Court File No. CV-12-9667-00-CL

*ONTARIO*
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE AND ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No.: CV-11-431153-00CP

*ONTARIO*
SUPERIOR COURT OF JUSTICE

BETWEEN:

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA, THE TRUSTEES OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS LOCAL 793 PENSION PLAN FOR OPERATING ENGINEERS IN ONTARIO, SJUNDE AP-FONDEN, DAVID GRANT and ROBERT WONG

Plaintiffs

- and -

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, BDO LIMITED (formerly known as BDO MCCABE LO LIMITED), ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, CREDIT SUISSE SECURITIES (CANADA), INC., TD SECURITIES INC., DUNDEE SECURITIES CORPORATION, RBC DOMINION SECURITIES INC., SCOTIA CAPITAL INC., CIBC WORLD MARKETS INC., MERRILL LYNCH CANADA INC., CANACCORD FINANCIAL LTD., MAISON PLACEMENTS CANADA INC., CREDIT SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED
(successor by merger to Banc of America Securities LLC)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

**BRIEF OF AUTHORITIES OF THE U.S. PLAINTIFFS**
**(Motion for Approval of U.S. Counsel Fees, returnable December 13, 2013)**

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**TO:** **THE ATTACHED SERVICE LIST**

| TAB | AUTHORITY |
| --- | --- |
| 1. | *Citigroup Inc. Sec. Litig.*, --- F. Supp. 2d, 2013 WL 3942951 (S.D.N.Y. Aug. 1, 2013) |
| 2. | *Wal-Mart Stores, Inc. v. Dukes,* 131 S.Ct. 2541 (2011) |
| 3. | *Dukes v. Wal-Mart Stores, Inc.,* No. C 01-02252 CRB, 2012 WL 4329009 |
| 4. | *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 313 (2007) |
| 5. | *Kalnit v. Eichler*, 264 F.3d 131, 138 (2d Cir. 2001) |

# TAB 1

2013 WL 3942951
Only the Westlaw citation is currently available.
United States District Court,
S.D. New York.

In re CITIGROUP INC. SECURITIES LITIGATION.

Nos. 09 MD 2070(SHS), 07 Civ. 9901 SHS. | Aug. 1, 2013.

Synopsis
**Background:** Shareholders filed putative securities fraud class action against corporation alleging it had misled investors by understating risks associated with assets backed by subprime mortgages and overstating value of those assets. Following preliminary approval of proposed settlement, plaintiffs moved for final approval and award of attorney fees.

**Holdings:** The District Court, Sidney H. Stein, J., held that:

[1] notice of settlement was sufficient;

[2] proposed settlement providing for payment of $590 million to shareholders was fair, reasonable, and adequate;

[3] plan of allocation was fair, reasonable, and adequate; but

[4] attorney fees set forth in settlement agreement were excessive, requiring reduction.

Motion granted

West Headnotes (11)

[1] **Compromise and Settlement**
⇐Notice and Communications
**Constitutional Law**
⇐Compromise and Settlement
**Federal Civil Procedure**
⇐Sufficiency

Notice to shareholders of proposed settlement of securities fraud class action against corporation alleging fraudulent exposure to potential mortgage-backed collateralized debt obligation (CDO) losses was sufficient to comply with federal class action rule and due process where notice was sent to 2.4 million class members who could be identified through reasonable effort, and notice clearly described nature of action, class claims and defenses, time and manner for exclusion, and binding effect of class judgment on members. U.S.C.A. Const.Amend. 14; Private Securities Litigation Reform Act of 1995, § 101(a)(7), 15 U.S.C.A. § 78u–4(a)(7); Fed.Rules Civ.Proc.Rule 23(c), 28 U.S.C.A.

1 Cases that cite this headnote

[3] **Compromise and Settlement**
⇐Factors, Standards and Considerations; Discretion Generally

In approving or rejecting a proposed class action settlement, court must exercise its discretion in light of general judicial policy favoring settlement. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[3] **Compromise and Settlement**
⇐Fairness, Adequacy, and Reasonableness

General policy favoring settlements does not substitute for a court's rigorous scrutiny to determine whether proposed class action settlement is fair, reasonable, and adequate. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

1 Cases that cite this headnote

[4] **Compromise and Settlement**
⇐Stockholders, Actions Involving

Proposed settlement of shareholders' securities fraud class action against corporation alleging fraudulent exposure to potential mortgage-backed collateralized debt obligation (CDO) losses, which provided for total payment of $590 million to be shared by approximately two million plaintiffs, was fair, reasonable, and adequate, and thus would be approved; following extensive discovery, settlement had been negotiated by experienced counsel at arm's length in a two-day mediation conducted by retired federal judge, and although settlement amount was a fraction of the damages that might have been won at trial, only 11 shareholders had objected and amount was both substantial and reasonable in light of risks faced if action had proceeded to trial. Private Securities Litigation Reform Act of 1995, § 101(a)(7), 15 U.S.C.A. § 78u–4(a)(7); Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[5] **Compromise and Settlement**
Stockholders, Actions Involving

In reviewing fairness of proposed settlement of securities fraud class action under federal class action rule, court considers only whether total compensation to class members is fair, reasonable, and adequate, not how defendants have apportioned liability for that compensation among themselves, since deterring future corporate wrongdoing is a concern for Congress and the Securities and Exchange Commission (SEC), not for a district court reviewing fairness of settlement. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.;.

1 Cases that cite this headnote

[6] **Compromise and Settlement**
Stockholders, Actions Involving

Plan of allocation provided for in proposed settlement of shareholders' securities fraud class action against corporation alleging fraudulent exposure to potential mortgage-backed collateralized debt obligation (CDO) losses, was fair, reasonable, and adequate, and thus would be approved; plan for allocation of $590 million included share-price inflation schedule which reflected the injuries claimed by different class members, sustained under significantly different circumstances during class period, since effect of fraud on the market price, and thus harm suffered by purchasers, changed each time the market learned more of the truth. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

[7] **Attorney and Client**
Allowance and Payment from Funds in Court
**Federal Civil Procedure**
Class Actions; Settlements

Courts traditionally award plaintiffs' counsel fees in class actions based on either: (1) the percentage of the fund method whereby attorney receives a reasonable percentage of the settlement fund, or (2) the lodestar method where award is based on the market value of the work plaintiffs' attorneys performed. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[8] **Attorney and Client**
Allowance and Payment from Funds in Court

In complex securities fraud class actions, courts typically use a percentage of recovery as the preferred method of calculating an award for class counsel in common fund cases. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

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[9] **Attorney and Client**
Allowance and Payment from Funds in Court

Whether calculated pursuant to the lodestar or the percentage method, the fees awarded in common fund class action cases may not exceed what is reasonable under the circumstances. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[10] **Federal Civil Procedure**
Amount and Elements

The lodestar method of calculating attorney fees is based upon the number of hours reasonably expended by counsel on the litigation multiplied by a reasonable hourly rate.

