loss causation." *Id.*

H. How much truth must be revealed to establish loss causation?

1. Courts have held that if part of the fraud is revealed it is sufficient, at least at the pleading stage, to satisfy *Dura.* Thus, a financial fraud complaint has been held sufficient to withstand a motion for judgment on the pleadings where it alleged four specific interconnected fraudulent deals and a press release disclosing one of them was followed by a price drop. The court rejected a *Dura* challenge, holding that "While the thread of causation may be long and somewhat tortured, at this stage…Plaintiffs have alleged enough . . [there is] corrective disclosure followed by a drop in the stock price." *In re Retek Sec. Litig.*, 2005 WL 3059566 (D. Minn. Oct. 21, 2005).

2. In contrast, where a complaint was based on two separate schemes and one was revealed by the state attorney general, the court held that *Dura* was only satisfied as to the one scheme: "In essence, lead plaintiff's position is that a corrective disclosure about any questionable conduct that impacts a company's financial statements is sufficient . . . [this]would create a boundless rule, rendering meaningless the loss causation requirement . . . *See also, Marsden v. Select Medical Corp.,* 2007 WL 1725204 (E.D. Pa. Jun. 12, 2007)(same).

I. Source of the truth. The truth need not come from the company. The critical fact is that it is revealed to the market. In *In re Winstar Comm.*, 2006 WL 473885 (S.D.N.Y. Feb. 27, 2006), the complaint was based on two key allegations. One claimed that the financial statements were false. A second alleged that the company had made misrepresentations and concealed material facts about its financing status and relationship with a vendor. Subsequently, an analyst report based on public information revealed the truth. Following the report the stock price dropped. The court held that the complaint satisfied *Dura*. "The key to this [materialization] is the veracity of the information, the source." The fact that the report is from public information "does not mean that a reasonable investor could have drawn those same conclusions."

J. General bad news. Where general declining economic conditions are the cause of the price drop, *Dura* is not satisfied. In *In re Acterna Corp. Sec. Litig.*, the complaint alleged that plaintiffs purchased shares at an inflated price because the defendant fraudulently failed to write down good will from acquisitions. 378 F. Supp. 2d 561 (D. Md. 2005). During the class period the share price dropped 94%. Nevertheless the court held that the complaint failed to adequately plead loss causation: "Not only do plaintiffs not allege that the rapid decline in Acterna's share price was caused in some way by Defendant's alleged misrepresentations or omissions, their complaint suggests otherwise, alleging that prior to the class period, the global communications industry experienced a severe economic slow down that continued throughout the class period . . ." *See also In re Tellium, Inc. Sec. Litig.*, 2005 WL 1677467 (D. N.J. Jun. 30, 2005)(same).

K. Other causes.

1 Generally at the pleading stage to satisfy *Dura* it is not necessary to establish that the cause of the loss is the sole cause. In *In re Daou Systems, Inc., Sec. Litig.*, a financial fraud complaint claimed that revenues were overstated. 411 F.3d 1006 (9th Cir. 2005). By the third quarter the financial condition of the company was deteriorating. When the quarterly results were announced the price of the stock dropped. An analyst report suggested that the company was "cooking the books." The district court dismissed the complaint. The circuit court reversed in part and remanded for further proceedings holding that to establish loss causation plaintiff must demonstrate a causal link between the fraud and the injury suffered. Plaintiff is not required to show that the misrepresentation was the sole cause. Rather, plaintiff must only demonstrate that it is 'one substantial cause' for the decline in value of the shares. The fact that there are other contributing causes will not bar recovery." *See id*. at 1025.

2. Similarly, the court in *In re Geopharma Inc. Sec. Litig.*, held that all other possible causes need not be excluded to plead loss causation. 399 F. Supp 2d 432 (S.D.N.Y. Sep. 30, 2005). In that case, the complaint alleged a fraud based on a claim that a press release wrongly represented FDA approval of a dug when in fact the agency had actually approved a device. In rejecting a challenge to the complaint based on *Dura*, the court noted that: "Defendants overstate the nature of plaintiffs' burden at this stage of the proceedings when they argue that plaintiffs must exclude all other possible causes of the artificial inflation. To the contrary, plaintiffs must only allege a false or misleading statement, which caused an artificial inflation of the stock, followed by a dissipation of that inflation after corrective disclosures were made." *Id*. at 453.

VII. **Conclusion**

A. Both Congress and the courts have taken steps to curtail perceived abuses in filing securities damage actions. The goal of these limitations has been to weed out frivolous suits, while permitting those with merit to proceed.

1. Congress acted on this perception by passing the PSLRA which contained substantive and procedural limitations regarding these cases. A key part of these limitations is the pleading requirements. Those requirements incorporate the "particularity" requirements of Federal Rule of Civil Procedure 9(b). In addition, for the first time, the PSLRA imposed strict pleading requirements on the key element of "state of mind," generally determined to be scienter for fraud cases.

2. The Supreme Court, which has long expressed concern about abuses in bringing securities class actions, has imposed a substantive limitations, as well as pleading requirements. These include:

   a. Precluding the expansion of those who may be liable under antifraud provision Section 10(b) and Rule 10b-5 by concluding that the Section and Rule do not include liability for aiding and abetting and that scheme liability cannot be used to expand the reach of the statute;

   b. Bolstering the requirements of Federal Civil Rule 8(a), adding a plausibility standard;

c. Interpreting the PSLRA pleading standard regarding "state of mind" to require that plaintiff plead facts which raise an inference of scienter which is cogent and that a reasonable person would view as at least equal to any opposing inference; and

d. Concluding that the elements of the implied cause of action under Section 10(b) requires that plaintiff plead and prove loss causation, establishing a causal link between the claimed harm and loss.

3. The lower federal courts, following the lead of Congress and the Supreme Court, have tightened pleading requirements for devices such as "the group pleading doctrine" and limiting the circumstances under which "confidential informants" can be used as a source of facts for a securities law complaint.

B. Since the passage of the PSLRA in 1995 and as the courts have handed down their decisions, the number of securities damage actions has been reduced.

1. In 2007 fewer cases were filed that the prior year. However, in 2007 there were more cases filed than in any other post-PSLRA year other than 2006.

2. In 2007, there was only one settlement over $1 billion, compared to three the prior year. However, the mean settlement amount in 2007 was the highest since the passage of the PSLRA. This is due in large part to an increase in the number of settlements in the $20 million to $30 million range.

3. Some commentators have argued that the reduced number of cases is the result of less fraud. Others have argued that it may be the result of market volatility and less fraud.

4. One commentator has noted that the number of smaller cases that tend to have limited damage claims, small class periods and which are often quickly settled has diminished substantially. Those case tend to be associated with so-called "strike suits," that is, the kind of cases Congress and the courts have sought to weed out.

5. The reduced number of cases being filed each year, while consistent with the "less fraud" and "market volatility" theories, may also reflect the increased substantive and procedural requirements for brining and maintaining these cases. Those limitations may be weeding out non-meritorious cases which is

consistent with the finding that there has been a substantial reduction in the number of suits which appear to be "strike suits." At the same time the increased settlement value of those cases which have been filed suggests that those which have been brought may be more meritorious. Overall, these points suggests that the actions of Congress and the courts may be having the desired impact.

*128 S. Ct. 761, *; 169 L. Ed. 2d 627, **;*
*2008 U.S. LEXIS 1091, ***; 76 U.S.L.W. 4039*

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STONERIDGE INVESTMENT PARTNERS, LLC, PETITIONER v. SCIENTIFIC-ATLANTA, INC., ET AL.

No. 06-43

SUPREME COURT OF THE UNITED STATES

128 S. Ct. 761; 169 L. Ed. 2d 627; 2008 U.S. LEXIS 1091; 76 U.S.L.W. 4039; Fed. Sec. L. Rep. (CCH) P94,556; 21 Fla. L. Weekly Fed. S 46

October 9, 2007, Argued
January 15, 2008, Decided

NOTICE:

The LEXIS pagination of this document is subject to change pending release of the final published version.

SUBSEQUENT HISTORY: On remand at Stoneridge Inv. Partners, LLS v. Scientific-Atlanta, Inc. (In re Charter Communs., Inc.), 2008 U.S. App. LEXIS 5418 (8th Cir. Mo., Mar. 3, 2008)

PRIOR HISTORY: [*1]**
ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.
Stoneridge Investment Partners, LLS v. Scientific-Atlanta, Inc. (In re Charter Communs., Inc.), 443 F.3d 987, 2006 U.S. App. LEXIS 8798 (8th Cir. Mo., 2006)

DISPOSITION: Affirmed and remanded.

Case in Brief **($)**
Time-saving, comprehensive research tool. Includes expanded summary, extensive research and analysis, and links to LexisNexis® content and available court documents.

Expert Commentary **($)**
Wiltenburg on Court's "Reliance" Test for § 10(b) Private Causes of Action
At first blush, the Supreme Court's closely watched decision in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. appears to proclaim the demise of so-called "scheme liability." But in basing its holding on the plaintiff's inability to prove it relied on defendants' alleged deceptive conduct, the Court actually left the door ajar for colorable claims against a secondary actor. This commentary, written by David Wiltenburg, explores how the Court's attempt to draw a bright line between the "realm of financing" and the "realm of ordinary business" may be challenged by future plaintiffs in § 10(b) private actions.

Expert Commentary **($)**
Stengel, Fink, & Fournier on Stoneridge Investment v. Scientific Atlanta, Inc.
Although the Supreme Court's closely watched decision in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. would appear to toll the death knell for so-called "scheme liability," it leaves a narrow opening for plaintiffs to argue that "secondary actors" who do not themselves make actionable misrepresentations or omissions may still be liable in some circumstances. But the Court's opinion may also raise the bar for proving the reliance element in a §10(b) claim in a way that was not anticipated by the Court. This commentary, written by James Stengel, Steven Fink, and Kristen Fournier of Orrick, Herrington & Sutcliffe, LLP, explores those ambiguities and their potential impact on future §10(b) and Rule 10b-5 litigation.

Expert Commentary **($)**

Davis, Lowenthal, & Ruskin on Stoneridge Investment v. Scientific Atlanta, Inc.

The Supreme Court may not have shut the door on so-called "scheme liability" as decisively as it might have in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., but the stringent test the opinion fashions for proving reliance in a §10(b) claim makes it difficult to imagine how a private suit could ever prevail against "secondary actors" in an alleged securities fraud. This commentary, written by Evan A. Davis, Mitchell A. Lowenthal, and Nancy I. Ruskin of Cleary Gottlieb Steen & Hamilton LLP, traces the Court's determination to constrain the limits of judicially implied private §10(b) claims.

Expert Commentary **($)**

Wilson on the Supreme Court's Decision in Stoneridge Investment Partners

On January 15, 2008, the Supreme Court ruled that there is no private right of action under Section 10(b) of the 1934 Securities Exchange Act ("Exchange Act") against secondary actors (e.g., accounting firms, lawyers, suppliers and investment banks) who knowingly participated in sham transactions that helped another company violate Section 10(b) by issuing misleading public statements, but who did not themselves issue misleading public statements. The Stoneridge decision is the third from the Supreme Court in the last few years to address the reach of private class action securities claims under Section 10(b) of the Exchange Act. James Wilson discusses the the implications of the Supreme Court's decision in Stoneridge and what the immediate and long-lasting effects are.

Expert Commentary **($)**

The "Bad Apples" Perspective on Corporate Scandals: Stoneridge Investment Partners, LLC. v. Scientific-Atlanta, Inc.

On January 15, 2008, the United States Supreme Court, in Stoneridge Investment Partners, LLC. v. Scientific-Atlanta, Inc., 2008 U.S. LEXIS 1091, held that participants in a public company's fraud may not be sued by investors under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the Securities and Exchange Commission under that Act, unless they made the statements or representations that the investors relied upon in their securities trading. Significantly, the case reflects the Court's perspective that corporate fraud is the product of a few "bad apples" in a corporation's hierarchy. Professor James Fanto discusses why the major problem with the decision,in that the court's perspective does not reflect the social psychological and organizational reality of corporate fraud.

Expert Commentary **($)**

Eisenberg's Emerging issues coming from the Stoneridge Investments' decision

Could one result of Stoneridge be the shift of securities fraud litigation, involving aiding and abetting to state courts? The Supreme Court's decision in Stoneridge closes the door to the federal courts to shareholder actions under Sec. 10(b) of the Exchange Act against "secondary" actors, who are accused of aiding and abetting a securities fraud.Hailed as signal victory by business interests and by SEC Commissioner Paul Atkins as a victory for investors, will these actions now be brought by state officials, by state and municipal pension funds and by other investors that may, under the Reform Act's carve-out from the federal preemption provision, bring similar cases in state courts under their often more hospitable state antifraud statutes?

CASE SUMMARY

PROCEDURAL POSTURE: Petitioner investors sued respondent suppliers and customers under S.E.C. Rule 10b-5, 17 C.F.R. § 240.10b-5, and the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), alleging respondents' arrangements allowed the investors' company to mislead its auditor and issue a misleading financial statement. A writ of certiorari was issued to the United States Court of Appeals for the Eighth Circuit on its affirmance of the dismissal of respondents.

OVERVIEW: The Eighth Circuit correctly ruled that the allegations did not show respondents made misstatements relied upon by the public or that they violated a disclosure duty. The § 78j(b) implied private right of action did not extend to aiders and abettors. Respondents had no role in preparing or disseminating the financial statements. Respondents had no duty to disclose and their deceptive acts were not communicated to the public. No member of the investing public had knowledge of respondents' deceptive acts during the relevant times. Thus, reliance could not be shown except in an indirect chain that was too remote for liability. The company, not respondents, misled its auditor and filed fraudulent

financial statements. Nothing respondents did made it necessary or inevitable for the company to record the transactions as it did, thus, the investors' "scheme liability" theory failed. In 15 U.S.C.S. § 78t(e), Congress amended the securities laws to provide for limited coverage of aiders and abettors, in actions to be brought by the Securities and Exchange Commission, but not by private parties. Concerns with the judicial creation of a private cause of action cautioned against its expansion.

OUTCOME: The judgment of the Eighth Circuit was affirmed.

CORE TERMS: cause of action, investor, private cause of action, deceptive acts, private right of action, causation, aiding and abetting, aiders and abettors, financial statement, common-law, deceptive, misstatement, Securities Exchange Act, right of action, stock, box, securities laws, duty to disclose, fraudulent, misrepresentation, marketplace, customer, omission, auditor, issuing, fraud-on-the-market, advertising, top, remote, securities laws

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Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > General Overview

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN1 Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange to use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Securities and Exchange Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. 15 U.S.C.S. § 78j. More Like This Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN2 The Securities and Exchange Commission, pursuant to 15 U.S.C.S. § 78j, promulgated S.E.C. Rule 10b-5, which makes it unlawful (a) to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > General Overview

HN3 S.E.C. Rule 10b-5, 17 C.F.R. § 240.10b-5, encompasses only conduct already prohibited by § 10 (b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b). Though the text of the Act does not provide for a private cause of action for § 78j(b) violations, a right of action has been found to be implied in the words of the statute and its implementing regulation. In a typical § 78j(b) private action, a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Secondary Liability > Aiding & Abetting > Private Actions

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Reliance > General Overview
Securities Law > Liability > Statutory Application & Interpretation

HN4 15 U.S.C.S. § 78j(b) does not extend to aiders and abettors. The scope of § 78j(b) is delimited by the text, which makes no mention of aiding and abetting liability. Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on S.E.C. Rule 10b-5, 17 C.F.R. § 240.10b-5, recovery mandated by earlier cases. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Secondary Liability > Aiding & Abetting > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN5 In § 104 of the Private Securities Litigation Reform Act of 1995, 109 Stat. 757, Congress directed prosecution of aiders and abettors by the Securities and Exchange Commission. 15 U.S.C.S. § 78t(e). More Like This Headnote

Securities Law > Liability > Secondary Liability > Aiding & Abetting > Private Actions
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > General Overview

HN6 The § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), implied private right of action does not extend to aiders and abettors. The conduct of a secondary actor must satisfy each of the elements or preconditions for liability. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN7 Conduct itself can be deceptive under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), or S.E.C. Rule 10b-5, 17 C.F.R. § 240.10b-5. More Like This Headnote | *Shepardize:* Restrict By Headnote

Evidence > Inferences & Presumptions > Creation of Presumptions
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Duty to Disclose
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Reliance > Fraud on the Market

HN8 Reliance by a plaintiff upon a defendant's deceptive acts is an essential element of the § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), private cause of action. It ensures that, for liability to arise, the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury exists as a predicate for liability. Courts have found a rebuttable presumption of reliance in two different circumstances. First, if there is an omission of a material fact by one with a duty to disclose, the investor to whom the duty was owed need not provide specific proof of reliance. Second, under the fraud-on-the-market doctrine, reliance is presumed when the statements at issue become public. The public information is reflected in the market price of the security. Then it can be assumed that an investor who buys or sells stock at the market price relies upon the statement. More Like This Headnote

Securities Law > Liability > Secondary Liability > Aiding & Abetting > Elements of Proof

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Causation
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Reliance > General Overview

HN9 Reliance under § 10(b) of the Securities Exchange Act of 1934 is tied to causation, leading to the inquiry whether respondents' acts were immediate or remote to the injury. Section 10(b) provides that the deceptive act must be in connection with the purchase or sale of any security. 15 U.S.C.S. § 78j(b). Though this phrase in part defines the statute's coverage rather than causation, the emphasis on a purchase or sale of securities does provide some insight into the deceptive acts that concerned the enacting Congress. More Like This Headnote

Securities Law > Liability > Securities Act of 1933 Actions > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > General Overview

HN10 Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud. More Like This Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Causation

HN11 Though § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), is not limited to preserving the integrity of the securities markets, it does not reach all commercial transactions that are fraudulent and affect the price of a security in some attenuated way. More Like This Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > General Overview

HN12 Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), does not incorporate common law fraud into federal law. Just as § 78j(b) is surely badly strained when construed to provide a cause of action to the world at large, it should not be interpreted to provide a private cause of action against the entire marketplace in which the issuing company operates. More Like This Headnote

Securities Law > Liability > Secondary Liability > Aiding & Abetting > Private Actions

HN13 In § 104 of the Private Securities Litigation Reform Act of 1995, 109 Stat. 757, Congress amended the securities laws to provide for limited coverage of aiders and abettors. Aiding and abetting liability is authorized in actions brought by the Securities and Exchange Commission but not by private parties. 15 U.S.C.S. § 78t(e). More Like This Headnote

Governments > Legislation > Interpretation

HN14 The express provision of one method of enforcing a substantive rule suggests that Congress intended to preclude others. More Like This Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > General Overview
Securities Law > Liability > Statutory Application & Interpretation

HN15 The § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), private cause of action is a judicial construct that Congress did not enact in the text of the relevant statutes. Though the rule once may have been otherwise, it is settled that there is an implied cause of action only if the underlying statute can be interpreted to disclose the intent to create one. More Like This Headnote

Constitutional Law > The Judiciary > Congressional Limits

Governments > Courts > Common Law

HN16 In the absence of congressional intent, the Judiciary's recognition of an implied private right of action necessarily extends its authority to embrace a dispute Congress has not assigned it to resolve. This runs contrary to the established principle that the jurisdiction of the federal courts is carefully guarded against expansion by judicial interpretation, and conflicts with the authority of Congress under U.S. Const. art. III to set the limits of federal jurisdiction. The determination of who can seek a remedy has significant consequences for the reach of federal power. More Like This Headnote

Securities Law > Liability > Secondary Liability > Aiding & Abetting > Private Actions
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN17 Though it remains the law, the private right of action under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), should not be extended beyond its present boundaries. More Like This Headnote

Securities Law > Liability > Secondary Liability > Aiding & Abetting > Private Actions
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN18 The Private Securities Litigation Reform Act of 1995 (PSLRA) imposed heightened pleading requirements and a loss causation requirement upon "any private action" arising from the Securities Exchange Act of 1934. 15 U.S.C.S. § 78u-4(b). It is clear these requirements touch upon the implied right of action, which is now a prominent feature of federal securities regulation. Congress thus ratified the implied right of action after the United States Supreme Court moved away from a broad willingness to imply private rights of action. It is appropriate to assume that when § 78u-4 was enacted, Congress accepted the § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), private cause of action as then defined but chose to extend it no further. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Secondary Liability > General Overview
Securities Law > U.S. Securities & Exchange Commission > Penalties & Unlawful Representations

HN19 Secondary actors are subject to criminal penalties and civil enforcement by the Securities and Exchange Commission. The enforcement power is not toothless. More Like This Headnote

Securities Law > Liability > Secondary Liability > Primary & Secondary Liability
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN20 The securities statutes provide an express private right of action against accountants and underwriters in certain circumstances, 15 U.S.C.S. § 77k, and the implied right of action in § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), continues to cover secondary actors who commit primary violations. More Like This Headnote | *Shepardize:* Restrict By Headnote

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SYLLABUS

Alleging losses after purchasing Charter Communications, Inc., common stock, petitioner filed suit against respondents and others under § 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission (SEC) Rule 10b-5. Acting as Charter's customers and suppliers, respondents had agreed to arrangements that allowed Charter to mislead its auditor and issue a misleading financial statement affecting its stock price, but they had no role in preparing or disseminating the financial statement. Affirming the District Court's dismissal of respondents, the Eighth Circuit ruled that the allegations did not show that respondents made misstatements relied upon by the public or violated a duty to disclose. The court observed that, at most, respondents had aided and abetted Charter's misstatement, and noted that the private cause of action this Court has found implied in § 10(b) and Rule 10b-5, *Superintendent of Ins. of N. Y.* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13, n. 9, 92 S. Ct. 165, 30 L. Ed. 2d 128, does not extend to aiding and abetting a § 10(b) violation, see *Central Bank of Denver, N. A.* v. *First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 191, 114 S. Ct. 1439, 128 L. Ed. 2d 119.

Held: **[***2]** The § 10(b) private right of action does not reach respondents because Charter investors did not rely upon respondents' statements or representations. Pp. 5-16.

(a) Although *Central Bank* prompted calls for creation of an express cause of action for aiding and abetting, Congress did not follow this course. Instead, in § 104 of the Private Securities Litigation Reform Act of 1995 (PSLRA), it directed the SEC to prosecute aiders and abettors. Thus, the § 10(b) private right of action does not extend to aiders and abettors. Because the conduct of a secondary actor must therefore satisfy each of the elements or preconditions for § 10(b) liability, the plaintiff must prove, as here relevant, reliance upon a material misrepresentation or omission by the defendant. Pp. 5-7.

(b) The Court has found a rebuttable presumption of reliance in two circumstances. First, if there is an omission of a material fact by one with a duty to disclose, the investor to whom the duty was owed need not provide specific proof of reliance. *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128, 153-154, 92 S. Ct. 1456, 31 L. Ed. 2d 741. Second, under the fraud-on-the-market doctrine, reliance is presumed when the statements at issue become **[***3]** public. Neither presumption applies here: Respondents had no duty to disclose; and their deceptive acts were not communicated to the investing public during the relevant times. Petitioner, as a result, cannot show reliance upon any of respondents' actions except in an indirect chain that is too remote for liability. P. 8.

(c) Petitioner's reference to so-called "scheme liability" does not, absent a public statement, answer the objection that petitioner did not in fact rely upon respondents' deceptive conduct. Were the Court to adopt petitioner's concept of reliance--*i.e.*, that in an efficient market investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect--the implied cause of action would reach the whole marketplace in which the issuing company does business. There is no authority for this rule. Reliance is tied to causation, leading to the inquiry whether respondents' deceptive acts were immediate or remote to the injury. Those acts, which were not disclosed to the investing public, are too remote to satisfy the reliance requirement. It was Charter, not respondents, that misled its auditor and filed fraudulent **[***4]** financial statements; nothing respondents did made it necessary or inevitable for Charter to record the transactions as it did. The Court's precedents counsel against petitioner's attempt to extend the § 10(b) private cause of action beyond the securities markets into the realm of ordinary business operations, which are governed, for the most part, by state law. See, *e.g.*, *Marine Bank* v. *Weaver*, 455 U.S. 551, 556, 102 S. Ct. 1220, 71 L. Ed. 2d 409. The argument that there could be a reliance finding if this were a common-law fraud action is answered by the fact that § 10(b) does not incorporate common-law fraud into federal law, see, *e.g.*, *SEC* v. *Zandford*, 535 U.S. 813, 820, 122 S. Ct. 1899, 153 L. Ed. 2d 1, and should not be interpreted to provide a private cause of action against the entire marketplace in which the issuing company operates, cf. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 733, n. 5, 95 S. Ct. 1917, 44 L. Ed. 2d 539. Petitioner's theory, moreover, would put an unsupportable interpretation on Congress' specific response to *Central Bank* in PSLRA § 104 by, in substance, reviving the implied cause of action against most aiders and abettors and thereby undermining Congress' determination that this class of defendants should be pursued only by the SEC. The practical **[***5]** consequences of such an expansion provide a further reason to reject petitioner's approach. The extensive discovery and the potential for uncertainty and disruption in a lawsuit could allow plaintiffs with weak claims to extort settlements from innocent companies. See, *e.g.*, *Blue Chip*, *supra*, at 740-741, 95 S. Ct. 1917, 44 L. Ed. 2d 539. It would also expose to such risks a new class of defendants--overseas firms with no other exposure to U.S. securities laws--thereby deterring them from doing business here, raising the cost of being a

publicly traded company under U.S. law, and shifting securities offerings away from domestic capital markets. Pp. 8-13.

(d) Upon full consideration, the history of the § 10(b) private right of action and the careful approach the Court has taken before proceeding without congressional direction provide further reasons to find no liability here. The § 10(b) private cause of action is a judicial construct that Congress did not direct in the text of the relevant statutes. See, *e.g.*, *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 358-359, 111 S. Ct. 2773, 115 L. Ed. 2d 321. Separation of powers provides good reason for the now-settled view that an implied cause of action exists only if the underlying statute **[***6]** can be interpreted to disclose the intent to create one, see, *e.g.*, *Alexander* v. *Sandoval*, 532 U.S. 275, 286-287, 121 S. Ct. 1511, 149 L. Ed. 2d 517. The decision to extend the cause of action is thus for the Congress, not for this Court. This restraint is appropriate in light of the PSLRA, in which Congress ratified the implied right of action after the Court moved away from a broad willingness to imply such private rights, see, *e.g.*, *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 381-382, 102 S. Ct. 1825, 72 L. Ed. 2d 182, and n. 66. It is appropriate for the Court to assume that when PSLRA § 104 was enacted, Congress accepted the § 10(b) private right as then defined but chose to extend it no further. See, *e.g.*, *Alexander, supra*, at 286-287, 121 S. Ct. 1511, 149 L. Ed. 2d 517. Pp. 13-15.

443 F.3d 987, affirmed and remanded.

COUNSEL: **Stanley M. Grossman** argued the cause for petitioner.

Stephen M. Shapiro argued the cause for respondents.

Thomas G. Hungar argued the cause for the United States, as amicus curiae, by special leave of court.

JUDGES: KENNEDY, J., delivered the opinion of the Court, in which ROBERTS, C. J., and SCALIA, THOMAS, and ALITO, JJ., joined. STEVENS, J., filed a dissenting opinion, in which SOUTER and GINSBURG, JJ., joined. BREYER, J., took no part in the consideration or decision of the case.

OPINION BY: KENNEDY

OPINION

[*766] **[**634]** JUSTICE KENNEDY delivered the opinion of the Court.

We consider the reach of the private right of action the Court has found implied in § 10(b) of the Securities Exchange **[***7]** Act of 1934, 48 Stat. 891, as amended, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 CFR § 240.10b-5 (2007). In this suit investors alleged losses after purchasing common stock. They sought to impose liability on entities who, acting both as customers and suppliers, agreed to arrangements that allowed the investors' company to mislead its auditor and issue a misleading financial statement affecting the stock price. We conclude the implied right of action does not reach the customer/supplier companies because the investors did not rely upon their statements or representations. We affirm the judgment of the Court of Appeals.

I

This class-action suit by investors was filed against Charter Communications, Inc., in the United States District Court for the Eastern District of Missouri. Stoneridge Investment Partners, LLC, a limited liability company organized under the laws of Delaware, was the lead plaintiff and is petitioner here.

Charter issued the financial statements **[**635]** and the securities in question. It was a named defendant along with some of its executives and Arthur Andersen LLP, Charter's independent auditor during the period in question. We are concerned, though, with two other defendants, **[***8]** respondents here. Respondents are Scientific-Atlanta, Inc., and Motorola, Inc. They were suppliers, and later customers, of Charter.

For purposes of this proceeding, we take these facts, alleged by petitioner, to be true. Charter, a cable

operator, engaged in a variety of fraudulent practices so its quarterly reports would meet Wall Street expectations for cable subscriber growth and operating cash flow. The fraud included misclassification of its customer base; delayed reporting of terminated customers; improper capitalization of costs that should have been shown as expenses; and manipulation of the company's billing cutoff dates to inflate reported revenues. In late 2000, Charter executives realized that, despite these efforts, the company would miss projected operating cash flow numbers by $ 15 to $ 20 million. To help meet the shortfall, Charter decided to alter its existing arrangements with respondents, Scientific-Atlanta and Motorola. Petitioner's theory as to whether Arthur Andersen was altogether misled or, on the other hand, knew the structure of the contract arrangements and was complicit to some degree, is not clear at this stage of the case. The point, however, is neither **[***9]** controlling nor significant for our present disposition, and in our decision we assume it was misled.

Respondents supplied Charter with the digital cable converter (set top) boxes that Charter furnished to its customers. Charter arranged to overpay respondents $ 20 for each set top box it purchased until the end of the year, with the understanding that respondents would return the overpayment by purchasing advertising from Charter. The transactions, it is alleged, had no economic substance; but, because Charter would then record the advertising purchases as revenue and capitalize its purchase of the set top boxes, in violation of generally accepted accounting principles, the transactions would enable Charter to fool its auditor into approving a financial statement showing it met projected revenue and operating cash flow numbers. Respondents agreed to the arrangement.

[*767] So that Arthur Andersen would not discover the link between Charter's increased payments for the boxes and the advertising purchases, the companies drafted documents to make it appear the transactions were unrelated and conducted in the ordinary course of business. Following a request from Charter, Scientific-Atlanta sent **[***10]** documents to Charter stating--falsely--that it had increased production costs. It raised the price for set top boxes for the rest of 2000 by $ 20 per box. As for Motorola, in a written contract Charter agreed to purchase from Motorola a specific number of set top boxes and pay liquidated damages of $ 20 for each unit it did not take. The contract was made with the expectation Charter would fail to purchase all the units and pay Motorola the liquidated damages.

To return the additional money from the set top box sales, Scientific-Atlanta and Motorola signed contracts with Charter to purchase advertising time for a price higher than fair value. The new set top box agreements were backdated to make it appear that they were negotiated a **[**636]** month before the advertising agreements. The backdating was important to convey the impression that the negotiations were unconnected, a point Arthur Andersen considered necessary for separate treatment of the transactions. Charter recorded the advertising payments to inflate revenue and operating cash flow by approximately $ 17 million. The inflated number was shown on financial statements filed with the Securities and Exchange Commission (SEC) and reported **[***11]** to the public.

Respondents had no role in preparing or disseminating Charter's financial statements. And their own financial statements booked the transactions as a wash, under generally accepted accounting principles. It is alleged respondents knew or were in reckless disregard of Charter's intention to use the transactions to inflate its revenues and knew the resulting financial statements issued by Charter would be relied upon by research analysts and investors.

Petitioner filed a securities fraud class action on behalf of purchasers of Charter stock alleging that, by participating in the transactions, respondents violated § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

The District Court granted respondents' motion to dismiss for failure to state a claim on which relief can be granted. The United States Court of Appeals for the Eighth Circuit affirmed. *In re Charter Communications, Inc., Securities Litigation*, 443 F.3d 987 (2006). In its view the allegations did not show that respondents made misstatements relied upon by the public or that they violated a duty to disclose; and on this premise it found no violation of § 10(b) by respondents. *Id.*, at 992. At most, **[***12]** the court observed, respondents had aided and abetted Charter's misstatement of its financial results; but, it noted, there is no private right of action for aiding and abetting a § 10(b) violation. See *Central Bank of Denver, N. A. v. First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 191, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994). The court also affirmed the District Court's denial of petitioner's motion to amend the complaint, as the revised pleading would not change the court's conclusion on the merits. 443 F.3d at 993.

Decisions of the Courts of Appeals are in conflict respecting when, if ever, an injured investor may rely upon § 10(b) to recover from a party that neither makes a public misstatement nor violates a duty to disclose but does participate in a scheme to violate § 10(b). Compare *Simpson* v. *AOL Time Warner Inc.*, 452 F.3d 1040 (CA9 2006), with *Regents of Univ. of Cal.* v. *Credit Suisse First Boston (USA), Inc.*, **[*768]** 482 F.3d 372 (CA5 2007). We granted certiorari. 549 U.S. , 127 S. Ct. 1873, 167 L. Ed. 2d 363 (2007).

II

HN1 Section 10(b) of the Securities Exchange Act makes it

> "unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities **[***13]** exchange . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary **[**637]** or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j.

HN2 The SEC, pursuant to this section, promulgated Rule 10b-5, which makes it unlawful

> "(a) To employ any device, scheme, or artifice to defraud,
>
> "(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, "in connection with the purchase or sale of any security." 17 CFR § 240.10b-5.

HN3 Rule 10b-5 encompasses only conduct already prohibited by § 10(b). *United States* v. *O'Hagan*, 521 U.S. 642, 651, 117 S. Ct. 2199, 138 L. Ed. 2d 724 (1997). Though the text of the Securities Exchange Act does not provide for a private cause of action for § 10(b) violations, the Court has found a right of action implied in the words of the statute **[***14]** and its implementing regulation. *Superintendent of Ins. of N. Y.* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13, n. 9, 92 S. Ct. 165, 30 L. Ed. 2d 128 (1971). In a typical § 10(b) private action a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation. See *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 341-342, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005).

In *Central Bank*, the Court determined that HN4 § 10(b) liability did not extend to aiders and abettors. The Court found the scope of § 10(b) to be delimited by the text, which makes no mention of aiding and abetting liability. 511 U.S., at 177, 114 S. Ct. 1439, 128 L. Ed. 2d 119. The Court doubted the implied § 10 (b) action should extend to aiders and abettors when none of the express causes of action in the securities Acts included that liability. *Id.*, at 180, 114 S. Ct. 1439, 128 L. Ed. 2d 119. It added the following:

> "Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions. See also *Chiarella* [v. *United States*, 445 U.S. 222, 228, 100 S. Ct. 1108, 63 L. Ed. 2d 348 (1980)]. **[***15]** Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases." *Ibid.*

The decision in *Central Bank* led to calls for Congress to create an express cause of action for aiding and abetting within the Securities Exchange Act. Then-SEC Chairman Arthur Levitt, testifying before the Senate Securities Subcommittee, cited *Central Bank* and recommended that aiding **[*769]** and abetting liability in private claims be established. S. Hearing No. 103-759, pp. 13-14 (1994). Congress did not follow this

course. Instead, HN5 in § 104 of the Private Securities Litigation Reform Act of 1995 (PSLRA), 109 Stat. 757, it directed prosecution of aiders and abettors by the SEC. 15 U.S.C. § 78t(e).

[638]** HN6 The § 10(b) implied private right of action does not extend to aiders and abettors. The conduct of a secondary actor must satisfy each of the elements or preconditions for liability; and we consider whether the allegations here are sufficient to do so.

III

The Court of Appeals concluded petitioner had not alleged that respondents engaged in a deceptive act within the reach of the § 10(b) private right of action, noting that only misstatements, omissions **[***16]** by one who has a duty to disclose, and manipulative trading practices (where "manipulative" is a term of art, see, *e.g.*, *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 476-477, 97 S. Ct. 1292, 51 L. Ed. 2d 480 (1977)) are deceptive within the meaning of the rule. 443 F.3d at 992. If this conclusion were read to suggest there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5, it would be erroneous. HN7 Conduct itself can be deceptive, as respondents concede. In this case, moreover, respondents' course of conduct included both oral and written statements, such as the backdated contracts agreed to by Charter and respondents.

A different interpretation of the holding from the Court of Appeals opinion is that the court was stating only that any deceptive statement or act respondents made was not actionable because it did not have the requisite proximate relation to the investors' harm. That conclusion is consistent with our own determination that respondents' acts or statements were not relied upon by the investors and that, as a result, liability cannot be imposed upon respondents.

A

HN8 Reliance by the plaintiff upon the defendant's deceptive acts is an essential element **[***17]** of the § 10(b) private cause of action. It ensures that, for liability to arise, the "requisite causal connection between a defendant's misrepresentation and a plaintiff's injury" exists as a predicate for liability. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 243, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988); see also *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128, 154, 92 S. Ct. 1456, 31 L. Ed. 2d 741 (1972) (requiring "causation in fact"). We have found a rebuttable presumption of reliance in two different circumstances. First, if there is an omission of a material fact by one with a duty to disclose, the investor to whom the duty was owed need not provide specific proof of reliance. *Id.*, at 153-154, 92 S. Ct. 1456, 31 L. Ed. 2d 741. Second, under the fraud-on-the-market doctrine, reliance is presumed when the statements at issue become public. The public information is reflected in the market price of the security. Then it can be assumed that an investor who buys or sells stock at the market price relies upon the statement. *Basic, supra*, at 247, 108 S. Ct. 978, 99 L. Ed. 2d 194.

Neither presumption applies here. Respondents had no duty to disclose; and their deceptive acts were not communicated to the public. No member of the investing public had knowledge, either actual or presumed, of respondents' deceptive **[***18]** acts during the relevant times. Petitioner, as a result, cannot show reliance upon any of respondents' actions except in an indirect chain that we find too remote for liability.