[11] **Attorney and Client**
Allowance and Payment from Funds in Court

Attorney fees of $97.5 million to lead counsel, set forth in settlement of shareholders' securities fraud class action against corporation alleging fraudulent exposure to potential mortgage-backed collateralized debt obligation (CDO) losses, which represented roughly 16.5% of the $590 million fund, was subject to deductions under lodestar cross-check analysis, resulting in final, reasonable award of 12% of common fund, or $70.8 million; it was not reasonable for defendants to pay $4 million for time spent by one shareholder in an unsuccessful attempt to become lead plaintiff, a reduction of $7.5 million was necessary for 16,292 attorney-hours billed to review documents after parties had reached a settlement, a reduction of $12 million compensated for work performed by contract attorneys at higher rates than appropriate, and a 10% cut from remaining balance accounted for waste and inefficiency. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

**Opinion**

***OPINION***

SIDNEY H. STEIN, District Judge.

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## I. INTRODUCTION AND SUMMARY

***1** Plaintiffs bring this securities fraud action on behalf of a class of purchasers of Citigroup, Inc. common stock against that company and certain of its officials. Plaintiffs allege that Citigroup misled investors by understating the risks associated with assets backed by subprime mortgages and overstating the value of those assets, in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934; as a result, all those who purchased Citigroup common stock between February 26, 2007 and April 18, 2008 paid an allegedly inflated price. The parties have now reached a settlement of their dispute for $590 million to be paid to the class. The Court must determine whether that settlement is fair, reasonable, and adequate and what a reasonable fee for plaintiffs' attorneys should be.

On plaintiffs' unopposed motion pursuant to Federal Rule of Civil Procedure 23, the Court preliminarily approved that proposed settlement, certified the class for settlement purposes, and provided for notice to the class of the proposed settlement. In certifying the class, the Court appointed the proposed representatives as class representatives and appointed Kirby McInerney LLP as lead counsel for the class ("Kirby," "Lead Counsel," or "Counsel"). Now before the Court are two motions: (1) plaintiffs' motion for final approval of the class action settlement and approval of the plan of allocation (Dkt. No. 164) and (2) Lead Counsel's motion for an award of attorneys' fees and reimbursement of litigation expenses (Dkt. No. 165). The Court considered written submissions both supporting and opposing the settlement and held a fairness hearing on April 8, 2013 pursuant to Rule 23(e)(2).

The Court finds that the proposed settlement is fair, reasonable, and adequate and should be approved. Class members received adequate notice and had a fair opportunity to object or exclude themselves; very few have voiced their opposition. The settlement is procedurally sound because it was negotiated at arm's length by qualified counsel. The Court also concludes that the settlement is substantively fair. Although the $590 million recovery is a fraction of the damages that might have been won at trial, it is substantial and reasonable in light of the risks faced if the action proceeded to trial.

The Court also approves the proposed plan of allocation, subject to a clarification sought by certain objecting class members. Specifically, the issue was how to treat purchases of Citigroup stock made through an employee stock-purchase plan in which employees committed to purchases on one date, determined their price on another date based on six dates spread over six months, and then received their shares on yet another date. The Court agrees with the objectors that the substance, rather than the form, of those transactions should determine how the purchasers are compensated in connection with the settlement. For purposes of the alleged securities law violations, plan members purchased shares as the money was deducted each month, and the plan of allocation should reflect that the share price inflation at the end of each month approximates their harm.

***2** The Court also concludes that Lead Counsel is entitled to a fee award, albeit a smaller one than it has proposed, as well as reimbursement of the requested litigation expenses. Because of the size of the settlement, the Court places particular emphasis on the lodestar cross-check. Lead Counsel undoubtedly secured an impressive recovery for the class and legitimately expended millions of dollars in attorney and staff hours doing so. But the Court finds that Counsel's proposed lodestar is significantly overstated.

The Court makes the following deductions in the lodestar:

1) $4 million in time that one plaintiffs' firm expended in an unsuccessful attempt to become Lead Counsel and now wants the class to pay for that

unsuccessful effort;

2) $7.5 million for 16,292 hours of attorneys' time spent in pursuing discovery after the parties reached an agreement to settle their dispute. That time was spent largely on "document review" by contract attorneys, a full twenty of whom were hired for the first time on or about the same day the parties notified the Court that an agreement in principle had been reached;

3) A $12 million reduction by applying a reasonable blended hourly rate for the large number of contract attorneys of $200—rather than the blended rate submitted by Lead Counsel of $466 per hour—for the 45,300 hours worked by contract attorneys; and

4) A 10% cut from the remaining balance to account for waste and inefficiency which, the Court concludes, a reasonable hypothetical client would not accept. One such unfortunate example is the 157.5 hours for $66,937.50 in requested time spent digesting a single day's deposition.

These adjustments result in a lodestar of $51.4 million, resulting in a revised lodestar of $25.1 million. Factoring the proper lodestar into the Court's analysis of the requested $97.5 million fee pursuant to *Goldberger v. Integrated Resources, Inc.,* 209 F.3d 43 (2d Cir.2000), the Court instead awards $70.8 million in attorneys' fees, which is 12% of the $590 million common fund and represents a multiplier of 2.8 on the reduced lodestar.

## II. BACKGROUND

### A. The Alleged Fraud Summarized

A brief summary of plaintiffs' claims frames the Court's discussion of these motions. The allegations at issue concern Citigroup's investment in, and exposure to, risks associated with a now-infamous species of complex financial instruments: collateralized debt obligations ("CDOs") that have as some or all of their collateral residential mortgage backed securities ("RMBS"). Following dismissal by the Court of a variety of additional claims, the only claims that have survived concern Citigroup's exposure to potential mortgage-backed-CDO losses. *See In re Citigroup Inc. Sec. Litig.,* 753 F.Supp.2d 206 (S.D.N.Y.2010).

The gravamen of the surviving allegations is that Citigroup's public statements painted a misleading portrait of Citigroup as relatively safe from the market's concerns about potential losses resulting from falling CDO values. From February 26, 2007 to November 4, 2007, defendants allegedly "gave the impression that Citigroup had minimal, if any, exposure to CDOs when, in fact, it had more than $50 billion in exposure," *id.* at 235—CDOs that were backed by subprime mortgages and wrongly valued at par despite objective indications that such mortgage-backed CDOs had lost value by February 2007. "On November 4, 2007, Citigroup disclosed that it held $43 billion of super senior CDO tranches simultaneously with the fact of their writedown by an expected $8–$11 billion." *Id.* at 239–40. That disclosure, plaintiffs allege, omitted "$10.5 billion in hedged CDOs" that were purportedly insured against loss, and it also overstated the CDOs' value, thus underreporting losses. *Id.* at 240. Plaintiffs contend that defendants continued to overstate the value of the CDOs until a final corrective disclosure on April 18, 2008.

***3** As relevant here, the overall effect of these alleged misstatements was that the market overvalued Citigroup's assets, or undervalued its liabilities, and thus overvalued Citigroup common stock. Class members, purchasing based on the market price, thus paid too much for the Citigroup stock they purchased, and so plaintiffs claim as damages the amount by which they allegedly overpaid.

### B. Pre–Settlement Procedural History

#### *1. Consolidation of Similar Suits and Appointment of Interim Lead Plaintiffs and Counsel*

Various plaintiffs filed a number of separate complaints against defendants in distinct class actions, each purporting to represent the class of investors in Citigroup that were allegedly harmed by defendants' misstatements or omissions. Because of the similarity of the claims, the Court consolidated the actions filed by these and other plaintiffs into a single consolidated class action, No. 07 Civ. 9901. (*See* Order dated Aug. 19, 2008, Dkt. No. 59.)