[*770] [639]** B

Invoking what some courts call "scheme liability," see, *e.g.*, *In re Enron Corp. Secs. v. Enron Corp.*, 439 F. Supp. 2d 692, 723 (SD Tex. 2006), petitioner nonetheless seeks to impose liability on respondents even absent a public statement. In our view this approach does not answer the objection that petitioner did not in fact rely upon respondents' own deceptive conduct.

Liability is appropriate, petitioner contends, because respondents engaged in conduct with the purpose and effect of creating a false appearance of material fact to further a scheme to misrepresent Charter's revenue. The argument is that the financial statement Charter released to the public was a natural and expected consequence of respondents' deceptive acts; had respondents not assisted Charter, Charter's auditor would not have been fooled, and the financial statement would have been a more accurate reflection of Charter's financial condition. That causal link is sufficient, petitioner argues, to apply *Basic*'s presumption **[***19]** of reliance to respondents' acts. See, *e.g.*, *Simpson*, 452 F.3d at 1051-1052; *In re*

Parmalat Securities Litigation, 376 F. Supp. 2d 472, 509 (SDNY 2005).

In effect petitioner contends that in an efficient market investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect. Were this concept of reliance to be adopted, the implied cause of action would reach the whole marketplace in which the issuing company does business; and there is no authority for this rule.

As stated above, HN9 reliance is tied to causation, leading to the inquiry whether respondents' acts were immediate or remote to the injury. In considering petitioner's arguments, we note § 10(b) provides that the deceptive act must be "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b). Though this phrase in part defines the statute's coverage rather than causation (and so we do not evaluate the "in connection with" requirement of § 10(b) in this case), the emphasis on a purchase or sale of securities does provide some insight into the deceptive acts that concerned the enacting Congress. See Black, Securities Commentary: The Second Circuit's **[***20]** Approach to the 'In Connection With' Requirement of Rule 10b-5, 53 Brooklyn L. Rev. 539, 541 (1987) ("While the 'in connection with' and causation requirements are analytically distinct, they are related to each other, and discussion of the first requirement may merge with discussion of the second"). In all events we conclude respondents' deceptive acts, which were not disclosed to the investing public, are too remote to satisfy the requirement of reliance. It was Charter, not respondents, that misled its auditor and filed fraudulent financial statements; nothing respondents did made it necessary or inevitable for Charter to record the transactions as it did.

The petitioner invokes the private cause of action under § 10(b) and seeks to apply it beyond the securities markets--the realm of financing business--to purchase and supply contracts--the realm of ordinary business operations. The latter realm is governed, for the most part, by state law. It is true that if business operations are used, as alleged here, to affect securities markets, the SEC enforcement power may reach the culpable actors. It is true as well that a **[**640]** dynamic, free economy presupposes a high degree of integrity in **[***21]** all of its parts, an integrity that must be underwritten by rules enforceable in fair, independent, accessible courts. Were the implied cause of action to be extended to the practices described here, however, **[*771]** there would be a risk that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees. Our precedents counsel against this extension. See *Marine Bank* v. *Weaver*, 455 U.S. 551, 556, 102 S. Ct. 1220, 71 L. Ed. 2d 409 (1982) (HN10 "Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud"); *Santa Fe*, 430 U.S., at 479-480, 97 S. Ct. 1292, 51 L. Ed. 2d 480 ("There may well be a need for uniform federal fiduciary standards . . . . But those standards should not be supplied by judicial extension of § 10(b) and Rule 10b-5 to 'cover the corporate universe'" (quoting Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 Yale L. J. 663, 700 (1974))). HN11 Though § 10(b) is "not 'limited to preserving the integrity of the securities markets,'" *Bankers Life*, 404 U.S., at 12, 92 S. Ct. 165, 30 L. Ed. 2d 128, it does not reach all commercial transactions that are fraudulent and affect the price of a security in some attenuated **[***22]** way.

These considerations answer as well the argument that if this were a common-law action for fraud there could be a finding of reliance. Even if the assumption is correct, it is not controlling. HN12 Section 10(b) does not incorporate common-law fraud into federal law. See, *e.g.*, *SEC* v. *Zandford*, 535 U.S. 813, 820, 122 S. Ct. 1899, 153 L. Ed. 2d 1 (2002) ("[Section 10(b)] must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation"); *Central Bank*, 511 U.S., at 184, 114 S. Ct. 1439, 128 L. Ed. 2d 119 ("Even assuming . . . a deeply rooted background of aiding and abetting tort liability, it does not follow that Congress intended to apply that kind of liability to the private causes of action in the securities Acts"); see also *Dura*, 544 U.S., at 341, 125 S. Ct. 1627, 161 L. Ed. 2d 577. Just as § 10(b) "is surely badly strained when construed to provide a cause of action . . . to the world at large," *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 733, n. 5, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975), it should not be interpreted to provide a private cause of action against the entire marketplace in which the issuing company operates.

Petitioner's theory, moreover, would put an unsupportable interpretation on Congress' specific response to *Central Bank* HN13 in § 104 of the PSLRA. Congress **[***23]** amended the securities laws to provide for limited coverage of aiders and abettors. Aiding and abetting liability is authorized in actions brought by the SEC but not by private parties. See 15 U.S.C. § 78t(e). Petitioner's view of primary liability makes any aider and abettor liable under § 10(b) if he or she committed a deceptive act in the process of providing assistance. Reply Brief for Petitioner 6, n. 2; Tr. of Oral Arg. 24. Were we to adopt this construction of § 10

(b), it would revive in substance the implied cause of action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud; and we would undermine Congress' determination **[**641]** that this class of defendants should be pursued by the SEC and not by private litigants. See *Alexander* v. *Sandoval*, 532 U.S. 275, 290, 121 S. Ct. 1511, 149 L. Ed. 2d 517 (2001) (HN14 "The express provision of one method of enforcing a substantive rule suggests that Congress intended to preclude others"); *FDA* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 143, 120 S. Ct. 1291, 146 L. Ed. 2d 121 (2000) ("At the time a statute is enacted, it may have a range of plausible meanings. Over time, however, subsequent acts can shape or focus those meanings"); see also *Seatrain Shipbuilding Corp.* v. *Shell Oil Co.*, 444 U.S. 572, 596, 100 S. Ct. 800, 63 L. Ed. 2d 36 (1980) **[***24]** ("While the views of subsequent Congresses **[*772]** cannot override the unmistakable intent of the enacting one, such views are entitled to significant weight, and particularly so when the precise intent of the enacting Congress is obscure" (citations omitted)).

This is not a case in which Congress has enacted a regulatory statute and then has accepted, over a long period of time, broad judicial authority to define substantive standards of conduct and liability. Cf. *Leegin Creative Leather Prods.* v. *PSKS, Inc.*, 551 U.S. , , 127 S. Ct. 2705, 168 L. Ed. 2d 623 (2007) (slip op., at 19-20). And in accord with the nature of the cause of action at issue here, we give weight to Congress' amendment to the Act restoring aiding and abetting liability in certain cases but not others. The amendment, in our view, supports the conclusion that there is no liability.

The practical consequences of an expansion, which the Court has considered appropriate to examine in circumstances like these, see *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1104-1105, 111 S. Ct. 2749, 115 L. Ed. 2d 929 (1991); *Blue Chip*, 421 U.S., at 737, 95 S. Ct. 1917, 44 L. Ed. 2d 539, provide a further reason to reject petitioner's approach. In *Blue Chip*, the Court noted that extensive discovery and the potential for uncertainty **[***25]** and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies. *Id.*, at 740-741, 95 S. Ct. 1917, 44 L. Ed. 2d 539. Adoption of petitioner's approach would expose a new class of defendants to these risks. As noted in *Central Bank*, contracting parties might find it necessary to protect against these threats, raising the costs of doing business. See 511 U.S., at 189, 114 S. Ct. 1439, 128 L. Ed. 2d 119. Overseas firms with no other exposure to our securities laws could be deterred from doing business here. See Brief for Organization for International Investment et al. as *Amici Curiae* 17-20. This, in turn, may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets. Brief for NASDAQ Stock Market, Inc., et al. as *Amici Curiae* 12-14.

C

The history of the § 10(b) private right and the careful approach the Court has taken before proceeding without congressional direction provide further reasons to find no liability here. HN15 The § 10(b) private cause of action is a judicial construct that Congress did not enact in the text of the relevant statutes. See *Lampf, Pleva, Lipkind, Prupis & Petigrow* v. *Gilbertson*, 501 U.S. 350, 358-359, 111 S. Ct. 2773, 115 L. Ed. 2d 321 (1991); *Blue Chip, supra*, at 729, 95 S. Ct. 1917, 44 L. Ed. 2d 539. **[***26]** Though the rule once may have been otherwise, see *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432-433, **[**642]** 84 S. Ct. 1555, 12 L. Ed. 2d 423 (1964), it is settled that there is an implied cause of action only if the underlying statute can be interpreted to disclose the intent to create one, see, *e.g.*, *Alexander, supra*, at 286-287, 121 S. Ct. 1511, 149 L. Ed. 2d 517; *Virginia Bankshares, supra*, at 1102; *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 575, 99 S. Ct. 2479, 61 L. Ed. 2d 82 (1979). This is for good reason. HN16 In the absence of congressional intent the Judiciary's recognition of an implied private right of action

> "necessarily extends its authority to embrace a dispute Congress has not assigned it to resolve. This runs contrary to the established principle that 'the jurisdiction of the federal courts is carefully guarded against expansion by judicial interpretation . . . ,' *American Fire & Casualty Co.* v. *Finn*, 341 U.S. 6, 17, 71 S. Ct. 534, 95 L. Ed. 702 (1951), and conflicts with the authority of Congress under Art. III to set the limits of federal jurisdiction." *Cannon* v. *University of* **[*773]** *Chicago*, 441 U.S. 677, 746, 99 S. Ct. 1946, 60 L. Ed. 2d 560 (1979) (Powell, J., dissenting) (citations and footnote omitted).

The determination of who can seek a remedy has significant consequences for the reach of federal power. See *Wilder* v. *Virginia Hosp. Ass'n*, 496 U.S. 498, 509, n. 9, 110 S. Ct. 2510, 110 L. Ed. 2d 455 (1990) **[***27]** (requirement of congressional intent "reflects a concern, grounded in separation of powers, that

Congress rather than the courts controls the availability of remedies for violations of statutes").

Concerns with the judicial creation of a private cause of action caution against its expansion. The decision to extend the cause of action is for Congress, not for us.[HN17] Though it remains the law, the § 10(b) private right should not be extended beyond its present boundaries. See *Virginia Bankshares, supra*, at 1102, 111 S. Ct. 2749, 115 L. Ed. 2d 929 ("The breadth of the [private right of action] once recognized should not, as a general matter, grow beyond the scope congressionally intended"); see also *Central Bank, supra*, at 173, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (determining that the scope of conduct prohibited is limited by the text of § 10(b)).

This restraint is appropriate in light of [HN18] the PSLRA, which imposed heightened pleading requirements and a loss causation requirement upon "any private action" arising from the Securities Exchange Act. See 15 U.S.C. § 78u-4(b). It is clear these requirements touch upon the implied right of action, which is now a prominent feature of federal securities regulation. See *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 81-82, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (2006); **[***28]** *Dura*, 544 U.S., at 345-346, 125 S. Ct. 1627, 161 L. Ed. 2d 577; see also S. Rep. No. 104-98, p. 4-5 (1995) (recognizing the § 10(b) implied cause of action, and indicating the PSLRA was intended to have "Congress . . . reassert its authority in this area"); *id.*, at 26 (indicating the pleading standards covered § 10(b) actions). Congress thus ratified the implied right of action after the Court moved away from a broad willingness to imply private rights of action. See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 381-382, 102 S. Ct. 1825, 72 L. Ed. 2d 182, and n. 66 (1982); cf. *Borak, supra*, at 433, 84 S. Ct. 1555, 12 L. Ed. 2d 423. It is **[**643]** appropriate for us to assume that when § 78u-4 was enacted, Congress accepted the § 10(b) private cause of action as then defined but chose to extend it no further.

IV

[HN19] Secondary actors are subject to criminal penalties, see, *e.g.*, 15 U.S.C. § 78ff, and civil enforcement by the SEC, see, *e.g.*, § 78t(e). The enforcement power is not toothless. Since September 30, 2002, SEC enforcement actions have collected over $ 10 billion in disgorgement and penalties, much of it for distribution to injured investors. See SEC, 2007 Performance and Accountability Report, p. 26, http://www.sec.gov/about/secpar2007.shtml (as visited Jan. 2, 2008, and **[***29]** available in Clerk of Court's case file). And in this case both parties agree that criminal penalties are a strong deterrent. See Brief for Respondents 48; Reply Brief for Petitioner 17. In addition some state securities laws permit state authorities to seek fines and restitution from aiders and abettors. See, *e.g.*, Del. Code Ann., Tit. 6, § 7325 (2005). All secondary actors, furthermore, are not necessarily immune from private suit. [HN20] The securities statutes provide an express private right of action against accountants and underwriters in certain circumstances, see 15 U.S.C. § 77k, and the implied right of action in § 10(b) continues to cover secondary actors who **[*774]** commit primary violations. *Central Bank, supra*, at 191, 114 S. Ct. 1439, 128 L. Ed. 2d 119.

Here respondents were acting in concert with Charter in the ordinary course as suppliers and, as matters then evolved in the not so ordinary course, as customers. Unconventional as the arrangement was, it took place in the marketplace for goods and services, not in the investment sphere. Charter was free to do as it chose in preparing its books, conferring with its auditor, and preparing and then issuing its financial statements. In these circumstances the investors cannot **[***30]** be said to have relied upon any of respondents' deceptive acts in the decision to purchase or sell securities; and as the requisite reliance cannot be shown, respondents have no liability to petitioner under the implied right of action. This conclusion is consistent with the narrow dimensions we must give to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.

The judgment of the Court of Appeals is affirmed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

JUSTICE BREYER took no part in the consideration or decision of this case.

DISSENT BY: STEVENS

DISSENT

JUSTICE STEVENS, with whom JUSTICE SOUTER and JUSTICE GINSBURG join, dissenting.

Charter Communications, Inc., inflated its revenues by $ 17 million in order to cover up a $ 15 to $ 20 million expected cash flow shortfall. It could not have done so absent the knowingly fraudulent actions of Scientific-Atlanta, Inc., and Motorola, Inc. Investors relied on Charter's revenue statements in deciding whether to invest in Charter and in doing so relied on respondents' fraud, which was itself a "deceptive device" prohibited by § 10(b) of the Securities **[***31]** Exchange Act **[**644]** of 1934. 15 U.S.C. § 78j (b). This is enough to satisfy the requirements of § 10(b) and enough to distinguish this case from *Central Bank of Denver, N. A. v. First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994).

The Court seems to assume that respondents' alleged conduct could subject them to liability in an enforcement proceeding initiated by the Government, *ante,* at 15, but nevertheless concludes that they are not subject to liability in a private action brought by injured investors because they are, at most, guilty of aiding and abetting a violation of § 10(b), rather than an actual violation of the statute. While that conclusion results in an affirmance of the judgment of the Court of Appeals, it rests on a rejection of that court's reasoning. Furthermore, while the Court frequently refers to petitioner's attempt to "expand" the implied cause of action, [1]--a conclusion that begs the question of the contours of that cause of action--it is today's decision that results in a significant departure from *Central Bank*.

FOOTNOTES

1 See *ante*, at 10 ("were the implied cause of action to be extended to the practices described here . . . "); *ante*, at 12 ("the practical consequences of **[***32]** an expansion"); *ante*, at 14 ("Concerns with the judicial creation of a private cause of action caution against its expansion. The decision to extend the cause of action is for the Congress, not for us").

The Court's conclusion that no violation of § 10(b) giving rise to a private right of action has been alleged in this case rests on two faulty premises: (1) the Court's overly broad reading of *Central Bank*, and (2) the view that reliance requires a kind of super-causation--a view contrary to both the Securities and Exchange Commission's (SEC) position in a recent Ninth **[*775]** Circuit case [2] and our holding in *Basic Inc. v. Levinson*, 485 U.S. 224, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988). These two points merit separate discussion.

FOOTNOTES

2 See Brief for SEC as *Amicus Curiae* in *Simpson* v. *AOL Time Warner Inc.*, No. 04-55665 (CA9), p. 21 ("The reliance requirement is satisfied where a plaintiff relies on a material deception flowing from a defendant's deceptive act, even though the conduct of other participants in the fraudulent scheme may have been a subsequent link in the causal chain leading to the plaintiff's securities transaction").

I

The Court of Appeals incorrectly based its decision on the view that "[a] device or contrivance is **[***33]** not 'deceptive,' within the meaning of § 10(b), absent some misstatement or a failure to disclose by one who has a duty to disclose." *In re Charter Communications, Inc., Securities Litigation*, 443 F.3d 987, 992 (CA8 2006). The Court correctly explains why the statute covers nonverbal as well as verbal deceptive conduct. *Ante*, at 7. The allegations in this case--that respondents produced documents falsely claiming costs had risen and signed contracts they knew to be backdated in order to disguise the connection between the increase in costs and the purchase of advertising--plainly describe "deceptive devices" under any standard reading of the phrase.

What the Court fails to recognize is that this case is critically different from *Central Bank* because the bank in that case did not engage in any deceptive act and, therefore, did not *itself* violate § 10(b). The Court sweeps aside any distinction, remarking that holding respondents liable would "revive the implied cause of **[**645]** action against all aiders and abettors except those who committed no deceptive act in the process of facilitating the fraud." *Ante*, at 12. But the fact that Central Bank engaged in no deceptive conduct whatsoever--in other **[***34]** words, that it was at most an aider and abettor--sharply distinguishes *Central Bank* from cases that do involve allegations of such conduct. 511 U.S., at 167, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (stating that the question presented was "whether private civil liability under § 10(b) extends as well to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation").

The Central Bank of Denver was the indenture trustee for bonds issued by a public authority and secured by liens on property in Colorado Springs. After default, purchasers of $ 2.1 million of those bonds sued the underwriters, alleging violations of § 10(b); they also named Central Bank as a defendant, contending that the bank's delay in reviewing a suspicious appraisal of the value of the security made it liable as an aider and abettor. *Id.*, at 167-168, 114 S. Ct. 1439, 128 L. Ed. 2d 119. The facts of this case would parallel those of *Central Bank* if respondents had, for example, merely delayed sending invoices for set-top boxes to Charter. Conversely, the facts in *Central Bank* would mirror those in the case before us today if the bank had knowingly purchased real estate in wash transactions at above-market prices in order to facilitate the appraiser's overvaluation **[***35]** of the security. *Central Bank*, thus, poses no obstacle to petitioner's argument that it has alleged a cause of action under § 10(b).

II

The Court's next faulty premise is that petitioner is required to allege that Scientific-Atlanta and Motorola made it "necessary or inevitable for Charter to record the transactions in the way it did," *ante*, at 10, in order to demonstrate reliance. Because the Court of Appeals did not base its **[*776]** holding on reliance grounds, see 443 F.3d at 992, the fairest course to petitioner would be for the majority to remand to the Court of Appeals to determine whether petitioner properly alleged reliance, under a correct view of what § 10(b) covers. [3] Because the Court chooses to rest its holding on an absence of reliance, a response is required.

FOOTNOTES

[3] Though respondents did argue to the Court of Appeals that reliance was lacking, see Brief for Appellee Motorola, Inc., in No. 05-1974 (CA8), p. 15, that argument was quite short and was based on an erroneously broad reading of *Central Bank of Denver, N. A.* v. *First Interstate Bank of Denver, N. A.*, 511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994), as discussed, *supra*, at 3 and this page. The Court of Appeals mentioned reliance only once, stating that **[***36]** respondents "did not issue any misstatement relied upon by the investing public." 443 F.3d at 992. Furthermore, that statement was made in the context of the Court of Appeals' holding that a deceptive act must be a misstatement or omission--a holding which the Court unanimously rejects.

In *Basic Inc.*, 485 U.S., at 243, 108 S. Ct. 978, 99 L. Ed. 2d 194, we stated that "reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." The Court's view of the causation required to demonstrate reliance is unwarranted and without precedent.

In *Basic Inc.*, we held that the "fraud-on-the-market" theory provides adequate support for a presumption in private securities actions **[**646]** that shareholders (or former shareholders) in publicly traded companies rely on public material misstatements that affect the price of the company's stock. *Id.*, at 248, 108 S. Ct. 978, 99 L. Ed. 2d 194. The holding in *Basic* is surely a sufficient response to the argument that a complaint alleging that deceptive acts which had a material effect on the price of a listed stock should be dismissed because the plaintiffs were not subjectively aware of the deception at the time of the securities' purchase or sale. This Court has not held that **[***37]** investors must be aware of the specific deceptive act which violates § 10b to demonstrate reliance.

The Court is right that a fraud-on-the-market presumption coupled with its view on causation would not support petitioner's view of reliance. The fraud-on-the-market presumption helps investors who cannot

demonstrate that they, *themselves*, relied on fraud that reached the market. But that presumption says nothing about causation from the other side: what an individual or corporation must do in order to have "caused" the misleading information that reached the market. The Court thus has it backwards when it first addresses the fraud-on-the-market presumption, rather than the causation required. See, *ante*, at 8. The argument is not that the fraud-on-the-market presumption is enough standing alone, but that a correct view of causation coupled with the presumption would allow petitioner to plead reliance.

Lower courts have correctly stated that the causation necessary to demonstrate reliance is not a difficult hurdle to clear in a private right of action under § 10(b). Reliance is often equated with "'transaction causation.'" *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 341, 342, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005). **[***38]** Transaction causation, in turn, is often defined as requiring an allegation that but for the deceptive act, the plaintiff would not have entered into the securities transaction. See, *e.g.*, *Lentell* v. *Merrill Lynch & Co.*, 396 F.3d 161, 172 (CA2 2005); *Binder* v. *Gillespie*, 184 F.3d 1059, 1065-1066 (CA9 1999).

Even if but-for causation, standing alone, is too weak to establish reliance, petitioner has also alleged that respondents proximately caused Charter's **[*777]** misstatement of income; petitioner has alleged that respondents knew their deceptive acts would be the basis for statements that would influence the market price of Charter stock on which shareholders would rely. Second Amended Consolidated Class Action Complaint PP 8, 98, 100, 109, App. 19a, 55a-56a, 59a. Thus, respondents' acts had the foreseeable effect of causing petitioner to engage in the relevant securities transactions. The Restatement (Second) of Torts § 533, pp. 72-73 (1977), provides that "the maker of a fraudulent misrepresentation is subject to liability . . . if the misrepresentation, although not made directly to the other, is made to a third person and the maker intends or has reason to expect that its terms will be **[***39]** repeated or its substance communicated to the other." The sham transactions described in the complaint in this case had the same effect on Charter's profit and loss statement as a false entry directly on its books that included $ 17 million of gross revenues that had not been received. And respondents are alleged to have known that the outcome of their fraudulent **[**647]** transactions would be communicated to investors.

The Court's view of reliance is unduly stringent and unmoored from authority. The Court first says that if the petitioner's concept of reliance is adopted the implied cause of action "would reach the whole marketplace in which the issuing company does business." *Ante*, at 9. The answer to that objection is, of course, that liability only attaches when the company doing business with the issuing company has *itself* violated § 10(b). [4] The Court next relies on what it views as a strict division between the "realm of financing business" and the "ordinary business operations." *Ante*, at 10. But petitioner's position does not merge the two: A corporation engaging in a business transaction with a partner who transmits false information to the market is only liable where the corporation **[***40]** *itself* violates § 10(b). Such a rule does not invade the province of "ordinary" business transactions.

FOOTNOTES

4 Because the kind of sham transactions alleged in this complaint are unquestionably isolated departures from the ordinary course of business in the American marketplace, it is hyperbolic for the Court to conclude that petitioner's concept of reliance would authorize actions "against the entire marketplace in which the issuing company operates." *Ante,* at 11.

The majority states that "section 10(b) does not incorporate common-law fraud into federal law," citing *SEC* v. *Zandford*, 535 U.S. 813, 122 S. Ct. 1899, 153 L. Ed. 2d 1 (2002). *Ante*, at 11. Of course, not every common-law fraud action that happens to touch upon securities is an action under § 10(b), but the Court's opinion in *Zandford* did not purport to jettison all reference to common-law fraud doctrines from § 10(b) cases. In fact, our prior cases explained that to the extent that "the antifraud provisions of the securities laws are not coextensive with common-law doctrines of fraud," it is because common-law fraud doctrines might be too restrictive. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 388-389, 103 S. Ct. 683, 74 L. Ed. 2d 548 (1983). "Indeed, an important purpose of the federal securities **[***41]** statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry." *Id.*, at 389, 103 S. Ct. 683, 74 L. Ed. 2d 548. I, thus, see no reason to abandon common-law approaches to causation in § 10(b) cases.

Finally, the Court relies on the course of action Congress adopted after our decision in *Central Bank* to argue that siding with **[*778]** petitioner on reliance would run contrary to congressional intent. Senate hearings on *Central Bank* were held within one month of our decision. [5] Less than one year later, Senators Dodd and Domenici introduced S. 240, which became the Private Securities Litigation Reform Act of 1995 (PSLRA), 109 Stat. 737. [6] Congress stopped short of undoing *Central Bank* entirely, instead adopting a compromise which restored the authority of the SEC to enforce aiding and abetting liability. [7] A private right of action based on aiding and abetting violations of **[**648]** § 10(b) was not, however, included in the PSLRA, [8] despite support from Senator Dodd and members of the Senate Subcommittee on Securities. [9] This compromise surely provides no support for extending *Central Bank* in order to immunize an undefined class of actual violators **[***42]** of § 10(b) from liability in private litigation. Indeed, as Members of Congress--including those who rejected restoring a private cause of action against aiders and abettors--made clear, private litigation under § 10(b) continues to play a vital role in protecting the integrity of our securities markets. [10] That Congress chose **[*779]** not to restore the aiding and abetting liability removed by *Central Bank* does not mean that Congress wanted to exempt from liability the broader range of conduct that today's opinion excludes.

FOOTNOTES

5 See S. Rep. No. 104-98, p. 2 (1995) (hereinafter S. Rep.).

6 *Id.*, at 1.

7 The opinion in *Central Bank* discussed only private remedies, but its rationale--that the text of § 10(b) did not cover aiding and abetting--obviously limited the authority of public enforcement agencies. See 511 U.S., at 199-200, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (STEVENS, J., dissenting); see also S. Rep., at 19 ("The Committee does, however, grant the SEC express authority to bring actions seeking injunctive relief or money damages against persons who knowingly aid and abet primary violators of the securities laws").

8 PSLRA, § 104, 109 Stat. 757; see also S. Rep., at 19 ("The Committee believes that amending the 1934 Act to provide explicitly **[***43]** for private aiding and abetting liability actions under Section 10 (b) would be contrary to S. 240's goal of reducing meritless securities litigation").

9 See *id.*, at 51 (additional views of Sen. Dodd) ("I am pleased that the Committee bill grants the Securities and Exchange Commission explicit authority to bring actions against those who knowingly aid and abet primary violators. However, I remain concerned about liability in private actions and will continue work with other Committee members on this issue as we move to floor consideration"). Senators Sarbanes, Boxer, and Bryan also submitted additional views in which they stated that "while the provision in the bill is of some help, the deterrent effect of the securities laws would be strengthened if aiding and abetting liability were restored in private actions as well." *Id.*, at 49.

10 *Id.*, at 8 ("The success of the U.S. securities markets is largely the result of a high level of investor confidence in the integrity and efficiency of our markets. The SEC enforcement program and the availability of private rights of action together provide a means for defrauded investors to recover damages and a powerful deterrent against violations of **[***44]** the securities laws"); see also *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 310, 105 S. Ct. 2622, 86 L. Ed. 2d 215 (1985) ("Moreover, we repeatedly have emphasized that implied private actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action'"); Brief for Former SEC Commissioners as *Amici Curiae* 4 ("Liability [of the kind at issue here] neither results in undue liability exposure for non-issuers, nor an undue burden upon capital formation. Holding liable wrongdoers who actively engage in fraudulent conduct that lacks a legitimate business purpose does not hinder, but rather enhances, the integrity of our markets and our economy. We believe that the integrity of our securities markets is their strength. Investors, both domestic and foreign, trust that fraud is not tolerated in our nation's securities markets and that strong remedies exist to deter and protect against fraud and to recompense investors when it occurs").

The Court is concerned that such liability would deter overseas firms from doing business in the United States or "shift securities offerings away from domestic capital markets." *Ante,* at 13. But liability for

[*45]** those who violate § 10(b) "will not harm American competitiveness; in fact, investor faith in the safety and integrity of our markets *is* their strength. The fact that our markets are the safest in the world has helped make them the strongest in the world." Brief for Former SEC Commissioners as *Amici Curiae* 9.

Accordingly, while I recognize that the *Central Bank* opinion provides a precedent for judicial policymaking decisions in this area of the law, I respectfully dissent from the Court's continuing campaign to render the private cause of action under § 10(b) **[**649]** toothless. I would reverse the decision of the Court of Appeals.

III

While I would reverse for the reasons stated above, I must also comment on the importance of the private cause of action that Congress implicitly authorized when it enacted the Securities Exchange Act of 1934. A theme that underlies the Court's analysis is its mistaken hostility towards the § 10(b) private cause of action. [11] *Ante,* at 13. The Court's current view of implied causes of action is that they are merely a "relic" of our prior "heady days." *Correctional Services Corp.* v. *Malesko*, 534 U.S. 61, 75, 122 S. Ct. 515, 151 L. Ed. 2d 456 (2001) (SCALIA, J., concurring). Those "heady days" persisted **[***46]** for two hundred years.

FOOTNOTES

11 The Court does concede that Congress has now ratified the private cause of action in the PSLRA. See *ante*, at 15.

During the first two centuries of this Nation's history much of our law was developed by judges in the common-law tradition. A basic principle animating our jurisprudence was enshrined in state constitution provisions guaranteeing, in substance, that "every wrong shall have a remedy." [12] Fashioning appropriate remedies **[*780]** for the violation of rules of law designed to protect a class of citizens was the routine business of judges. See *Marbury* v. *Madison*, 5 U.S. 137, 1 Cranch 137, 166, 2 L. Ed. 60 (1803). While it is true that in the early days state law was the source of most of those rules, throughout our history--until 1975--the same practice prevailed in federal courts with regard to federal statutes that left questions of remedy open for judges to answer. In *Texas & Pacific R. Co.* v. *Rigsby*, 241 U.S. 33, 39, 36 S. Ct. 482, 60 L. Ed. 874 (1916), this Court stated the following:

> **[**650]** "A disregard of the command of the statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied, **[***47]** according to a doctrine of the common law expressed in 1 Com. Dig., *tit.* Action upon Statute (F), in these words: 'So, in every case, where a statute enacts, or prohibits a thing for the benefit of a person, he shall have a remedy upon the same statute for the thing enacted for his advantage, or for the recompense of a wrong done to him contrary to the said law.' (*Per* Holt, C. J., *Anon.*, 6 Mod. 26, 27.)"

FOOTNOTES

12 Today, the guarantee of a remedy for every injury appears in nearly three-quarters of state constitutions. Ala. Const., Art. I, § 13; Ark. Const., Art. II, § 13; Colo. Const., Art. II, § 6; Conn. Const., Art. I, § 10; Del. Const., Art. I, § 9; Fla. Const., Art. I, § 21; Idaho Const., Art. I, § 18; Ill. Const., Art. I, § 12; Ind. Const., Art. I, § 12; Kan. Const., Bill of Rights § 18; , Ky. Const., § 14; La. Const., Art. I, § 22; Me. Const., Art. I, § 19; Md. Const., Declaration of Rights, Art. 19; Mass. Const., pt. I, Art. 11; Minn. Const., Art. 1, § 8; Miss. Const., Art. III, § 24; Mo. Const., Art. I, § 14; Mont. Const., Art. II, § 16; Neb. Const., Art. I, § 13; N. H. Const., pt. I, Art. 14; N. C. Const., Art. I, § 18; N. D. Const., Art. I, § 9; Ohio Const., Art. I, § 16; Okla. Const., Art. II, § 6; **[***48]** Ore. Const., Art. I, § 10; Pa. Const., Art. I, § 11; R. I. Const., Art. I, § 5; S. C. Const., Art. I, § 9; S. D. Const., Art. VI, § 20; Tenn. Const., Art. I, § 17; Tex. Const., Art. I, § 13; Utah Const., Art. I, § 11; Vt. Const., ch. I, Art.

4; W. Va. Const., Art. III, § 17; Wis. Const., Art. I, § 9; Wyo. Const., Art. I, § 8; see also Phillips, The Constitutional Right to a Remedy, 78 N. Y. U. L. Rev. 1309, 1310, n. 6 (2003) (hereinafter Phillips).

The concept of a remedy for every wrong most clearly emerged from Sir Edward Coke's scholarship on Magna Carta. See 1 Second Part of the Institutes of the Laws of England (1797). At the time of the ratification of the United States Constitution, Delaware, Massachusetts, Maryland, New Hampshire, and North Carolina had all adopted constitutional provisions reflecting the provision in Coke's scholarship. Del. Declaration of Rights and Fundamental Rules § 12 (1776), reprinted in 2 W. Swindler, Sources and Documents of United States Constitutions 198 (1973) (hereinafter Swindler); Mass. Const., pt. I, Art. XI (1780), reprinted in 3 Federal and State Constitutions, Colonial Charters, and Other Organic Laws 1891 (F. Thorpe ed. 1909) (reprinted 1993) **[***49]** (hereinafter Thorpe); Md. Const., Declaration of Rights, Art. XVII (1776), in *id.*, at 1688; N. H. Const., Art. XIV (1784), in 4 *id.*, at 2455; N. C. Const., Declaration of Rights, Art. XIII (1776), in 5 *id.*, at 2787, 2788; see also Phillips 1323-1324. Pennsylvania's Constitution of 1790 contains a guarantee. Pa. Const., Art. IX, § 11, in 5 Thorpe 3101. Connecticut's 1818 Constitution, Art. I, § 12, contained such a provision. Reprinted in Swindler 145.

Judge Friendly succinctly described the post-*Rigsby*, pre-1975 practice in his opinion in *Leist* v. *Simplot*, 638 F.2d 283, 298-299 (CA2 1980):

> "Following *Rigsby* the Supreme Court recognized implied causes of action on numerous occasions, see, e.g., *Wyandotte Transportation Co. v. United States*, 389 U.S. 191, 88 S. Ct. 379, 19 L. Ed. 2d 407 . . . (1967) (sustaining implied cause of action by United States for damages under Rivers and Harbors Act for removing negligently sunk vessel despite express remedies of *in rem* action and criminal penalties); *United States v. Republic Steel Corp.*, 362 U.S. 482, 80 S. Ct. 884, 4 L. Ed. 2d 903 . . . (1960) (sustaining implied cause of action by United States for an injunction under the Rivers and Harbors Act); *Tunstall* v. *Locomotive Firemen & Enginemen*, 323 U.S. 210, 65 S. Ct. 235, 89 L. Ed. 187 . . . (1944) **[***50]** (sustaining implied cause of action by union member against union for discrimination among members despite existence of Board of Mediation); *Sullivan v. Little Hunting Park, Inc.*, 396 U.S. 229, 90 S. Ct. 400, 24 L. Ed. 2d 386 . . . (1969) (sustaining implied private cause of action under 42 U.S.C. § 1982); *Allen v. State Board of Elections*, 393 U.S. 544, 89 S. Ct. 817, 22 L. Ed. 2d 1 . . . (1969) (sustaining implied private cause of action under § 5 of the Voting Rights Act despite the existence of a complex regulatory scheme and explicit rights of action in the Attorney General); and, of course, the aforementioned decisions under the securities laws. As the Supreme Court itself has recognized, the period of the 1960's and early 1970's was one in which the 'Court had consistently found implied remedies.' *Cannon v. University of Chicago*, 441 U.S. 677, 698, 99 S. Ct. 1946, 60 L. Ed. 2d 560 . . . (1979)."

[*781] In a law-changing opinion written by Justice Brennan in 1975, the Court decided to modify its approach to private causes of action. ***Cort* v. *Ash*, 422 U.S. 66, 95 S. Ct. 2080, 45 L. Ed. 2d 26** (constraining courts to use a strict four-factor test to determine whether Congress intended a private cause of action). A few years later, in *Cannon* v. *University of Chicago*, 441 U.S. 677, 99 S. Ct. 1946, 60 L. Ed. 2d 560 (1979), we adhered to the strict approach **[***51]** mandated by *Cort* v. *Ash* in 1975, but made it clear that "our evaluation of congressional action in 1972 must take into account its contemporary legal context." 441 U.S., at 698-699, 99 S. Ct. 1946, 60 L. Ed. 2d 560. That context persuaded the majority that Congress had intended the courts to authorize a private remedy for members of the protected class.

Until *Central Bank,* the federal courts continued to enforce a broad implied cause of action for the violation **[**651]** of statutes enacted in 1933 and 1934 for the protection of investors. As Judge Friendly explained:

> "During the late 1940's, the 1950's, the 1960's and the early 1970's there was widespread, indeed almost general, recognition of implied causes of action for damages under many provisions of the Securities Exchange Act, including not only the antifraud provisions, §§ 10 and 15(c)(1), see *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 513-14 (E.D.Pa.1946); *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2 Cir. 1951) (Frank, J.); *Fratt v. Robinson,*

> 203 F.2d 627, 631-33 (9 Cir. 1953), but many others. These included the provision, § 6(a)(1), requiring securities exchanges to enforce compliance with the Act and any rule or regulation made thereunder, see *Baird v. Franklin*, 141 F.2d 238, 239, 240, 244-45 **[***52]** (2 Cir.), *cert. denied*, 323 U.S. 737 . . ., 65 S. Ct. 38, 89 L. Ed. 591 (1944), and provisions governing the solicitation of proxies, see *J. I. Case Co. v. Borak*, 377 U.S. 426, 431-35, 84 S. Ct. 1555, 12 L. Ed. 2d 423 . . . (1964) . . . . Writing in 1961, Professor Loss remarked with respect to violations of the antifraud provisions that with one exception 'not a single judge has expressed himself to the contrary.' 3 Securities Regulation 1763-64. See also Bromberg & Lowenfels, *supra*, § 2.2 (462) (describing 1946-1974 as the 'expansion era' in implied causes of action under the securities laws). When damage actions for violation of § 10(b) and Rule 10b-5 reached the Supreme Court, the existence of an implied cause of action was not deemed worthy of extended discussion. *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 92 S. Ct. 165, 30 L. Ed. 2d 128 . . . (1971)." *Leist*, 638 F.2d at 296-297 (footnote omitted).

In light of the history of court-created remedies and specifically the history of implied causes of action under § 10(b), the Court is simply wrong when it states that Congress did not impliedly authorize this private cause of action "when it first enacted the statute." *Ante*, at 16. Courts near in time to the enactment of the securities laws recognized **[***53]** that the principle in *Rigsby* applied to the securities laws. [13] **[*782]** Congress enacted § 10(b) with the understanding that federal courts respected the principle that every wrong would have a remedy. Today's decision simply cuts back further on Congress' intended remedy. I respectfully dissent.

FOOTNOTES

13 See, *e.g.*, *Slavin* v. *Germantown Fire Ins. Co.*, 174 F.2d 799 (CA3 1949); *Baird* v. *Franklin*, 141 F.2d 238, 244-245 (CA2) ("The fact that the statute provides no machinery or procedure by which the individual right of action can proceed is immaterial. It is well established that members of a class for whose protection a statutory duty is created may sue for injuries resulting from its breach and that the common law will supply a remedy if the statute gives none"), cert. denied, 323 U.S. 737, 65 S. Ct. 38, 89 L. Ed. 591 (1944); *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (ED Pa. 1946) ("The right to recover damages arising by reason of violation of a statute . . . is so fundamental and so deeply ingrained in the law that where it is not expressly denied the intention to withhold it should appear very clearly and plainly").

*127 S. Ct. 1955, *; 167 L. Ed. 2d 929, **;*
*2007 U.S. LEXIS 5901, ***; 75 U.S.L.W. 4337*

BELL ATLANTIC CORPORATION, et al., Petitioners v.WILLIAM **TWOMBLY,** et al.

No. 05-1126

SUPREME COURT OF THE UNITED STATES

127 S. Ct. 1955; 167 L. Ed. 2d 929; 2007 U.S. LEXIS 5901; 75 U.S.L.W. 4337; 2007-1 Trade Cas. (CCH) P75,709; 68 Fed. R. Serv. 3d (Callaghan) 661; 20 Fla. L. Weekly Fed. S 267; 41 Comm. Reg. (P & F) 567

November 27, 2006, Argued
May 21, 2007, Decided

NOTICE:

[*1]** The LEXIS pagination of this document is subject to change pending release of the final published version.

PRIOR HISTORY: ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.
Twombly v. Bell Atl. Corp., 425 F.3d 99, 2005 U.S. App. LEXIS 21390 (2d Cir., 2005)

DISPOSITION: Reversed and remanded.

commentary, written by James C. Ho, who is of counsel in the Dallas office of Gibson, Dunn & Crutcher and a former counsel for the Senate Judiciary Committee and the U.S. Department of Justice, and Kahn A. Scolnick, an associate in the Los Angeles office of Gibson, Dunn & Crutcher and former federal district court and appellate court law clerk, examines the implications of Twombly beyond antitrust litigation and discusses how lower courts will respond to motions to dismiss in the future.

CASE SUMMARY

PROCEDURAL POSTURE: Respondent subscribers to local telephone and Internet services brought an action against petitioner local exchange carriers, alleging that the carriers engaged in parallel conduct to preclude competition in violation of § 1 of the Sherman Act, 15 U.S.C.S. § 1. Upon the grant of a writ of certiorari, the carriers appealed the judgment of the U.S. Court of Appeals for the Second Circuit which held that the subscribers sufficiently stated a claim.

OVERVIEW: The subscribers asserted that the carriers were former local monopolies which engaged in parallel billing and contracting misconduct designed to discourage new competitors from entering their markets through sharing of the carriers' networks. The subscribers also alleged that the carriers agreed not to compete outside their own markets. The U.S. Supreme Court held that the subscribers' allegations that the carriers engaged in certain parallel conduct unfavorable to competition, absent some factual context suggesting agreement, were insufficient to state a claim under § 1 of the Sherman Act. To state such a violation, allegations of parallel conduct were required to be placed in a factual context which raised a plausible suggestion of a preceding agreement rather than identical independent action. Further, the subscribers' complaint did not indicate that the carriers' resistance to competitors was anything more than the natural, unilateral reaction of each carrier which was intent on keeping its regional dominance. Also, the alleged anti-competitive conduct of the carriers itself indicated that a carrier's attempt to compete in another carrier's market would not be profitable.

OUTCOME: The judgment finding that the subscribers' complaint stated a claim was reversed, and the case was remanded for further proceedings.

CORE TERMS: conspiracy, discovery, federal rules, antitrust, notice, Sherman Act, competitive, local telephone, territory, compete, summary judgment, plausibility, civil procedure, competitors, network, entitle, pleading stage, internet, pleader', factual allegations, entitlement, monopoly, antitrust case, parallelism, heightened', quotation, regional, Telecommunications Act, antitrust law, high speed

LEXISNEXIS® HEADNOTES ⊖ **Hide**

Antitrust & Trade Law > Sherman Act > Coverage > General Overview

HN1 Liability under § 1 (15 U.S.C.S. § 1) of the Sherman Act requires a contract, combination, or conspiracy, in restraint of trade or commerce. More Like This Headnote | *Shepardize:* Restrict By Headnote

Antitrust & Trade Law > Sherman Act > Coverage > General Overview

HN2 15 U.S.C.S. § 1 prohibits every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations. More Like This Headnote | *Shepardize:* Restrict By Headnote

Antitrust & Trade Law > Sherman Act > Coverage > General Overview

HN3 Because § 1 (15 U.S.C.S. § 1) of the Sherman Act does not prohibit all unreasonable restraints of trade, but only restraints effected by a contract, combination, or conspiracy, the crucial question is whether challenged anticompetitive conduct stems from independent decision or from an agreement, tacit or express. While a showing of parallel business behavior is admissible circumstantial evidence from which the fact finder may infer agreement, it falls short of conclusively establishing agreement or itself constituting a Sherman Act offense. Even conscious parallelism, a common reaction of firms in a concentrated market that recognize their shared economic interests and their interdependence with respect to price and output decisions is not in itself unlawful. The inadequacy of showing parallel conduct or interdependence, without more,

mirrors the ambiguity of the behavior: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Pleadings > Complaints > Requirements

HN4 Fed. R. Civ. P. 8(a)(2) requires only a short and plain statement of a claim showing that the pleader is entitled to relief, in order to give a defendant fair notice of what the claim is and the grounds upon which it rests. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims

HN5 While a complaint attacked by a Fed. R. Civ. P. 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do. Factual allegations must be enough to raise a right to relief above the speculative level. More Like This Headnote | *Shepardize:* Restrict By Headnote

Antitrust & Trade Law > Sherman Act > Coverage > General Overview

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims

HN6 Stating a claim under § 1 (15 U.S.C.S. § 1) of the Sherman Act requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement. And, of course, a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable, and that a recovery is very remote and unlikely. In identifying facts that are suggestive enough to render a § 1 conspiracy plausible, courts have the benefit of the prior rulings and considered views of leading commentators that lawful parallel conduct fails to bespeak unlawful agreement. It makes sense to say, therefore, that an allegation of parallel conduct and a bare assertion of conspiracy will not suffice. Without more, parallel conduct does not suggest conspiracy, and a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality. Hence, when allegations of parallel conduct are set out in order to make a § 1 claim, they must be placed in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action. More Like This Headnote | *Shepardize:* Restrict By Headnote

Antitrust & Trade Law > Sherman Act > Coverage > General Overview

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims

Civil Procedure > Pleading & Practice > Pleadings > Complaints > Requirements

HN7 The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) agreement in violation of § 1 (15 U.S.C.S. § 1) of the Sherman Act reflects the threshold requirement of Fed. R. Civ. P. 8(a)(2) that a plain statement possess enough heft to show that the pleader is entitled to relief. A statement of parallel conduct, even conduct consciously undertaken, needs some setting suggesting the agreement necessary to make out a claim under § 1 of the Sherman Act; without that further circumstance pointing toward a meeting of the minds, an account of a defendant's commercial efforts stays in neutral territory. An allegation of parallel conduct is thus much like a naked assertion of conspiracy in a § 1 complaint: it gets the complaint close to stating a claim, but without some further factual enhancement it stops short of the line between possibility and plausibility of entitlement to relief. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims

HN8 When the allegations in a complaint, however true, could not raise a claim of entitlement to relief, this basic deficiency should be exposed at the point of minimum expenditure of time and money by the parties and the court. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims

HN9 A district court must retain the power to insist upon some specificity in pleading before allowing

a potentially massive factual controversy to proceed. More Like This Headnote | *Shepardize:* Restrict By Headnote

Evidence > Procedural Considerations > Burdens of Proof > General Overview

HN10 Once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims

HN11 When a complaint adequately states a claim, it may not be dismissed based on a district court's assessment that the plaintiff will fail to find evidentiary support for his allegations or prove his claim to the satisfaction of the factfinder. More Like This Headnote | *Shepardize:* Restrict By Headnote

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DECISION:

[929]** Telephone and Internet service subscribers held to have failed to state claim against local exchange carriers for alleged parallel billing and contracting designed to discourage competition in asserted violation of § 1 of Sherman Act (15 U.S.C.S. § 1).

SUMMARY:

Procedural posture: Respondent subscribers to local telephone and Internet services brought an action against petitioner local exchange carriers, alleging that the carriers engaged in parallel conduct to preclude competition in violation of § 1 of the Sherman Act, 15 U.S.C.S. § 1. Upon the grant of a writ of certiorari, the carriers appealed the judgment of the U.S. Court of Appeals for the Second Circuit which held that the subscribers sufficiently stated a claim.

Overview: The subscribers asserted that the carriers were former local monopolies which engaged in parallel billing and contracting misconduct designed to discourage new competitors from entering their markets through sharing of the carriers' networks. The subscribers also alleged that the carriers agreed not to compete outside their own markets. The U.S. Supreme Court held that the subscribers' allegations that the carriers engaged in certain parallel conduct unfavorable to competition, absent some factual context suggesting agreement, were insufficient to state a claim under § 1 of the Sherman Act. To state such a violation, allegations of parallel conduct were required to be placed in a factual context which raised a plausible suggestion of a preceding agreement rather than identical independent action. Further, the subscribers' complaint did not indicate that the carriers' resistance to competitors was anything more than the natural, unilateral reaction of each carrier which was intent on keeping its regional dominance. Also, the alleged **[**930]** anti-competitive conduct of the carriers itself indicated that a carrier's attempt to compete in another carrier's market would not be profitable.

Outcome: The judgment finding that the subscribers' complaint stated a claim was reversed, and the case was remanded for further proceedings.

LAWYERS' EDITION HEADNOTES:

[LEdHN1]**

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES § 5

SHERMAN ACT LIABILITY

Headnote:LEdHN(1)[1]

Liability under § 1 (15 U.S.C.S. § 1) of the Sherman Act requires a contract, combination, or conspiracy, in restraint of trade or commerce. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN2]**

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES § 5

SHERMAN ACT PROHIBITIONS

Headnote:LEdHN(2)[2]

15 U.S.C.S. § 1 prohibits every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN3]**

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES § 14 RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES § 15

SHERMAN ACT -- TRADE RESTRAINTS PROHIBITED -- PARALLEL BUSINESS BEHAVIOR

Headnote:LEdHN(3)[3]

Because § 1 (15 U.S.C.S. § 1) of the Sherman Act does not prohibit all unreasonable restraints of trade, but only restraints effected by a contract, combination, or conspiracy, the crucial question is whether challenged anticompetitive conduct stems from independent decision or from an agreement, tacit or express. While a showing of parallel business behavior is admissible circumstantial evidence from which the fact finder may infer agreement, it falls short of conclusively establishing agreement or itself constituting a Sherman Act offense. Even conscious parallelism, a common reaction of firms in a concentrated market that recognize their shared economic interests and their interdependence with respect to price and output decisions is not in itself unlawful. The inadequacy of showing parallel conduct or interdependence, without more, mirrors the ambiguity of the behavior: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN4]**

PLEADING § 130

PLEADING -- PLAIN STATEMENT

Headnote:LEdHN(4)[4]

Fed. R. Civ. P. 8(a)(2) requires only a short and plain statement of a claim showing that the pleader is entitled to relief, in order to give a defendant fair notice of what the claim is and the grounds upon which it rests. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN5]**

PLEADING § 103

COMPLAINT -- MOTION TO DISMISS

Headnote:[LEdHN(5)][5]

While a complaint attacked by a Fed. R. Civ. P. 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to **[**931]** provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do. Factual allegations must be enough to raise a right to relief above the speculative level. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN6]**

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES § 63

SHERMAN ACT -- STATING ANTITRUST CLAIM -- ILLEGAL AGREEMENT -- PARALLEL CONDUCT

Headnote:[LEdHN(6)][6]

Stating a claim under § 1 (15 U.S.C.S. § 1) of the Sherman Act requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement. And, of course, a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable, and that a recovery is very remote and unlikely. In identifying facts that are suggestive enough to render a § 1 conspiracy plausible, courts have the benefit of the prior rulings and considered views of leading commentators that lawful parallel conduct fails to bespeak unlawful agreement. It makes sense to say, therefore, that an allegation of parallel conduct and a bare assertion of conspiracy will not suffice. Without more, parallel conduct does not suggest conspiracy, and a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality. Hence, when allegations of parallel conduct are set out in order to make a § 1 claim, they must be placed in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN7]**

PLEADING § 176

PLEADING -- ANTITRUST ALLEGATIONS -- ENTITLEMENT TO RELIEF

Headnote:[LEdHN(7)][7]

The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) agreement in violation of § 1 (15 U.S.C.S. § 1) of the Sherman Act reflects the threshold requirement of Fed. R. Civ. P. 8(a)(2) that a plain statement possess enough heft to show that the pleader is entitled to relief. A statement of parallel conduct, even conduct consciously undertaken, needs some setting suggesting the agreement necessary to make out a claim under § 1 of the Sherman Act; without that further circumstance pointing toward a meeting of the minds, an account of a defendant's commercial efforts stays in neutral territory. An allegation of parallel conduct is thus much like a naked assertion of conspiracy in a § 1 complaint: it gets the complaint close to stating a claim, but without some further factual enhancement it stops short of the line between possibility and plausibility of entitlement to relief. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN8]**

PLEADING § 106

FAILURE TO RAISE CLAIM

Headnote:LEdHN(8)[8]

When the allegations in a complaint, however true, could not raise a claim of entitlement to relief, this basic deficiency should be exposed at the point of minimum expenditure of **[**932]** time and money by the parties and the court. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN9]**

PLEADING § 103

PLEADING -- SPECIFICITY

Headnote:LEdHN(9)[9]

A district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy to proceed. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN10]**

PLEADING § 130

PLEADING -- CONSISTENT FACTS

Headnote:LEdHN(10)[10]

Once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.)

[LEdHN11]**

PLEADING § 103

DISMISSAL OF COMPLAINT

Headnote:LEdHN(11)[11]

When a complaint adequately states a claim, it may not be dismissed based on a district court's assessment that the plaintiff will fail to find evidentiary support for his allegations or prove his claim to the satisfaction of the factfinder. (Souter, J., joined by Roberts, Ch. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ.) **[**933]**

SYLLABUS

The 1984 divestiture of the American Telephone & Telegraph Company's (AT&T) local telephone business left a system of regional service monopolies, sometimes called Incumbent Local Exchange Carriers (ILECs), and a separate long-distance market from which the ILECs were excluded. The Telecommunications Act of 1996 withdrew approval of the ILECs' monopolies, "fundamentally restructur[ing] local telephone markets" and "subject[ing] [ILECs] to a host of duties intended to facilitate market entry." *AT&T Corp.* v. *Iowa Utilities Bd.*, 525 U.S. 366, 371, 119 S. Ct. 721, 142 L. Ed. 2d 834. It also authorized them to enter the long-distance market. **[***2]** "Central to the [new] scheme [was each ILEC's] obligation . . . to share its

network with" competitive local exchange carriers (CLECs)." *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 402, 124 S. Ct. 872, 157 L. Ed. 2d 823.

Respondents (hereinafter plaintiffs) represent a class of subscribers of local telephone and/or high speed Internet services in this action against petitioner ILECs for claimed violations of § 1 of the Sherman Act, which prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations." The complaint alleges that the ILECs conspired to restrain trade (1) by engaging in parallel conduct in their respective service areas to inhibit the growth of upstart CLECs; and (2) by agreeing to refrain from competing against one another, as indicated by their common failure to pursue attractive business opportunities in contiguous markets and by a statement by one ILEC's chief executive officer that competing in another ILEC's territory did not seem right. The District Court dismissed the complaint, concluding that parallel business conduct **[***3]** allegations, taken alone, do not state a claim under § 1; plaintiffs must allege additional facts tending to exclude independent self-interested conduct as an explanation for the parallel actions. Reversing, the Second Circuit held that plaintiffs' parallel conduct allegations were sufficient to withstand a motion to dismiss because the ILECs failed to show that there is no set of facts that would permit plaintiffs to demonstrate that the particular parallelism asserted was the product of collusion rather than coincidence.

Held:

1. Stating a § 1 claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. An allegation of parallel conduct and a bare assertion of conspiracy will not suffice. Pp. 6-17

(a) Because § 1 prohibits "only restraints effected by a contract, combination, or conspiracy," *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 775, 104 S. Ct. 2731, 81 L. Ed. 2d 628, "[t]he crucial question" is whether the challenged anticompetitive conduct "stem[s] from independent decision or from an agreement," *Theatre Enterprises, Inc.* v. *Paramount Film Distributing Corp.*, 346 U.S. 537, 540, 74 S. Ct. 257, 98 L. **[**934]** Ed. 273. While **[***4]** a showing of parallel "business behavior is admissible circumstantial evidence from which" agreement may be inferred, it falls short of "conclusively establish[ing] agreement or . . . itself constitut[ing] a Sherman Act offense." *Id.*, at 540-541, 540, 74 S. Ct. 257, 98 L. Ed. 273. The inadequacy of showing parallel conduct or interdependence, without more, mirrors the behavior's ambiguity: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market. Thus, this Court has hedged against false inferences from identical behavior at a number of points in the trial sequence, *e.g.*, at the summary judgment stage, see *Matsushita Elec. Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348, 89 L. Ed. 2d 538.

(b) This case presents the antecedent question of what a plaintiff must plead in order to state a § 1 claim. Federal Rule of Civil Procedure 8(a)(2) requires only "a short and plain statement of the claim showing that the pleader is entitled to relief," in order to "give the defendant fair notice of what the . . . claim is and the grounds upon which it rests," *Conley* v. *Gibson*, 355 U.S. 41, 47, 78 S. Ct. 99, 2 L. Ed. 2d 80. **[***5]** While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, *ibid.*, a plaintiff's obligation to provide the "grounds" of his "entitle[ment] to relief" requires more than labels and conclusions, and a formulaic recitation of a cause of action's elements will not do. Factual allegations must be enough to raise a right to relief above the speculative level on the assumption that all of the complaint's allegations are true. Applying these general standards to a § 1 claim, stating a claim requires a complaint with enough factual matter to suggest an agreement. Asking for plausible grounds does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement. The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) agreement reflects Rule 8(a)(2)'s threshold requirement that the "plain statement" possess enough heft to "sho[w] that the pleader is entitled to relief." A parallel conduct allegation gets the § 1 complaint close to stating a claim, but without further factual enhancement **[***6]** it stops short of the line between possibility and plausibility. The requirement of allegations suggesting an agreement serves the practical purpose of preventing a plaintiff with "'a largely groundless claim'" from "'tak[ing] up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value.'" Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 347, 125 S. Ct. 1627, 161 L. Ed. 2d 577. It is one thing to be cautious before dismissing an antitrust complaint in advance of discovery, but quite another to forget that proceeding to antitrust

discovery can be expensive. That potential expense is obvious here, where plaintiffs represent a putative class of at least 90 percent of subscribers to local telephone or high-speed Internet service in an action against America's largest telecommunications firms for unspecified instances of antitrust violations that allegedly occurred over a 7-year period. It is no answer to say that a claim just shy of plausible **[**935]** entitlement can be weeded out early in the discovery process, given the common lament that the success of judicial supervision in checking discovery abuse has been modest. Plaintiffs' main **[***7]** argument against the plausibility standard at the pleading stage is its ostensible conflict with a literal reading of *Conley*'s statement construing Rule 8: "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." 355 U.S., at 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80. The "no set of facts" language has been questioned, criticized, and explained away long enough by courts and commentators, and is best forgotten as an incomplete, negative gloss on an accepted pleading standard: once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint. *Conley* described the breadth of opportunity to prove what an adequate complaint claims, not the minimum standard of adequate pleading to govern a complaint's survival.

2. Under the plausibility standard, plaintiffs' claim of conspiracy in restraint of trade comes up short. First, the complaint leaves no doubt that plaintiffs rest their § 1 claim on descriptions of parallel conduct, not on any independent allegation of actual agreement **[***8]** among the ILECs. The nub of the complaint is the ILECs' parallel behavior, and its sufficiency turns on the suggestions raised by this conduct when viewed in light of common economic experience. Nothing in the complaint invests either the action or inaction alleged with a plausible conspiracy suggestion. As to the ILECs' supposed agreement to disobey the 1996 Act and thwart the CLECs' attempts to compete, the District Court correctly found that nothing in the complaint intimates that resisting the upstarts was anything more than the natural, unilateral reaction of each ILEC intent on preserving its regional dominance. The complaint's general collusion premise fails to answer the point that there was no need for joint encouragement to resist the 1996 Act, since each ILEC had reason to try and avoid dealing with CLECs and would have tried to keep them out, regardless of the other ILECs' actions. Plaintiffs' second conspiracy theory rests on the competitive reticence among the ILECs themselves in the wake of the 1996 Act to enter into their competitors' territories, leaving the relevant market highly compartmentalized geographically, with minimal competition. This parallel conduct did **[***9]** not suggest conspiracy, not if history teaches anything. Monopoly was the norm in telecommunications, not the exception. Because the ILECs were born in that world, doubtless liked it, and surely knew the adage about him who lives by the sword, a natural explanation for the noncompetition is that the former Government-sanctioned monopolists were sitting tight, expecting their neighbors to do the same. Antitrust conspiracy was not suggested by the facts adduced under either theory of the complaint, which thus fails to state a valid § 1 claim. This analysis does not run counter to *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 508, 122 S. Ct. 992, 152 L. Ed. 2d 1, which held that "a complaint in an employment discrimination lawsuit [need] not contain specific facts establishing a prima facie case of discrimination." Here, the Court is not requiring heightened fact **[**936]** pleading of specifics, but only enough facts to state a claim to relief that is plausible on its face. Because the plaintiffs here have not nudged their claims across the line from conceivable to plausible, their complaint must be dismissed.

425 F.3d 99, reversed and remanded.

COUNSEL: **Michael Kellogg** argued the cause for petitioners.

Thomas O. Barnett argued the cause for the United States, as amicus curiae, by special leave of court.

J. Douglas Richards argued the cause for respondents.

JUDGES: Souter, J., delivered the opinion **[***10]** of the Court, in which Roberts, C. J., and Scalia, Kennedy, Thomas, Breyer, and Alito, JJ., joined. Stevens, J., filed a dissenting opinion, in which Ginsburg, J., joined, except as to Part IV.

OPINION BY: SOUTER

OPINION

[*1961] Justice **Souter** delivered the opinion of the Court.

HN1 **[**LEdHR1]** LEdHR(1)[1] Liability under § 1 of the Sherman Act, 15 U.S.C. § 1, requires a "contract, combination . . ., or conspiracy, in restraint of trade or commerce." The question in this putative class action is whether a § 1 complaint can survive a motion to dismiss when it alleges that major telecommunications providers engaged in certain parallel conduct unfavorable to competition, absent some factual context suggesting agreement, as distinct from identical, independent action. We hold that such a complaint should be dismissed.

I

The upshot of the 1984 divestiture of the American Telephone & Telegraph Company's (AT&T) local telephone business was a system of regional service monopolies (variously called "Regional Bell Operating Companies," "Baby Bells," or "Incumbent Local Exchange Carriers" (ILECs)), and a separate, competitive market for long-distance service from which the ILECs were excluded. More than a decade **[***11]** later, Congress withdrew approval of the ILECs' monopolies by enacting the Telecommunications Act of 1996 (1996 Act), 110 Stat. 56, which "fundamentally restructure[d] local telephone markets" and "subject[ed] [ILECs] to a host of duties intended to facilitate market entry." *AT&T Corp.* v. *Iowa Utilities Bd.*, 525 U.S. 366, 371, 119 S. Ct. 721, 142 L. Ed. 2d 834 (1999). In recompense, the 1996 Act set conditions for authorizing ILECs to enter the long-distance market. See 47 U.S.C. § 271.

"Central to the [new] scheme [was each ILEC's] obligation . . . to share its network with competitors," *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 402, 124 S. Ct. 872, 157 L. Ed. 2d 823 (2004), which came to be known as "competitive local exchange carriers" (CLECs), Pet. for Cert. 6, n 1. A CLEC could make use of an ILEC's network in any of three ways: by (1) "purchas[ing] local telephone services at wholesale rates for resale to end users," (2) "leas[ing] elements of the [ILEC's] network 'on an unbundled basis,'" or (3) "interconnect[ing] its own facilities with the [ILEC's] network." *Iowa Utilities Bd., supra*, at 371, 119 S. Ct. 721, 142 L. Ed. 2d 834 (quoting 47 U.S.C. § 251(c) **[***12]**). Owing to the "considerable expense and effort" required to make unbundled network elements available to rivals at wholesale prices, *Trinko, supra*, at 410, 124 S. Ct. 872, 157 L. Ed. 2d 823, the ILECs vigorously litigated the scope of the sharing obligation imposed by the 1996 Act, with the result that the Federal Communications Commission (FCC) **[**937]** three times revised its **[*1962]** regulations to narrow the range of network elements to be shared with the CLECs. See *Covad Communs. Co. v. FCC*, 450 F.3d 528, 533-534 (CADC 2006) (summarizing the 10-year-long regulatory struggle between the ILECs and CLECs).

Respondents William Twombly and Lawrence Marcus (hereinafter plaintiffs) represent a putative class consisting of all "subscribers of local telephone and/or high speed internet services . . . from February 8, 1996 to present." Amended Complaint in No. 02 CIV. 10220 (GEL) (SDNY) P 53, App. 28 (hereinafter Complaint). In this action against petitioners, a group of ILECs,[1] plaintiffs seek treble damages and declaratory and injunctive relief for claimed violations of § 1 of the Sherman Act, ch. 647, 26 Stat. 209, as amended, HN2 **[**LEdHR2]** LEdHR(2)**[2]**15 U.S.C. § 1, which prohibits "[e]very contract, **[***13]** combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations."

FOOTNOTES

1 The 1984 divestiture of AT&T's local telephone service created seven Regional Bell Operating Companies. Through a series of mergers and acquisitions, those seven companies were consolidated into the four ILECs named in this suit: BellSouth Corporation, Qwest Communications International, Inc., SBC Communications, Inc., and Verizon Communications, Inc. (successor-in-interest to Bell Atlantic Corporation). Complaint P 21, App. 16. Together, these ILECs allegedly control 90 percent or more of the market for local telephone service in the 48 contiguous States. *Id.*, P 48, App. 26.

The complaint alleges that the ILECs conspired to restrain trade in two ways, each supposedly inflating charges for local telephone and high-speed Internet services. Plaintiffs say, first, that the ILECs "engaged in parallel conduct" in their respective service areas to inhibit the growth **[***14]** of upstart CLECs. Complaint P 47, App. 23-26. Their actions allegedly included making unfair agreements with the CLECs for access to ILEC networks, providing inferior connections to the networks, overcharging, and billing in ways

designed to sabotage the CLECs' relations with their own customers. *Ibid.* According to the complaint, the ILECs' "compelling common motivatio[n]" to thwart the CLECs' competitive efforts naturally led them to form a conspiracy; "[h]ad any one [ILEC] not sought to prevent CLECs . . . from competing effectively . . ., the resulting greater competitive inroads into that [ILEC's] territory would have revealed the degree to which competitive entry by CLECs would have been successful in the other territories in the absence of such conduct." *Id.*, P 50, App. 26-27.

Second, the complaint charges agreements by the ILECs to refrain from competing against one another. These are to be inferred from the ILECs' common failure "meaningfully [to] pursu[e]" "attractive business opportunit[ies]" in contiguous markets where they possessed "substantial competitive advantages," *id.*, PP 40-41, App. 21-22, and from a statement of Richard Notebaert, chief executive officer **[***15]** (CEO) of the ILEC Qwest, that competing in the territory of another ILEC "'might be a good way to turn a quick dollar but that doesn't make it right,'" *id.*, P 42, App. 22.

The complaint couches its ultimate allegations this way:

> "In the absence of any meaningful competition between the [ILECs] in one another's markets, and in light of the parallel course of conduct that each engaged in to prevent competition from CLECs within **[**938]** their respective local telephone and/or high speed internet services markets and the other facts and market circumstances alleged above, Plaintiffs allege upon information **[*1963]** and belief that [the ILECs] have entered into a contract, combination or conspiracy to prevent competitive entry in their respective local telephone and/or high speed internet services markets and have agreed not to compete with one another and otherwise allocated customers and markets to one another." *Id.*, P 51, App. 27.[2]

FOOTNOTES

2 In setting forth the grounds for § 1 relief, the complaint repeats these allegations in substantially similar language:

> "Beginning at least as early as February 6, 1996, and continuing to the present, the exact dates being unknown to Plaintiffs, Defendants and their co-conspirators engaged in a contract, combination or conspiracy to prevent competitive entry in their respective local telephone and/or high speed internet services markets by, among other things, agreeing not to compete with one another and to stifle attempts by others to compete with them and otherwise allocating customers and markets to one another in violation of Section 1 of the Sherman Act." Id., P 64, App. 30-31.

[*16]** The United States District Court for the Southern District of New York dismissed the complaint for failure to state a claim upon which relief can be granted. The District Court acknowledged that "plaintiffs may allege a conspiracy by citing instances of parallel business behavior that suggest an agreement," but emphasized that "while '[c]ircumstantial evidence of consciously parallel behavior may have made heavy inroads into the traditional judicial attitude toward conspiracy[, . . .] "conscious parallelism" has not yet read conspiracy out of the Sherman Act entirely.'" 313 F. Supp. 2d 174, 179 (2003) (quoting *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 541, 74 S. Ct. 257, 98 L. Ed. 273 (1954); alterations in original). Thus, the District Court understood that allegations of parallel business conduct, taken alone, do not state a claim under § 1; plaintiffs must allege additional facts that "ten[d] to exclude independent self-interested conduct as an explanation for defendants' parallel behavior." 313 F. Supp. 2d, at 179. The District Court found plaintiffs' allegations of parallel ILEC actions to discourage competition inadequate **[***17]** because "the behavior of each ILEC in resisting the incursion of CLECs is fully explained by the ILEC's own interests in defending its individual territory." *Id.*, at 183. As to the ILECs'

supposed agreement against competing with each other, the District Court found that the complaint does not "alleg[e] facts . . . suggesting that refraining from competing in other territories as CLECs was contrary to [the ILECs'] apparent economic interests, and consequently [does] not rais[e] an inference that [the ILECs'] actions were the result of a conspiracy." *Id.*, at 188.

The Court of Appeals for the Second Circuit reversed, holding that the District Court tested the complaint by the wrong standard. It held that "plus factors are not *required* to be pleaded to permit an antitrust claim based on parallel conduct to survive dismissal." 425 F.3d 99, 114 (2005) (emphasis in original). Although the Court of Appeals took the view that plaintiffs must plead facts that "include conspiracy among the realm of 'plausible' possibilities in order to survive a motion to dismiss," it then said that "to rule that allegations of parallel anticompetitive conduct **[***18]** fail to support a plausible conspiracy claim, a court would have to conclude that there is no set of facts that would permit a **[**939]** plaintiff to demonstrate that the particular parallelism asserted was the product of collusion rather than coincidence." *Ibid.*

We granted certiorari to address the proper standard for pleading an antitrust conspiracy through allegations of parallel conduct, 547 U.S. , 126 S. Ct. 2965, 165 L. Ed. 2d 949 (2006), and now reverse.

[*1964] II

A

HN3 **[**LEdHR3]** LEdHR(3) **[3]** Because § 1 of the Sherman Act "does not prohibit [all] unreasonable restraints of trade . . . but only restraints effected by a contract, combination, or conspiracy," *Copperweld Corp.* v. *Independence Tube Corp.*, 467 U.S. 752, 775, 104 S. Ct. 2731, 81 L. Ed. 2d 628 (1984), "[t]he crucial question" is whether the challenged anticompetitive conduct "stem[s] from independent decision or from an agreement, tacit or express," *Theatre Enterprises*, 346 U.S., at 540, 74 S. Ct. 257, 98 L. Ed. 273. While a showing of parallel "business behavior is admissible circumstantial evidence from which the fact finder may infer agreement," it falls short of "conclusively establish[ing] agreement or . . . itself constitut [ing] a Sherman Act offense." *Id.*, at 540-541, 74 S. Ct. 257, 98 L. Ed. 273. Even "conscious **[***19]** parallelism," a common reaction of "firms in a concentrated market [that] recogniz[e] their shared economic interests and their interdependence with respect to price and output decisions" is "not in itself unlawful." *Brooke Group Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 227, 113 S. Ct. 2578, 125 L. Ed. 2d 168 (1993); see 6 P. Areeda & H. Hovenkamp, Antitrust Law P 1433a, p 236 (2d ed. 2003) (hereinafter Areeda & Hovenkamp) ("The courts are nearly unanimous in saying that mere interdependent parallelism does not establish the contract, combination, or conspiracy required by Sherman Act § 1"); Turner, The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal, 75 Harv. L. Rev. 655, 672 (1962) ("[M]ere interdependence of basic price decisions is not conspiracy").

The inadequacy of showing parallel conduct or interdependence, without more, mirrors the ambiguity of the behavior: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market. See, *e.g.*, AEI-Brookings Joint Center for Regulatory Studies, Epstein, Motions to Dismiss **[***20]** Antitrust Cases: Separating Fact from Fantasy, Related Publication 06-08, pp 3-4 (2006) (discussing problem of "false positives" in § 1 suits). Accordingly, we have previously hedged against false inferences from identical behavior at a number of points in the trial sequence. An antitrust conspiracy plaintiff with evidence showing nothing beyond parallel conduct is not entitled to a directed verdict, see *Theatre Enterprises, supra;* proof of a § 1 conspiracy must include evidence tending to exclude the possibility of independent action, see *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752, 104 S. Ct. 1464, 79 L. Ed. 2d 775 (1984); and at the summary judgment stage a § 1 plaintiff's offer of conspiracy evidence must tend to rule out the possibility that the defendants were acting independently, see *Matsushita Elec. Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986). **[**940]**

B

This case presents the antecedent question of what a plaintiff must plead in order to state a claim under § 1 of the Sherman Act. HN4 **[**LEdHR4]** LEdHR(4) **[4]** Federal Rule of Civil Procedure 8(a)(2) requires only "a short and plain statement of the claim showing that the pleader is entitled to relief," in **[***21]** order to "give the defendant fair notice of what the . . . claim is and the grounds upon which it rests," *Conley* v. *Gibson*, 355 U.S. 41, 47, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957). HN5 **[**LEdHR5]** LEdHR(5) **[5]**

While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, *ibid.*; *Sanjuan* v. *American Bd. of Psychiatry and Neurology, Inc.*, 40 F.3d 247, 251 (CA7 1994), a plaintiff's obligation to provide the **[*1965]** "grounds" of his "entitle[ment] to relief" requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do, see *Papasan* v. *Allain*, 478 U.S. 265, 286, 106 S. Ct. 2932, 92 L. Ed. 2d 209 (1986) (on a motion to dismiss, courts "are not bound to accept as true a legal conclusion couched as a factual allegation"). Factual allegations must be enough to raise a right to relief above the speculative level, see 5 C. Wright & A. Miller, Federal Practice and Procedure § 1216, pp 235-236 (3d ed. 2004) (hereinafter Wright & Miller) ("[T]he pleading must contain something more . . . than . . . a statement of facts that merely creates a suspicion [of] a legally cognizable right of action"),[3] on the assumption that all the allegations **[***22]** in the complaint are true (even if doubtful in fact), see, *e.g.*, *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 508, n. 1, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002); *Neitzke* v. *Williams*, 490 U.S. 319, 327, 109 S. Ct. 1827, 104 L. Ed. 2d 338 (1989) ("Rule 12(b)(6) does not countenance . . . dismissals based on a judge's disbelief of a complaint's factual allegations"); *Scheuer* v. *Rhodes*, 416 U.S. 232, 236, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974) (a well-pleaded complaint may proceed even if it appears "that a recovery is very remote and unlikely").