The Court also resolved a contentious battle between competing plaintiffs and counsel to be appointed as interim lead plaintiffs and interim lead counsel—though the competition was primarily between the law firms and only derivatively between their clients. Two main groups of stock purchasers were vying for the appointment. First, Jonathan Butler, M. David Diamond, David Whitcomb and Henrietta Whitcomb (the "ATD Group") were four former owners of Automated Trading Desk, Inc. ("ATD"); they acquired their Citigroup stock pursuant to a merger in which Citigroup purchased ATD in exchange for a mix of cash and Citigroup stock. Second, a group of five institutional investment funds (the "Funds") comprised of three foreign entities, as well as the Public

Employees' Retirement Association of Colorado ("COPERA") and the Tennessee Consolidated Retirement System ("TCRS"), which all purchased Citigroup stock as part of their investments. Kirby represented the ATD Group, and Entwistle & Cappucci LLP represented the Funds.

The Court found that, pursuant to the Private Securities Litigation Reform Act ("PSLRA"), the ATD Group was the presumptive lead plaintiff because it (1) timely moved for appointment, (2) "has the largest financial interest in the relief sought by the class," and (3) made a preliminary showing that it met the typicality and adequacy requirements of Federal Rule of Civil Procedure 23(a). *See* 15 U.S.C. § 78u–4(a)(3)(B)(iii)(I). The Court found that the other movants for appointment as lead plaintiff, including the Funds, failed to rebut the presumption that ATD was the most adequate lead plaintiff. (*See* Tr. of Aug.19, 2008 Pretrial Conference at 11–12, Dkt. No. 111–24.) The Court appointed the ATD Group as interim lead plaintiffs and Kirby, its counsel, as interim lead counsel.

COPERA and TCRS moved to reconsider that appointment. (Dkt. No. 60.) The Court granted the motion to the extent the Funds sought limited discovery on whether the ATD Group possessed non-public information at the time of their stock acquisition; the Court, however, stayed discovery pending resolution of defendants' then-pending motion to dismiss. (Order dated Aug. 31, 2009, Dkt. No. 85.) As explained below, COPERA and TCRS subsequently withdrew their motion to reconsider.

***2. Consolidated Class Action Complaint and Motion to Dismiss***

*4 Following the appointment of the ATD Group, plaintiffs filed a consolidated amended complaint (Dkt. No. 69), and then amended once more, resulting in the "Amended Consolidated Class Action Complaint" (the "Complaint") (Dkt. No. 74). Defendants moved to dismiss the Complaint, and the Court granted that motion in part and denied it in part. *See In re Citigroup Inc. Sec. Litig.,* 753 F.Supp.2d 206, 212 (S.D.N.Y.2010).

As explained above, the Court permitted only the claims concerning Citigroup's exposure to CDO-related losses to proceed, albeit for a narrower time period and against a narrower group of defendants than alleged in the Complaint. *Id.* at 249. The Court in its opinion described the dismissed claims and the "gallimaufry of financial instruments" involved in detail and summarizes those claims here to illustrate the breadth of the claims initially asserted. *See id* at 214. The dismissed claims concern misstatements and omissions in the following categories:

1) that Citigroup misleadingly described and overvalued its investment in so-called "Alt–A" RMBS, which are RMBS backed by mortgages one cut above subprime, *see id.* at 227–28, 241–43;

2) that Citigroup concealed its exposure to risks associated with purportedly independent structured investment vehicles and overvalued the assets those vehicles held, *id. at* 228–29, 243–44;

3) "that defendants misrepresented Citigroup's mortgage lending business" in a number of ways, *id.* at 244;

4) that defendants concealed, and then overvalued, Citigroup's auction-rate securities holdings, *id.* at 230, 245–46;

5) that Citigroup similarly misled investors about its exposure to losses from leveraged loans and collateralized loan obligations, *id.* at 231, 246–47; and

6) finally, that Citigroup broadly misrepresented its overall financial health and solvency, *id.* at 231, 247–48.

Overall, plaintiffs alleged that defendants could see the financial-crisis writing on the walls in multiple areas of Citigroup's operations and sought to obscure or downplay the extant and future losses. The Court found the allegations sufficient to proceed as a matter of law only for claims regarding Citigroup's exposure to CDO-related losses. *Id.* at 249.

***3. Discovery and Motion for Class Certification***

Following the Court's decision on defendants' motion to dismiss, the parties conducted discovery related to class certification and the merits of the sustained CDO-related claims. That discovery, which overlapped with the class certification motion and the negotiation and finalization of the settlement, was voluminous. In all, Lead Counsel and the firms that were assisting it obtained and reviewed approximately 40 million pages of documents. Defendants produced approximately 35 million pages, and third parties produced 5 million additional pages. (Joint Decl. of Ira M. Press & Peter S. Linden dated Dec. 7, 2012 ("Joint Decl.") ¶ 68, Dkt. No. 171.) Lead Counsel also deposed thirty-three defense witnesses and defended depositions of sixteen witnesses. (*See* Joint Decl. ¶¶ 75, 87.)

*5 Pursuant to the Court's decision on Entwistle & Cappucci's motion to reconsider the appointment of the ATD Group as interim lead plaintiffs, COPERA and TCRS were permitted to conduct discovery into the ATD Group's fitness to serve as class representatives following the decision on the motion to dismiss. Instead, those funds reached an agreement with the ATD Group that the motion would be withdrawn and the two sides to the appointment dispute would join forces to seek class certification with all of them as class representatives. Thus, following class discovery, the ATD Group, COPERA, TCRS, and five other individuals together moved for class certification and proposed the entire group as class representatives. Those added individuals were John A. Baden III, Warren Pinchuck, Anthony Sedutto, Edward Claus, and Carol Weil, all of whom purchased shares of Citigroup stock on the open market during the class period.

The motion for class certification was heavily contested. The parties submitted legal memoranda as well as five attorney declarations appending hundreds of exhibits and four expert declarations from three different experts. Defendants challenged the commonality of the class and the typicality and adequacy of the proposed representatives pursuant to Rule 23(a). They further contended that common questions did not predominate over individualized questions pursuant to Rule 23(b)(3). Much of the dispute turned on two main issues: (1) whether the unique circumstances of the ATD Group's stock acquisition via merger agreement rendered it unfit to represent the class, and (2) whether plaintiffs had demonstrated that the alleged misrepresentations were material, a showing defendants contended was required for plaintiffs to invoke a class-wide presumption of reliance on the market price such that common questions would predominate.[1]

Prior to the Court's rendering a decision on the class certification motion, the parties entered into a settlement agreement.

### C. Settlement Negotiation and the Approval Process

#### *1. Negotiations and Preliminary Approval*

In early 2012, the parties jointly retained Layn R. Phillips, a retired federal district judge, to mediate their settlement negotiations. The parties participated in two full-day mediation sessions and also submitted extensive written materials. (Joint Decl. ¶¶ 96–97.) That process culminated in the mediator's ultimate proposal that the parties settle the action for $590 million; the parties on May 8, 2012 agreed to accept that proposal as the basis for a formal stipulation to be submitted to the Court for approval. (*Id.* ¶ 98.) As Lead Counsel has set forth in its fee request, "[s]hortly thereafter, Lead Counsel informed the Court of the proposed Settlement." (*Id.* ¶ 99.)