FOOTNOTES

3 The dissent greatly oversimplifies matters by suggesting that the Federal Rules somehow dispensed with the pleading of facts altogether. See *post*, at ____, 167 L. Ed. 2d, at 955 (opinion of Stevens, J.) (pleading standard of Federal Rules "does not require, or even invite, the pleading of facts"). While, for most types of cases, the Federal Rules eliminated the cumbersome requirement that a claimant "set out *in detail* the facts upon which he bases his claim," *Conley* v. *Gibson*, 355 U.S. 41, 47, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957) (emphasis added), Rule 8(a)(2) still requires a "showing," rather than a blanket assertion, of entitlement to relief. Without some factual allegation in the complaint, it is hard to see how a claimant could satisfy the requirement of providing not only "fair notice" of the nature of the claim, but also "grounds" on which the claim rests. See 5 Wright & Miller § 1202, at 94, 95 (Rule 8(a) "contemplate[s] the statement of circumstances, occurrences, and events in support of the claim presented" and does not authorize a pleader's "bare averment that he wants relief and is entitled to it").

[*23]** In applying these general standards to a § 1 claim, we hold that HN6 **[**LEdHR6]** LEdHR(6) **[6]** stating such a claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made. Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement.[4] And, of course, a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof **[**941]** of those facts is improbable, and "that a recovery is very remote and unlikely." *Ibid.* In identifying facts that are suggestive enough to render a § 1 conspiracy plausible, we have the benefit **[*1966]** of the prior rulings and considered views of leading commentators, already quoted, that lawful parallel conduct fails to bespeak unlawful agreement. It makes sense to say, therefore, that an allegation of parallel conduct and a bare assertion of conspiracy will not suffice. Without more, parallel conduct does not suggest conspiracy, and a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality. Hence, when **[***24]** allegations of parallel conduct are set out in order to make a § 1 claim, they must be placed in a context that raises a suggestion of a preceding agreement, not merely parallel conduct that could just as well be independent action.

FOOTNOTES

4 Commentators have offered several examples of parallel conduct allegations that would state a § 1 claim under this standard. See, *e.g.*, 6 Areeda & Hovenkamp P 1425, at 167-185 (discussing "parallel behavior that would probably not result from chance, coincidence, independent responses to common stimuli, or mere interdependence unaided by an advance understanding among the parties"); Blechman, Conscious Parallelism, Signalling and Facilitating Devices: The Problem of Tacit Collusion Under the Antitrust Laws, 24 N. Y. L. S. L. Rev. 881, 899 (1979) (describing "conduct [that] indicates the sort of restricted freedom of action and sense of obligation that one generally associates with agreement"). The parties in this case agree that "complex and historically unprecedented changes in pricing structure made at the very same time by multiple competitors, and made for no other

discernible reason" would support a plausible inference of conspiracy. Brief for Respondents 37; see also Reply Brief for Petitioners 12.

[LEdHR7]** LEdHR(7)[7] **[***25]** HN7The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) agreement reflects the threshold requirement of Rule 8(a)(2) that the "plain statement" possess enough heft to "sho[w] that the pleader is entitled to relief." A statement of parallel conduct, even conduct consciously undertaken, needs some setting suggesting the agreement necessary to make out a § 1 claim; without that further circumstance pointing toward a meeting of the minds, an account of a defendant's commercial efforts stays in neutral territory. An allegation of parallel conduct is thus much like a naked assertion of conspiracy in a § 1 complaint: it gets the complaint close to stating a claim, but without some further factual enhancement it stops short of the line between possibility and plausibility of "entitle[ment] to relief." Cf. *DM Research, Inc.* v. *College of Am. Pathologists*, 170 F.3d 53, 56 (CA1 1999) ("[T]erms like 'conspiracy,' or even 'agreement,' are border-line: they might well be sufficient in conjunction with a more specific allegation--for example, identifying a written agreement or even a basis for inferring a tacit agreement, . . . but a court **[***26]** is not required to accept such terms as a sufficient basis for a complaint").[5]

FOOTNOTES

5 The border in *DM Research* was the line between the conclusory and the factual. Here it lies between the factually neutral and the factually suggestive. Each must be crossed to enter the realm of plausible liability.

We alluded to the practical significance of the Rule 8 entitlement requirement in *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005), when we explained that something beyond the mere possibility of loss causation must be alleged, lest a plaintiff with "'a largely groundless claim'" be allowed to "'take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value.'" *Id.*, at 347, 125 S. Ct. 1627, **[**942]** 161 L. Ed. 2d 577 (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 741, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975)). So, HN8**[**LEdHR8]** LEdHR(8)[8] when the allegations in a complaint, however true, could not raise a claim of entitlement to relief, "'this basic deficiency **[***27]** should . . . be exposed at the point of minimum expenditure of time and money by the parties and the court.'" 5 Wright & Miller § 1216, at 233-234 (quoting *Daves* v. *Hawaiian Dredging Co.*, 114 F. Supp. 643, 645 (Haw. 1953)); see also *Dura, supra*, at 346, 125 S. Ct. 1627, 161 L. Ed. 2d 577; *Asahi Glass Co.* v. *Pentech Pharmaceuticals, Inc.*, 289 F. Supp. 2d 986, 995 (ND Ill. 2003) (Posner, J., sitting by designation) ("[S]ome threshold of plausibility must be crossed at the outset before a patent antitrust case should be permitted to go into its inevitably costly and protracted discovery phase").

Thus, it is one thing to be cautious before dismissing an antitrust complaint in advance of discovery, cf. **[*1967]** *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U.S. 464, 473, 82 S. Ct. 486, 7 L. Ed. 2d 458 (1962), but quite another to forget that proceeding to antitrust discovery can be expensive. As we indicated over 20 years ago in *Associated Gen. Contractors of Cal., Inc.* v. *Carpenters*, 459 U.S. 519, 528, n. 17, 103 S. Ct. 897, 74 L. Ed. 2d 723 (1983), HN9**[**LEdHR9]** LEdHR(9)[9]"a district court must retain the power to insist upon some specificity in pleading before allowing a potentially massive factual controversy **[***28]** to proceed." See also *Car Carriers, Inc.* v. *Ford Motor Co.*, 745 F.2d 1101, 1106 (CA7 1984) ("[T]he costs of modern federal antitrust litigation and the increasing caseload of the federal courts counsel against sending the parties into discovery when there is no reasonable likelihood that the plaintiffs can construct a claim from the events related in the complaint"); Note, Modeling the Effect of One-Way Fee Shifting on Discovery Abuse in Private Antitrust Litigation, 78 N. Y. U. L. Rev. 1887, 1898-1899 (2003) (discussing the unusually high cost of discovery in antitrust cases); Manual for Complex Litigation, Fourth, § 30, p. 519 (2004) (describing extensive scope of discovery in antitrust cases); Memorandum from Paul V. Niemeyer, Chair, Advisory Committee on Civil Rules, to Hon. Anthony J. Scirica, Chair, Committee on Rules of Practice and Procedure (May 11, 1999), 192 F.R.D. 354, 357 (2000) (reporting that discovery accounts for as much as 90 percent of litigation costs when discovery is actively employed). That potential expense is obvious enough in the present case: plaintiffs represent a putative class of at least 90 percent of all **[***29]** subscribers to local telephone or high-speed Internet service in the continental United States,

in an action against America's largest telecommunications firms (with many thousands of employees generating reams and gigabytes of business records) for unspecified (if any) instances of antitrust violations that allegedly occurred over a period of seven years.

It is no answer to say that a claim just shy of a plausible entitlement to relief can, if groundless, be weeded out early in the discovery process through "careful case management," *post* at ____, 167 L. Ed. 2d, at 951, given the common lament that the success of judicial supervision in checking discovery abuse has been on the modest side. See, *e.g.*, Easterbrook, Discovery as Abuse, 69 B. U. L. Rev. 635, 638 (1989) ("Judges can do little about impositional discovery when parties control the legal claims **[**943]** to be presented and conduct the discovery themselves"). And it is self-evident that the problem of discovery abuse cannot be solved by "careful scrutiny of evidence at the summary judgment stage," much less "lucid instructions to juries," *post*, at ____, 167 L. Ed. 2d, at 951; the threat of discovery expense will push cost-conscious defendants to settle even **[***30]** anemic cases before reaching those proceedings. Probably, then, it is only by taking care to require allegations that reach the level suggesting conspiracy that we can hope to avoid the potentially enormous expense of discovery in cases with no "'reasonably founded hope that the [discovery] process will reveal relevant evidence'" to support a § 1 claim. *Dura*, 544 U.S., at 347, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (quoting *Blue Chip Stamps, supra*, at 741, 95 S. Ct. 1917, 44 L. Ed. 2d 539; alteration in *Dura*).[6]

FOOTNOTES

6 The dissent takes heart in the reassurances of plaintiffs' counsel that discovery would be "'"phased"'" and "limited to the existence of the alleged conspiracy and class certification." *Post*, at ____, 167 L. Ed. 2d, at 963. But determining whether some illegal agreement may have taken place between unspecified persons at different ILECs (each a multibillion dollar corporation with legions of management level employees) at some point over seven years is a sprawling, costly, and hugely time-consuming undertaking not easily susceptible to the kind of line drawing and case management that the dissent envisions. Perhaps the best answer to the dissent's optimism that antitrust discovery is open to effective judicial control is a more extensive quotation of the authority just cited, a judge with a background in antitrust law. Given the system that we have, the hope of effective judicial supervision is slim: "The timing is all wrong. The plaintiff files a sketchy complaint (the Rules of Civil Procedure discourage fulsome documents), and discovery is launched. A judicial officer does not know the details of the case the parties will present and in theory *cannot* know the details. Discovery is used to find the details. The judicial officer always knows less than the parties, and the parties themselves may not know very well where they are going or what they expect to find. A magistrate supervising discovery does not--cannot--know the expected productivity of a given request, because the nature of the requester's claim and the contents of the files (or head) of the adverse party are unknown. Judicial officers cannot measure the costs and benefits to the requester and so cannot isolate impositional requests. Requesters have no reason to disclose their own estimates because they gain from imposing costs on rivals (and may lose from an improvement in accuracy). The portions of the Rules of Civil Procedure calling on judges to trim back excessive demands, therefore, have been, and are doomed to be, hollow. We cannot prevent what we cannot detect; we cannot detect what we cannot define; we cannot define 'abusive' discovery except in theory, because in practice we lack essential information." Easterbrook, Discovery as Abuse, 69 B. U. L. Rev. 635, 638-639 (1989).

[*31]** **[*1968]** Plaintiffs do not, of course, dispute the requirement of plausibility and the need for something more than merely parallel behavior explained in *Theatre Enterprises, Monsanto*, and *Matsushita*, and their main argument against the plausibility standard at the pleading stage is its ostensible conflict with an early statement of ours construing Rule 8. Justice Black's opinion for the Court in *Conley* v. *Gibson* spoke not only of the need for fair notice of the grounds for entitlement to relief but of "the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." 355 U.S., at 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80. This "no set of facts" language can be read in isolation as saying that any statement revealing the theory of the claim will suffice unless its factual impossibility may be shown from the face of the pleadings; and the Court of Appeals appears to have read *Conley* in some such way when formulating its understanding of the proper pleading standard, see 425 F.3d at 106, 114 (invoking *Conley*'s "no set **[***32]** of **[**944]** facts" language in describing the standard for dismissal).[7]

FOOTNOTES

7 The Court of Appeals also relied on Chief Judge Clark's suggestion in *Nagler* v. *Admiral Corp.*, 248 F.2d 319 (CA2 1957), that facts indicating parallel conduct alone suffice to state a claim under § 1. 425 F.3d at 114 (citing *Nagler, supra*, at 325). But *Nagler* gave no explanation for citing *Theatre Enterprises* (which upheld a denial of a directed verdict for plaintiff on the ground that proof of parallelism was not proof of conspiracy) as authority that pleading parallel conduct sufficed to plead a Sherman Act conspiracy. Now that *Monsanto Co.* v. *Spray-Rite Service Corp.*, 465 U.S. 752, 104 S. Ct. 1464, 79 L. Ed. 2d 775 (1984), and *Matsushita Elec. Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986), have made it clear that neither parallel conduct nor conscious parallelism, taken alone, raise the necessary implication of conspiracy, it is time for a fresh look at adequacy of pleading when a claim rests on parallel action.

[*33]** On such a focused and literal reading of *Conley*'s "no set of facts," a wholly conclusory statement of claim would survive a motion to dismiss whenever the pleadings left open the possibility that a plaintiff might later establish some "set of [undisclosed] facts" to support recovery. So here, the Court of Appeals specifically found the prospect of unearthing direct evidence of conspiracy sufficient to preclude dismissal, even though the complaint **[*1969]** does not set forth a single fact in a context that suggests an agreement. 425 F.3d, at 106, 114. It seems fair to say that this approach to pleading would dispense with any showing of a "'reasonably founded hope'" that a plaintiff would be able to make a case, see *Dura*, 544 U.S., at 347, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (quoting *Blue Chip Stamps*, 421 U.S., at 741, 95 S. Ct. 1917, 44 L. Ed. 2d 539); Mr. Micawber's optimism would be enough.

Seeing this, a good many judges and commentators have balked at taking the literal terms of the *Conley* passage as a pleading standard. See, *e.g.*, *Car Carriers*, 745 F.2d at 1106 ("*Conley* has never been interpreted literally" and, "[i]n practice, a complaint . . . must contain either direct or **[***34]** inferential allegations respecting all the material elements necessary to sustain recovery under *some* viable legal theory" (internal quotation marks omitted; emphasis and omission in original); *Ascon Properties, Inc.* v. *Mobil Oil Co.*, 866 F.2d 1149, 1155 (CA9 1989) (tension between *Conley*'s "no set of facts" language and its acknowledgment that a plaintiff must provide the "grounds" on which his claim rests); *O'Brien v. Di Grazia*, 544 F.2d 543, 546, n. 3 (CA1 1976) ("[W]hen a plaintiff . . . supplies facts to support his claim, we do not think that *Conley* imposes a duty on the courts to conjure up unpleaded facts that might turn a frivolous claim of unconstitutional . . . action into a substantial one"); *McGregor* v. *Industrial Excess Landfill, Inc.*, 856 F.2d 39, 42-43 (CA6 1988) (quoting *O'Brien*'s analysis); Hazard, From Whom No Secrets Are Hid, 76 Tex. L. Rev. 1665, 1685 (1998) (describing *Conley* as having "turned Rule 8 on its head"); Marcus, The Revival of Fact Pleading Under the Federal Rules of Civil Procedure, 86 Colum. L. Rev. 433, 463-465 (1986) (noting tension between **[***35]** *Conley* and subsequent understandings of Rule 8).

We could go on, but there is no need to pile up further citations to show that *Conley*'s "no set of facts" language has been questioned, criticized, and explained away long enough. To be fair to the *Conley* Court, the passage should be understood in light of the opinion's preceding summary of the complaint's concrete allegations, which the Court quite reasonably understood as amply stating a claim for **[**945]** relief. But the passage so often quoted fails to mention this understanding on the part of the Court, and after puzzling the profession for 50 years, this famous observation has earned its retirement. The phrase is best forgotten as an incomplete, negative gloss on an accepted pleading standard: **HN10** **[**LEdHR10]** **LEdHR(10)** **[10]** once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint. See *Sanjuan*, 40 F.3d at 251 (once a claim for relief has been stated, a plaintiff "receives the benefit of imagination, so long as the hypotheses are consistent with the complaint"); accord, *Swierkiewicz*, 534 U.S., at 514, 122 S. Ct. 992, 152 L. Ed. 2d 1; *National Organization for Women, Inc.* v. *Scheidler*, 510 U.S. 249, 256, 114 S. Ct. 798, 127 L. Ed. 2d 99 (1994); **[***36]** *H. J. Inc.* v. *Northwestern Bell Telephone Co.*, 492 U.S. 229, 249-250, 109 S. Ct. 2893, 106 L. Ed. 2d 195 (1989); *Hishon* v. *King & Spalding*, 467 U.S. 69, 73, 104 S. Ct. 2229, 81 L. Ed. 2d 59 (1984). *Conley*, then, described the breadth of opportunity to prove what an adequate complaint claims, not the minimum standard of adequate pleading to govern a complaint's survival.[8]

FOOTNOTES

8 Because *Conley*'s "'no set of facts'" language was one of our earliest statements about pleading under the Federal Rules, it is no surprise that it has since been "cited as authority" by this Court and others. *Post*, at ____, 167 L. Ed. 2d, at 953. Although we have not previously explained the circumstances and rejected the literal reading of the passage embraced by the Court of Appeals, our analysis comports with this Court's statements in the years since *Conley*. See *Dura*, 544 U.S., at 347, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 741, 95 S. Ct. 1917, 44 L. Ed. 2d 539 (1975); (requiring "'reasonably founded hope that the [discovery] process will reveal relevant evidence'" to support the claim (alteration in *Dura*)); *Associated Gen. Contractors of Cal., Inc.* v. *Carpenters*, 459 U.S. 519, 526, 103 S. Ct. 897, 74 L. Ed. 2d 723 (1983) ("It is not . . . proper to assume that [the plaintiff] can prove facts that it has not alleged or that the defendants have violated the antitrust laws in ways that have not been alleged"); *Wilson* v. *Schnettler*, 365 U.S. 381, 383, 81 S. Ct. 632, 5 L. Ed. 2d 620 (1961) ("In the absence of . . . an allegation [that the arrest was made without probable cause] the courts below could not, nor can we, assume that respondents arrested petitioner without probable cause to believe that he had committed . . . a narcotics offense"). Nor are we reaching out to decide this issue in a case where the matter was not raised by the parties, see *post*, at ____, 167 L. Ed. 2d, at 955, since both the ILECs and the Government highlight the problems stemming from a literal interpretation of *Conley*'s "no set of facts" language and seek clarification of the standard. Brief for Petitioners 27-28; Brief for United States as *Amicus Curiae* 22-25; see also Brief for Respondents 17 (describing "[p]etitioners and their amici" as mounting an "attack on *Conley*'s 'no set of facts' standard"). The dissent finds relevance in Court of Appeals precedents from the 1940s, which allegedly gave rise to Conley's "no set of facts" language. *See post, at* ____-____, 167 L. Ed. 2d, at 955-957. Even indulging this line of analysis, these cases do not challenge the understanding that, before proceeding to discovery, a complaint must allege facts suggestive of illegal conduct. See, e.g., *Leimer* v. *State Mut. Life Assur. Co.*, 108 F.2d 302, 305 (CA8 1940) ("'[I]f, in view of what is alleged, it can reasonably be conceived that the plaintiffs . . . could, upon a trial, establish a case which would entitle them to . . . relief, the motion to dismiss should not have been granted'"); *Continental Collieries, Inc.* v. *Shober*, 130 F.2d 631, 635 (CA3 1942) ("No matter how likely it may seem that the pleader will be unable to prove his case, he is entitled, upon averring a claim, to an opportunity to try to prove it"). Rather, these cases stand for the unobjectionable proposition that, ***HN11*** **[**LEdHR11]** ***LEdHR(11)*** **[11]** when a complaint adequately states a claim, it may not be dismissed based on a district court's assessment that the plaintiff will fail to find evidentiary support for his allegations or prove his claim to the satisfaction of the factfinder. Cf. *Scheuer* v. *Rhodes*, 416 U.S. 232, 236, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974) (a district court weighing a motion to dismiss asks "not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims").

[946]**

[*37]** **[*1970]** III

When we look for plausibility in this complaint, we agree with the District Court that plaintiffs' claim of conspiracy in restraint of trade comes up short. To begin with, the complaint leaves no doubt that plaintiffs rest their § 1 claim on descriptions of parallel conduct and not on any independent allegation of actual agreement among the ILECs. *Supra*, at ____, 167 L. Ed. 2d, at 937-938. Although in form a few stray statements speak directly of agreement,[9] on fair reading these are merely legal conclusions resting on the prior allegations. Thus, the complaint first takes account of the alleged "absence of any meaningful competition between [the ILECs] in one another's markets," "the parallel course of conduct that each [ILEC] engaged in to prevent competition from CLECs," "and the other facts and market circumstances alleged [earlier]"; "in light of" these, the complaint concludes "that [the ILECs] have entered into a contract, combination or conspiracy to prevent competitive entry into their . . . markets and have agreed not to compete with one another." Complaint P 51, App. 27.[10] The nub of the **[*1971]** complaint, then, is the ILECs' parallel behavior, consisting of steps to keep the CLECs out **[***38]** and manifest disinterest in becoming CLECs themselves, and its sufficiency turns on the suggestions raised by this conduct when viewed in light of common economic experience.[11]

FOOTNOTES

9 See Complaint PP 51, 64, App. 27, 30-31 (alleging that ILECs engaged in a "contract, combination or conspiracy" and agreed not to compete with one another).

10 If the complaint had not explained that the claim of agreement rested on the parallel conduct

described, we doubt that the complaint's references to an agreement among the ILECs would have given the notice required by Rule 8. Apart from identifying a seven-year span in which the § 1 violations were supposed to have occurred (*i.e.*, "[b]eginning at least as early as February 6, 1996, and continuing to the present," *id.*, P 64, App. 30), the pleadings mentioned no specific time, place, or person involved in the alleged conspiracies. This lack of notice contrasts sharply with the model form for pleading negligence, Form 9, which the dissent says exemplifies the kind of "bare allegation" that survives a motion to dismiss. *Post*, at ____, 167 L. Ed. 2d, at 953. Whereas the model form alleges that the defendant struck the plaintiff with his car while plaintiff was crossing a particular highway at a specified date and time, the complaint here furnishes no clue as to which of the four ILECs (much less which of their employees) supposedly agreed, or when and where the illicit agreement took place. A defendant wishing to prepare an answer in the simple fact pattern laid out in Form 9 would know what to answer; a defendant seeking to respond to plaintiffs' conclusory allegations in the § 1 context would have little idea where to begin. **[***39]

11 The dissent's quotations from the complaint leave the impression that plaintiffs directly allege illegal agreement; in fact, they proceed exclusively via allegations of parallel conduct, as both the District Court and Court of Appeals recognized. See 313 F. Supp. 2d 174, 182 (SDNY 2003); 425 F.3d 99, 102-104 (CA 2005).

We think that nothing contained in the complaint invests either the action or inaction alleged with a plausible suggestion of conspiracy. As to the ILECs' supposed agreement to disobey the 1996 Act and thwart the CLECs' attempts to compete, we agree with the District Court that nothing in the complaint intimates that the resistance to the upstarts was anything more than the natural, unilateral reaction of each ILEC intent on keeping its regional dominance. The 1996 Act did more than just subject the ILECs to competition; it obliged them to subsidize their competitors with their own equipment at **[**947]** wholesale rates. The economic incentive to resist was powerful, but resisting competition is routine market conduct, and even if the ILECs flouted the 1996 **[***40]** Act in all the ways the plaintiffs allege, see *id.*, P 47, App. 23-24, there is no reason to infer that the companies had agreed among themselves to do what was only natural anyway; so natural, in fact, that if alleging parallel decisions to resist competition were enough to imply an antitrust conspiracy, pleading a § 1 violation against almost any group of competing businesses would be a sure thing.

The complaint makes its closest pass at a predicate for conspiracy with the claim that collusion was necessary because success by even one CLEC in an ILEC's territory "would have revealed the degree to which competitive entry by CLECs would have been successful in the other territories." *Id.*, P 50, App. 26-27. But, its logic aside, this general premise still fails to answer the point that there was just no need for joint encouragement to resist the 1996 Act; as the District Court said, "each ILEC has reason to want to avoid dealing with CLECs" and "each ILEC would attempt to keep CLECs out, regardless of the actions of the other ILECs." 313 F. Supp. 2d, at 184; cf. *Kramer* v. *Pollock-Krasner Foundation*, 890 F. Supp. 250, 256 (SDNY 1995) (while the **[***41]** plaintiff "may believe the defendants conspired . . ., the defendants' allegedly conspiratorial actions could equally have been prompted by lawful, independent goals which do not constitute a conspiracy").[12]

FOOTNOTES

12 From the allegation that the ILECs belong to various trade associations, see Complaint P 46, App. 23, the dissent playfully suggests that they conspired to restrain trade, an inference said to be "buttressed by the common sense of Adam Smith." *Post*, at ____, ____ - ____, 167 L. Ed. 2d, at 962, 963-964. If Adam Smith is peering down today, he may be surprised to learn that his tongue-in-cheek remark would be authority to force his famous pinmaker to devote financial and human capital to hire lawyers, prepare for depositions, and otherwise fend off allegations of conspiracy; all this just because he belonged to the same trade guild as one of his competitors when their pins carried the same price tag.

[*1972] Plaintiffs' second conspiracy theory rests on the competitive reticence among the ILECs themselves in the wake of the 1996 Act, which was **[***42]** supposedly passed in the "'hop[e] that the large incumbent local monopoly companies . . . might attack their neighbors' service areas, as they are the

best situated to do so.'" Complaint P 38, App. 20 (quoting Consumer Federation of America, Lessons from 1996 Telecommunications Act: Deregulation Before Meaningful Competition Spells Consumer Disaster, p 12 (Feb. 2000). Contrary to hope, the ILECs declined "'to enter each other's service territories in any significant way,'" Complaint P 38, App. 20, and the local telephone and high speed Internet market remains highly compartmentalized geographically, with minimal competition. Based on this state of affairs, and perceiving the ILECs to be blessed with "especially attractive business opportunities" in surrounding markets dominated by other ILECs, the plaintiffs assert that the ILECs' parallel conduct was "strongly suggestive of conspiracy." *Id.*, P 40, App. 21.

But it was not suggestive of conspiracy, not if history teaches anything. In a traditionally unregulated industry with low barriers to entry, sparse competition among large firms dominating separate geographical segments of the market could very well signify illegal agreement, **[***43]** but here we have an obvious alternative **[**948]** explanation. In the decade preceding the 1996 Act and well before that, monopoly was the norm in telecommunications, not the exception. See *Verizon Communs., Inc. v. FCC*, 535 U.S. 467, 477-478, 122 S. Ct. 1646, 152 L. Ed. 2d 701 (2002) (describing telephone service providers as traditional public monopolies). The ILECs were born in that world, doubtless liked the world the way it was, and surely knew the adage about him who lives by the sword. Hence, a natural explanation for the noncompetition alleged is that the former Government-sanctioned monopolists were sitting tight, expecting their neighbors to do the same thing.

In fact, the complaint itself gives reasons to believe that the ILECs would see their best interests in keeping to their old turf. Although the complaint says generally that the ILECs passed up "especially attractive business opportunit[ies]" by declining to compete as CLECs against other ILECs, Complaint P 40, App. 21, it does not allege that competition as CLECs was potentially any more lucrative than other opportunities being pursued by the ILECs during the same period,[13] and **[*1973]** the complaint is replete with indications that any CLEC faced **[***44]** nearly insurmountable barriers to profitability owing to the ILECs' flagrant resistance to the network sharing requirements of the 1996 Act, *id.*, P 47; App. 23-26. Not only that, but even without a monopolistic tradition and the peculiar difficulty of mandating shared networks, "[f]irms do not expand without limit and none of them enters every market that an outside observer might regard as profitable, or even a small portion of such markets." Areeda & Hovenkamp P 307d, at 155 (Supp. 2006) (commenting on the case at bar). The upshot is that Congress may have expected some ILECs to become CLECs in the legacy territories of other ILECs, but the disappointment does not make conspiracy plausible. We agree with the District Court's assessment that antitrust conspiracy was not suggested by the facts adduced under either theory of the complaint, which thus fails to state a valid § 1 claim.[14]

FOOTNOTES

13 The complaint quoted a reported statement of Qwest's CEO, Richard Notebaert, to suggest that the ILECs declined to compete against each other despite recognizing that it "'might be a good way to turn a quick dollar.'" P 42, App. 22 (quoting Chicago Tribune, Oct. 31, 2002, Business Section, p 1). This was only part of what he reportedly said, however, and the District Court was entitled to take notice of the full contents of the published articles referenced in the complaint, from which the truncated quotations were drawn. See Fed. Rule Evid. 201. Notebaert was also quoted as saying that entering new markets as a CLEC would not be "a sustainable economic model" because the CLEC pricing model is "just . . . nuts." Chicago Tribune, Oct. 31, 2002, Business Section, p 1 (cited at Complaint P 42, App. 22). Another source cited in the complaint quotes Notebaert as saying he thought it "unwise" to "base a business plan" on the privileges accorded to CLECs under the 1996 Act because the regulatory environment was too unstable. Chicago Tribune, Dec. 19, 2002, Business Section, p 2 (cited at Complaint P 45, App. 23). **[***45]**

14 In reaching this conclusion, we do not apply any "heightened" pleading standard, nor do we seek to broaden the scope of Federal Rule of Civil Procedure 9, which can only be accomplished "'by the process of amending the Federal Rules, and not by judicial interpretation.'" *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 515, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002) (quoting *Leatherman* v. *Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 168, 113 S. Ct. 1160, 122 L. Ed. 2d 517 (1993)). On certain subjects understood to raise a high risk of abusive litigation, a plaintiff must state factual allegations with greater particularity than Rule 8 requires. Fed. Rules Civ. Proc. 9(b)-(c). Here, our concern is not that the allegations in the complaint were insufficiently "particular[ized]", *ibid.;* rather, the complaint warranted dismissal because it failed *in toto* to render plaintiffs' entitlement to relief

plausible.

Plaintiffs say that our analysis runs counter to *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 508, 122 S. Ct. 992, **[**949]** 152 L. Ed. 2d 1 (2002), which held that "a complaint in an employment discrimination **[***46]** lawsuit [need] not contain specific facts establishing a prima facie case of discrimination under the framework set forth in *McDonnell Douglas Corp.* v. *Green*, 411 U.S. 792, 93 S. Ct. 1817, 36 L. Ed. 2d 668 (1973)." They argue that just as the prima facie case is a "flexible evidentiary standard" that "should not be transposed into a rigid pleading standard for discrimination cases," *Swierkiewicz*, *supra*, at 512, 122 S. Ct. 992, 152 L. Ed. 2d 1, "transpos[ing] 'plus factor' summary judgment analysis woodenly into a rigid Rule 12(b)(6) pleading standard . . . would be unwise," Brief for Respondents 39. As the District Court correctly understood, however, "*Swierkiewicz* did not change the law of pleading, but simply re-emphasized . . . that the Second Circuit's use of a heightened pleading standard for Title VII cases was contrary to the Federal Rules' structure of liberal pleading requirements." 313 F. Supp. 2d, at 181 (citation and footnote omitted). Even though Swierkiewicz's pleadings "detailed the events leading to his termination, provided relevant dates, and included the ages and nationalities of at least some of the relevant persons involved with his termination," the Court of Appeals dismissed **[***47]** his complaint for failing to allege certain additional facts that Swierkiewicz would need at the trial stage to support his claim in the absence of direct evidence of discrimination. *Swierkiewicz*, 534 U.S., at 514, 122 S. Ct. 992, 152 L. Ed. 2d 1. We reversed on the ground that the Court of Appeals had impermissibly applied what amounted to a heightened pleading requirement by insisting that Swierkiewicz allege "specific facts" beyond **[*1974]** those necessary to state his claim and the grounds showing entitlement to relief. *Id.*, at 508, 122 S. Ct. 992, 152 L. Ed. 2d 1.

Here, in contrast, we do not require heightened fact pleading of specifics, but only enough facts to state a claim to relief that is plausible on its face. Because the plaintiffs here have not nudged their claims across the line from conceivable to plausible, their complaint must be dismissed.

* * *

The judgment of the Court of Appeals for the Second Circuit is reversed, and the cause is remanded for further proceedings consistent with this opinion.

It is so ordered.

DISSENT BY: STEVENS

DISSENT

Justice **Stevens,** with whom Justice **Ginsburg** joins except as to Part IV, dissenting.

In the first paragraph of its 24-page opinion the Court states that the question to be **[***48]** decided is whether allegations that "major telecommunications providers engaged in certain parallel conduct unfavorable to competition" suffice to state a violation of § 1 of the Sherman Act. *Ante*, at ____, 167 L. Ed. 2d, at 936. The answer to that question has been settled for more than 50 years. If that were indeed the issue, a summary reversal citing *Theatre Enterprises, Inc.* v. *Paramount Film Distributing Corp.*, 346 U.S. 537, 74 S. Ct. 257, 98 L. Ed. 273 (1954), would adequately resolve **[**950]** this case. As *Theatre Enterprises* held, parallel conduct is circumstantial evidence admissible on the issue of conspiracy, but it is not itself illegal. *Id.*, at 540-542, 74 S. Ct. 257, 98 L. Ed. 273.

Thus, this is a case in which there is no dispute about the substantive law. If the defendants acted independently, their conduct was perfectly lawful. If, however, that conduct is the product of a horizontal agreement among potential competitors, it was unlawful. Plaintiffs have alleged such an agreement and, because the complaint was dismissed in advance of answer, the allegation has not even been denied. Why, then, does the case not proceed? Does a judicial opinion that the charge is not "plausible" provide a legally

acceptable reason **[***49]** for dismissing the complaint? I think not.

Respondents' amended complaint describes a variety of circumstantial evidence and makes the straightforward allegation that petitioners

> "entered into a contract, combination or conspiracy to prevent competitive entry in their respective local telephone and/or high speed internet services markets and have agreed not to compete with one another and otherwise allocated customers and markets to one another." Amended Complaint in No. 02 CIV. 10220 (GEL) (SDNY) P 51, App. 27 (hereinafter Complaint).

The complaint explains that, contrary to Congress' expectation when it enacted the 1996 Telecommunications Act, and consistent with their own economic self-interests, petitioner Incumbent Local Exchange Carriers (ILECs) have assiduously avoided infringing upon each other's markets and have refused to permit nonincumbent competitors to access their networks. The complaint quotes Richard Notebaert, the former CEO of one such ILEC, as saying that competing in a neighboring ILEC's territory "might be a good way to turn a quick dollar but that doesn't make it right." *Id.,* P 42, App. 22. Moreover, respondents allege that petitioners "communicate **[***50]** amongst themselves" through numerous industry associations. *Id.,* P 46, App. 23. In sum, respondents allege that petitioners entered into an agreement that has long been recognized as a classic *per se* violation of the Sherman Act. See Report **[*1975]** of the Attorney General's National Committee to Study the Antitrust Laws 26 (1955).

Under rules of procedure that have been well settled since well before our decision in *Theatre Enterprises*, a judge ruling on a defendant's motion to dismiss a complaint, "must accept as true all of the factual allegations contained in the complaint." *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 508, n. 1, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002); see *Overstreet* v. *North Shore Corp.*, 318 U.S. 125, 127, 63 S. Ct. 494, 87 L. Ed. 656 (1943). But instead of requiring knowledgeable executives such as Notebaert to respond to these allegations by way of sworn depositions or other limited discovery--and indeed without so much as requiring petitioners to file an answer denying that they entered into any agreement--the majority permits immediate dismissal based on the assurances of company lawyers that nothing untoward was afoot. The Court embraces the argument of those lawyers that **[***51]** "there is no reason to infer that the companies had agreed among themselves to do what was only natural anyway," *ante,* at ____, 167 L. Ed. 2d, at 947; that "there was just no need for joint encouragement **[**951]** to resist the 1996 Act," *ante,* at ____, 167 L. Ed. 2d, at 947; and that the "natural explanation for the noncompetition alleged is that the former Government-sanctioned monopolists were sitting tight, expecting their neighbors to do the same thing," *ante,* at ____, 167 L. Ed. 2d, at 948.

The Court and petitioners' legal team are no doubt correct that the parallel conduct alleged is consistent with the absence of any contract, combination, or conspiracy. But that conduct is also entirely consistent with the *presence* of the illegal agreement alleged in the complaint. And the charge that petitioners "agreed not to compete with one another" is not just one of "a few stray statements," *ante,* at ____, 167 L. Ed. 2d, at 946; it is an allegation describing unlawful conduct. As such, the Federal Rules of Civil Procedure, our longstanding precedent, and sound practice mandate that the District Court at least require some sort of response from petitioners before dismissing the case.

Two practical concerns presumably explain the Court's dramatic departure from settled procedural **[***52]** law. Private antitrust litigation can be enormously expensive, and there is a risk that jurors may mistakenly conclude that evidence of parallel conduct has proved that the parties acted pursuant to an agreement when they in fact merely made similar independent decisions. Those concerns merit careful case management, including strict control of discovery, careful scrutiny of evidence at the summary judgment stage, and lucid instructions to juries; they do not, however, justify the dismissal of an adequately pleaded complaint without even requiring the defendants to file answers denying a charge that they in fact engaged in collective decisionmaking. More importantly, they do not justify an interpretation of Federal Rule of Civil Procedure 12(b)(6) that seems to be driven by the majority's appraisal of the plausibility of the ultimate factual allegation rather than its legal sufficiency.

I

Rule 8(a)(2) of the Federal Rules requires that a complaint contain "a short and plain statement of the claim showing that the pleader is entitled to relief." The rule did not come about by happenstance and its language is not inadvertent. The English experience with Byzantine special pleading rules **[***53]** -- illustrated by the hypertechnical Hilary rules of 1834[1] -- made obvious **[*1976]** the appeal of a pleading standard that was easy for the common litigant to understand and sufficed to put the defendant on notice as to the nature of the claim against him and the relief sought. Stateside, David Dudley Field developed the highly influential New York Code of 1848, which required "[a] statement of the facts constituting the cause of action, in ordinary and concise language, without repetition, and in such a manner as to enable a person of common understanding to know what is intended." An Act to Simplify and Abridge the Practice, Pleadings and Proceedings of the Courts of this State, ch. 379, § 120(2), 1848 N. Y. Laws pp. 497, 521. Substantially similar language appeared in the Federal Equity Rules adopted in 1912. See Fed. Equity Rule 25 (requiring "a short and simple statement of the ultimate facts upon which the plaintiff asks relief, omitting any mere statement of evidence").

FOOTNOTES

1 See 9 W. Holdsworth, History of English Law 324-327 (1926).

[*54]** **[**952]** A difficulty arose, however, in that the Field Code and its progeny required a plaintiff to plead "facts" rather than "conclusions," a distinction that proved far easier to say than to apply. As commentators have noted,

> "it is virtually impossible logically to distinguish among 'ultimate facts,' 'evidence,' and 'conclusions.' Essentially any allegation in a pleading must be an assertion that certain occurrences took place. The pleading spectrum, passing from evidence through ultimate facts to conclusions, is largely a continuum varying only in the degree of particularity with which the occurrences are described." Weinstein & Distler, Comments on Procedural Reform: Drafting Pleading Rules, 57 Colum. L. Rev. 518, 520-521 (1957).

See also Cook, Statements of Fact in Pleading Under the Codes, 21 Colum. L. Rev. 416, 417 (1921) (hereinafter Cook) ("[T]here is no logical distinction between statements which are grouped by the courts under the phrases 'statements of fact' and 'conclusions of law'"). Rule 8 was directly responsive to this difficulty. Its drafters intentionally avoided any reference to "facts" or "evidence" or "conclusions." See 5 C. **[***55]** Wright & A. Miller, Federal Practice and Procedure § 1216, p 207 (3d ed. 2004) (hereinafter Wright & Miller) ("The substitution of 'claim showing that the pleader is entitled to relief' for the code formulation of the 'facts' constituting a 'cause of action' was intended to avoid the distinctions drawn under the codes among 'evidentiary facts,' 'ultimate facts,' and 'conclusions' . . .").

Under the relaxed pleading standards of the Federal Rules, the idea was not to keep litigants out of court but rather to keep them in. The merits of a claim would be sorted out during a flexible pretrial process and, as appropriate, through the crucible of trial. See *Swierkiewicz*, 534 U.S., at 514, 122 S. Ct. 992, 152 L. Ed. 2d 1 ("The liberal notice pleading of Rule 8(a) is the starting point of a simplified pleading system, which was adopted to focus litigation on the merits of a claim"). Charles E. Clark, the "principal draftsman" of the Federal Rules,[2] put it thus:

> "Experience has shown . . . that we cannot expect the proof of the case to be made through the pleadings, and that such proof is really not their function. We can expect a general statement distinguishing the case from all others, so **[***56]** that the manner and form of trial and remedy expected are clear, and so that a permanent judgment will result." The **[*1977]** New Federal Rules of Civil Procedure: The Last Phase--Underlying Philosophy Embodied in Some of the Basic Provisions of the New Procedure, 23 A. B. A. J. 976, 977 (1937) (hereinafter Clark, New Federal Rules).

The pleading paradigm under the new Federal Rules was well illustrated by the inclusion in the appendix of Form 9, a complaint for negligence. As relevant, the Form 9 complaint states only: "On June 1, 1936, in a public highway called Boylston Street in Boston, Massachusetts, defendant negligently drove a motor vehicle against plaintiff who was then **[**953]** crossing said highway." Form 9, Complaint for Negligence, Forms App., Fed. Rules Civ. Proc., 28 U.S.C. App., p 829 (hereinafter Form 9). The complaint then describes the plaintiff's injuries and demands judgment. The asserted ground for relief--namely, the defendant's negligent driving--would have been called a "'conclusion of law'" under the code pleading of old. See, *e.g.*, Cook 419. But that bare allegation suffices under a system that "restrict[s] the pleadings to **[***57]** the task of general notice-giving and invest[s] the deposition-discovery process with a vital role in the preparation for trial."[3] *Hickman* v. *Taylor*, 329 U.S. 495, 501, 67 S. Ct. 385, 91 L. Ed. 451 (1947); see also *Swierkiewicz*, 534 U.S., at 513, n. 4, 122 S. Ct. 992, 152 L. Ed. 2d 1 (citing Form 9 as an example of "'the simplicity and brevity of statement which the rules contemplate'"); *Thomson* v. *Washington*, 362 F.3d 969, 970 (CA7 2004) (Posner, J.) ("The federal rules replaced fact pleading with notice pleading").

FOOTNOTES

2 *Gulfstream Aerospace Corp.* v. *Mayacamas Corp.*, 485 U.S. 271, 283, 108 S. Ct. 1133, 99 L. Ed. 2d 296 (1988).

3 The Federal Rules do impose a "particularity" requirement on "all averments of fraud or mistake," Fed. Rule Civ. Proc. 9(b), neither of which has been alleged in this case. We have recognized that the canon of *expressio unius est exclusio alterius* applies to Rule 9(b). See *Leatherman* v. *Tarrant Cty. Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 168, 113 S. Ct. 1160, 122 L. Ed. 2d 517 (1993).

II

[*58]** It is in the context of this history that *Conley* v. *Gibson*, 355 U.S. 41, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957), must be understood. The *Conley* plaintiffs were black railroad workers who alleged that their union local had refused to protect them against discriminatory discharges, in violation of the National Railway Labor Act. The union sought to dismiss the complaint on the ground that its general allegations of discriminatory treatment by the defendants lacked sufficient specificity. Writing for a unanimous Court, Justice Black rejected the union's claim as foreclosed by the language of Rule 8. *Id.*, at 47-48, 78 S. Ct. 99, 2 L. Ed. 2d 80. In the course of doing so, he articulated the formulation the Court rejects today: "In appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Id.*, at 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80.

Consistent with the design of the Federal Rules, *Conley*'s "no set of facts" formulation permits outright dismissal only when proceeding to discovery or beyond **[***59]** would be futile. Once it is clear that a plaintiff has stated a claim that, if true, would entitle him to relief, matters of proof are appropriately relegated to other stages of the trial process. Today, however, in its explanation of a decision to dismiss a complaint that it regards as a fishing expedition, the Court scraps *Conley*'s "no set of facts " language. Concluding that the phrase has been "questioned, criticized, and explained away long enough," *ante*, at ____, 167 L. Ed. 2d, at 944, the Court dismisses it as careless composition.

[*1978] If *Conley*'s "no set of facts" language is to be interred, let it not be without a eulogy. That exact language, which the majority says has "puzzl[ed] the profession for 50 years," *ibid.*, has been cited as authority in a dozen opinions of this Court and four separate **[**954]** writings.[4] In not one of those 16 opinions was the language "questioned," "criticized," or "explained away." Indeed, today's opinion is the first by any Member of this Court to express *any* doubt as to the adequacy of the *Conley* formulation. Taking their cues from the federal courts, 26 States and the District of Columbia utilize as their standard for dismissal of a complaint the very language **[***60]** the majority repudiates: whether it appears "beyond doubt" that "no set of facts" in support of the claim would entitle the plaintiff to relief.[5]

FOOTNOTES

4 *SEC* v. *Zandford*, 535 U.S. 813, 818, 122 S. Ct. 1899, 153 L. Ed. 2d 1 (2002); *Davis* v. *Monroe County Bd. of Ed.*, 526 U.S. 629, 654, 119 S. Ct. 1661, 143 L. Ed. 2d 839 (1999); *Hartford Fire Ins. Co.* v. *California*, 509 U.S. 764, 811, 113 S. Ct. 2891, 125 L. Ed. 2d 612 (1993); *Brower* v. *County of Inyo*, 489 U.S. 593, 598, 109 S. Ct. 1378, 103 L. Ed. 2d 628 (1989); *Hughes* v. *Rowe*, 449 U.S. 5, 10, 101 S. Ct. 173, 66 L. Ed. 2d 163 (1980) *(per curiam)*; *McLain* v. *Real Estate Bd. of New Orleans, Inc.*, 444 U.S. 232, 246, 100 S. Ct. 502, 62 L. Ed. 2d 441 (1980); *Estelle* v. *Gamble*, 429 U.S. 97, 106, 97 S. Ct. 285, 50 L. Ed. 2d 251 (1976); *Hospital Building Co.* v. *Trustees of Rex Hospital*, 425 U.S. 738, 746, 96 S. Ct. 1848, 48 L. Ed. 2d 338 (1976); *Scheuer* v. *Rhodes*, 416 U.S. 232, 236, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974); *Cruz* v. *Beto*, 405 U.S. 319, 322, 92 S. Ct. 1079, 31 L. Ed. 2d 263 (1972) *(per curiam)*; *Haines* v. *Kerner*, 404 U.S. 519, 521, 92 S. Ct. 594, 30 L. Ed. 2d 652 (1972) *(per curiam)*; *Jenkins* v. *McKeithen*, 395 U.S. 411, 422, 89 S. Ct. 1843, 23 L. Ed. 2d 404 (1969) (plurality opinion); see also *Cleveland Bd. of Ed.* v. *Loudermill*, 470 U.S. 532, 554, 105 S. Ct. 1487, 84 L. Ed. 2d 494 (1985) (Brennan, J., concurring in part and dissenting in part); *Hoover* v. *Ronwin*, 466 U.S. 558, 587, 104 S. Ct. 1989, 80 L. Ed. 2d 590 (1984) (Stevens, J., dissenting); *United Air Lines, Inc.* v. *Evans*, 431 U.S. 553, 561, n. 1, 97 S. Ct. 1885, 52 L. Ed. 2d 571 (1977) (Marshall, J., dissenting); *Simon* v. *Eastern Ky. Welfare Rights Organization*, 426 U.S. 26, 55, n. 6, 96 S. Ct. 1917, 48 L. Ed. 2d 450 (1976) (Brennan, J., concurring in judgment). **[***61]**

5 See, *e.g.*, *EB Invs., LLC* v. *Atlantis Development, Inc.*, 930 So. 2d 502, 507 (Ala. 2005); *Department of Health & Social Servs.* v. *Native Village of Curyung*, 151 P. 3d 388, 396 (Alaska 2006); *Newman* v. *Maricopa Cty.*, 167 Ariz. 501, 503, 808 P.2d 1253, 1255 (App. 1991); *Public Serv. Co. of Colo.* v. *Van Wyk*, 27 P. 3d 377, 385-386 (Colo. 2001) (en banc); *Clawson* v. *St. Louis Post-Dispatch, LLC*, 906 A.2d 308, 312 (D. C. 2006); *Hillman Constr. Corp.* v. *Wainer*, 636 So. 2d 576, 578 (Fla. App. 1994); *Kaplan* v. *Kaplan*, 266 Ga. 612, 613, 469 S. E. 2d 198, 199 (1996); *Wright* v. *Home Depot U.S.A.*, 111 Haw. 401, 406, 142 P. 3d 265, 270 (2006); *Taylor* v. *Maile*, 142 Idaho 253, 257, 127 P. 3d 156, 160 (2005); *Fink* v. *Bryant*, 2001-CC-0987, p. 4 (La. 11/28/01), 801 So. 2d 346, 349; *Gagne* v. *Cianbro Corp.*, 431 A.2d 1313, 1318-1319 (Me. 1981); *Gasior* v. *Massachusetts Gen. Hospital*, 446 Mass. 645, 647, 846 N.E.2d 1133, 1135 (2006); *Ralph Walker, Inc.* v. *Gallagher*, 926 So. 2d 890, 893 (Miss. 2006); *Jones* v. *Montana Univ. System*, 337 Mont. 1, 7, 155 P. 3d 1247, ____ (2007); *Johnston v. Neb. Dep't of Corr. Servs.*, 270 Neb. 987, 989, 709 N.W.2d 321, 324 (2006); *Blackjack Bonding* v. *Las Vegas Munic. Ct.*, 116 Nev. 1213, 1217, 14 P. 3d 1275, 1278 (2000); *Shepard* v. *Ocwen Fed. Bank*, 361 N. C. 137, 139, 638 S. E. 2d 197, 199 (2006); *Rose* v. *United Equitable Ins. Co.*, 2001 ND 154, P10, 632 N.W.2d 429, 434; *State ex rel. Turner* v. *Houk*, 112 Ohio St. 3d 561, 562, 2007-Ohio-814, P5, 862 N.E.2d 104, 105 *(per curiam)*; *Moneypenney* v. *Dawson*, 2006 OK 53, P2, 141 P. 3d 549, 551; *Gagnon* v. *State*, 570 A.2d 656, 659 (R. I. 1990); *Osloond* v. *Farrier*, 2003 SD 28, P4, 659 N.W.2d 20, 22 *(per curiam)*; *Smith* v. *Lincoln Brass Works, Inc.*, 712 S.W.2d 470, 471 (Tenn. 1986); *Association of Haystack Property Owners* v. *Sprague*, 145 Vt. 443, 446, 494 A.2d 122, 124 (1985); *In re Coday*, 156 Wn. 2d 485, 497, 130 P. 3d 809, 815 (2006) (en banc); *Haines* v. *Hampshire Cty. Comm'n*, 216 W. Va. 499, 502, 607 S. E. 2d 828, 831 (2004); *Warren* v. *Hart*, 747 P.2d 511, 512 (Wyo. 1987); see also *Malpiede* v. *Townson*, 780 A.2d 1075, 1082-1083 (Del. 2001) (permitting dismissal only "where the court determines with reasonable certainty that the plaintiff could prevail on no set of facts that may be inferred from the well-pleaded allegations in the complaint" (internal quotation marks omitted)); *Canel* v. *Topinka*, 212 Ill. 2d 311, 318, 818 N.E.2d 311, 317, 288 Ill. Dec. 623 (2004) (replacing "appears beyond doubt" in the *Conley* formulation with "is clearly apparent"); *In re Young*, 522 N.E.2d 386, 388 (Ind. 1988) *(per curiam)* (replacing "appears beyond doubt" with "appears to a certainty"); *Barkema* v. *Williams Pipeline Co.*, 666 N.W.2d 612, 614 (Iowa 2003) (holding that a motion to dismiss should be sustained "only when there exists no conceivable set of facts entitling the non-moving party to relief"); *Pioneer Village* v. *Bullitt Cty.*, 104 S. W. 3d 757, 759 (Ky. 2003) (holding that judgment on the pleadings should be granted "if it appears beyond doubt that the nonmoving party cannot prove any set of facts that would entitle him/her to relief"); *Corley* v. *Detroit Bd. of Ed.*, 470 Mich. 274, 277, 681 N.W.2d 342, 345 (2004) *(per curiam)* (holding that a motion for judgment on the pleadings should be granted only "'if no factual development could possibly justify recovery'"); *Oberkramer* v. *Ellisville*, 706 S.W.2d 440, 441 (Mo. 1986) (en banc) (omitting the words "beyond doubt" from the *Conley* formulation); *Colman* v. *Utah State Land Bd.*, 795 P.2d 622, 624 (Utah 1990) (holding that a motion to dismiss is appropriate "only if it clearly appears that [the plaintiff] can prove no set of facts in support of his claim"); *NRC Mgmt. Servs. Corp. v. First Va. Bank - Southwest*, 63 Va. Cir. 68, 70 (2003) ("The Virginia standard is identical [to the *Conley* formulation], though the Supreme Court of Virginia may not have used the same words to describe it").

[*62]** **[*1979]** Petitioners have not requested that the *Conley* formulation be retired, nor have any of the six *amici* who filed **[**955]** briefs in support of petitioners. I would not rewrite the Nation's civil procedure textbooks and call into doubt the pleading rules of most of its States without far more informed deliberation as to the costs of doing so. Congress has established a process--a rulemaking process--for revisions of that order. See 28 U.S.C. §§ 2072-2074 (2000 ed. and Supp. IV).

Today's majority calls *Conley*'s "'no set of facts'" language "an incomplete, negative gloss on an accepted pleading standard: once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint." *Ante*, at ____, 167 L. Ed. 2d, at 945. This is not and cannot be what the *Conley* Court meant. First, as I have explained, and as the *Conley* Court well knew, the pleading standard the Federal Rules meant to codify does not require, or even invite, the pleading of facts.[6] The "pleading standard" label the majority gives to what it reads into the *Conley* opinion--a statement of the permissible factual support for an adequately **[***63]** pleaded complaint--would not, therefore, have impressed the *Conley* Court itself. Rather, that Court would have understood the majority's remodeling of its language to express an *evidentiary* standard, which the *Conley* Court had neither need nor want to explicate. Second, it is pellucidly clear that the *Conley* Court was interested in what a complaint *must* contain, not what it *may* contain. In fact, the Court said without qualification that it was "appraising the *sufficiency* of the complaint." **[*1980]** 355 U.S., at 45, 78 S. Ct. 99, 2 L. Ed. 2d 80 (emphasis added). It was, to paraphrase today's majority, describing "the minimum standard of adequate pleading to govern a complaint's survival," *ante*, at ____ - ____, 167 L. Ed. 2d, at 945.

FOOTNOTES

6 The majority is correct to say that what the Federal Rules require is a "'showing'" of entitlement to relief. *Ante*, at ____, n 3, 167 L. Ed. 2d, at 940. Whether and to what extent that "showing" requires allegations of fact will depend on the particulars of the claim. For example, had the amended complaint in this case alleged *only* parallel conduct, it would not have made the required "showing." See *supra*, at ____, 167 L. Ed. 2d, at 949. Similarly, had the pleadings contained *only* an allegation of agreement, without specifying the nature or object of that agreement, they would have been susceptible to the charge that they did not provide sufficient notice that the defendants may answer intelligently. Omissions of that sort instance the type of "bareness" with which the Federal Rules are concerned. A plaintiff's inability to persuade a district court that the allegations actually included in her complaint are "plausible" is an altogether different kind of failing, and one that should not be fatal at the pleading stage.

[*64]** We can be triply sure as to *Conley*'s meaning by examining the three Court of Appeals cases the *Conley* Court cited as support for the "accepted rule" that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of **[**956]** facts in support of his claim which would entitle him to relief." 355 U.S., at 45-46, 78 S. Ct. 99, 2 L. Ed. 2d 80. In the first case, *Leimer v. State Mut. Life Assur. Co. of Worcester, Mass.*, 108 F.2d 302 (CA8 1940), the plaintiff alleged that she was the beneficiary of a life insurance plan and that the insurance company was wrongfully withholding proceeds from her. In reversing the District Court's grant of the defendant's motion to dismiss, the Eighth Circuit noted that court's own longstanding rule that, to warrant dismissal, "'it should appear from the allegations that a cause of action does not exist, rather than that a cause of action has been defectively stated.'" *Id.*, at 305 (quoting *Winget v. Rockwood*, 69 F.2d 326, 329 (CA8 1934)).

The *Leimer* court viewed the Federal Rules--specifically Rules 8(a)(2), 12(b)(6), 12(e) (motion for **[***65]** a more definite statement), and 56 (motion for summary judgment)--as reinforcing the notion that "there is no justification for dismissing a complaint for insufficiency of statement, except where it appears to a certainty that the plaintiff would be entitled to no relief under any state of facts which could be proved in support of the claim." 108 F.2d at 306. The court refuted in the strongest terms any suggestion that the unlikelihood of recovery should determine the fate of a complaint: "No matter how improbable it may be that she can prove her claim, she is entitled to an opportunity to make the attempt, and is not required to accept as final a determination of her rights based upon inferences drawn in favor of the defendant from her amended complaint." *Ibid.*

The Third Circuit relied on *Leimer*'s admonition in *Continental Collieries, Inc.* v. *Shober*, 130 F.2d 631 (1942), which the *Conley* Court also cited in support of its "no set of facts" formulation. In a diversity action the plaintiff alleged breach of contract, but the District Court dismissed the complaint on the ground that the contract appeared to be unenforceable under state **[***66]** law. The Court of Appeals reversed, concluding that there were facts in dispute that went to the enforceability of the contract, and that the rule at the pleading stage was as in *Leimer:* "No matter how likely it may seem that the pleader will be unable to prove his case, he is entitled, upon averring a claim, to an opportunity to try to prove it." 130 F.2d at 635.

The third case the *Conley* Court cited approvingly was written by Judge Clark himself. In *Dioguardi* v. *Durning*, 139 F.2d 774 (CA2 1944), the *pro se* plaintiff, an importer of "tonics," charged the customs inspector with auctioning off the plaintiff's former merchandise for less than was bid for it--and indeed for an amount equal to the plaintiff's own bid--and complained that two cases of tonics went missing three weeks before the sale. The inference, hinted at by the averments but never stated in so many words, was that the defendant fraudulently denied the plaintiff his rightful claim to the tonics, which, if true, would have violated federal law. Writing six years after the adoption of the Federal Rules he held the lead rein in drafting, Judge Clark said that the defendant **[***67]**

> "could have disclosed the facts from his point of view, in advance of a trial if he **[*1981]** chose, by asking for a pre-trial hearing or by moving for a summary judgment with supporting affidavits. But, as it stands, we do not see how the plaintiff may properly be deprived of his day in court to show what he obviously so **[**957]** firmly believes and what for present purposes defendant must be taken as admitting." *Id.*, at 775.

As any civil procedure student knows, Judge Clark's opinion disquieted the defense bar and gave rise to a movement to revise Rule 8 to require a plaintiff to plead a "'cause of action.'" See 5 Wright & Miller § 1201, at 86-87. The movement failed, see *ibid.; Dioguardi* was explicitly approved in *Conley;* and "[i]n retrospect the case itself seems to be a routine application of principles that are universally accepted," 5 Wright & Miller § 1220, at 284-285.

In light of *Leimer, Continental Collieries*, and *Dioguardi, Conley*'s statement that a complaint is not to be dismissed unless "no set of facts" in support thereof would entitle the plaintiff to relief is hardly "puzzling," *ante*, at _____, 167 L. Ed. 2d, at 945. It reflects a philosophy that, unlike **[***68]** in the days of code pleading, separating the wheat from the chaff is a task assigned to the pretrial and trial process. *Conley*'s language, in short, captures the policy choice embodied in the Federal Rules and binding on the federal courts.

We have consistently reaffirmed that basic understanding of the Federal Rules in the half century since *Conley.* For example, in *Scheuer* v. *Rhodes*, 416 U.S. 232, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974), we reversed the Court of Appeals' dismissal on the pleadings when the respondents, the Governor and other officials of the State of Ohio, argued that petitioners' claims were barred by sovereign immunity. In a unanimous opinion by then-Justice Rehnquist, we emphasized that

> "[w]hen a federal court reviews the sufficiency of a complaint, before the reception of any evidence either by affidavit or admissions, its task is necessarily a limited one. The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims. *Indeed it may appear on the face of the pleadings that a recovery is very remote and unlikely but that is not the test.*" *Id.*, at 236, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (emphasis added). **[***69]**

The *Rhodes* plaintiffs had "alleged generally and in conclusory terms" that the defendants, by calling out the National Guard to suppress the Kent State University student protests, "were guilty of wanton, wilful and negligent conduct." *Krause* v. *Rhodes*, 471 F.2d 430, 433 (CA6 1972). We reversed the Court of Appeals on the ground that "[w]hatever the plaintiffs may or may not be able to establish as to the merits of their allegations, their claims, as stated in the complaints, given the favorable reading required by the

Federal Rules of Civil Procedure," were not barred by the Eleventh Amendment because they were styled as suits against the defendants in their individual capacities. 416 U.S., at 238, 94 S. Ct. 1683, 40 L. Ed. 2d 90.

We again spoke with one voice against efforts to expand pleading requirements beyond their appointed limits in *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 113 S. Ct. 1160, 122 L. Ed. 2d 517 (1993). Writing for the unanimous Court, Chief Justice Rehnquist rebuffed the Fifth Circuit's effort to craft a standard for pleading municipal liability that accounted for "the enormous expense involved today in litigation," **[***70]** *Leatherman v. Tarrant Cty. Narcotics Intelligence and Coordination Unit*, **[**958]** 954 F.2d 1054, 1057 (1992) (internal quotation marks omitted), by requiring a plaintiff to "state with factual detail and **[*1982]** particularity the basis for the claim which necessarily includes why the defendant-official cannot successfully maintain the defense of immunity." *Leatherman*, 507 U.S., at 167, 113 S. Ct. 1160, 122 L. Ed. 2d 517 (internal quotation marks omitted). We found this language inconsistent with Rules 8(a)(2) and 9(b) and emphasized that motions to dismiss were not the place to combat discovery abuse: "In the absence of [an amendment to Rule 9(b)], federal courts and litigants must rely on summary judgment and control of discovery to weed out unmeritorious claims sooner rather than later." *Id.*, at 168-169,113 S. Ct. 1160, 122 L. Ed. 2d 517.

Most recently, in *Swierkiewicz*, 534 U.S. 506, 122 S. Ct. 992, 152 L. Ed. 2d 1, we were faced with a case more similar to the present one than the majority will allow. In discrimination cases, our precedents require a plaintiff at the summary judgment stage to produce either direct evidence of discrimination or, if the claim is based primarily on circumstantial evidence, to meet the shifting **[***71]** evidentiary burdens imposed under the framework articulated in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 93 S. Ct. 1817, 36 L. Ed. 2d 668 (1973). *See, e.g., Trans World Airlines, Inc. v. Thurston*, 469 U.S. 111, 121, 105 S. Ct. 613, 83 L. Ed. 2d 523 (1985). Swierkiewicz alleged that he had been terminated on account of national origin in violation of Title VII of the Civil Rights Act of 1964. The Second Circuit dismissed the suit on the pleadings because he had not pleaded a prima facie case of discrimination under the *McDonnell Douglas* standard.

We reversed in another unanimous opinion, holding that "under a notice pleading system, it is not appropriate to require a plaintiff to plead facts establishing a prima facie case because the *McDonnell Douglas* framework does not apply in every employment discrimination case." *Swierkiewicz*, 534 U.S., at 511, 122 S. Ct. 992, 152 L. Ed. 2d 1. We also observed that Rule 8(a)(2) does not contemplate a court's passing on the merits of a litigant's claim at the pleading stage. Rather, the "simplified notice pleading standard" of the Federal Rules "relies on liberal discovery rules and summary judgment motions to define disputed facts and issues and to dispose of unmeritorious **[***72]** claims." *Id.*, at 512, 122 S. Ct. 992, 152 L. Ed. 2d 1; see Brief for United States et al. as *Amici Curiae* in *Swierkiewicz v. Sorema N. A.*, O. T. 2001, No. 00-1853, p 10 (stating that a Rule 12(b)(6) motion is not "an appropriate device for testing the truth of what is asserted or for determining whether a plaintiff has any evidence to back up what is in the complaint" (internal quotation marks omitted)).[7]

FOOTNOTES

7 See also 5 Wright & Miller § 1202, at 89-90 ("[P]leadings under the rules simply may be a general summary of the party's position that is sufficient to advise the other party of the event being sued upon, to provide some guidance in a subsequent proceeding as to what was decided for purposes of res judicata and collateral estoppel, and to indicate whether the case should be tried to the court or to a jury. No more is demanded of the pleadings than this; indeed, history shows that no more can be performed successfully by the pleadings" (footnotes omitted)).

As in the discrimination context, we have developed **[***73]** an evidentiary framework for evaluating claims under § 1 of the Sherman Act when those claims rest on entirely circumstantial evidence of conspiracy. See *Matsushita* **[**959]** *Elec. Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986). Under *Matsushita*, a plaintiff's allegations of an illegal conspiracy may not, at the summary judgment stage, rest solely on the inferences that may be drawn from the parallel conduct of the defendants. In order to survive a Rule 56 motion, a § 1 plaintiff "must present evidence 'that tends to exclude **[*1983]** the possibility' that the alleged conspirators acted independently.'" *Id.*, at 588, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (quoting *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 764, 104 S.

Ct. 1464, 79 L. Ed. 2d 775 (1984)). That is, the plaintiff "must show that the inference of conspiracy is reasonable in light of the competing inferences of independent action or collusive action." 475 U.S., at 588, 106 S. Ct. 1348, 89 L. Ed. 2d 538.

Everything today's majority says would therefore make perfect sense if it were ruling on a Rule 56 motion for summary judgment and the evidence included nothing more than the Court has described. But it should go without saying in the wake of *Swierkiewicz* **[***74]** that a heightened production burden at the summary judgment stage does not translate into a heightened pleading burden at the complaint stage. The majority rejects the complaint in this case because--in light of the fact that the parallel conduct alleged is consistent with ordinary market behavior--the claimed conspiracy is "conceivable" but not "plausible," *ante*, at ____, 167 L. Ed. 2d, at 949. I have my doubts about the majority's assessment of the plausibility of this alleged conspiracy. See Part III, *infra.* But even if the majority's speculation is correct, its "plausibility" standard is irreconcilable with Rule 8 and with our governing precedents. As we made clear in *Swierkiewicz* and *Leatherman*, fear of the burdens of litigation does not justify factual conclusions supported only by lawyers' arguments rather than sworn denials or admissible evidence.

This case is a poor vehicle for the Court's new pleading rule, for we have observed that "in antitrust cases, where 'the proof is largely in the hands of the alleged conspirators,' . . . dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly." *Hospital Building Co. v. Trustees of Rex Hospital*, 425 U.S. 738, 746, 96 S. Ct. 1848, 48 L. Ed. 2d 338 (1976) **[***75]** (quoting *Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464, 473, 82 S. Ct. 486, 7 L. Ed. 2d 458 (1962)); see also *Knuth v. Erie-Crawford Dairy Cooperative Asso.*, 395 F.2d 420, 423 (CA3 1968) ("The 'liberal' approach to the consideration of antitrust complaints is important because inherent in such an action is the fact that all the details and specific facts relied upon cannot properly be set forth as part of the pleadings"). Moreover, the fact that the Sherman Act authorizes the recovery of treble damages and attorney's fees for successful plaintiffs indicates that Congress intended to encourage, rather than discourage, private enforcement of the law. See *Radovich v. National Football League*, 352 U.S. 445, 454, 77 S. Ct. 390, 1 L. Ed. 2d 456 (1957) ("Congress itself has placed the private antitrust litigant in a most favorable position . . . . In the face of such a policy this Court should not add requirements to burden the private litigant beyond what is specifically set forth by Congress in those laws"). It is therefore more, not less, important in antitrust cases to resist the urge to **[**960]** engage in armchair economics at the pleading stage.

The same year we decided *Conley* **[***76]** , Judge Clark wrote, presciently,

> "I fear that every age must learn its lesson that special pleading cannot be made to do the service of trial and that live issues between active litigants are not to be disposed of or evaded on the paper pleadings, i.e., the formalistic claims of the parties. Experience has found no quick and easy short cut for trials in cases generally *and antitrust cases in particular.*" Special Pleading in the "Big Case"? in Procedure--The Handmaid of Justice 147, 148 (C. Wright & H. Reasoner eds. 1965) (hereinafter **[*1984]** Clark, Special Pleading in the Big Case) (emphasis added).

In this "Big Case," the Court succumbs to the temptation that previous Courts have steadfastly resisted.[8] While the majority assures us that it is not applying any "'heightened'" pleading standard, see *ante*, at ____, n 14, 167 L. Ed. 2d, at 948-949, I shall now explain why I have a difficult time understanding its opinion any other way.

FOOTNOTES

8 Our decision in *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005), is not to the contrary. There, the plaintiffs failed adequately to allege loss causation, a required element in a private securities fraud action. Because it alleged nothing more than that the prices of the securities the plaintiffs purchased were artificially inflated, the *Dura* complaint failed to "provide the defendants with notice of what the relevant economic loss might be or of what the causal connection might be between that loss and the [alleged] misrepresentation." *Id.*, at 347, 125 S. Ct. 1627, 161 L. Ed. 2d 577. Here, the failure the majority identifies is not a failure of notice--which "notice pleading" rightly condemns--but rather a failure to satisfy the Court that the agreement alleged might plausibly

have occurred. That being a question not of *notice* but of *proof*, it should not be answered without first hearing from the defendants (as apart from their lawyers). Similarly, in *Associated Gen. Contractors of Cal., Inc.* v. *Carpenters*, 459 U.S. 519, 103 S. Ct. 897, 74 L. Ed. 2d 723 (1983), in which we also found an antitrust complaint wanting, the problem was not that the injuries the plaintiffs alleged failed to satisfy some threshold of plausibility, but rather that the injuries as alleged were not "the type that the antitrust statute was intended to forestall." *Id.*, at 540, 103 S. Ct. 897, 74 L. Ed. 2d 723; see *id.*, at 526, 103 S. Ct. 897, 74 L. Ed. 2d 723 ("As the case comes to us, we must assume that the Union can prove the facts alleged in its amended complaint. It is not, however, proper to assume that the Union can prove facts that it has not alleged or that the defendants have violated the antitrust laws in ways that have not been alleged").

[*77]** III

The Court does not suggest that an agreement to do what the plaintiffs allege would be permissible under the antitrust laws, *see, e.g.*, *Associated Gen. Contractors of Cal., Inc.* v. *Carpenters*, 459 U.S. 519, 526-527, 103 S. Ct. 897, 74 L. Ed. 2d 723 (1983). Nor does the Court hold that these plaintiffs have failed to allege an injury entitling them to sue for damages under those laws, see *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489-490, 97 S. Ct. 690, 50 L. Ed. 2d 701 (1977). Rather, the theory on which the Court permits dismissal is that, so far as the Federal Rules are concerned, no agreement has been alleged at all. This is a mind-boggling conclusion.

As the Court explains, prior to the enactment of the Telecommunications Act of 1996 the law prohibited the defendants from competing with each other. The new statute was enacted to replace a monopolistic market with a competitive one. The Act did not merely require the regional monopolists **[**961]** to take affirmative steps to facilitate entry to new competitors, see *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 402, 124 S. Ct. 872, 157 L. Ed. 2d 823 (2004); it also permitted the existing firms to compete with each **[***78]** other and to expand their operations into previously forbidden territory. See 47 U.S.C. § 271. Each of the defendants decided not to take the latter step. That was obviously an extremely important business decision, and I am willing to presume that each company acted entirely independently in reaching that decision. I am even willing to entertain the majority's belief that any agreement among the companies was unlikely. But the plaintiffs allege in three places in their complaint, PP 4, 51, 64, App. 11, 27, 30, that the ILECs did in fact agree both to prevent competitors from entering into their local markets and to forgo competition with each other. And as the Court **[*1985]** recognizes, at the motion to dismiss stage, a judge assumes "that all the allegations in the complaint are true (even if doubtful in fact)." *Ante*, at ____ - ____, 167 L. Ed. 2d, at 940.

The majority circumvents this obvious obstacle to dismissal by pretending that it does not exist. The Court admits that "in form a few stray statements in the complaint speak directly of agreement," but disregards those allegations by saying that "on fair reading these are merely legal conclusions resting on the prior allegations" of parallel **[***79]** conduct. *Ante*, at ____, 167 L. Ed. 2d, at 946. The Court's dichotomy between factual allegations and "legal conclusions" is the stuff of a bygone era, *supra*, at ____ - ____, 167 L. Ed. 2d, at 938-939. That distinction was a defining feature of code pleading, see generally Clark, The Complaint in Code Pleading, 35 Yale L. J. 259 (1925-1926), but was conspicuously abolished when the Federal Rules were enacted in 1938. See *United States v. Employing Plasterers Ass'n*, 347 U.S. 186, 188, 74 S. Ct. 452, 98 L. Ed. 618 (1954) (holding, in an antitrust case, that the Government's allegations of effects on interstate commerce must be taken into account in deciding whether to dismiss the complaint "[w]hether these charges be called 'allegations of fact' or 'mere conclusions of the pleader'"); *Brownlee* v. *Conine*, 957 F.2d 353, 354 (CA7 1992) ("The Federal Rules of Civil Procedure establish a system of notice pleading rather than of fact pleading, . . . so the happenstance that a complaint is 'conclusory,' whatever exactly that overused lawyers' cliche means, does not automatically condemn it"); *Walker Distributing Co.* v. *Lucky Lager Brewing Co.*, 323 F.2d 1, 3-4 (CA9 1963) ("[O]ne purpose of Rule 8 **[***80]** was to get away from the highly technical distinction between statements of fact and conclusions of law . . ."); *Oil, Chemical & Atomic Workers Int'l Union* v. *Delta*, 277 F.2d 694, 697 (CA6 1960) ("Under the notice system of pleading established by the Rules of Civil Procedure, . . . the ancient distinction between pleading 'facts' and 'conclusions' is no longer significant"); 5 Wright & Miller § 1218, at 267 ("[T]he federal rules do not prohibit the pleading of facts or legal conclusions as long as fair notice is given to the parties"). "Defendants entered into a contract" is no more a legal conclusion than "defendant negligently drove," see Form 9; *supra*, at **[**962]** ____, 167 L. Ed. 2d, at 952. Indeed it is less of one.[9]

FOOTNOTES

9 The Court suggests that the allegation of an agreement, even if credited, might not give the notice required by Rule 8 because it lacks specificity. *Ante*, at ____ - ____, n 10, 167 L. Ed. 2d, at 946. The remedy for an allegation lacking sufficient specificity to provide adequate notice is, of course, a Rule 12 (e) motion for a more definite statement. See *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 514, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002). Petitioners made no such motion and indeed have conceded that "[o]ur problem with the current complaint is not a lack of specificity, it's quite specific." Tr. of Oral Arg. 14. Thus, the fact that "the pleadings mentioned no specific time, place, or persons involved in the alleged conspiracies," *ante*, at ____, n 10, 167 L. Ed. 2d, at 946, is, for our purposes, academic.

[*81]** Even if I were inclined to accept the Court's anachronistic dichotomy and ignore the complaint's actual allegations, I would dispute the Court's suggestion that any inference of agreement from petitioners' parallel conduct is "implausible." Many years ago a truly great economist perceptively observed that "[p]eople of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." A. Smith, An Inquiry Into the Nature and Causes of the Wealth of Nations, in 39 Great Books of the Western World 55 (R. Hutchins & M. Adler eds. 1952). I am not so cynical as to accept that sentiment at face value, but I need not do so here. Respondents' complaint **[*1986]** points not only to petitioners' numerous opportunities to meet with each other, Complaint P 46, App. 23,[10] but also to Notebaert's curious statement that encroaching on a fellow incumbent's territory "might be a good way to turn a quick dollar but that doesn't make it right," *id.*, P 42, App. 22. What did he mean by that? One possible (indeed plausible) inference is that he meant that while it would be in his company's economic self-interest **[***82]** to compete with its brethren, he had agreed with his competitors not to do so. According to the complaint, that is how the Illinois Coalition for Competitive Telecom construed Notebaert's statement, *id.*, P 44, App. 22 (calling the statement "evidence of potential collusion among regional Bell phone monopolies to not compete against one another and kill off potential competitors in local phone service"), and that is how Members of Congress construed his company's behavior, *id.*, P 45, App. 23 (describing a letter to the Justice Department requesting an investigation into the possibility that the ILECs'"very apparent non-competition policy" was coordinated).