In the ensuing months, the parties hashed out the details of the formal stipulation. The main outstanding issue was the so-called exclusion threshold or "blow-up" provision. Defendants were empowered to withdraw from the settlement *if* the aggregate claim value of potential class members who excluded themselves from the settlement reached a certain threshold. A lower threshold meant a greater chance that defendants would have the discretion to nullify—or "blow up"—the settlement. In May, plaintiffs and defendants initially disagreed on the correct threshold, but they again sought the mediator's assistance and agreed on the threshold by "mid-July." (Supp. Joint Resp. Decl. of Ira M. Press & Peter S. Linden dated March 25, 2013 ("Supp. Joint Resp. Decl.") ¶ 54, Dkt. No. 233.)

*6 The parties finalized the details of the settlement and entered into the Stipulation and Agreement of Settlement dated August 28, 2012; plaintiffs then moved for preliminary approval of the settlement and certification of the class for settlement purposes. Having had the benefit of the parties' earlier reports on the settlement terms and proposed approval procedures, as well as extensive submissions on consideration of the motion for class certification, the Court granted that motion. (Order Preliminarily Approving Proposed Settlement and Providing for Notice dated Aug. 29, 2012 ("Preliminary Approval Order"), Dkt. No. 156.) In doing so, the Court certified a class of "[a]ll persons who purchased or otherwise acquired common stock issued by Citigroup during the period between February 26, 2007 and April 18, 2008, inclusive." (*See id.*) The Court set forth a schedule for providing notice to the class and procedures by which class members could, *inter alia,* submit claim forms, object to the proposed settlement or Lead Counsel's fee request, exclude themselves from the class, and appear at a fairness hearing.[2] (*Id.*) At the parties' requests, the Court in September 2012 made minor modifications to the Preliminary Approval Order, including the class definition and notice procedures, in two orders. (*See* Orders dated Sept. 6, 2012 & Sept. 28, 2012, Dkt. Nos. 158, 159.)[3]

#### *2. Objections and the Fairness Hearing*

##### *a. Few class members object or exclude themselves*

The claims administrator sent notices to over 2.4 million

potential class members. (Cirami Supp. Aff. ¶ 17.) Excluding a few objections from individuals who did not provide the required evidence of class membership or who provided evidence indicating they were not class members, the Court received only eleven written objections. Further, only 294 recipients of the 2.4 million notices timely submitted exclusion requests, of which only 134 provided evidence of membership in the class. (*Id.* ¶ 21.) And twenty-three of the 134 exclusions came from investors who had already commenced separate actions. (Supp. Joint Resp. Decl. ¶ 5.)

Two objections merit discussion. The first such objection was filed by six purchasers of Citigroup stock through the company's voluntary employee stock-purchase plan—the FA Capital Accumulation Program ("FA CAP"). These FA CAP objectors are also interim lead plaintiffs in a parallel putative class action concerning Citigroup employees' stock purchases through the FA CAP, which is currently pending before this Court: *Brecher v. Citigroup, Inc.,* No. 09 Civ. 7359. Here, the FA CAP objectors contend that the Court cannot approve the settlement because, *inter alia,* the FA CAP participant class members would release certain claims without compensation and because the proposed plan of allocation does not properly compensate them.

The second detailed objection was filed pro se by Theodore H. Frank, an individual investor in Citigroup who is also an attorney and the founder of the Center for Class Action Fairness. Frank objects to Lead Counsel's fee request. He contends, *inter alia,* that the fees requested—nearly $100 million—are unreasonably high when compared with similarly sized settlements and that Lead Counsel has improperly inflated its lodestar calculation in a variety of ways. Frank focuses largely on Lead Counsel's extensive use of contract attorneys—both on whether their asserted hourly billing rates are consistent with market rates and on whether a reasonable client would pay for all of the hours included in the lodestar.

#### *b. The fairness hearing*

*7 After proper notice to the class, the Court held a hearing on the fairness of the settlement and the reasonableness of the fee request on April 8, 2013. The settling parties, the FA CAP objectors, and Frank appeared, with each arguing its position regarding the pending motions. The Court also heard from plaintiffs' damages expert on the plan of allocation, and from Lead Counsel's expert on the reasonableness of the lawyers' hourly rates submitted in the request for attorneys' fees.

## III. FINAL APPROVAL OF CLASS ACTION SETTLEMENT

### A. Proper Notice of Class Certification and the Settlement

Rule 23 requires notice to the class both when the class is certified pursuant to Rule 23(b)(3) and when a class action settlement has been proposed for court approval. *See* Rule 23(c) (2)(B), (e)(1). The Court provided for combined notice of both events in order to save the class the expense of a second round of class-wide notice. "As Rule 23(e)'s notice requirements are less specific than that of Rule 23(c)'s, the Court will focus on Rule 23(c)'s requirements." *In re Global Crossing Sec. & ERISA Litig.,* 225 F.R.D. 436,448 (S.D.N.Y.2004) (citation omitted). The notice must describe

> (i) the nature of the action; (ii) the definition of the class certified; (iii) the class claims, issues, or defenses; (iv) that a class member may enter an appearance through an attorney if the member so desires; (v) that the court will exclude from the class any member who requests exclusion; (vi) the time and manner for requesting exclusion; and (vii) the binding effect of a class judgment on members under Rule 23(c)(3).

Rule 23(c)(2)(B). Further, "due process and the Federal Rules require individual notice [ ] to 'all class members whose names and addresses may be ascertained through reasonable effort.' " *In re Global Crossing,* 225 F.R.D. at 448 (quoting *Eisen v. Carlisle & Jacquelin,* 417 U.S.156,173 (1974)).

[1] The notices distributed include all of the information that the Rules require, as well as the additional disclosures required in securities cases. *See In re IIVIAX Sec. Litig.,* 283 F.R.D. 178, 185 (S.D.N.Y.2012) (citing 15 U.S.C. § 78u–4(a)(7)). The Court further finds that the claims administrator provided individual notice to those class members who could "be identified through reasonable effort." *See* Fed.R.Civ.P. 23(c)(2)(B). The Court finds that the notice here complied with Rule 23 and due process.

### B. Fairness of the Settlement

***1. The Standard for Approving a Proposed Class Action Settlement***

Settlement of the claims of a certified class requires court approval. Fed.R.Civ.P. 23(e). "A court may approve a class action settlement if it is 'fair, adequate, and reasonable, and not a product of collusion.' " *Wal–Mart Stores, Inc. v. Visa U.S.A. Inc.,* 396 F.3d 96,116 (2d Cir.2005) (quoting *Joel A. v. Giuliani,* 218 F.3d 132,138 (2d Cir.2000)). Thus, the Court must scrutinize "both the settlement's terms and the negotiating process leading to settlement." *Wal–Mart Stores,* 396 F.3d at 116 (citing *D'Amato v. Deutsche Bank,* 236 F.3d 78, 85 (2d Cir.2001)).