FOOTNOTES

10 The Court describes my reference to the allegation that the defendants belong to various trade associations as "playfully" suggesting that the defendants conspired to restrain trade. *Ante*, at ____, n 12, 167 L. Ed. 2d, at 947. Quite the contrary: an allegation that competitors meet on a regular basis, like the allegations of parallel conduct, is consistent with--though not sufficient to prove--the plaintiffs' entirely serious and unequivocal allegation that the defendants entered into an unlawful agreement. Indeed, if it were true that the plaintiffs "rest their § 1 claim on descriptions of parallel conduct and not on any independent allegation of actual agreement among the ILECs," *ante*, at ____, 167 L. Ed. 2d, at 946, there would have been no purpose in including a reference to the trade association meetings in the amended complaint.

[*83]** Perhaps Notebaert meant instead that competition would be sensible in the short term but not in the long run. That's what his lawyers tell us anyway. See Brief for Petitioners 36. But I would think that no one would know better what Notebaert meant than Notebaert himself. Instead of permitting respondents to ask Notebaert, however, the Court looks to other **[**963]** quotes from that and other articles and decides that what he meant was that entering new markets as a CLEC would not be a "'sustainable economic model.'" *Ante*, at ____, n 13, 167 L. Ed. 2d, at 948. Never mind that--as anyone ever interviewed knows--a newspaper article is hardly a verbatim transcript; the writer selects quotes to package his story, not to record a subject's views for posterity. But more importantly the District Court was required at this stage of the proceedings to construe Notebaert's ambiguous statement in the plaintiffs' favor.[11] See *Allen* v. *Wright*, 468 U.S. 737, 768, n. 1, 104 S. Ct. 3315, 82 L. Ed. 2d 556 (1984). The inference the statement supports--that simultaneous decisions by ILECs not even to attempt to poach customers from one another once the law authorized them to do so were the product of an agreement--sits comfortably within **[***84]** the realm of possibility. That is all the Rules require.

FOOTNOTES

11 It is ironic that the Court seeks to justify its decision to draw factual inferences in the defendants' favor at the pleading stage by citing to a rule of evidence, *ante*, at ____, n 13, 167 L. Ed. 2d, at 948. Under Federal Rule of Evidence 201(b), a judicially noticed fact "must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Whether Notebaert's statements constitute evidence of a conspiracy is hardly beyond reasonable dispute.

To be clear, if I had been the trial judge in this case, I would not have permitted the plaintiffs to engage in massive discovery based solely on the allegations in this complaint. On the other hand, I surely would not have dismissed the complaint **[*1987]** without requiring the defendants to answer the charge that they "have agreed not to compete with **[***85]** one another and otherwise allocated customers and markets to one another."[12] P 51, App. 27. Even a sworn denial of that charge would not justify a summary dismissal without giving the plaintiffs the opportunity to take depositions from Notebaert and at least one responsible executive representing each of the other defendants.

FOOTNOTES

12 The Court worries that a defendant seeking to respond to this "conclusory" allegation "would have little idea where to begin." *Ante*, at ____, n 10, 167 L. Ed. 2d, at 946. A defendant could, of course, begin by either denying or admitting the charge.

Respondents in this case proposed a plan of "'phased discovery'" limited to the existence of the alleged conspiracy and class certification. Brief for Respondents 25-26. Two petitioners rejected the plan. *Ibid.* Whether or not respondents' proposed plan was sensible, it was an appropriate subject for negotiation.[13] Given the charge in the complaint--buttressed **[**964]** by the common sense of Adam Smith--I cannot say that the possibility that joint discussions **[***86] [*1988]** and perhaps some agreements played a role in petitioners' decisionmaking process is so implausible that dismissing the complaint before any defendant has denied the charge is preferable to granting respondents even a minimal opportunity to prove their claims. See Clark, New Federal Rules 977 ("[T]hrough the weapons of discovery and summary judgment we have developed new devices, with more appropriate penalties to aid in matters of *proof*, and do not need to force the pleadings to their less appropriate function").

FOOTNOTES

13 The potential for "sprawling, costly, and hugely time-consuming" discovery, *ante*, at ____, n 6, 167 L. Ed. 2d, at 943, is no reason to throw the baby out with the bathwater. The Court vastly underestimates a district court's case-management arsenal. Before discovery even begins, the court may grant a defendant's Rule 12(e) motion; Rule 7(a) permits a trial court to order a plaintiff to reply to a defendant's answer, see *Crawford-El* v. *Britton*, 523 U.S. 574, 598, 118 S. Ct. 1584, 140 L. Ed. 2d 759 (1998); and Rule 23 requires "rigorous analysis" to ensure that class certification is appropriate, *General Telephone Co. of Southwest* v. *Falcon*, 457 U.S. 147, 160, 102 S. Ct. 2364, 72 L. Ed. 2d 740 (1982); see *In re Initial Public Offering Securities Litigation*, 471 F.3d 24 (CA2 2006) (holding that a district court may not certify a class without ruling that each Rule 23 requirement is met, even if a requirement overlaps with a merits issue). Rule 16 invests a trial judge with the power, backed by sanctions, to regulate pretrial proceedings via conferences and scheduling orders, at which the parties may discuss, *inter alia*, "the elimination of frivolous claims or defenses," Rule 16(c)(1); "the necessity or desirability of amendments to the pleadings," Rule 16(c)(2); "the control and scheduling of discovery," Rule 16(c)(6); and "the need for adopting special procedures for managing potentially difficult or protracted actions that may involve complex issues, multiple parties, difficult legal questions, or unusual proof problems," Rule 16(c)(12). Subsequently, Rule 26 confers broad discretion to control the combination of interrogatories, requests for admissions, production requests, and depositions permitted in a given case; the sequence in which such discovery devices may be deployed; and the

limitations imposed upon them. See 523 U.S., at 598-599, 118 S. Ct. 1584, 140 L. Ed. 2d 759. Indeed, Rule 26(c) specifically permits a court to take actions "to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense" by, for example, disallowing a particular discovery request, setting appropriate terms and conditions, or limiting its scope. In short, the Federal Rules contemplate that pretrial matters will be settled through a flexible process of give and take, of proffers, stipulations, and stonewalls, not by having trial judges screen allegations for their plausibility vel non without requiring an answer from the defendant. See Societe Internationale pour Participations Industrielles et *Commerciales, S. A.* v. *Rogers*, 357 U.S. 197, 206, 78 S. Ct. 1087, 2 L. Ed. 2d 1255 (1958) ("Rule 34 is sufficiently flexible to be adapted to the exigencies of particular litigation"). And should it become apparent over the course of litigation that a plaintiff's filings bespeak an in terrorem suit, the district court has at its call its own in terrorem device, in the form of a wide array of Rule 11 sanctions. See Rules 11(b), (c) (authorizing sanctions if a suit is presented "for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation"); see *Business Guides, Inc.* v. *Chromatic Communications Enterprises, Inc.*, 498 U.S. 533, 111 S. Ct. 922, 112 L. Ed. 2d 1140 (1991) (holding that Rule 11 applies to a represented party who signs a pleading, motion, or other papers, as well as to attorneys); *Atkins* v. *Fischer*, 232 F.R.D. 116, 126 (DC 2005) ("As possible sanctions pursuant to Rule 11, the court has an arsenal of options at its disposal").

[*87]** I fear that the unfortunate result of the majority's new pleading rule will be to invite lawyers' debates over economic theory to conclusively resolve antitrust suits in the absence of any evidence. It is no surprise that the antitrust defense bar--among whom "lament" as to inadequate judicial supervision of discovery is most "common," see *ante*, at ____, 167 L. Ed. 2d, at 942--should lobby for this state of affairs. But "we must recall that their primary responsibility is to win cases for their clients, not to improve law administration for the public." Clark, Special Pleading in the Big Case 152. As we did in our prior decisions, we should have instructed them that their remedy was to seek to amend the Federal Rules--not our interpretation of them.[14] See *Swierkiewicz*, 534 U.S., at 515, 122 S. Ct. 992, 152 L. **[**965]** Ed. 2d 1; *Crawford-El* v. *Britton*, 523 U.S. 574, 595, 118 S. Ct. 1584, 140 L. Ed. 2d 759 (1998); *Leatherman*, 507 U.S., at 168, 113 S. Ct. 1160, 122 L. Ed. 2d 517.

FOOTNOTES

14 Given his "background in antitrust law," *ante*, at ____, n 6, 167 L. Ed. 2d, at 943, Judge Easterbrook has recognized that the most effective solution to discovery abuse lies in the legislative and rulemaking arenas. He has suggested that the remedy for the ills he complains of requires a revolution in the rules of civil procedure:

> "Perhaps a system in which judges pare away issues and focus on investigation is too radical to contemplate in this country--although it prevailed here before 1938, when the Federal Rules of Civil Procedure were adopted. The change could not be accomplished without abandoning notice pleading, increasing the number of judicial officers, and giving them more authority . . . . If we are to rule out judge-directed discovery, however, we must be prepared to pay the piper. Part of the price is the high cost of unnecessary discovery--impositional and otherwise." Discovery as Abuse, 69 B. U. L. Rev. 635, 645 (1989).

[*88]** IV

Just a few weeks ago some of my colleagues explained that a strict interpretation of the literal text of statutory language is essential to avoid judicial decisions that are not faithful to the intent of Congress. *Zuni Pub. Sch. Dist. No. 89 v. Dep't of Educ.*, 550 U.S. ___, ___, 127 S. Ct. 1534, 167 L. Ed. 2d 449 (2007) (Scalia, J., dissenting). I happen to believe that there are cases in which other tools of construction are more reliable than text, but I agree of course that congressional intent should guide us in matters of statutory interpretation. *Id.*, at ___, 127 S.

Ct. 1534, 167 L. Ed. 2d 449 (Stevens, J., concurring). This is a case in which the intentions of the drafters of three important sources of law--the Sherman Act, the Telecommunications Act of 1996, and the Federal Rules of Civil Procedure--all point unmistakably in the same direction, yet the Court marches resolutely the other way. Whether the Court's actions will benefit only defendants in antitrust treble-damages cases, or whether its test for the sufficiency of a complaint will inure to the benefit of all civil defendants, is a question that the future will answer. But that the Court has announced a significant new rule that does not even purport to **[***89]** respond **[*1989]** to any congressional command is glaringly obvious.

The transparent policy concern that drives the decision is the interest in protecting antitrust defendants--who in this case are some of the wealthiest corporations in our economy--from the burdens of pretrial discovery. *Ante*, at ____ - ____, 167 L. Ed. 2d, at 942-943. Even if it were not apparent that the legal fees petitioners have incurred in arguing the merits of their Rule 12 (b) motion have far exceeded the cost of limited discovery, or that those discovery costs would burden respondents as well as petitioners,[15] that concern would not provide an adequate justification for this law-changing decision. For in the final analysis it is only a lack of confidence in the ability of trial judges to control discovery, buttressed by appellate judges' independent appraisal of the plausibility of profoundly serious factual allegations, that could account for this stark break from precedent.

FOOTNOTES

15 It would be quite wrong, of course, to assume that dismissal of an antitrust case after discovery is costless to plaintiffs. See Fed. Rule Civ. Proc. 54(d)(1) ("[C]osts other than attorneys' fees shall be allowed as of course to the prevailing party unless the court otherwise directs").

[*90]** If the allegation of conspiracy happens to be true, today's decision obstructs the congressional policy favoring competition that undergirds both the Telecommunications Act of 1996 and the Sherman Act itself. More importantly, even if there is abundant evidence that the allegation is untrue, directing that the case be dismissed without even looking at any of that evidence marks a fundamental--and unjustified--change in the character of pretrial practice.

Accordingly, I respectfully dissent.

REFERENCES

15 U.S.C.S. § 1

Antitrust Laws and Trade Regulation §§ 11.02, 164.01, 164.02 (Matthew Bender)

Moore's Federal Practice §§ 8.02, 12.03 (Matthew Bender 3d ed.)

L Ed Digest, Restraints of Trade, Monopolies, and Unfair Trade Practices § 45

L Ed Index, Sherman Act

Supreme Court's construction and application of Rules 8 and 9 of Federal Rules of Civil Procedure, concerning general rules of pleading and pleading special matters. 122 L. Ed. 2d 897.

Supreme Court's views as to what constitutes per se illegal "price fixing" under the Sherman Act (15 U.S.C.S. § 1 et seq.). 64 L. Ed. 2d 997.

Applicability of federal antitrust laws as affected by other federal statutes or by Federal Constitution--Supreme Court cases. 45 L. Ed. 2d 841.

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*127 S. Ct. 2499, *; 168 L. Ed. 2d 179, **;*
*2007 U.S. LEXIS 8270, ***; 75 U.S.L.W. 4462*

TELLABS, INC., ET AL., PETITIONERS v. MAKOR ISSUES & RIGHTS, LTD., ET AL.

No. 06-484

SUPREME COURT OF THE UNITED STATES

127 S. Ct. 2499; 168 L. Ed. 2d 179; 2007 U.S. LEXIS 8270; 75 U.S.L.W. 4462; Fed. Sec. L. Rep. (CCH) P94,335; 20 Fla. L. Weekly Fed. S 374

March 28, 2007, Argued
June 21, 2007, Decided

NOTICE:

[*1]** The LEXIS pagination of this document is subject to change pending release of the final published version.

PRIOR HISTORY: ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.
Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588, 2006 U.S. App. LEXIS 1865 (7th Cir. Ill., 2006)

DISPOSITION: Vacated and remanded.

Pleading Scienter: Vairo on Tellabs v. Makor Issues & Rights
Georgene Vairo on the Supreme Court's Analysis of Pleading the Strong Inference of Scienter as Required by the PSLRA.

CASE SUMMARY

PROCEDURAL POSTURE: Respondent shareholders of a corporation brought a securities fraud action against petitioner officer of the corporation, alleging that the officer deceived the public concerning the value of the corporation's stock. Upon the grant of a writ of certiorari, the officer challenged the judgment of the U.S. Court of Appeals for the Seventh Circuit which held that the shareholders sufficiently pleaded scienter under 15 U.S.C.S. § 78u-4(b)(2).

OVERVIEW: The shareholders contended that their allegations were sufficient to establish a strong inference that the officer acted with the intent to deceive, manipulate, or defraud, as required by § 78u-4(b)(2). The officer argued that the shareholders failed to allege any financial motive of the officer to support scienter and offered vague and ambiguous allegations. The U.S. Supreme Court held that, while the shareholders' allegations plausibly permitted an inference of the requisite scienter, further analysis was required to determine whether the inference of fraudulent intent was a powerful or cogent inference which was at least as compelling as any opposing inference of nonfraudulent intent. The strong inference of scienter required by § 78u-4(b)(2) was not required to be irrefutable or even the most plausible inference, but the strength of the inference could not be evaluated in a vacuum and consideration of plausible, nonculpable explanations for the officer's conduct was required. Further, any lack of pecuniary motive on the part of the officer did not by itself preclude a finding of scienter, and any ambiguities in the shareholders' allegations were relevant but not determinative.

OUTCOME: The judgment holding that scienter was sufficiently alleged was vacated, and the case was remanded for further proceedings.

CORE TERMS: scienter, particularity, state of mind, pleading requirements, facts giving rise, misleading, requisite, opposing, pleaded, cogent, reasonable person, collectively, heightened, motive, securities fraud, prescribe, channel, comparative, discovery, investors', stuffing, survive, frivolous, stock, quotation marks omitted, prescription, nonculpable, omission, customers, falcon

LEXISNEXIS® HEADNOTES Hide

Securities Law > Liability > Private Securities Litigation > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN1 The Private Securities Litigation Reform Act of 1995, 109 Stat. 737, requires plaintiffs to state with particularity both the facts constituting an alleged securities violation, and the facts evidencing scienter, i.e., a defendant's intention to deceive, manipulate, or defraud. 15 U.S.C.S. § 78u-4(b)(1), (2). As set out in § 78u-4(b)(2), the plaintiffs must state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview

HN2 It does not suffice that a reasonable factfinder plausibly could infer from the allegations of a securities fraud complaint the requisite state of mind. Rather, to determine whether the complaint's scienter allegations can survive threshold inspection for sufficiency, a court governed by 15 U.S.C.S. § 78u-4(b)(2) must engage in a comparative evaluation; it must consider not only inferences urged by a plaintiff, but also competing inferences rationally drawn from the facts alleged. An inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for a defendant's conduct. To qualify as "strong" within the intendment of § 78u-4(b)(2), an inference of scienter must be more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN3 Section 10(b) of the Securities Exchange Act of 1934 forbids the use or employ, in connection with the purchase or sale of any security, of any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Securities and Exchange Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. 15 U.S.C.S. § 78j(b). 17 C.F.R. § 240.10b-5 implements 15 U.S.C.S. § 78j(b) by declaring it unlawful: (a) to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made not misleading; or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview

HN4 15 U.S.C.S. § 78j(b), the U.S. Supreme Court implies from the statute's text and purpose, affords a right of action to purchasers or sellers of securities injured by its violation. To establish liability under § 78j(b) and 17 C.F.R. § 240.10b-5, a private plaintiff must prove that a defendant acted with scienter, a mental state embracing intent to deceive, manipulate, or defraud. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Pleadings > Complaints > Requirements

HN5 In an ordinary civil action, the Federal Rules of Civil Procedure require only a short and plain statement of the claim showing that the pleader is entitled to relief. Fed. R. Civ. P. 8(a)(2). Although the rule encourages brevity, the complaint must say enough to give a defendant fair notice of what a plaintiff's claim is and the grounds upon which it rests. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements > Fraud Claims

HN6 Fed. R. Civ. P. 9(b) requires that the circumstances constituting fraud be stated with particularity but provides that malice, intent, knowledge, and other condition of mind of a person, may be averred generally. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN7 Under the heightened pleading instructions of the Private Securities Litigation Reform Act of 1995, 109 Stat. 737, any private securities complaint alleging that a defendant made a false or misleading statement must: (1) specify each statement alleged to have been misleading and the reason or reasons why the statement is misleading, 15 U.S.C.S. § 78u-4(b)(1); and (2) state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind, § 78u-4(b)(2). More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > General Overview

HN8 Faced with a Fed. R. Civ. P. 12(b)(6) motion to dismiss a securities fraud action under 15 U.S.C.S. § 78j(b), courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Defenses, Demurrers, & Objections > Failures to State Claims
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action >

ightened Pleading Requirements

HN9 A court must consider a securities fraud complaint under 15 U.S.C.S. § 78j(b) in its entirety, as well as other sources courts ordinarily examine when ruling on Fed. R. Civ. P. 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice. The inquiry is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN10 In determining whether the pleaded facts in a securities fraud complaint under 15 U.S.C.S. § 78j(b) give rise to a strong inference of scienter, a court must take into account plausible opposing inferences. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN11 In the Private Securities Litigation Reform Act of 1995, 109 Stat. 737, Congress does not merely require plaintiffs to provide a factual basis for their scienter allegations, i.e., to allege facts from which an inference of scienter rationally could be drawn. Instead, Congress requires the plaintiffs to plead with particularity facts that give rise to a strong--i.e., a powerful or cogent--inference. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN12 To determine whether a plaintiff in a securities fraud action under 15 U.S.C.S. § 78j(b) has alleged facts that give rise to the requisite strong inference of scienter, a court must consider plausible nonculpable explanations for a defendant's conduct, as well as inferences favoring the plaintiff. The inference that the defendant acted with scienter need not be irrefutable, i.e., of the smoking-gun genre, or even the most plausible of competing inferences. The inference of scienter must be more than merely reasonable or permissible--it must be cogent and compelling, thus strong in light of other explanations. A complaint survives only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity

HN13 While it is true that motive can be a relevant consideration in a securities fraud action under 15 U.S.C.S. § 78j(b), and personal financial gain may weigh heavily in favor of a scienter inference, the absence of a motive allegation is not fatal. Allegations must be considered collectively; the significance that can be ascribed to an allegation of motive, or lack thereof, depends on the entirety of the complaint. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN14 Omissions and ambiguities count against inferring scienter in a securities fraud action under 15 U.S.C.S. § 78j(b), for plaintiffs must state with particularity facts giving rise to a strong inference that a defendant acted with the required state of mind. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN15 A court's job in a securities fraud action under 15 U.S.C.S. § 78j(b) is not to scrutinize each allegation in isolation but to assess all the allegations holistically. In sum, the court must ask: when the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference? More Like This Headnote | *Shepardize:* Restrict By Headnote

Constitutional Law > Bill of Rights > Fundamental Rights > Trial by Jury in Civil Actions
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > General Overview

HN16 Congress, as creator of federal statutory claims, has power to prescribe what must be pleaded to state a claim in a securities fraud action under 15 U.S.C.S. § 78j(b), just as it has power to determine what must be proved to prevail on the merits. It is the federal lawmaker's prerogative, therefore, to allow, disallow, or shape the contours of--including the pleading and proof requirements for--§ 78j(b) private actions. The Seventh Amendment does not inhibit Congress from establishing whatever pleading requirements it finds appropriate for federal statutory claims. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

HN17 A plaintiff alleging fraud in a securities fraud action under 15 U.S.C.S. § 78j(b), must plead facts rendering an inference of scienter at least as likely as any plausible opposing inference. At trial, she must then prove her case by a preponderance of the evidence. Stated otherwise, she must demonstrate that it is more likely than not that a defendant acted with scienter. More Like This Headnote | *Shepardize:* Restrict By Headnote

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SYLLABUS

As a check against abusive litigation in private securities fraud actions, the Private Securities Litigation Reform Act of 1995 (PSLRA) includes exacting pleading requirements. The Act requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, *i.e.*, the defendant's intention "to deceive, manipulate, or defraud." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194, 96 S. Ct. 1375, 47 L. Ed. 2d 668, and n. 12. As set out in § 21D(b)(2), plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state **[***2]** of mind." 15 U.S.C. § 78u-4(b)(2). Congress left the key term "strong inference" undefined.

Petitioner Tellabs, Inc., manufactures specialized equipment for fiber optic networks. Respondents (Shareholders) purchased Tellabs stock between December 11, 2000, and June 19, 2001. They filed a class action, alleging that Tellabs and petitioner Notebaert, then Tellabs' chief executive officer and president, had engaged in securities fraud in violation of § 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5, and that Notebaert was a "controlling person" under the 1934 Act, and therefore derivatively liable for the company's fraudulent acts. Tellabs moved to dismiss the complaint on the ground that the Shareholders had failed to plead their case with the particularity the PSLRA requires. The District Court agreed, dismissing the complaint without prejudice. The Shareholders then amended their complaint, adding references to 27 confidential sources and making further, more specific, allegations concerning Notebaert's mental state. The District Court again dismissed, this time with prejudice. The Shareholders had sufficiently **[***3]** pleaded that Notebaert's statements were misleading, the court

determined, but they had insufficiently alleged that he acted with scienter. The Seventh Circuit reversed in relevant part. Like the District Court, it found that the Shareholders had pleaded the misleading character of Notebaert's statements with sufficient particularity. Unlike the District Court, however, it concluded that the Shareholders had sufficiently alleged that Notebaert acted with the requisite state of mind. In evaluating whether the PSLRA's pleading standard is met, the Circuit said, courts should examine all of the complaint's allegations to decide whether collectively they establish an inference of scienter; the complaint would survive, the court stated, if a reasonable person could infer from the complaint's allegations that the defendant acted with the requisite state of mind.

Held: To qualify as "strong" within the intendment of § 21D(b)(2), an inference of scienter must be more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent. Pp. 6-18.

(a) Setting a uniform pleading standard for § 10(b) actions was among **[***4]** Congress' objectives in enacting the PSLRA. Designed to curb perceived abuses of the § 10(b) private action, the PSLRA installed both substantive and procedural controls. As relevant here, § 21D(b) of the PSLRA "impose[d] heightened pleading requirements in [§ 10(b) and Rule 10b-5] actions." *Dabit*, 547 U.S., at 81, 126 S. Ct. 1503, 164 L. Ed. 2d 179. In the instant case, the District Court and the Seventh Circuit agreed that the complaint sufficiently specified Notebaert's alleged misleading statements and the reasons why the statements were misleading. But those courts disagreed on whether the Shareholders, as required by § 21D(b)(2), "state[d] with particularity facts giving rise to a strong inference that [Notebaert] acted with [scienter]," § 78u-4(b)(2). Congress did not shed much light on what facts would create a strong inference or how courts could determine the existence of the requisite inference. With no clear guide from Congress other than its "inten[tion] to strengthen existing pleading requirements," H. R. Conf. Rep., at 41, Courts of Appeals have diverged in construing the term "strong inference." Among the uncertainties, should courts consider competing inferences in determining **[***5]** whether an inference of scienter is "strong"? This Court's task is to prescribe a workable construction of the "strong inference" standard, a reading geared to the PSLRA's twin goals: to curb frivolous, lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims. Pp. 6-10.

(b) The Court establishes the following prescriptions: *First*, faced with a Federal Rule of Civil Procedure 12(b)(6) motion to dismiss a § 10(b) action, courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true. See *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 164, 113 S. Ct. 1160, 122 L. Ed. 2d 517. *Second*, courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions. The inquiry is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard. *Third*, in determining whether the pleaded facts give rise to a "strong" inference of scienter, **[***6]** the court must take into account plausible opposing inferences. The Seventh Circuit expressly declined to engage in such a comparative inquiry. But in § 21D(b)(2), Congress did not merely require plaintiffs to allege facts from which an inference of scienter rationally *could* be drawn. Instead, Congress required plaintiffs to plead with particularity facts that give rise to a "strong"--*i.e.*, a powerful or cogent--inference. To determine whether the plaintiff has alleged facts giving rise to the requisite "strong inference," a court must consider plausible nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff. The inference that the defendant acted with scienter need not be irrefutable, but it must be more than merely "reasonable" or "permissible"--it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any plausible opposing inference one could draw from the facts alleged. Pp. 11-13.

(c) Tellabs contends that when competing inferences are considered, Notebaert's evident lack of **[***7]** pecuniary motive will be dispositive. The Court agrees that motive can be a relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference. The absence of a motive allegation, however, is not fatal for allegations must be considered collectively; the significance that can be ascribed to an allegation of motive, or lack thereof, depends on the complaint's entirety. Tellabs also maintains that several of the Shareholders' allegations are too vague or ambiguous to contribute to a strong inference of scienter. While omissions and ambiguities count against inferring scienter, the court's job is not to scrutinize each allegation in isolation but to access all the allegations holistically. Pp. 13-15.

(d) The Seventh Circuit was unduly concerned that a court's comparative assessment of plausible inferences would impinge upon the Seventh Amendment right to jury trial. Congress, as creator of federal statutory claims, has power to prescribe what must be pleaded to state the claim, just as it has power to determine what must be proved to prevail on the merits. It is the federal lawmaker's prerogative, therefore, to allow, disallow, or shape the contours **[***8]** of--including the pleading and proof requirements for--§ 10(b) private actions. This Court has never questioned that authority in general, or suggested, in particular, that the Seventh Amendment inhibits Congress from establishing whatever pleading requirements it finds appropriate for federal statutory claims. Provided that the Shareholders have satisfied the congressionally "prescribe[d] . . . means of making an issue," *Fidelity & Deposit Co. of Md. v. United States*, 187 U.S. 315, 320, 23 S. Ct. 120, 47 L. Ed. 194, the case will fall within the jury's authority to assess the credibility of witnesses, resolve genuine issues of fact, and make the ultimate determination whether Notebaert and, by imputation, Tellabs acted with scienter. Under this Court's construction of the "strong inference" standard, a plaintiff is not forced to plead more than she would be required to prove at trial. A plaintiff alleging fraud under § 10(b) must plead facts rendering an inference of scienter *at least as likely as* any plausible opposing inference. At trial, she must then prove her case by a "preponderance of the evidence." Pp. 15-17.

(e) Neither the District Court nor the Court of Appeals had **[***9]** the opportunity to consider whether the Shareholders' allegations warrant "a strong inference that [Notebaert and Tellabs] acted with the required state of mind," 15 U.S.C. § 78u-4(b)(2), in light of the prescriptions announced today. Thus, the case is remanded for a determination under this Court's construction of § 21D(b)(2). P. 18.

437 F.3d 588, vacated and remanded.

COUNSEL: Carter G. Phillips argued the cause for petitioners.

Kannon K. Shanmugam argued the cause for the United States, as amicus curiae, by special leave of court.

Arthur R. Miller argued the cause for respondents.

JUDGES: GINSBURG, J., delivered the opinion of the Court, in which ROBERTS, C. J., and KENNEDY, SOUTER, THOMAS, and BREYER, JJ., joined. SCALIA, J., and ALITO, J., filed opinions concurring in the judgment. STEVENS, J., filed a dissenting opinion.

OPINION BY: GINSBURG

OPINION

[*2504] **[**187]** JUSTICE GINSBURG delivered the opinion of the Court.

This Court has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission (SEC). See, *e.g.*, *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 345, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005); *J. I. Case Co. v. Borak*, 377 U.S. 426, 432, 84 S. Ct. 1555, 12 L. Ed. 2d 423 (1964). **[***10]** Private securities fraud actions, however, if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law. See *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (2006). As a check against abusive litigation by private parties, Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA), 109 Stat. 737.

Exacting pleading requirements are among the control measures Congress included in the PSLRA. HN1 The Act requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, *i.e.*, the defendant's intention "to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194, 96 S. Ct. 1375, 47 L. Ed. 2d 668, and n. 12 (1976); see 15 U.S.C. § 78u-4(b)(1),(2). This case concerns the latter requirement. As set out in § 21D(b)(2) of the PSLRA, plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with

the required state of mind." 15 U.S.C. § 78u-4(b)(2).

Congress left the key term **[***11]** "strong inference" undefined, and Courts of Appeals have divided on its meaning. In the case before us, the Court of Appeals for the Seventh Circuit held that the "strong inference" standard would be met if the complaint "allege[d] facts from which, if true, a reasonable person could infer that the defendant acted with the required intent." 437 F.3d 588, 602 (2006). That formulation, we conclude, does not capture the stricter demand Congress sought to convey in § 21D(b)(2). HN2 It does not suffice that a reasonable factfinder plausibly could infer from the complaint's allegations the requisite state of mind. Rather, to determine whether a complaint's scienter allegations can survive threshold inspection for sufficiency, a court governed by § 21D(b)(2) must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff, as the Seventh Circuit did, but also competing inferences rationally drawn from the facts alleged. An **[**188]** inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for the defendant's conduct. To qualify as "strong" within the intendment of § 21D(b)(2), we hold, an inference of scienter **[***12]** must be **[*2505]** more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.

I

Petitioner Tellabs, Inc., manufactures specialized equipment used in fiber optic networks. During the time period relevant to this case, petitioner Richard Notebaert was Tellabs' chief executive officer and president. Respondents (Shareholders) are persons who purchased Tellabs stock between December 11, 2000, and June 19, 2001. They accuse Tellabs and Notebaert (as well as several other Tellabs executives) of engaging in a scheme to deceive the investing public about the true value of Tellabs' stock. See 437 F.3d at 591; App. 94-98. [1]

FOOTNOTES

1 The Shareholders brought suit against Tellabs executives other than Notebaert, including Richard Birck, Tellabs' chairman and former chief executive officer. Because the claims against the other executives, many of which have been dismissed, are not before us, we focus on the allegations as they relate to Notebaert. We refer to the defendant-petitioners collectively as "Tellabs."

[*13]** Beginning on December 11, 2000, the Shareholders allege, Notebaert (and by imputation Tellabs) "falsely reassured public investors, in a series of statements . . . that Tellabs was continuing to enjoy strong demand for its products and earning record revenues," when, in fact, Notebaert knew the opposite was true. *Id.*, at 94-95, 98. From December 2000 until the spring of 2001, the Shareholders claim, Notebaert knowingly misled the public in four ways. 437 F.3d at 596. First, he made statements indicating that demand for Tellabs' flagship networking device, the TITAN 5500, was continuing to grow, when in fact demand for that product was waning. *Id.*, at 596, 597. Second, Notebaert made statements indicating that the TITAN 6500, Tellabs' next-generation networking device, was available for delivery, and that demand for that product was strong and growing, when in truth the product was not ready for delivery and demand was weak. *Id.*, at 596, 597-598. Third, he falsely represented Tellabs' financial results for the fourth quarter of 2000 (and, in connection with those results, condoned the practice of "channel stuffing," under which Tellabs **[***14]** flooded its customers with unwanted products). *Id.*, at 596, 598. Fourth, Notebaert made a series of overstated revenue projections, when demand for the TITAN 5500 was drying up and production of the TITAN 6500 was behind schedule. *Id.*, at 596, 598-599. Based on Notebaert's sunny assessments, the Shareholders contend, market analysts recommended that investors buy Tellabs' stock. See *id.*, at 592.

The first public glimmer that business was not so healthy came in March 2001 when Tellabs modestly reduced its first quarter sales projections. *Ibid.* In the next months, Tellabs made progressively more cautious statements about its projected sales. On June 19, 2001, the last day of the class period, Tellabs disclosed that demand for the TITAN 5500 had significantly dropped. *Id.*, at 593. Simultaneously, the company substantially lowered its revenue projections for the second quarter of 2001. The next day, the price of Tellabs stock, which had reached a high of $ 67 during **[**189]** the period, plunged to a low of $ 15.87. *Ibid.*

On December 3, 2002, the Shareholders filed a class action in the District Court for the Northern **[***15]** District of Illinois. *Ibid.* Their complaint stated, *inter alia*, that Tellabs and Notebaert had engaged in securities fraud in violation of § 10(b) of the Securities Exchange Act of 1934, 48 Stat. **[*2506]** 891, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 CFR § 240.10b-5 (2006), also that Notebaert was a "controlling person" under § 20(a) of the 1934 Act, 15 U.S.C. § 78t(a), and therefore derivatively liable for the company's fraudulent acts. See App. 98-101, 167-171. Tellabs moved to dismiss the complaint on the ground that the Shareholders had failed to plead their case with the particularity the PSLRA requires. The District Court agreed, and therefore dismissed the complaint without prejudice. App. to Pet. for Cert. 80a-117a; see *Johnson* v. *Tellabs, Inc.*, 303 F. Supp. 2d 941, 945 (ND Ill. 2004).

The Shareholders then amended their complaint, adding references to 27 confidential sources and making further, more specific, allegations concerning Notebaert's mental state. See 437 F.3d at 594; App. 91-93, 152-160. The District Court again dismissed, this time with prejudice. 303 F. Supp. 2d, at 971. **[***16]** The Shareholders had sufficiently pleaded that Notebaert's statements were misleading, the court determined, *id.*, at 955-961, but they had insufficiently alleged that he acted with scienter, *id.*, at 954-955, 961-969.

The Court of Appeals for the Seventh Circuit reversed in relevant part. 437 F.3d at 591. Like the District Court, the Court of Appeals found that the Shareholders had pleaded the misleading character of Notebaert's statements with sufficient particularity. *Id.*, at 595-600. Unlike the District Court, however, the Seventh Circuit concluded that the Shareholders had sufficiently alleged that Notebaert acted with the requisite state of mind. *Id.*, at 603-605.

The Court of Appeals recognized that the PSLRA "unequivocally raise[d] the bar for pleading scienter" by requiring plaintiffs to "plea[d] sufficient facts to create a strong inference of scienter." *Id.*, at 601 (internal quotation marks omitted). In evaluating whether that pleading standard is met, the Seventh Circuit said, "courts [should] examine all of the allegations in the complaint and then . . . decide whether **[***17]** collectively they establish such an inference." *Ibid.* "[W]e will allow the complaint to survive," the court next and critically stated, "if it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent . . . . If a reasonable person could not draw such an inference from the alleged facts, the defendants are entitled to dismissal." *Id.*, at 602.

In adopting its standard for the survival of a complaint, the Seventh Circuit explicitly rejected a stiffer standard adopted by the Sixth Circuit, *i.e.*, that "plaintiffs are entitled only to the most plausible of competing inferences." *Id.*, at 601, 602 (quoting *Fidel* v. *Farley*, 392 F.3d 220, 227 (CA6 2004)). The Sixth Circuit's standard, the court observed, because it involved an assessment of competing inferences, "could potentially infringe upon plaintiffs' Seventh Amendment rights." 437 F.3d at 602. We granted certiorari to resolve the disagreement among the Circuits on whether, and to what extent, a court must consider **[**190]** competing inferences in determining whether a securities fraud complaint gives rise to **[***18]** a "strong inference" of scienter. [2] 549 U.S. , 127 S. Ct. 853, 166 L. Ed. 2d 681 (2007).

FOOTNOTES

2 See, *e.g.*, 437 F.3d 588, 602 (CA7 2006) (decision below); *In re Credit Suisse First Boston Corp.*, 431 F.3d 36, 49, 51 (CA1 2005); *Ottmann* v. *Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 347-349 (CA4 2003); *Pirraglia* v. *Novell, Inc.*, 339 F.3d 1182, 1187-1188 (CA10 2003); *Gompper* v. *VISX, Inc.*, 298 F.3d 893, 896-897 (CA9 2002); *Helwig* v. *Vencor, Inc.*, 251 F.3d 540, 553 (CA6 2001) (en banc).

[*2507] II

HN3 Section 10(b) of the Securities Exchange Act of 1934 forbids the "use or employ, in connection with the purchase or sale of any security . . ., [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). SEC Rule 10b-5 implements § 10(b) **[***19]** by declaring it unlawful:

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 CFR § 240.10b-5.

HN4 Section 10(b), this Court has implied from the statute's text and purpose, affords a right of action to purchasers or sellers of securities injured by its violation. See, *e.g.*, *Dura Pharms., Inc.*, 544 U.S., at 341, 125 S. Ct. 1627, 161 L. Ed. 2d 577. See also *id.*, at 345, 125 S. Ct. 1627, 161 L. Ed. 2d 577 ("The securities statutes seek to maintain public confidence in the marketplace . . . . by deterring fraud, in part, through the availability of private securities fraud actions."); *Borak*, 377 U.S., at 432, 84 S. Ct. 1555, 12 L. Ed. 2d 423 (private securities fraud actions provide "a most effective weapon in the enforcement" of securities laws and are "a necessary supplement to Commission action"). To establish liability under § 10 (b) and Rule 10b-5, a private plaintiff **[***20]** must prove that the defendant acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst*, 425 U.S., at 193-194, and n. 12, 96 S. Ct. 1375, 47 L. Ed. 2d 668. [3]

FOOTNOTES

3 We have previously reserved the question whether reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194, n. 12, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976). Every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required. See *Ottmann*, 353 F.3d at 343 (collecting cases). The question whether and when recklessness satisfies the scienter requirement is not presented in this case.

HN5 In an ordinary civil action, the Federal Rules of Civil Procedure require only "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. Rule Civ. Proc. 8(a)(2). **[***21]** Although the rule encourages brevity, the complaint must say enough to give the defendant "fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Dura Pharms., Inc.*, 544 U.S., at 346, 125 S. Ct. 1627, 161 L. **[**191]** Ed. 2d 577 (internal quotation marks omitted). Prior to the enactment of the PSLRA, the sufficiency of a complaint for securities fraud was governed not by Rule 8, but by the heightened pleading standard set forth in Rule 9(b). See *Greenstone* v. *Cambex Corp.*, 975 F.2d 22, 25 (CA1 1992) (Breyer, J.) (collecting cases). Rule 9(b) applies to "all averments of fraud or mistake"; HN6 it requires that "the circumstances constituting fraud . . . be stated with particularity" but provides that "[m]alice, intent, knowledge, and other condition of mind of a person, may be averred generally."

Courts of Appeals diverged on the character of the Rule 9(b) inquiry in § 10(b) cases: Could securities fraud plaintiffs allege the requisite mental state "simply by stating that scienter existed," *In re GlenFed, Inc. Securities Litigation*, 42 F.3d 1541, 1546-1547 **[*2508]** (CA9 1994) (en banc), or were they required to allege with particularity facts giving rise **[***22]** to an inference of scienter? Compare *id.*, at 1546 ("We are not permitted to add new requirements to Rule 9(b) simply because we like the effects of doing so."), with, *e.g.*, *Greenstone*, 975 F.2d at 25 (were the law to permit a securities fraud complaint simply to allege scienter without supporting facts, "a complaint could evade too easily the 'particularity' requirement in Rule 9(b)'s first sentence"). Circuits requiring plaintiffs to allege specific facts indicating scienter expressed that requirement variously. See 5A C. Wright & A. Miller, Federal Practice and Procedure § 1301.1, pp. 300-302 (3d ed. 2004) (hereinafter Wright & Miller). The Second Circuit's formulation was the most stringent. Securities fraud plaintiffs in that Circuit were required to "specifically plead those [facts] which they assert give rise to a *strong inference* that the defendants had" the requisite state of mind. *Ross* v. *A. H. Robins Co.*, 607 F.2d 545, 558 (1979) (emphasis added). The "strong inference" formulation was appropriate, the Second Circuit said, to ward off allegations of "fraud by hindsight." See, *e.g.*, *Shields* v. *Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1129 (1994) **[***23]** (quoting *Denny* v. *Barber*, 576 F.2d 465, 470 (CA2 1978) (Friendly, J.)).

Setting a uniform pleading standard for § 10(b) actions was among Congress' objectives when it enacted the PSLRA. Designed to curb perceived abuses of the § 10(b) private action--"nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests and manipulation by class action lawyers," *Dabit*, 547 U.S., at 81, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (quoting H. R. Conf. Rep. No. 104-369, p. 31 (1995) (hereinafter H. R. Conf. Rep.))--the PSLRA installed both substantive and procedural controls. [4] Notably, Congress prescribed new procedures for the appointment of lead plaintiffs and lead counsel. This innovation aimed to increase the likelihood that institutional investors--parties more likely to balance the interests of the class with the long-term interests of the company--would serve as lead plaintiffs. See *id.*, at 33-34; S. Rep. No. 104-98, p. 11 (1995). Congress also "limit[ed] recoverable damages and **[**192]** attorney's fees, provide[d] a 'safe harbor' for forward-looking statements, . . . mandate[d] imposition of sanctions for frivolous litigation, and authorize[d] a stay of discovery **[***24]** pending resolution of any motion to dismiss." *Dabit*, 547 U.S., at 81, 126 S. Ct. 1503, 164 L. Ed. 2d 179. And in § 21D(b) of the PSLRA, Congress "impose[d] heightened pleading requirements in actions brought pursuant to § 10(b) and Rule 10b-5." *Ibid.*

FOOTNOTES

4 Nothing in the Act, we have previously noted, casts doubt on the conclusion "that private securities litigation [i]s an indispensable tool with which defrauded investors can recover their losses"--a matter crucial to the integrity of domestic capital markets. See *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 81, 126 S. Ct. 1503, 164 L. Ed. 2d 179 (2006) (internal quotation marks omitted).

HN7 Under the PSLRA's heightened pleading instructions, any private securities complaint alleging that the defendant made a false or misleading statement must: (1) "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); and (2) "state with particularity facts giving rise **[***25]** to a strong inference that the defendant acted with the required state of mind," § 78u-4(b)(2). In the instant case, as earlier stated, see *supra*, at 5, the District Court and the Seventh Circuit agreed that the Shareholders met the first of the two requirements: The complaint sufficiently **[*2509]** specified Notebaert's alleged misleading statements and the reasons why the statements were misleading. 303 F. Supp. 2d, at 955-961; 437 F.3d at 596-600. But those courts disagreed on whether the Shareholders, as required by § 21D(b)(2), "state[d] with particularity facts giving rise to a strong inference that [Notebaert] acted with [scienter]," § 78u-4(b)(2). See *supra*, at 5.

The "strong inference" standard "unequivocally raise[d] the bar for pleading scienter," 437 F.3d at 601, and signaled Congress' purpose to promote greater uniformity among the Circuits, see H. R. Conf. Rep., p. 41. But "Congress did not . . . throw much light on what facts . . . suffice to create [a strong] inference," or on what "degree of imagination courts can use in divining whether" the requisite inference exists. 437 F.3d at 601. While adopting **[***26]** the Second Circuit's "strong inference" standard, Congress did not codify that Circuit's case law interpreting the standard. See § 78u-4(b)(2). See also Brief for United States as *Amicus Curiae* 18. With no clear guide from Congress other than its "inten[tion] to strengthen existing pleading requirements," H. R. Conf. Rep., p. 41, Courts of Appeals have diverged again, this time in construing the term "strong inference." Among the uncertainties, should courts consider competing inferences in determining whether an inference of scienter is "strong"? See 437 F.3d at 601-602 (collecting cases). Our task is to prescribe a workable construction of the "strong inference" standard, a reading geared to the PSLRA's twin goals: to curb frivolous, lawyer-driven litigation, while preserving investors' ability to recover on meritorious claims.

III

A

We establish the following prescriptions: *First*, HN8 faced with a Rule 12(b)(6) motion to dismiss a § 10(b) action, courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true. See *Leatherman* v. *Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 164, 113 S. Ct. 1160, 122 L. Ed. 2d 517 (1993). **[***27]** On this point, the parties agree. See Reply Brief 8; Brief for Respondents 26; Brief for United States as *Amicus Curiae* 8, 20, 21.

[193]** *Second*, HN9 courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice. See 5B Wright & Miller § 1357 (3d ed. 2004 and Supp. 2007). The inquiry, as several Courts of Appeals have recognized, is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard. See, *e.g.*, *Abrams* v. *Baker Hughes Inc.*, 292 F.3d 424, 431 (CA5 2002); *Gompper* v. *VISX, Inc.*, 298 F.3d 893, 897 (CA9 2002). See also Brief for United States as *Amicus Curiae* 25.

Third, HN10 in determining whether the pleaded facts give rise to a "strong" inference of scienter, the court must take into account plausible opposing inferences. The Seventh Circuit expressly declined to engage in such a comparative **[***28]** inquiry. A complaint could survive, that court said, as long as it "alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent"; in other words, only "[i]f a reasonable person could not draw such an inference from **[*2510]** the alleged facts" would the defendant prevail on a motion to dismiss. 437 F.3d at 602. But in § 21D(b)(2), HN11 Congress did not merely require plaintiffs to "provide a factual basis for [their] scienter allegations," *ibid.* (quoting *In re Cerner Corp. Securities Litigation*, 425 F.3d 1079, 1084, 1085 (CA8 2005)), *i.e.*, to allege facts from which an inference of scienter rationally *could* be drawn. Instead, Congress required plaintiffs to plead with particularity facts that give rise to a "strong"--*i.e.*, a powerful or cogent--inference. See American Heritage Dictionary 1717 (4th ed. 2000) (defining "strong" as "[p]ersuasive, effective, and cogent"); 16 Oxford English Dictionary 949 (2d ed. 1989) (defining "strong" as "[p]owerful to demonstrate or convince" (definition 16b)); cf. 7 *id.*, at 924 (defining "inference" as "a conclusion [drawn] from known or assumed facts **[***29]** or statements"; "reasoning from something known or assumed to something else which follows from it").

The strength of an inference cannot be decided in a vacuum. The inquiry is inherently comparative: How likely is it that one conclusion, as compared to others, follows from the underlying facts? HN12 To determine whether the plaintiff has alleged facts that give rise to the requisite "strong inference" of scienter, a court must consider plausible nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff. The inference that the defendant acted with scienter need not be irrefutable, *i.e.*, of the "smoking-gun" genre, or even the "most plausible of competing inferences," *Fidel*, 392 F.3d at 227 (quoting *Helwig* v. *Vencor, Inc.*, 251 F.3d 540, 553 (CA6 2001) (en banc)). Recall in this regard that § 21D(b)'s pleading requirements are but one constraint among many the PSLRA installed to screen out frivolous suits, while allowing meritorious actions to move forward. See *supra*, at 9, and n. 4. Yet the inference of scienter must be more than merely "reasonable" or "permissible"--it must be cogent and compelling, **[***30]** thus strong in light of other explanations. A complaint will survive, we hold, only if a reasonable person would deem the inference of **[**194]** scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged. [5]

FOOTNOTES

5 JUSTICE SCALIA objects to this standard on the ground that "[i]f a jade falcon were stolen from a room to which only A and B had access," it could not "*possibly* be said there was a 'strong inference' that B was the thief." *Post*, at 1 (opinion concurring in judgment) (emphasis in original). I suspect, however, that law enforcement officials as well as the owner of the precious falcon would find the inference of guilt as to B quite strong--certainly strong enough to warrant further investigation. Indeed, an inference at least as likely as competing inferences can, in some cases, warrant recovery. See *Summers* v. *Tice*, 33 Cal.2d 80, 84-87, 199 P.2d 1, 3-5 (1948) (in bank) (plaintiff wounded by gunshot could recover from two defendants, even though the most he could prove was that each defendant was at least as likely to have injured him as the other); Restatement (Third) of Torts § 28(b), Comment *e*, p. 504 (Proposed Final Draft No. 1, Apr. 6, 2005) ("Since the publication of the Second Restatement in 1965, courts have generally accepted the alternative-liability principle of [*Summers* v. *Tice*, adopted in] § 433B(3), while fleshing out its limits."). In any event, we disagree with JUSTICE SCALIA that the hardly stock term "strong inference" has only one invariably right ("natural" or "normal") reading--his. See *post*, at 3.

JUSTICE ALITO agrees with JUSTICE SCALIA, and would transpose to the pleading stage "the test that is used at the summary-judgment and judgment-as-a-matter-of-law stages." *Post*, at 3 (opinion concurring in judgment). But the test at each stage is measured against a different backdrop. It is

improbable that Congress, without so stating, intended courts to test pleadings, unaided by discovery, to determine whether there is "no genuine issue as to any material fact." See Fed. Rule Civ. Proc. 56(c). And judgment as a matter of law is a post-trial device, turning on the question whether a party has produced evidence "legally sufficient" to warrant a jury determination in that party's favor. See Rule 50 (a)(1).

[*2511] [*31]** B

Tellabs contends that when competing inferences are considered, Notebaert's evident lack of pecuniary motive will be dispositive. The Shareholders, Tellabs stresses, did not allege that Notebaert sold any shares during the class period. See Brief for Petitioners 50 ("The absence of any allegations of motive color all the other allegations putatively giving rise to an inference of scienter."). HN13 While it is true that motive can be a relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference, we agree with the Seventh Circuit that the absence of a motive allegation is not fatal. See 437 F.3d at 601. As earlier stated, *supra*, at 11, allegations must be considered collectively; the significance that can be ascribed to an allegation of motive, or lack thereof, depends on the entirety of the complaint.

Tellabs also maintains that several of the Shareholders' allegations are too vague or ambiguous to contribute to a strong inference of scienter. For example, the Shareholders alleged that Tellabs flooded its customers with unwanted products, a practice known as "channel stuffing." See *supra*, at 3. But they failed, Tellabs **[***32]** argues, to specify whether the channel stuffing allegedly known to Notebaert was the illegitimate kind (*e.g.*, writing orders for products customers had not requested) or the legitimate kind (*e.g.*, offering customers discounts as an incentive to buy). Brief for Petitioners 44-46; Reply Brief 8. See also *id.*, at 8-9 (complaint lacks precise dates of reports critical to distinguish legitimate conduct from culpable conduct). But see 437 F.3d at 598, 603-604 (pointing to multiple particulars alleged by the Shareholders, including specifications as to timing). We agree that HN14 omissions and ambiguities count against inferring scienter, for plaintiffs must "state with particularity facts giving rise to a strong inference **[**195]** that the defendant acted with the required state of mind." § 78u-4(b)(2). We reiterate, however, that HN15 the court's job is not to scrutinize each allegation in isolation but to assess all the allegations holistically. See *supra*, at 11; 437 F.3d at 601. In sum, the reviewing court must ask: When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any **[***33]** opposing inference? [6]

FOOTNOTES

[6] The Seventh Circuit held that allegations of scienter made against one defendant cannot be imputed to all other individual defendants. 437 F.3d at 602-603. See also *id.*, at 603 (to proceed beyond the pleading stage, the plaintiff must allege as to each defendant facts sufficient to demonstrate a culpable state of mind regarding his or her violations) (citing *Phillips* v. *Scientific-Atlanta, Inc.*, 374 F.3d 1015, 1018 (CA11 2004)). Though there is disagreement among the Circuits as to whether the group pleading doctrine survived the PSLRA, see, *e.g.*, *Southland Securities Corp.* v. *Inspire Ins. Solutions Inc.*, 365 F.3d 353, 364 (CA5 2004), the Shareholders do not contest the Seventh Circuit's determination, and we do not disturb it.

IV

Accounting for its construction of § 21D(b)(2), the Seventh Circuit explained that the court "th[ought] it wis [e] to adopt an approach that [could not] be misunderstood as **[***34]** a usurpation of the jury's role." 437 F.3d at 602. In our view, the Seventh Circuit's concern was undue. [7] A court's **[*2512]** comparative assessment of plausible inferences, while constantly assuming the plaintiff's allegations to be true, we think it plain, does not impinge upon the Seventh Amendment right to jury trial. [8]

FOOTNOTES

[7] The Seventh Circuit raised the possibility of a Seventh Amendment problem on its own initiative. The Shareholders did not contend below that dismissal of their complaint under § 21D(b)(2) would violate

their right to trial by jury. Cf. *Monroe Employees Retirement System* v. *Bridgestone Corp.*, 399 F.3d 651, 683, n. 25 (CA6 2005) (noting possible Seventh Amendment argument but declining to address it when not raised by plaintiffs).

8 In numerous contexts, gatekeeping judicial determinations prevent submission of claims to a jury's judgment without violating the Seventh Amendment. See, *e.g.*, *Daubert* v. *Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 589, 113 S. Ct. 2786, 125 L. Ed. 2d 469 (1993) (expert testimony can be excluded based on judicial determination of reliability); *Neely* v. *Martin K. Eby Constr. Co.*, 386 U.S. 317, 321, 87 S. Ct. 1072, 18 L. Ed. 2d 75 (1967) (judgment as a matter of law); *Pease* v. *Rathbun-Jones Engineering Co.*, 243 U.S. 273, 278, 37 S. Ct. 283, 61 L. Ed. 715 (1917) (summary judgment).

[*35]** HN16 Congress, as creator of federal statutory claims, has power to prescribe what must be pleaded to state the claim, just as it has power to determine what must be proved to prevail on the merits. It is the federal lawmaker's prerogative, therefore, to allow, disallow, or shape the contours of--including the pleading and proof requirements for--§ 10(b) private actions. No decision of this Court questions that authority in general, or suggests, in particular, that the Seventh Amendment inhibits Congress from establishing whatever pleading requirements it finds appropriate for federal statutory claims. Cf. *Swierkiewicz* v. *Sorema N. A.*, 534 U.S. 506, 512-513, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002); *Leatherman*, 507 U.S., at 168, 113 S. Ct. 1160, 122 L. Ed. 2d 517 (both recognizing that heightened pleading requirements can be established by Federal Rule, citing Fed. Rule Civ. Proc. 9(b), which requires that **[**196]** fraud or mistake be pleaded with particularity). 9

FOOTNOTES

9 Any heightened pleading rule, including Fed. Rule Civ. Proc. 9(b), could have the effect of preventing a plaintiff from getting discovery on a claim that might have gone to a jury, had discovery occurred and yielded substantial evidence. In recognizing Congress' or the Federal Rule makers' authority to adopt special pleading rules, we have detected no Seventh Amendment impediment.

[*36]** Our decision in *Fidelity & Deposit Co. of Md.* v. *United States*, 187 U.S. 315, 23 S. Ct. 120, 47 L. Ed. 194 (1902), is instructive. That case concerned a rule adopted by the Supreme Court of the District of Columbia in 1879 pursuant to rulemaking power delegated by Congress. The rule required defendants, in certain contract actions, to file an affidavit "specifically stating . . ., in precise and distinct terms, the grounds of his defen[s]e." *Id.*, at 318, 23 S. Ct. 120, 47 L. Ed. 194 (internal quotation marks omitted). The defendant's affidavit was found insufficient, and judgment was entered for the plaintiff, whose declaration and supporting affidavit had been found satisfactory. *Ibid.* This Court upheld the District's rule against the contention that it violated the Seventh Amendment. *Id.*, at 320, 23 S. Ct. 120, 47 L. Ed. 194. Just as the purpose of § 21D(b) is to screen out frivolous complaints, the purpose of the prescription at issue in *Fidelity & Deposit Co.* was to "preserve the courts from frivolous defen[s]es," *ibid.* Explaining why the Seventh Amendment was not implicated, this Court said that the heightened pleading rule simply "prescribes the means of making an issue," and that, when "[t]he **[***37]** issue [was] made as prescribed, the right of trial by jury accrues." *Ibid.*; accord *Ex parte Peterson*, 253 U.S. 300, 310, 40 S. Ct. 543, 64 L. Ed. 919 (1920) (Brandeis, J.) (citing *Fidelity & Deposit Co.*, and reiterating: "It does not infringe the constitutional right to a trial by jury [in a civil case], to require, with a view to formulating the issues, an oath by each party to the facts relied upon."). See also *Walker* v. *New Mexico & Southern Pacific R. Co.*, 165 U.S. 593, 596, **[*2513]** 17 S. Ct. 421, 41 L. Ed. 837 (1897) (Seventh Amendment "does not attempt to regulate matters of pleading").

In the instant case, provided that the Shareholders have satisfied the congressionally "prescribe[d] . . . means of making an issue," *Fidelity & Deposit Co.*, 187 U.S., at 320, 23 S. Ct. 120, 47 L. Ed. 194, the case will fall within the jury's authority to assess the credibility of witnesses, resolve any genuine issues of fact, and make the ultimate determination whether Notebaert and, by imputation, Tellabs acted with scienter. We emphasize, as well, that under our construction of the "strong inference" standard, a plaintiff is not forced to plead more than she would be required to prove at trial. HN17 A plaintiff alleging fraud **[***38]** in a § 10(b) action, we hold today, must plead facts rendering an inference of scienter *at least as likely as*

any plausible opposing inference. At trial, she must then prove her case by a "preponderance of the evidence." Stated otherwise, she must demonstrate that it is *more likely* than not that the defendant acted with scienter. See *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 390, 103 S. Ct. 683, 74 L. Ed. 2d 548 (1983).

* * *

While we reject the Seventh Circuit's approach to § 21D(b)(2), we do not decide whether, under the standard we have described, see *supra*, at **[**197]** 11-14, the Shareholders' allegations warrant "a strong inference that [Notebaert and Tellabs] acted with the required state of mind," 15 U.S.C. § 78u-4(b)(2). Neither the District Court nor the Court of Appeals had the opportunity to consider the matter in light of the prescriptions we announce today. We therefore vacate the Seventh Circuit's judgment so that the case may be reexamined in accord with our construction of § 21D(b)(2).

The judgment of the Court of Appeals is vacated, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

CONCUR BY: SCALIA; ALITO

CONCUR

JUSTICE SCALIA, concurring in the judgment.

[*39]** I fail to see how an inference that is merely "at least as compelling as any opposing inference," *ante,* at 2, can conceivably be called what the statute here at issue requires: a "strong inference," 15 U.S.C. § 78u-4(b)(2). If a jade falcon were stolen from a room to which only A and B had access, could it *possibly* be said there was a "strong inference" that B was the thief? I think not, and I therefore think that the Court's test must fail. In my view, the test should be whether the inference of scienter (if any) is *more plausible* than the inference of innocence. *

FOOTNOTES

* The Court suggests that "the owner of the precious falcon would find the inference of guilt as to B quite strong." *Ante*, at 13, n. 5. If he should draw such an inference, it would only prove the wisdom of the ancient maxim "*aliquis non debet esse Judex in propria causa*"--no man ought to be a judge of his own cause. *Dr. Bonham's Case*, 8 Co. 107a, 114a, 118a, 77 Eng. Rep. 638, 646, 652 (C. P. 1610). For it is quite clear (from the dispassionate perspective of one who does not own a jade falcon) that a *possibility*, even a strong possibility, that B is responsible is not a strong *inference* that B is responsible. "Inference" connotes "belief" in what is inferred, and it would be impossible to form a strong belief that it was B and not A, or A and not B.

[*40]** The Court's explicit rejection of this reading, *ante,* at 12, rests on two assertions. The first (doubtless true) is that the statute does not require that "[t]he inference that the defendant acted with scienter . . . be irrefutable, *i.e.*, of the 'smoking-gun' genre," *ibid.* It is up to Congress, **[*2514]** however, and not to us, to determine what pleading standard would avoid those extremities while yet effectively deterring baseless actions. Congress has expressed its determination in the phrase "strong inference"; it is our job to give that phrase its normal meaning. And if we are to abandon text in favor of unexpressed purpose, as the Court does, it is inconceivable that Congress's enactment of stringent pleading requirements in the Private Securities Litigation Reform Act of 1995 somehow manifests the purpose of giving plaintiffs the edge in close cases.

The Court's second assertion (also true) is that "an inference at least as likely as competing inferences can, in some cases, warrant recovery." *Ante*, at 13, n. 5 (citing *Summers* v. *Tice*, 33 Cal.2d 80, 84-87, 199 P.2d 1, 3-5 (1948) (in bank)). *Summers* is a famous case, however, because it sticks **[***41]** out of the

ordinary body of tort law like a sore thumb. It represented "a relaxation" of "such proof as is ordinarily required" to succeed in a negligence **[**198]** action. *Id.*, at 86, 199 P. 2d, at 4 (internal quotation marks omitted). There is no indication that the statute at issue here was meant to relax the ordinary rule under which a tie goes to the defendant. To the contrary, it explicitly strengthens that rule by extending it to the pleading stage of a case.

One of petitioners' *amici* suggests that my reading of the statute would transform the text from requiring a "strong" inference to requiring the "strongest" inference. See Brief for American Association for Justice as *Amicus Curiae* 27. The point might have some force if Congress could have more clearly adopted my standard by using the word "strongest" instead of the word "strong." But the use of the superlative would not have made any sense given the provision's structure: What does it mean to require a plaintiff to plead "facts giving rise to *the strongest* inference that the defendant acted with the required state of mind"? It is certainly true that, if Congress had wanted to adopt my standard with even **[***42]** greater clarity, it could have restructured the entire provision--to require, for example, that the plaintiff plead "facts giving rise to *an inference of scienter that is more compelling than the inference that the defendant acted with a nonculpable state of mind.*" But if one is to consider the possibility of total restructuring, it is equally true that, to express the Court's standard, Congress could have demanded "*an inference of scienter that is at least as compelling as the inference that the defendant acted with a nonculpable state of mind*." Argument from the possibility of saying it differently is clearly a draw. We must be content to give "strong inference" its normal meaning. I hasten to add that, while precision of interpretation should always be pursued for its own sake, I doubt that in this instance what I deem to be the correct test will produce results much different from the Court's. How often is it that inferences are precisely in equipoise? All the more reason, I think, to read the language for what it says.

The Court and the dissent criticize me for suggesting that there is only one reading of the text. *Ante*, at 13, n. 5; *post*, at 2, n. 1 (STEVENS, **[***43]** J., dissenting). They are both mistaken. I assert only that mine is the natural reading of the statute (*i.e.*, the normal reading), not that it is the only conceivable one. The Court has no standing to object to this approach, since it concludes that, in another respect, the statute admits of only one natural reading, namely, that competing inferences must be weighed because the strong-inference requirement "is inherently comparative" *ante*, at 12. As for the dissent, it asserts that the statute cannot possibly have a natural and discernible meaning, **[*2515]** since "courts of appeals" and "Members of this Court" "have divided" over the question. It was just weeks ago, however, that the author of the dissent, joined by the author of today's opinion for the Court, concluded that a statute's meaning was "plain," *Rockwell Int'l Corp.* v. *United States*, 549 U.S. , , 127 S. Ct. 1397, 167 L. Ed. 2d 190 (2007) (slip op., at 1) (STEVENS, J., dissenting), even though the Courts of Appeals and Members of this Court divided over the question, *id.*, at , n. 5, 127 S. Ct. 1397, 167 L. Ed. 2d 190 (slip op., at 12, n. 5). Was plain meaning then, as the dissent claims it is today, *post*, at 2, n. 1, "in the eye of the beholder"?

[199]** **[***44]** It is unremarkable that various Justices in this case reach different conclusions about the correct interpretation of the statutory text. It is remarkable, however, that the dissent believes that Congress "implicitly delegated significant lawmaking authority to the Judiciary in determining how th[e] [strong-inference] standard should operate in practice." *Post*, at 1. This is language usually employed to describe the discretion conferred upon administrative agencies, which need not adopt what courts would consider the interpretation most faithful to the text of the statute, but may choose some other interpretation, so long as it is within the bounds of the reasonable, and may later change to some *other* interpretation that is within the bounds of the reasonable. See *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984). Courts, by contrast, *must* give the statute its single, most plausible, reading. To describe this as an exercise of "delegated lawmaking authority" seems to me peculiar--unless one believes in lawmakers who have no discretion. Courts must apply judgment, to be sure. But judgment is not discretion.

Even **[***45]** if I agreed with the Court's interpretation of "strong inference," I would not join the Court's opinion because of its frequent indulgence in the last remaining legal fiction of the West: that the report of a single committee of a single House expresses the will of Congress. The Court says, for example, that "Congress'[s] purpose" was "to promote greater uniformity among the Circuits," *ante,* at 10, relying for that certitude upon the statement of managers accompanying a House Conference Committee Report whose text was never adopted by the House, much less by the Senate, and as far as we know was read by almost no one. The Court is sure that Congress "'inten[ded] to strengthen existing pleading requirements,'" *ibid.*, because--again--the statement of managers said so. I come to the same conclusion for the much

safer reason that the law which Congress adopted (and which the Members of both Houses actually *voted* on) so indicates. And had the legislation not done so, the statement of managers assuredly could not have remedied the deficiency.

With the above exceptions, I am generally in agreement with the Court's analysis, and so concur in its judgment.

JUSTICE ALITO, concurring **[***46]** in the judgment.

I agree with the Court that the Seventh Circuit used an erroneously low standard for determining whether the plaintiffs in this case satisfied their burden of pleading "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). I further agree that the case should be remanded to allow the lower courts to decide in the first instance whether the allegations survive under the correct standard. In two respects, however, I disagree with the opinion of the Court. First, the best interpretation of the statute is that only those facts that are **[*2516]** alleged "with particularity" may properly be considered in determining whether the allegations of scienter are sufficient. Second, I agree with JUSTICE SCALIA that a "strong inference" of scienter, in the **[**200]** present context, means an inference that is more likely than not correct.

I

On the first point, the statutory language is quite clear. Section 78u-4(b)(2) states that "the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference **[***47]** that the defendant acted with the required state of mind." Thus, "a strong inference" of scienter must arise from those facts that are stated "with particularity." It follows that facts not stated with the requisite particularity cannot be considered in determining whether the strong-inference test is met.

In dicta, however, the Court states that "omissions and ambiguities" merely "count against" inferring scienter, and that a court should consider all allegations of scienter, even nonparticularized ones, when considering whether a complaint meets the "strong inference" requirement. *Ante,* at 14. Not only does this interpretation contradict the clear statutory language on this point, but it undermines the particularity requirement's purpose of preventing a plaintiff from using vague or general allegations in order to get by a motion to dismiss for failure to state a claim. Allowing a plaintiff to derive benefit from such allegations would permit him to circumvent this important provision.

Furthermore, the Court's interpretation of the particularity requirement in no way distinguishes it from normal pleading review, under which a court naturally gives less weight to allegations **[***48]** containing "omissions and ambiguities" and more weight to allegations stating particularized facts. The particularity requirement is thus stripped of all meaning.

Questions certainly may arise as to whether certain allegations meet the statutory particularity requirement, but where that requirement is violated, the offending allegations cannot be taken into account.

II

I would also hold that a "strong inference that the defendant acted with the required state of mind" is an inference that is stronger than the inference that the defendant lacked the required state of mind. Congress has provided very little guidance regarding the meaning of "strong inference," and the difference between the Court's interpretation (the inference of scienter must be at least as strong as the inference of no scienter) and JUSTICE SCALIA's (the inference of scienter must be at least marginally stronger than the inference of no scienter) is unlikely to make any practical difference. The two approaches are similar in that they both regard the critical question as posing a binary choice (either the facts give rise to a "strong inference" of scienter or they do not). But JUSTICE SCALIA's interpretation would **[***49]** align the pleading test under § 78u-4(b)(2) with the test that is used at the summary-judgment and judgment-as-a-matter-of-law stages, whereas the Court's test would introduce a test previously unknown in civil litigation. It seems more likely that Congress meant to adopt a known quantity and thus to adopt JUSTICE SCALIA's approach.

DISSENT BY: STEVENS

DISSENT

JUSTICE STEVENS, dissenting.

As the Court explains, when Congress enacted a heightened pleading requirement for private actions to enforce **[**201]** the federal securities laws, it "left the key term 'strong inference' undefined." *Ante*, **[*2517]** at 2. It thus implicitly delegated significant lawmaking authority to the Judiciary in determining how that standard should operate in practice. Today the majority crafts a perfectly workable definition of the term, but I am persuaded that a different interpretation would be both easier to apply and more consistent with the statute.

The basic purpose of the heightened pleading requirement in the context of securities fraud litigation is to protect defendants from the costs of discovery and trial in unmeritorious cases. Because of its intrusive nature, discovery may also invade the privacy interests of the **[***50]** defendants and their executives. Like citizens suspected of having engaged in criminal activity, those defendants should not be required to produce their private effects unless there is probable cause to believe them guilty of misconduct. Admittedly, the probable-cause standard is not capable of precise measurement, but it is a concept that is familiar to judges. As a matter of normal English usage, its meaning is roughly the same as "strong inference." Moreover, it is most unlikely that Congress intended us to adopt a standard that makes it more difficult to commence a civil case than a criminal case. [1]

FOOTNOTES

1 The meaning of a statute can only be determined on a case by case basis and will, in each case, turn differently on the clarity of the statutory language, its context, and the intent of its drafters. Here, in my judgment, a probable-cause standard is more faithful to the intent of Congress, as expressed in both the specific pleading requirement and the statute as a whole, than the more defendant-friendly interpretation that JUSTICE SCALIA prefers. He is clearly wrong in concluding that in divining the meaning of this term, we can merely "read the language for what it says," and that it is susceptible to only one reading. *Ante*, at 3 (opinion concurring in judgment). He argues that we "must be content to give 'strong inference' its normal meaning," *ibid.*, and yet the "normal meaning" of a term such as "strong inference" is surely in the eye of the beholder. As the Court's opinion points out, Courts of Appeals have divided on the meaning of the standard, see *ante*, at 2, 10, and today, the Members of this Court have done the same. Although JUSTICE SCALIA may disagree with the Court's reading of the term, he should at least acknowledge that, in this case, the term itself is open to interpretation.

[*51]** In addition to the benefit of its grounding in an already familiar legal concept, using a probable-cause standard would avoid the unnecessary conclusion that "in determining whether the pleaded facts give rise to a 'strong' inference of scienter, the court *must* take into account plausible opposing inferences." *Ante*, at 11 (emphasis added). There are times when an inference can easily be deemed strong without any need to weigh competing inferences. For example, if a known drug dealer exits a building immediately after a confirmed drug transaction, carrying a suspicious looking package, a judge could draw a strong inference that the individual was involved in the aforementioned drug transaction without debating whether the suspect might have been leaving the building at that exact time for another unrelated reason.

If, using that same methodology, we assume (as we must, see *ante*, at 11, 14) the truth of the detailed factual allegations attributed to 27 different confidential informants described in the complaint, App. 91-93, and view those allegations collectively, I think it clear that they establish probable cause to believe that Tellabs' chief **[**202]** executive officer "acted **[***52]** with the required intent," as the Seventh Circuit held. [2] 437 F.3d 588, 602 (2006).

FOOTNOTES

2 The "channel stuffing" allegations in PP 62-72 of the amended complaint, App. 110-113, are particularly persuasive. Contrary to petitioners' arguments that respondents' allegations of channel stuffing "are too vague or ambiguous to contribute to a strong inference of scienter," *ante*, at 13, this portion of the complaint clearly alleges that Notebaert himself had specific knowledge of illegitimate channel stuffing during the relevant time period. See, *e.g.*, App. 111, P67 ("Defendant Notebaert worked directly with Tellabs' sales personnel to channel stuff SBC"); *id.*, at 110-112 (alleging, in describing such channel stuffing, that Tellabs took "extraordinary" steps that amounted to "an abnormal practice in the industry"; that "distributors were upset and later returned the inventory" (and, in the case of Verizon's Chairman, called Tellabs to complain); that customers "did not want" products that Tellabs sent and that Tellabs employees wrote purchase orders for; that "returns were so heavy during January and February 2001 that Tellabs had to lease extra storage space to accommodate all the returns"; and that Tellabs "backdat[ed] sales" that actually took place in 2001 to appear as having occurred in 2000). If these allegations are actually taken as true and viewed in the collective, it is hard to imagine what competing inference could effectively counteract the inference that Notebaert and Tellabs "'acted with the required state of mind.'" *Ante*, at 18 (opinion of the Court) (quoting 15 U.S.C. § 78u-4(b)(2)).

[*2518] **[***53]** Accordingly, I would affirm the judgment of the Court of Appeals.

*544 U.S. 336, *; 125 S. Ct. 1627, **;*
*161 L. Ed. 2d 577, ***; 2005 U.S. LEXIS 3478*

DURA PHARMACEUTICALS, INC., et al., Petitioners v. MICHAEL BROUDO et al.

No. 03-932

SUPREME COURT OF THE UNITED STATES

544 U.S. 336; 125 S. Ct. 1627; 161 L. Ed. 2d 577; 2005 U.S. LEXIS 3478; 73 U.S.L.W. 4283; Fed. Sec. L. Rep. (CCH) P93,218; 18 Fla. L. Weekly Fed. S 233

January 12, 2005, Argued
April 19, 2005, Decided

SUBSEQUENT HISTORY: Motion granted by, in part, Motion denied by, in part In re Dura Pharms., Inc. Secs. Litig., 452 F. Supp. 2d 1005, 2006 U.S. Dist. LEXIS 41193 (S.D. Cal., June 2, 2006)

PRIOR HISTORY: ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.
Broudo v. Dura Pharms., Inc., 339 F.3d 933, 2003 U.S. App. LEXIS 15621 (9th Cir. Cal., 2003)

DISPOSITION: Reversed and remanded.

CASE SUMMARY

PROCEDURAL POSTURE: Respondent purchasers of stock in a corporation sued petitioners, the corporation and corporate officials, alleging that a misrepresentation by petitioners caused the stock price to be artificially inflated. Upon the grant of a writ of certiorari, petitioners challenged the judgment of the U.S. Court of Appeals for the Ninth Circuit which held that the purchasers sufficiently pleaded loss causation as required by 15 U.S.C.S. § 78u-4(b)(4).