***8** [2] [3] The Court must exercise its discretion to approve or reject a settlement in light of the general judicial policy favoring settlement. *Weinberger v. Kendrick,* 698 F.2d 61, 73 (2d Cir.1982); *see also Wal–Mart Stores,* 396 F.3d at 116 (citing *In re PaineWebber Ltd. P'ships Litig.,* 147 F.3d 132,138 (2d Cir.1998)). Nonetheless, the policy favoring settlements generally will not substitute for rigorous scrutiny of this settlement. "[T]he Court must serve as a 'fiduciary' to protect the interests of absent class members affected by the settlement." *McBean v. City of New York,* 233 F.R.D. 377,382 (S.D.N.Y.2006) (quoting *Grant v. Bethlehem Steel Corp.,* 823 F.2d 20, 22 (2d Cir.1987)). Moreover, "[w]hen a settlement is negotiated prior to class certification, as is the case here, it is subject to a higher degree of scrutiny in assessing its fairness." *D'Amato,* 236 F.3d at 85; *see also Weinberger,* 698 F.2d at 73.

The Court first assesses "the negotiating process, examined in light of the experience of counsel, the vigor with which the case was prosecuted, and the coercion or collusion that may have marred the negotiations themselves." *Malchman v. Davis,* 706 F.2d 426,433 (2d Cir.1983) (citing *Weinberger,* 698 F.2d at 73). The Court then considers the "substantive terms of the settlement compared to the likely result of a trial." *Id.*

***2. Procedural Fairness: Arm's–Length Negotiations***

[4] The first indicator of the settlement's fairness is whether it was negotiated at arm's length by the parties. "As long as the integrity of the negotiating process is ensured by the Court, it is assumed that the forces of self-interest and vigorous advocacy will of their own accord produce the best possible result for all sides." *In re PaineWebber Ltd. P'ships Litig. ("PaineWebber"* ), 171 F.R.D.104,132 (S.D.N.Y.1997). Further, a "presumption of fairness, adequacy, and reasonableness may attach to a class settlement reached in arm's-length negotiations between experienced, capable counsel after meaningful discovery." *Wal–Mart Stores,* 396 F.3d at 116 (quoting *Manual for Complex Litigation (Third)* § 30.42 (1995)). The negotiations here bear each of those hallmarks. The Court has no doubts about the experience or ability of counsel. Nor, as explained further below, did they lack for knowledge of this case. And the history of the negotiations and the role of the mediator suggest that the parties actually dealt with one another at arm's length—going so far as accepting the mediator's proposed dollar amount. From his front row seat, the mediator concluded that "negotiations in this case were hard fought and at arm's-length at all times." (Decl. of Layn R. Phillips dated Nov. 19, 2012 ¶ 5, Dkt. No. 168.) The Court agrees. Accordingly, the Court concludes that the process was fair and free from collusion and that a presumption of the settlement's fairness arises.

***3. Substantive Fairness: The Grinnell Factors***

*9 The Court must next consider whether the substantive terms of the settlement support or rebut the presumption of fairness arising from the arm's-length negotiations. Courts in this Circuit analyze substantive fairness through the lens of the nine factors set forth in *City of Detroit v. Grinnell Corp.,* 495 F.2d 448, 463 (2d Cir.1974):

> (1) the complexity, expense and likely duration of the litigation;
>
> (2) the reaction of the class to the settlement;
>
> (3) the stage of the proceedings and the amount of discovery completed;
>
> (4) the risks of establishing liability;
>
> (5) the risks of establishing damages;
>
> (6) the risks of maintaining the class action through the trial;
>
> (7) the ability of the defendants to withstand a greater judgment;
>
> (8) the range of reasonableness of the settlement fund in light of the best possible recovery;
>
> (9) the range of reasonableness of the settlement fund [compared] to a possible recovery in light of all the attendant risks of litigation.

*Wal–Mart Stores,* 396 F.3d at 117 (quoting *Grinnell,* 495 F.2d at 463). In weighing the *Grinnell* factors, "[t]he Court must eschew any rubber stamp approval in favor of an independent evaluation, yet, at the same time, it must

stop short of the detailed and thorough investigation that it would undertake if it were actually trying the case." *Grinnell,* 495 F.2d at 462.

***a. The complexity, expense and likely duration of the litigation***

"As a general matter, the more complex, expensive, and time consuming the future litigation, the more beneficial settlement becomes as a matter of efficiency to the parties and to the Court." *McBean,* 233 F.R.D. at 385. Fact discovery here was nearly complete, and counsel for the parties had logged tens of thousands of hours. But because of the scope and complexity of this case, what remained was far from simple or brief, and certain to be costly. Of this there can be no doubt.

After the completion of fact discovery, the parties would undoubtedly pursue expert discovery, summary judgment motions, and pretrial motions prior to trial. A trial would then consume substantial resources, and its result would be appealable. In sum, the expense and duration of continued litigation weighs in favor of approving the settlement.

***b. The reaction of the class to the settlement***

A favorable reception by the class constitutes "strong evidence" that a proposed settlement is fair. *Grinnell,* 495 F.2d at 462. "If only a small number of objections are received, that fact can be viewed as indicative of the adequacy of the settlement." *Wal–Mart Stores,* 396 F.3d at 118 (quoting Alba Conte & Herbert B. Newberg, *Newberg on Class Actions* § 11:41, at 108 (4th ed.2002)). The numbers here overwhelmingly support approval of the settlement: a mere eleven objections in response to nearly 2.5 million notices, with only six objections challenging the settlement itself rather than the fee request or notice procedures. In addition, not a single objection was received from any of the institutional investors that hold the majority of Citigroup stock. (*See* Supp. Joint Resp. Decl. ¶ 4.) Further, only 134 class members submitted exclusion requests. *Cf. D'Amato,* 236 F.3d at 86–87 (finding class response of eighteen objections and seventy-two exclusions from 28,000 notices weighs in favor of approval). The Court concludes that the class's reaction weighs heavily in favor of approval.

***c. The stage of the proceedings and the amount of discovery completed***

***10** Although discovery had largely, but not yet fully, concluded, "plaintiffs entered into settlement only after a thorough understanding of their case." *See Wal–Mart Stores,* 396 F.3d at 118. The parties completed extensive discovery that included millions of pages of documents and depositions of key witnesses on both sides. The parties had also conducted a preliminary battle of the experts, including depositions, regarding the materiality of the alleged misstatements in connection with the class certification motion. That dispute effectively foreshadowed a loss-causation debate insofar as Citigroup contested the alleged effect of the misrepresentations on the market price for Citigroup stock. Lead Counsel had ample time, documents, and information from Citigroup to develop its knowledge of the strengths—and weaknesses—of the class's claims; in filings, Counsel provided the Court with adequate factual information upon which to evaluate the fairness, reasonableness, and adequacy of the proposed settlement. Plaintiffs, in short, had more than enough information to make an informed and intelligent decision. Accordingly, this third *Grinnell* factor also weighs in favor of approval.

***d. The risks of continued litigation associated with maintaining the class through trial and establishing liability and damages***

The road to recovery by means other than settlement was long and lacked a guardrail; the fourth, fifth, and sixth *Grinnell* factors all concern the obstacles plaintiffs faced in pursuing a final judgment in their favor. All litigation carries risk. *See PaineWebber,* 171 F.R.D. at 126. Indeed, "[i]f settlement has any purpose at all, it is to avoid a trial on the merits because of the uncertainty of the outcome." *In re Ira Haupt & Co.,* 304 F.Supp. 917, 934 (S.D.N.Y.1969). It is no coincidence that the parties' settlement talks ramped up specifically to avoid the first of these uncertainties: that the Court might deny class certification. In the class certification motion, the parties disputed, *inter alia,* the materiality of the alleged misstatements—a merits issue on which plaintiffs would have had to again prevail at summary judgment and trial. *See Erica P. John Fund, Inc. v. Halliburton Co.,* 563 U.S. ——, ——,131 S.Ct. 2179, 2185 (2011).

The most significant risks, however, concerned liability. Plaintiffs still had to prove that the alleged misstatements were false or misleading and that defendants had a duty to disclose information they had omitted from their public statements. The allegations here largely hinged on defendants' failure to provide the details of Citigroup's exposure to the super-senior tranches of CDOs, but the duty to provide those details had not been established. Further, plaintiffs would ultimately have to show that defendants had acted with fraudulent intent when making

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the alleged misstatements. Plaintiffs at summary judgment and trial would have to overcome defendants' arguments that Citigroup valued the CDOs in good faith, relying in part on their auditors and taking write downs when market data—the rating agency downgrades—required it. That is no small obstacle. The U.S. Securities and Exchange Commission elected not even to allege scienter-based fraud claims in its civil enforcement action against Citigroup for misleading investors about CDOs during this class period. *See* Complaint, *SEC v. Citigroup Inc.,* No.10–cv–1277–ESH (D.D.C. July 29, 2010); *see also SEC v. Stoker,* No. 11 Civ. 7388(JSR) (S.D.N.Y. July 31, 2012), Dkt. No. 118 (jury finding for Citigroup manager accused of fraud in connection with 2007 CDO transactions).

***11** Finally, plaintiffs would have had to show loss causation in order to establish both liability and damages. *See generally In re Omnicom Grp., Inc. Sec. Litig.,* 597 F.3d 501, 509 (2d Cir.2010) (citing *Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 341–42, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005)). To prove liability, plaintiffs had to prove "that the loss was foreseeable and caused by the materialization of the risk concealed by the fraudulent statement." *In re Omnicom,* 597 F.3d at 513 (citation omitted). Here, plaintiffs would have had to show that Citigroup's stock price fell specifically because the market learned the truth that defendants had concealed by their misstatements and omissions—not because the market learned of any of the myriad other developments in Citigroup's operations and the world financial system.

That loss causation analysis also highlights the risk that plaintiffs might not establish damages at the levels alleged. In other words, even if plaintiffs could have maintained class action status, and established defendants' liability, the question remained: could they prove that this fraud caused enough damages to justify the risk and expense of participating in a trial on the merits?

In sum, the risk that the plaintiffs might not prevail was significant. The Court concludes that the fourth *Grinnell* factor weighs heavily in favor of approval, and the fifth and sixth factors also support the conclusion that the settlement is fair and reasonable.

***e. The ability of the defendants to withstand a greater judgment***

Although plaintiffs initially conceded that "there is no basis to believe that Defendants are incapable of withstanding a greater judgment," they now suggest that Citigroup's solvency should not be conceded so cavalierly. (*Compare* Pls.' Mem. in Supp. of Preliminary Approval at 11, Dkt. No. 154, *with* Pls.' Mem. in Supp. of Final Approval at 18, Dkt. No. 169.) However, plaintiffs ignore that Citigroup carries insurance of unknown limits for this liability, and they fail to mention the ability of the *individual* defendants to pay more than the settlement requires them to pay-which is $0. But while the defendants' ability to pay more suggests a settlement might be unfair, "this factor, standing alone, does not suggest that the settlement is unfair." *D'Amato,* 236 F.3d at 86 (citing *PaineWebber,* 171 F.R.D. at 129).

***f. The range of reasonableness of the settlement fund in light of the best possible recovery and all attendant risks of litigation***

Finally, essential to analyzing a settlement's fairness is "the need to compare the terms of the compromise with the likely rewards of litigation." *Weinberger,* 698 F.2d at 73 (quoting *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414, 424–25, 88 S.Ct. 1157, 20 L.Ed.2d 1 (1968)). The U.S. Court of Appeals for the Second Circuit has emphasized that "[t]here is a range of reasonableness with respect to a settlement—a range which recognizes the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion." *Wal–Mart Stores,* 396 F.3d at 119 (quoting *Newman v. Stein,* 464 F.2d 689, 693 (2d Cir.1972)). In other words, the question for the Court is not whether the settlement represents the highest recovery possible—which it does not—but whether it represents a reasonable one in light of the many uncertainties the class faces—which it does. The "best possible recovery" estimated at $6.3 billion is an astronomical sum, but $590 million—more than half a billion dollars—is no small sum itself, and the risk that the class would recover nothing or would recover a fraction of the maximum possible recovery must factor into the decision-making calculus.

***12** Plaintiffs contend that, taking into account a number of variables, this is a truly impressive recovery. Those variables include the following: that the action concerned exposure to particularly complex risks associated with CDOs; that only one corporate defendant, Citigroup, can contribute to the fund; that no parallel SEC investigation or earnings restatement preceded the initiation of this suit; that related suits against some of the same defendants have failed or settled for far less; and, most of all, that the claims here require proof of scienter. (*See* Pls.' Mem. in Supp. of Mot. for Final Approval at 19–22.) Further, plaintiffs' experts point out that, for class actions with roughly equivalent alleged damages, investors have recovered a much smaller fraction of the amount

claimed—a mean of 2.2% and median of 1% compared to roughly 9.4% here. (*See* Decl. of John C. Coffee, Jr. dated Dec. 6, 2012 ¶ 120, Dkt. No. 167; Decl. of Geoffrey P. Miller dated Dec. 6, 2012 ¶ 128, Dkt. No. 166 (discussing Jordan Milev, Robert Patton & Svetlana Starykh, National Economic Research Associates, *Recent Trends in Securities Class Action Litigation: 2011 Mid-Year Review,* (2011)).)

The Court need not heap superlatives on the outcome in order to conclude that these two *Grinnell* factors together weigh heavily in favor of approval. This recovery stands out in the crowd, and is well within the range of reasonableness when comparing the best possible recovery to the risks of continued litigation. Accordingly, nearly all of the *Grinnell* factors strongly support approval.

***4. Overall Fairness Evaluation***

The Court has pressed the parties to explain why they have agreed that the individuals allegedly responsible for Citigroup's wrongs will pay nothing in this settlement while Citigroup—that is, its current shareholders, including many of those allegedly defrauded by defendants—foots the bill. After all, corporations only act through human beings. Indeed, the Court's concerns align with the scholarly work of one of Lead Counsel's own experts, Professor Coffee, and others. *See, e.g.,* John C. Coffee Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation,* 106 Colum. L.Rev. 1534 (2006). The Court shares Professor Coffee's concern that securities class actions in which the corporation and its insurers pay for the release of claims against its corporate officers and executives have essentially no deterrent value for those executives—the ones whose actions matter. The Court also laments that the shareholders, as owners, effectively pay the insurance premiums and any settlement amounts over the insurance coverage, such that most settlements are essentially transfers of wealth from all present shareholders to a subset of past and present shareholders, with significant sums siphoned off in the form of lawyers' fees and litigation costs. *Id.* at 1556–57.