OVERVIEW: The purchasers alleged that petitioners falsely stated that the corporation's pharmaceutical spray device would receive federal approval, and the purchasers also alleged that they suffered damages based on the artificially inflated price of the corporation's stock which resulted from the misrepresentation. The U.S. Supreme Court held that the purchasers' allegation that the price of the stock on the date of purchase was inflated because of the misrepresentation was insufficient by itself to establish the loss causation required by § 78u-4(b)(4). At the time of purchase, the purchasers suffered no loss since at that instant the stock price was in fact the value of the stock, and it was not necessarily

true that any subsequent decline in the value of the stock was caused by the artificially inflated price rather than other factors. Further, the purchasers' complaint nowhere provided petitioners with notice of what the relevant economic loss might have been or of what the causal connection was between that loss and the misrepresentation concerning the spray device.

OUTCOME: The judgment upholding the loss causation element of the purchasers' securities fraud claim was reversed, and the case was remanded for further proceedings.

CORE TERMS: misrepresentation, economic loss, inflated, purchase price, causation, securities fraud, spray, common-law, causal connection, artificially, deceit, purchaser, proximately cause, cause of action, asthmatic, resemble, notice, touch, Law of Torts, securities law, common law, securities market, tort action, suffered damage, proximate causation, proximate cause, quotation marks, state of mind, citation omitted, misleading

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Antitrust & Trade Law > Sherman Act > Claims

Securities Law > Liability > Private Securities Litigation > General Overview

HN1 A private plaintiff who claims securities fraud must prove that the defendant's fraud caused an economic loss. 15 U.S.C.S. § 78u-4(b)(4). More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

Torts > Business Torts > Fraud & Misrepresentation > Actual Fraud > Elements

HN2 Private federal securities fraud actions are based upon federal securities statutes and their implementing regulations. Section 10(b) of the Securities Exchange Act of 1934 forbids (1) the use or employment of any deceptive device, (2) in connection with the purchase or sale of any security, and (3) in contravention of Securities and Exchange Commission rules and regulations. 15 U.S.C.S. § 78j(b). S.E.C. Rule 10b-5 forbids, among other things, the making of any untrue statement of material fact or the omission of any material fact necessary in order to make the statements made not misleading. 17 C.F.R. § 240.10b-5 (2004). The courts imply from these statutes and rule a private damages action, which resembles, but is not identical to, common-law tort actions for deceit and misrepresentation. And Congress imposes statutory requirements on that private action. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN3 In cases involving publicly traded securities and purchases or sales in public securities markets, the basic elements of a private federal securities fraud action include: (1) a material misrepresentation (or omission); (2) scienter, i.e., a wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as transaction causation; (5) economic loss, 15 U.S.C.S. § 78u-4(b)(4); and (6) loss causation, i.e., a causal connection between the material misrepresentation and the loss. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN4 Normally, in fraud-on-the-market cases, an inflated purchase price for securities will not itself constitute or proximately cause the relevant economic loss. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action >

ceptive & Manipulative Devices

HN5 To "touch upon" an economic loss is not to cause a loss, and it is the latter that the law requires in a securities fraud action. 15 U.S.C.S. § 78u-4(b)(4). More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

Torts > Business Torts > Fraud & Misrepresentation > General Overview

HN6 Judicially implied private securities-fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions. The common law of deceit subjects a person who fraudulently makes a misrepresentation to liability for pecuniary loss caused to one who justifiably relies upon that misrepresentation. More Like This Headnote | *Shepardize:* Restrict By Headnote

Torts > Business Torts > Fraud & Misrepresentation > General Overview

HN7 A person who misrepresents the financial condition of a corporation in order to sell its stock becomes liable to a relying purchaser for the loss the purchaser sustains when the facts become generally known and as a result share value depreciates. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN8 The securities statutes seek to maintain public confidence in the marketplace. They do so by deterring fraud, in part, through the availability of private securities fraud actions. But the statutes make these latter actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause. More Like This Headnote | *Shepardize:* Restrict By Headnote

Securities Law > Liability > Private Securities Litigation > General Overview

HN9 The Private Securities Litigation Reform Act of 1995 insists that securities fraud complaints specify each misleading statement; that they set forth the facts on which a belief that a statement is misleading was formed; and that they state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. 15 U.S.C.S. §§ 78u-4 (b)(1), (2). And the statute expressly imposes on plaintiffs the burden of proving that the defendant's misrepresentations caused the loss for which the plaintiff seeks to recover. § 78u-4 (b)(4). More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Pleadings > Complaints > Requirements
Civil Procedure > Pleading & Practice > Pleadings > Rule Application & Interpretation

HN10 The Federal Rules of Civil Procedure require only a short and plain statement of the claim showing that the pleader is entitled to relief. Fed. R. Civ. P. 8(a)(2). The short and plain statement must provide the defendant with fair notice of what the plaintiff's claim is and the grounds upon which it rests. More Like This Headnote | *Shepardize:* Restrict By Headnote

Civil Procedure > Pleading & Practice > Pleadings > Rule Application & Interpretation

HN11 Ordinary pleading rules are not meant to impose a great burden upon a plaintiff. More Like This Headnote

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DECISION:

[*577]** Allegation of inflated purchase price held insufficient by itself to demonstrate loss and causation, for purposes of private damages action for securities fraud under § 10(b) of Securities Exchange Act of 1934 (15 USCS § 78j(b)) and Securities and Exchange Commission Rule 10b-5 (17 CFR § 240.10b-5).

SUMMARY:

A private damages action for securities fraud has been implied by the courts from § 10(b) of the Securities Exchange Act of 1934 (15 USCS § 78j(b)) and Securities and Exchange Commission Rule 10b-5 (17 CFR § 240.10b-5). Also, Congress has imposed some statutory requirements on such actions, including the 15 USCS § 78u-4(b)(4) requirement that a private plaintiff who claims securities fraud must demonstrate economic loss.

Some private individuals allegedly had bought stock in a corporation on the public securities market during a particular period. After some initial proceedings, the individuals eventually filed, in the United States District Court for the Southern District of California, a second amended complaint, for a purported class action, against the corporation and some of its managers and directors. The plaintiffs' lengthy complaint (1) included allegations of securities fraud under § 10(b) and Rule 10b-5; (2) asserted one claim which involved the defendants' alleged misrepresentations concerning a new asthmatic spray device; and (3) with respect to the loss supposedly caused by these alleged misrepresentations, contained only a statement that the plaintiffs had paid artificially inflated prices for the corporation's securities and had suffered damages. The District Court, in dismissing the complaint with prejudice, expressed the view, with respect to the spray-device claim, that the complaint had failed adequately to allege loss causation (2001 U.S. Dist. LEXIS 25907).

[*578]** On appeal, the United States Court of Appeals for the Ninth Circuit, in reversing in pertinent part and in ordering a remand, expressed the view that the plaintiffs had sufficiently pleaded loss causation to survive a motion to dismiss with respect to the spray-device claim, as (1) the plaintiffs would establish loss causation if they showed that the price on the date of purchase was inflated because of the alleged misrepresentations; and (2) the complaint had (a) pleaded that the price at the time of purchase was overstated, and (b) sufficiently identified the cause (339 F.3d 933).

On certiorari, the United States Supreme Court reversed and remanded. In an opinion by Breyer, J., expressing the unanimous view of the court, it was held--with respect to the private damages action for securities fraud that the courts had implied from § 10(b) and Rule 10b-5--that:

(1) A private plaintiff, in a case involving public securities markets, cannot satisfy § 78u-4(b)(4) simply by alleging in the complaint, and subsequently establishing, that the price of a security on the date of purchase was inflated because of a misrepresentation, as:

(a) Normally, in such cases, an inflated purchase price will not itself constitute or proximately cause the relevant economic loss.

(b) Allowing the inflated purchase price alone to establish loss causation would lack support in precedent among the Courts of Appeals other than the Court of Appeals for the Ninth Circuit.

(c) The inflated-purchase-price approach would be contrary to Congress' intent to permit private securities fraud actions for recovery only where plaintiffs adequately allege and prove the traditional elements of causation and loss.

(2) Thus, in the case at hand, the plaintiffs' complaint was legally insufficient in alleging the spray-device claim for securities fraud, for:

(a) The complaint's inflated-purchase-price allegation was not legally relevant.

(b) The complaint nowhere else provided the defendants with notice of what (i) the relevant economic loss might be, or (ii) the causal connection might be between that loss and the alleged misrepresentations.

LAWYERS' EDITION HEADNOTES:

[*LEdHN1]**

SECURITIES REGULATION §16

-- fraud -- private damages action -- loss and causation -- inflated purchase price

Headnote: LEdHN[1A][1A] LEdHN[1B][1B] LEdHN[1C][1C] LEdHN[1D][1D] LEdHN[1E][1E] LEdHN[1F][1F] LEdHN[1G][1G] LEdHN[1H][1H] LEdHN[1I][1I] LEdHN[1J][1J] LEdHN[1K][1K]

With respect to the private damages action for securities fraud that the courts have implied from § 10(b) of the Securities Exchange Act of 1934 (15 USCS § 78j(b)) and Securities and Exchange Commission Rule 10b-5 (17 CFR § 240.10b-5), for purposes of the 15 USCS § 78u-4(b)(4) requirement that a private plaintiff who claims securities fraud must demonstrate economic loss, such a plaintiff, in a case involving public securities markets (a fraud-on-the-market case) cannot satisfy this requirement simply by alleging in the complaint, and subsequently establishing, that the price of a security on the date of purchase was inflated because of a misrepresentation, as:

[*579]** (1) Normally, in such cases, an inflated purchase price will not itself constitute or proximately cause the relevant economic loss, where:

(a) As a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss.

(b) The logical link between the inflated purchase price and any later economic loss is not invariably strong.

(c) Even if one might say that the inflated purchase price suggests that the misrepresentation "touches upon" a later economic loss, that would be insufficient, for to touch upon a loss is not to cause a loss, as required by § 78u-4(b)(4).

(2) Allowing the inflated purchase price alone to establish loss causation would lack support in precedent, where--given the common-law roots of the securities fraud action (and the common-law requirement that a plaintiff must show actual damages)--(a) it is not surprising that other Federal Courts of Appeals have rejected the inflated-purchase-price approach of one Court of Appeals; and (b) the uniqueness of this one Court of Appeals' perspective argues against the validity of the court's approach in a case like this one.

(3) The inflated-purchase-price approach would be contrary to Congress' intent (as shown in § 78u-4(b)(4) and some 15 USCS § 78u-4(b) paragraphs that precede it) to permit private securities fraud actions for recovery only where plaintiffs adequately allege and prove the traditional elements of causation and loss, for this approach would allow recovery where a misrepresentation led to an inflated purchase price but nonetheless did not proximately cause any economic loss.

[*LEdHN2]**

PLEADING §171

-- complaint -- securities fraud -- alleging loss and causation

Headnote: LEdHN[2A][2A] LEdHN[2B][2B] LEdHN[2C][2C] LEdHN[2D][2D] LEdHN[2E][2E] LEdHN[2F][2F] LEdHN[2G][2G]

With respect to a Federal District Court complaint filed by some private plaintiffs in a purported class action against a corporation and some of its managers and directors, this complaint was legally insufficient in alleging a particular damages claim for securities fraud under § 10(b) of the Securities Exchange Act of 1934 (15 USCS § 78j(b)) and Securities and Exchange Commission Rule 10b-5 (17 CFR § 240.10b-5), as:

(1) The plaintiffs allegedly had bought stock in the corporation on the public securities market during a particular period.

(2) With respect to the claim at issue, which involved the defendants' alleged misrepresentations concerning a new asthmatic spray device, (a) the plaintiffs' lengthy complaint contained only one statement that could fairly be read as describing the loss supposedly caused by these alleged misrepresentations; and (b) this statement said that the plaintiffs had paid artificially inflated prices for the corporation's securities and had suffered damages; but (c) such an artificially inflated purchase price was not itself a relevant economic loss, for purposes of the 15 USCS § 78u-4(b)(4) requirement that a private plaintiff who claimed securities fraud had to demonstrate economic loss.

(3) Even if it were assumed, for the sake of argument, that neither the Federal Rules of Civil Procedure nor the federal securities statutes imposed any special requirement--beyond Rule 8(a)'s "short and plain statement" requirement--in respect to the pleading of proximate causation **[***580]** or economic loss, the plaintiffs' complaint nowhere else provided the defendants with notice of what (a) the relevant economic loss might be, or (b) the causal connection might be between that loss and the alleged misrepresentations.

(4) While it ought not to prove burdensome for a plaintiff who had suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff had in mind, allowing a plaintiff to forgo giving any such indication would bring about harm of the very sort that the federal securities statutes sought to avoid.

[*LEdHN3]**

SECURITIES REGULATION §16

-- fraud -- private damages action -- elements

Headnote: *LEdHN[3A]*[3A] *LEdHN[3B]*[3B] *LEdHN[3C]*[3C]

With respect to the private damages action for securities fraud that the courts have implied from § 10(b) of the Securities Exchange Act of 1934 (15 USCS § 78j(b)) and Securities and Exchange Commission Rule 10b-5 (17 CFR § 240.10b-5), this action resembles, but is not identical to, common-law tort actions for deceit and misrepresentation. Moreover, given that Congress (in provisions such as 15 USCS § 78u-4(b)(4)) has imposed statutory requirements on this private action, in cases involving publicly traded securities and purchases or sales in public securities markets, this action's basic elements include (1) a material misrepresentation or omission; (2) scienter (a wrongful state of mind); (3) a connection with the purchase or sale of a security; (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation"; (5) economic loss (under § 78u-4(b)(4)); and (6) also under § 78u-4(b)(4), "loss causation" (a causal connection between the material misrepresentation and the loss).

[*LEdHN4]**

FRAUD AND DECEIT §20

-- liability

Headnote: *LEdHN[4]*[4]

The common law of deceit subjects a person who fraudulently makes a misrepresentation to liability for

pecuniary loss caused to one who justifiably relies upon that misrepresentation.

[*LEdHN5]**

EVIDENCE §396

-- actual damages -- showing

Headnote: *LEdHN[5A]*[5A]*LEdHN[5B]*[5B]

Under the common law, when a plaintiff claims that a defendant is liable for fraudulent misrepresentation, there is requirement that the plaintiff must show actual damages.

[*LEdHN6]**

SECURITIES REGULATION §16

-- fraud -- private actions

Headnote: *LEdHN[6]*[6]

The federal securities statutes, in seeking to maintain public confidence in the marketplace, do so by deterring fraud, in part, through the availability of private securities-fraud actions.

[*LEdHN7]**

SECURITIES REGULATION §16

-- fraud -- private actions

Headnote: *LEdHN[7A]*[7A]*LEdHN[7B]*[7B]

The federal securities statutes make private securities-fraud actions available, not to provide investors with broad insurance against market losses, but to protect the investors against those economic losses that misrepresentations actually cause.

[*LEdHN8]**

PLEADING §130

-- plaintiff's claim

Headnote: *LEdHN[8]*[8]

With respect to a plaintiff's pleading, the "short and plain statement" required by Rule 8(a)(2) of the Federal Rules of Civil Procedure must provide a defendant with fair notice of what the plaintiff's claim is and the grounds upon which it rests. **[***581]**

[*LEdHN9]**

PLEADING §106

-- plaintiff

Headnote: *LEdHN[9]*[9]

Ordinary pleading rules for a federal-court civil case are not meant to impose a great burden upon a plaintiff.

SYLLABUS

Respondents filed a securities fraud class action, alleging that petitioners, Dura Pharmaceuticals, Inc., and some of its managers and directors (hereinafter Dura), made, *inter alia,* misrepresentations about future Food and Drug Administration approval of a new asthmatic spray device, leading respondents to purchase Dura securities at an artificially inflated price. In dismissing, the District Court found that the complaint failed adequately to allege "loss causation"--*i.e.,* a causal connection between the spray device misrepresentation and the economic loss, 15 USC § 78u-4(b)(4)] [15 USCS § 78u-4(b)(4)]. The Ninth Circuit reversed, finding that a plaintiff can satisfy the loss causation requirement simply by alleging that a security's price at the time of purchase **[***582]** was inflated because of the misrepresentation.

Held:

1. An inflated purchase price will not by itself constitute or proximately cause the relevant economic loss needed to allege and prove "loss causation." The basic elements of a private securities fraud action--which resembles a common-law tort action for deceit and misrepresentation--include, as relevant here, economic loss and "loss causation." The Ninth Circuit erred in following an inflated purchase price approach to showing causation and loss. First, as a matter of pure logic, the moment the transaction takes place, the plaintiff has suffered no loss because the inflated purchase price is offset by ownership of a share that possesses equivalent value at that instant. And the logical link between the inflated purchase price and any later economic loss is not invariably strong, since other factors may affect the price. Thus, the most logic alone permits this Court to say is that the inflated purchase price suggests that misrepresentation "touches upon" a later economic loss, as the Ninth Circuit found. However, to touch upon a loss is not to *cause* a loss, as 15 USC § 78u-4(b)(4)] [15 USCS § 78u-4(b)(4)] requires. The Ninth Circuit's holding also is not supported by precedent. The common-law deceit and misrepresentation actions that private securities fraud actions resemble require a plaintiff to show not only that had he known the truth he would not have acted, but also that he suffered actual economic loss. Nor can the holding below be reconciled with the views of other Courts of Appeals, which have rejected the inflated purchase price approach to showing loss causation. Finally, the Ninth Circuit's approach is inconsistent with an important securities law objective. The securities laws make clear Congress' intent to permit private securities fraud actions only where plaintiffs adequately allege and prove the traditional elements of cause and loss, but the Ninth Circuit's approach would allow recovery where a misrepresentation leads to an inflated purchase price, but does not proximately cause any economic loss.

2. Respondents' complaint was legally insufficient in respect to its allegation of "loss causation. " While Federal Rule of Civil Procedure 8(a)(2) requires only a "short and plain statement of the claim showing that the pleader is entitled to relief," and while the Court assumes that neither the Rules nor the securities statutes place any further requirement in respect to the pleading, the "short and plain statement" must give the defendant "fair notice of what the plaintiff's claim is and the grounds upon which it rests," *Conley v. Gibson,* 355 U.S. 41, 47, 2 L. Ed. 2d 80, 78 S. Ct. 99. The complaint here contains only respondents' allegation that their loss consisted of artificially inflated purchase prices. However, as this Court has concluded here, such a price is not itself a relevant economic loss. And the complaint nowhere else provides Dura with notice of what the relevant loss might be or of what the causal connection might be between that loss and the misrepresentation. Ordinary pleading rules are not meant to impose a great burden on a plaintiff, but it should not prove burdensome for a plaintiff suffering economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. Allowing **[***583]** a plaintiff to forgo giving any indication of the economic loss and proximate cause would bring about the very sort of harm the securities statutes seek to avoid, namely, the abusive practice of filing lawsuits with only a faint hope that discovery might lead to some plausible cause of action.

339 F.3d 933, reversed and remanded.

Breyer, J., delivered the opinion for a unanimous Court.

COUNSEL: William F. Sullivan argued the cause for petitioners.

Thomas G. Hungar argued the cause for the United States, as amicus curiae, by special leave of court.

Patrick J. Coughlin argued the cause for respondents.

JUDGES: Breyer, J., delivered the opinion for a unanimous Court.

OPINION BY: BREYER

OPINION

[*338] **[**1629]** Justice **Breyer** delivered the opinion of the Court.

HN1 **[***LEdHR1A]** LEdHN[1A][1A] **[***LEdHR2A]** LEdHN[2A][2A] A private plaintiff who claims securities fraud must prove that the defendant's fraud caused an economic loss. 109 Stat 747, 15 USC § 78u-4(b)(4)] [15 USCS § 78u-4(b)(4)]. We consider a Ninth Circuit holding that a plaintiff can satisfy this requirement--a requirement that courts call "loss causation"--simply by alleging in the complaint and subsequently establishing that "the price" of the security "*on the date of purchase* was inflated because of the misrepresentation." 339 F.3d 933, 938 (2003) (internal quotation marks omitted). In our view, the Ninth Circuit is wrong, both in respect to what a plaintiff must prove and in respect to what the plaintiffs' complaint here must allege.

[*339] I

[*LEdHR2B]** LEdHN[2B][2B] Respondents are individuals who bought stock in Dura Pharmaceuticals, Inc., on the public securities market between April 15, 1997, and February 24, 1998. They have brought this securities fraud class action against Dura and some of its managers **[**1630]** and directors (hereinafter Dura) in federal court. In respect to the question before us, their detailed amended (181 paragraph) complaint makes substantially the following allegations:

> (1) Before and during the purchase period, Dura (or its officials) made false statements concerning both Dura's drug profits and future Food and Drug Administration (FDA) approval of a new asthmatic spray device. See, *e.g.*, App. 45a, 55a, 89a.
>
> (2) In respect to drug profits, Dura falsely claimed that it expected that its drug sales would prove profitable. See, *e.g., id.*, at 66a-69a.
>
> (3) In respect to the asthmatic spray device, Dura falsely claimed that it expected the FDA would soon grant its approval. See, *e.g., id.*, at 89a-90a, 103a-104a.
>
> (4) On the last day of the purchase period, February 24, 1998, Dura announced that its earnings would be lower than expected, principally due to slow drug sales. *Id.,* at 51a.
>
> (5) The next day Dura's shares lost almost half their value (falling from about $39 per share to about $21). *Ibid.*
>
> (6) About eight months later (in November 1998), Dura announced that the FDA would not approve Dura's new asthmatic spray device. *Id.,* at 110a.
>
> (7) The next day Dura's share price temporarily fell but almost fully recovered within one week. *Id.,* at 156a.

Most importantly, the complaint **[***584]** says the following (and nothing significantly more than the following) about **[*340]** economic losses attributable to the spray device misstatement: *"In reliance on the integrity of the market, [the plaintiffs] . . . paid artificially inflated prices for Dura securities" and the plaintiffs suffered "damage[s]" thereby. Id.,* at 139a (emphasis added).

The District Court dismissed the complaint. In respect to the plaintiffs' drug-profitability claim, it held that the complaint failed adequately to allege an appropriate state of mind, *i.e.*, that defendants had acted knowingly, or the like. In respect to the plaintiffs' spray device claim, it held that the complaint failed adequately to allege "loss causation."

The Court of Appeals for the Ninth Circuit reversed. In the portion of the court's decision now before us--the portion that concerns the spray device claim--the Circuit held that the complaint adequately alleged "loss causation." The Circuit wrote that "plaintiffs establish loss causation if they have shown that the price *on the date of purchase* was inflated because of the misrepresentation." 339 F.3d at 938 (emphasis in original; internal quotation marks and citation omitted). It added that "the injury occurs at the time of the transaction." *Ibid.* Since the complaint pleaded "that the price at the time of purchase was overstated," and it sufficiently identified the cause, its allegations were legally sufficient. *Ibid.*

Because the Ninth Circuit's views about loss causation differ from those of other Circuits that have considered this issue, we granted Dura's petition for certiorari. Compare *ibid.* with, *e.g.*, *Emergent Capital Investment Management, LLC* v. *Stonepath Group, Inc.*, 343 F.3d 189, 198 (CA2 2003); *Semerenko* v. *Cendant Corp.*, 223 F.3d 165, 185 (CA3 2000); *Robbins* v. *Koger Properties, Inc.*, 116 F.3d 1441, 1447-1448 (CA11 1997); cf. *Bastian* v. *Petren Resources Corp.*, 892 F.2d 680, 685 (CA7 1990). We now reverse.

[*341] II

HN2 **[***LEdHR1B]** LEdHN[1B] [1B] **[***LEdHR2C]** LEdHN[2C] [2C] **[***LEdHR3A]** LEdHN[3A] [3A] Private federal securities fraud actions are based upon federal securities statutes and their implementing regulations. Section 10(b) of the Securities Exchange Act of 1934 **[**1631]** forbids (1) the "use or employ[ment] . . . of any . . . deceptive device," (2) "in connection with the purchase or sale of any security," and (3) "in contravention of" Securities and Exchange Commission "rules and regulations." 15 USC § 78j(b) [15 USCS § 78j(b)]. Commission Rule 10b-5 forbids, among other things, the making of any "untrue statement of a material fact" or the omission of any material fact "necessary in order to make the statements made . . . not misleading." 17 CFR § 240.10b-5 (2004).

The courts have implied from these statutes and Rule a private damages action, which resembles, but is not identical to, common-law tort actions for deceit and misrepresentation. See, *e.g.*, *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730, 744, 44 L. Ed. 2d 539, 95 S. Ct. 1917 (1975); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 196, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976). And Congress has imposed statutory requirements on that private action. *E.g.*, 15 USC § 78u-4(b)(4) [15 USCS § 78u-4(b)(4)].

HN3 In cases involving publicly traded securities and purchases or sales in public securities markets, the action's basic elements include: **[***585]**

(1) *a material misrepresentation (or omission),* see *Basic Inc.* v. *Levinson*, 485 U.S. 224, 231-232, 99 L. Ed. 2d 194, 108 S. Ct. 978 (1988);

(2) *scienter, i.e.,* a wrongful state of mind, see *Ernst & Ernst, supra,* at 197, 199, 47 L. Ed. 2d 668, 96 S. Ct. 1375;

(3) *a connection with the purchase or sale of a security,* see *Blue Chip Stamps, supra,* at 730-731, 44 L. Ed. 2d 539, 95 S. Ct. 1917;

(4) *reliance,* often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation," see *Basic, supra,* at 248-249, 99 L. Ed. 2d 194, 108 S. Ct. 978 (nonconclusively presuming that the price of a publicly **[*342]** traded share reflects a material misrepresentation and that plaintiffs have relied upon that misrepresentation as long as they would not have bought the share in its absence);

(5) *economic loss,* 15 USC § 78u-4(b)(4) [15 USCS § 78u-4(b)(4)]; and

(6) "*loss causation*," *i.e.*, a causal connection between the material misrepresentation and the

loss, *ibid.*; cf. T. Hazen, Law of Securities Regulation §§ 12.11[1], [3] (5th ed. 2005).

Dura argues that the complaint's allegations are inadequate in respect to these last two elements.

A

[*LEdHR1C]** LEdHN[1C][1C] We begin with the Ninth Circuit's basic reason for finding the complaint adequate, namely, that at the end of the day plaintiffs need only "establish," *i.e.*, prove, that "the price *on the date of purchase* was inflated because of the misrepresentation." 339 F.3d at 938 (internal quotation marks and citation omitted). In our view, this statement of the law is wrong. HN4Normally, in cases such as this one (*i.e.*, fraud-on-the-market cases), an inflated purchase price will not itself constitute or proximately cause the relevant economic loss.

For one thing, as a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value. Moreover, the logical link between the inflated share purchase price and any later economic loss is not invariably strong. Shares are normally purchased with an eye toward a later sale. But if, say, the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss. If the purchaser **[**1632]** sells later after the truth makes its way into the marketplace, an initially inflated purchase price *might* mean a later loss. But that is far from inevitably so. When the **[*343]** purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price. (The same is true in respect to a claim that a share's higher price is lower than it would otherwise have been--a claim we do not consider here.) Other things being equal, the longer the time between purchase and sale, the more likely that this is **[***586]** so, *i.e.*, the more likely that other factors caused the loss.

[*LEdHR1D]** LEdHN[1D][1D] **[***LEdHR3B]** LEdHN[3B][3B] Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss. It may prove to be a necessary condition of any such loss, and in that sense one might say that the inflated purchase price suggests that the misrepresentation (using language the Ninth Circuit used) "touches upon" a later economic loss. *Ibid.* But, even if that is so, it is insufficient. HN5To "touch upon" a loss is not to *cause* a loss, and it is the latter that the law requires. 15 USC § 78u-4(b)(4) [15 USCS § 78u-4(b)(4)].

[*LEdHR1E]** LEdHN[1E][1E] **[***LEdHR3C]** LEdHN[3C][3C] **[***LEdHR4]** LEdHN[4][4] **[***LEdHR5A]** LEdHN[5A][5A] For another thing, the Ninth Circuit's holding lacks support in precedent. HN6Judicially implied private securities fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions. See *Blue Chip Stamps, supra*, at 744, 44 L. Ed. 2d 539, 95 S. Ct. 1917; see also L. Loss & J. Seligman, Fundamentals of Securities Regulation 910-918 (5th ed. 2004) (describing relationship to common-law deceit). The common law of deceit subjects a person who "fraudulently" makes a "misrepresentation" to liability "for pecuniary loss caused" to one who justifiably relies upon that misrepresentation. Restatement (Second) of Torts § 525, p 55 (1976) (hereinafter Restatement of Torts); see also *Southern Development Co.* v. *Silva*, 125 U.S. 247, 250, 31 L. Ed. 678, 8 S. Ct. 881 (1888) (setting forth elements of fraudulent misrepresentation). And the common law has long insisted that a plaintiff in such a case show **[*344]** not only that had he known the truth he would not have acted but also that he suffered actual economic loss. See, *e.g.*, *Pasley* v *Freeman*, 3 T. R. 51, 65, 100 Eng. Rep. 450, 457 (1789) (if "no injury is occasioned by the lie, it is not actionable: but if it be attended with a damage, it then becomes the subject of an action"); *Freeman* v. *Venner*, 120 Mass. 424, 426 (1876) (a mortgagee cannot bring a tort action for damages stemming from a fraudulent note that a misrepresentation led him to execute unless and until the note has to be paid); see also M. Bigelow, Law of Torts 101 (8th ed. 1907) (damage "must already have been suffered before the bringing of the suit"); 2 T. Cooley, Law of Torts § 348, p 551 (4th ed. 1932) (plaintiff must show that he "suffered damage" and that the "damage followed proximately the deception"); W. Keeton, D. Dobbs, R. Keeton, & D. Owen, Prosser and Keeton on Law of Torts § 110, p 765 (5th ed. 1984) (hereinafter Prosser and Keeton) (plaintiff "must have suffered substantial damage," not simply nominal damages, before "the cause of action can arise").

[*LEdHR1F]** LEdHN[1F][1F] **[***LEdHR5B]** LEdHN[5B][5B] Given the common-law roots of the securities fraud action (and the common-law requirement that a plaintiff show actual damages), it is not surprising that other Courts of Appeals have rejected the Ninth Circuit's "inflated purchase price" approach to proving causation and loss. See, **[**1633]** *e.g.*, *Emergent Capital*, 343 F.3d, at 198 (inflation of purchase price alone cannot satisfy loss causation); *Semerenko*, 223 F.3d, at 185 (same); *Robbins*, 116 F.3d, at 1448 (same); cf. *Bastian*, 892 F.2d, at 685. Indeed, the Restatement of Torts, in setting forth the judicial consensus, says that HN7a person who "misrepresents the financial condition of a corporation in order to sell its stock" **[***587]** becomes liable to a relying purchaser "for the loss" the purchaser sustains "when the facts . . . become generally known" and "as a result" share value "depreciate[s]." § 548A, Comment *b*, at 107. Treatise writers, too, have emphasized the need to prove proximate causation. Prosser and Keeton § 110, at 767 (losses do "not **[*345]** afford any basis for recovery" if "brought about by business conditions or other factors").

[*LEdHR1G]** LEdHN[1G][1G] We cannot reconcile the Ninth Circuit's "inflated purchase price" approach with these views of other courts. And the uniqueness of its perspective argues against the validity of its approach in a case like this one where we consider the contours of a judicially implied cause of action with roots in the common law.

[*LEdHR1H]** LEdHN[1H][1H] **[***LEdHR6]** LEdHN[6][6] **[***LEdHR7A]** LEdHN[7A][7A] Finally, the Ninth Circuit's approach overlooks an important securities law objective. HN8The securities statutes seek to maintain public confidence in the marketplace. See *United States* v. *O'Hagan*, 521 U.S. 642, 658, 138 L. Ed. 2d 724, 117 S. Ct. 2199 (1997). They do so by deterring fraud, in part, through the availability of private securities fraud actions. *Randall* v. *Loftsgaarden*, 478 U.S. 647, 664, 92 L. Ed. 2d 525, 106 S. Ct. 3143 (1986). But the statutes make these latter actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause. Cf. *Basic*, 485 U.S., at 252, 99 L. Ed. 2d 194, 108 S. Ct. 978 (White, J., joined by O'Connor, J., concurring in part and dissenting in part) ("[A]llowing recovery in the face of affirmative evidence of nonreliance--would effectively convert Rule 10b-5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result" (internal quotation marks and citations omitted)).

[*LEdHR1I]** LEdHN[1I][1I] The statutory provision at issue here and the paragraphs that precede it emphasize this last mentioned objective. Private Securities Litigation Reform Act of 1995, 109 Stat 737. HN9The statute insists that securities fraud complaints "specify" each misleading statement; that they set forth the facts "on which [a] belief" that a statement is misleading was "formed"; and that they "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 USC §§ 78u-4(b)(1), (2) [15 USCS §§ 78u-4(b)(1), (2)]. And the statute expressly imposes on plaintiffs "the burden of proving" that the defendant's misrepresentations **[*346]** "caused the loss for which the plaintiff seeks to recover." § 78u-4(b)(4).

The statute thereby makes clear Congress' intent to permit private securities fraud actions for recovery where, but only where, plaintiffs adequately allege and prove the traditional elements of causation and loss. By way of contrast, the Ninth Circuit's approach would allow recovery where a misrepresentation leads to an inflated purchase price but nonetheless does not proximately cause any economic loss. That is to say, it would permit recovery where these two traditional elements in fact are missing.

In sum, we find the Ninth Circuit's approach inconsistent with the law's requirement that a plaintiff prove that the defendant's misrepresentation (or other fraudulent conduct) proximately caused the plaintiff's **[***588]** economic loss. We need **[**1634]** not, and do not, consider other proximate cause or loss-related questions.

B

[*LEdHR1J]** LEdHN[1J][1J] **[***LEdHR2D]** LEdHN[2D][2D] **[***LEdHR8]** LEdHN[8][8] Our holding about plaintiffs' need to *prove* proximate causation and economic loss leads us also to conclude that the plaintiffs' complaint here failed adequately to *allege* these requirements. We concede that HN10the Federal Rules of Civil Procedure require only "a short and plain statement of the claim showing that the

pleader is entitled to relief." Fed. Rule Civ. Proc. 8(a)(2). And we assume, at least for argument's sake, that neither the Rules nor the securities statutes impose any special further requirement in respect to the pleading of proximate causation or economic loss. But, even so, the "short and plain statement" must provide the defendant with "fair notice of what the plaintiff's claim is and the grounds upon which it rests. " *Conley* v. *Gibson*, 355 U.S. 41, 47, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957). The complaint before us fails this simple test.

[*LEdHR1K]** *LEdHN[1K]*[1K] **[***LEdHR2E]** *LEdHN[2E]*[2E] As we have pointed out, the plaintiffs' lengthy complaint contains only one statement that we can fairly read as describing the loss caused by the defendants' "spray device" **[*347]** misrepresentations. That statement says that the plaintiffs "paid artificially inflated prices for Dura's securities" and suffered "damage[s]." App. 139a. The statement implies that the plaintiffs' loss consisted of the "artificially inflated" purchase "prices." The complaint's failure to claim that Dura['s] share price fell significantly after the truth became known suggests that the plaintiffs considered the allegation of purchase price inflation alone sufficient. The complaint contains nothing that suggests otherwise.

For reasons set forth in Part II-A, *supra*, however, the "artificially inflated purchase price" is not itself a relevant economic loss. And the complaint nowhere else provides the defendants with notice of what the relevant economic loss might be or of what the causal connection might be between that loss and the misrepresentation concerning Dura's "spray device."

[*LEdHR2F]** *LEdHN[2F]*[2F] **[***LEdHR7B]** *LEdHN[7B]*[7B] **[***LEdHR9]** *LEdHN[9]*[9] We concede that *HN11*ordinary pleading rules are not meant to impose a great burden upon a plaintiff. ***Swierkiewicz v. Sorema N. A.,*** 534 U.S. 506, 513-515, 152 L. Ed. 2d 1, 122 S. Ct. 992 (2002). But it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. At the same time, allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid. Cf. H. R. Conf. Rep. No. 104-369, p 31 (1995) (criticizing "abusive" practices including "the routine filing of lawsuits . . . with only [a] faint hope that the discovery process might lead eventually to some plausible cause of action"). It would permit a plaintiff "with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the [discovery] process will reveal relevant evidence." *Blue Chip Stamps*, 421 U.S., at 741, 44 L. Ed. 2d 539, 95 S. Ct. 1917. Such a rule would **[***589]** tend to transform a private **[*348]** securities action into a partial downside insurance policy. See H. R. Conf. Rep. No. 104-369, at 31; see also *Basic, supra*, 485 U.S., at 252, 99 L. Ed. 2d 194, 108 S. Ct. 978 (White, J., joined by O'Connor, J., concurring in part and dissenting in part).

[*LEdHR2G]** *LEdHN[2G]*[2G] For these reasons, we find the plaintiffs' complaint legally insufficient. We reverse the judgment of the Ninth Circuit, and we **[**1635]** remand the case for further proceedings consistent with this opinion.

It is so ordered.

REFERENCES

69A Am Jur 2d, Securities Regulation--Federal §§ 1279, 1280, 1488-1493

15 USCS §§ 78j(b), 78u-4(b)(4)

L Ed Digest, Pleading § 171; Securities Regulation § 16

L Ed Index, Pleadings; Securities Regulation

Annotation References

Supreme Court's construction and application of Rules 8 and 9 of Federal Rules of Civil Procedure, concerning general rules of pleading and pleading special matters. 122 L Ed 2d 897.

Supreme Court's construction and application of antifraud provisions of § 10(b) of Securities Exchange Act of 1934 (15 USCS § 78j(b)) and SEC Rule 10b-5 (17 CFR § 240.10b-5). 99 L Ed 2d 950.

Implication of private right of action from provision of federal statute not expressly providing for one--Supreme Court cases. 61 L Ed 2d 910.

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