[5] The Court, however, concludes that the Rule 23 settlement approval process presents no occasion for the Court to consider whether plaintiffs' decision not to seek payment from the individual defendants and Citigroup's decision to use only corporate assets to pay for the release of all claims against high-ranking former employees and directors is fair to Citigroup's shareholders. As the Second Circuit has explained, district courts are to consider only whether "total compensation to class members is fair, reasonable, and adequate," not "how the defendants apportion liability for that compensation among themselves." *In re Warner Commc'ns. Sec. Litig.,* 798 F.2d 35, 37 (2d Cir.1986). In other words, "[t]he adequacy of the settlement does not depend upon the allocation of that amount among the Defendants." *In re NASDAQ Mkt.-Makers Antitrust Litig.,* 184 F.R.D. 506,512 (S.D.N.Y.1999) (citing *Warner Commc'ns.,* 798 F.2d at 37) (denying class member access to sealed document detailing apportionment of defendants' payments). That the apportionment of liability here and in similar cases might not serve as a deterrent to future corporate wrongdoing is a concern for Congress and the SEC, not for a district court reviewing a securities class action settlement. *See Warner Commc'ns.,* 798 F.2d at 37; *NASDAQ Mkt.-Makers,* 184 F.R.D. at 512.

***13** With that clarification, the Court concludes that nearly every traditional indicator of a settlement's fairness points in favor of approval of this settlement. The Court finds that it is certainly fair, reasonable, and adequate. Accordingly, the Court grants the motion for final approval of the settlement.

## IV. FINAL APPROVAL OF THE PLAN OF ALLOCATION

"As a general rule, the adequacy of an allocation plan turns on whether counsel has properly apprised itself of the merits of all claims, and whether the proposed apportionment is fair and reasonable in light of that information." *PaineWebber,* 171 F.R.D. at 133. "An allocation formula need only have a reasonable, rational basis, particularly if recommended by experienced and competent class counsel." *In re WorldCom, Inc. Sec. Litig.,* 388 F.Supp.2d 319, 344 (S.D.N.Y.2005) (citations and quotation marks omitted). "A reasonable plan may consider the relative strength and values of different categories of claims." *In re Telik, Inc. Sec. Litig.,* 576 F.Supp.2d 570,580 (S.D.N.Y.2008) (citing *In re Global Crossing Sec. & ERISA Litig.,* 225 F.R.D. 436,462 (S.D.N.Y.2004)).

[6] The plan of allocation in this action (the "Plan") derives from the alleged corrective disclosures and the market's reaction to those disclosures. Plaintiffs' expert estimated the portion of the drop in price following each corrective disclosure that is attributable to revelation of the information that the misstatements concealed pursuant to the law governing loss causation. The Plan then treats that portion of the price-drop as the estimated inflation in the price of Citigroup stock for the period between the prior corrective disclosure (or the start of the class period) and that corrective disclosure. The resulting schedule of

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estimated share-price inflation is the foundation for the Plan:

| ***Transaction Date*** | ***Per Share Price Inflation*** |
| --- | --- |
| 2/26/07–11/4/07 | $4.94 |
| 11/5/07 | $3.38 |
| 11/6/07–11/18/07 | $1.72 |
| 11/19/07–1/14/08 | $1.15 |
| 1/15/08 | $0.71 |
| 1/16/08–4/18/08 | $0.10 |

The inflation at the time of each class member's purchase is the per share harm she initially sustained due to the alleged fraud. If, however, the class member sold before the final corrective disclosure, the Plan then subtracts from the harm at the time of purchase the inflation in the price she received at the time of sale. The result—the total harm at purchase minus gain at sale—is each class member's "Recognized Loss." Once all class members' Recognized Losses are determined, the Plan provides for a proportional allocation of the net settlement fund. In other words, if the total Recognized Loss of all class members is triple the amount of the settlement fund that remains after deducting costs and fees, each class member will receive one third of their Recognized Loss. No one has filed any substantive objection to the fairness of that formula.

*14 The principal objection to the Plan comes from the FA CAP objectors and relates to the application of its underlying formula to FA CAP participants' purchases. Class members who acquired their Citigroup stock through the FA CAP's employee stock-purchase plan did not purchase their shares in traditional open market transactions, and so the Court must clarify the application of the Plan to their purchases.

The FA CAP operated as follows: In December, before the start of each calendar year, employees eligible to participate in the FA CAP decided whether to receive part of their compensation for the year in the form of Citigroup stock. The participant agreed to have a certain amount of his pre-tax paycheck deducted each month to be applied to the purchase of stock. But the stock was awarded after completing each six-month block of employment based on an average of the closing price at the end of each of those six months, less a 25% discount. For example, the employee would elect to participate throughout 2007 in December 2006. Each month, money was deducted from his paycheck. In early July, he received an award based on his contributions over the prior six months and an average of the closing price on the last trading day of each month from January to June. If the participant had committed $1,000 per month and the average of the six closing prices was $40, such that the price after discount was $30, the participant in July was awarded 200 shares ($6,000 divided by $30). That cycle

repeated for July 2007 through December 2007 based on the same December 2006 election, with shares then awarded in January 2008. Thus, for each award, the participant commits in December, the price is determined using market prices from six different days spread over six months (January to June or July to December), and the shares are then awarded shortly after the final price input is determined.

The parties contend that only the July 2007 and January 2008 awards should be compensated under the Plan because those are the only *awards* that occurred during the class period: February 26, 2007–April 18, 2008. The FA CAP objectors contend that the July 2008 award should also be included to the extent that participants committed during the class period, paid into the FA CAP during the class period in the form of both labor and payroll deductions, and paid a price determined in part by class period market prices. In substance, objectors contend, the transaction occurs in monthly installments even if the shares are awarded in semi-annual blocks; those monthly withdrawals and price-inputs determined the effect of the fraud on their purchases and so should determine their compensation here.

The Court agrees with objectors. The settling parties' formalistic view is inconsistent with the "flexib[ility]" required when applying Section 10(b) of the Exchange Act. *See SEC v. Zandford,* 535 U.S. 813, 819, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002); *Superintendent of Ins. v. Banker's Life & Cas. Co.,* 404 U.S. 6, 12, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971). Section 10(b) broadly prohibits fraud "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b). The employees, having already committed to participate, each month had money taken from their salaries to purchase shares based on the market price at the end of each month. The alleged fraud affected FA CAP participants' purchase of the security in monthly increments, and so too should their remedy be calculated in monthly increments. Treating the purchase as occurring in monthly installments for purposes of the Plan better accords with the substance of the transactions and so better "effectuate[s] [the statute's] remedial purposes." *See Zandford,* 535 U.S. at 819. Of course, the FA CAP participants cannot have it both ways. If the January, February, and March installments of the July 2008 award are included, then the January installment of the July 2007 award must be excluded because it precedes the start of the class period.

***15** In sum, the Court concludes that the basis for the Plan is rational, and that the Plan is fair and adequate. The share-price inflation schedule reflects that "the injuries claimed by different class members have been sustained under significantly different ... factual circumstances." *See PaineWebber,* 171 F.R.D. at 133. The effect of the fraud on the market price, and thus the harm suffered by purchasers, changed each time the market learned more of the truth. The Court interprets the Plan to apply to the FA CAP objectors in precisely the manner they propose. Accordingly, the Court grants the motion for final approval of the proposed plan of allocation.

## V. FEE AWARD

### A. Percentage of the Fund Method with Lodestar Cross–Check

[7] [8] Courts traditionally award plaintiffs' counsel fees in class actions based on either a reasonable percentage of the settlement fund or an assessment by the court of the market value of the work plaintiffs' attorneys performed. The former is known as the percentage of the fund method, and the latter is the lodestar method. In complex securities fraud class actions, courts have long observed that the "the trend in this Circuit has been toward the use of a percentage of recovery as the preferred method of calculating the award for class counsel in common fund cases." *In re Beacon Assocs. Litig.,* No. 09 Civ. 777(CM), 2013 WL 2450960, at *5 (S.D.N.Y. May 9, 2013); *see also, e.g., In re Avon Prods., Inc. Sec. Litig.,* No. 89 Civ. 6216(MEL), 1992 WL 349768 (S.D.N.Y. Nov.6,1992). In fact, the "trend" of using the percentage of the fund method to compensate plaintiffs' counsel in major securities fraud class actions is now firmly entrenched in the jurisprudence of this Circuit.

[9] But that method does not render the lodestar irrelevant. "It bears emphasis that whether calculated pursuant to the lodestar or the percentage method, the fees awarded in common fund cases may not exceed what is 'reasonable' under the circumstances." *Goldberger v. Integrated Res., Inc.,* 209 F.3d 43, 47 (2d Cir.2000) (citation omitted). Part of the reasonableness inquiry is a comparison of the lodestar to the fees awarded pursuant to the percentage of the fund method "[a]s a 'cross-check.' " *Wal–Mart Stores,* 396 F.3d at 123 (quoting *Goldberger,* 209 F.3d at 50). Moreover, as Lead Counsel's own expert recognizes, the lodestar cross-check is particularly important in so-called mega-fund settlements such as this one. (Miller Decl. ¶ 32.) The cross-check is crucial because "economies of scale could cause windfalls in common fund cases" with large funds, again such as this one. *See Wal–Mart Stores,* 396 F.3d at 121 (citing *Goldberger,* 209 F.3d at 52). For that same reason, "courts have traditionally awarded fees for common fund cases in the lower range of what is reasonable." *Id.* With that background, the Court considers the reasonableness of Kirby's request for $97.5

million in attorneys' fees-an award of roughly 16.5% of the $590 million fund.

B. Assessing Reasonableness Pursuant to *Goldberger*

*16 Courts in this Circuit determine reasonableness by reference to the factors set forth in *Goldberger v. Integrated Resources, Inc.,* and known as the *Goldberger* factors:

(1) the time and labor expended by counsel;

(2) the magnitude and complexities of the litigation;

(3) the risk of the litigation ...;

(4) the quality of representation;

(5) the requested fee in relation to the settlement; and

(6) public policy considerations.

*Wal–Mart Stores,* 396 F.3d at 121 (quoting *Goldberger,* 209 F.3d at 50). The Court will consider each factor in turn.

***1. Time and Labor Expended by Counsel: The Lodestar***

[10] Assessing the extent of time and labor expended effectively entails an estimate of Lead Counsel's lodestar. *See Febus v. Guardian First Funding Grp., LLC,* 870 F.Supp.2d 337,339 (S.D.N.Y.2012) (citation omitted). The lodestar is "based upon the number of hours reasonably expended by counsel on the litigation multiplied by a reasonable hourly rate." *Reiter v. MTA New York City Transit Auth.,* 457 F.3d 224,232 (2d Cir.2006) (citing *Blanchard v. Bergeron,* 489 U.S. 87, 94, 109 S.Ct. 939, 103 L.Ed.2d 67 (1989)).

Lead Counsel and the law firms that worked with it expended vast numbers of hours and should be compensated for their efforts. What is in dispute is whether all of those hours and the hourly rates proffered—to translate those hours into a hypothetical fee—are reasonable. "Because the lodestar is being used merely as a cross-check, it is unnecessary for the Court to delve into each hour of work that was performed by counsel to ascertain whether the number of hours reportedly expended was reasonable." *In re IPO Sec. Litig.,* 671 F.Supp.2d 467,506 (S.D.N.Y.2009) (citing *Goldberger,* 209 F.3d at 50). Similarly, the Court need not determine with precision a reasonable hourly rate for each attorney. But the lodestar serves little purpose as a cross-check if it is accepted at face value.

[11] The Court first identifies hours that it concludes were not reasonably expended for purposes of Lead Counsel's lodestar. The hours at issue include the following: (1) Entwistle & Cappucci's work unsuccessfully seeking appointment as lead counsel; (2) vast numbers of hours spent on discovery after settlement was reached, largely by contract attorneys; and (3) instances of waste and inefficiency that require an across-the-board lodestar cut. The Court next determines that a reasonable client, on balance, would accept the rates submitted for associates, counsel, partners and support staff, but would not pay the proffered associate-level rates for the services of contract attorneys to review documents.

***a. Hours reasonably expended***

The Court's task is to probe "the validity of the representations that a certain number of hours were usefully and reasonably expended." *Lunday v. City of Albany,* 42 F.3d 131,134 (2d Cir.1994).

**i. The $4 million in lodestar that Entwistle & Cappucci expended unsuccessfully attempting to become lead counsel is not compensable.**

*17 Not every hour worked by every attorney who seeks to represent a class is due compensation from the class. Lead Counsel has included in the lodestar the hours incurred by attorneys at other firms that were assisting Kirby in prosecuting this action, including the hours of Entwistle & Cappucci. But Entwistle & Cappucci's hours are not limited to its work *assisting* Lead Counsel; those hours include $4 million Entwistle & Cappucci spent attempting to secure appointment as lead counsel for itself—including its motion to reconsider the Court's appointment of Kirby as lead counsel. The hours Entwistle & Cappucci spent unsuccessfully seeking appointment should not yield compensation from a class they were not appointed to represent. Lead Counsel cannot, by later choosing Entwistle & Cappucci to assist its efforts, convert the hours Entwistle spent unsuccessfully attempting to become lead counsel into compensable time.

"It is well established that the common fund doctrine permits attorneys whose work created a common fund for the benefit of a group of plaintiffs to receive reasonable attorneys' fees from the fund." *Victor v. Argent Classic Convertible Arbitrage Fund L.P.,* 623 F.3d 82, 86 (2d Cir.2010). Although courts have typically applied that doctrine to compensate attorneys who performed work in the early stages of a class action but were not selected as

lead counsel, such work is compensable only to the extent the attorney's work "confer[red] substantial benefits on the class." *Id.* at 87. As interim lead counsel, Kirby was free to seek assistance from other firms, including from recently competing movants for the same position, and to include in the lodestar the work those firms reasonably performed under Kirby's supervision in prosecuting the case. But the decision by Kirby to seek the assistance of Entwistle & Cappucci cannot turn $4 million in time Entwistle & Cappucci spent opposing Kirby's appointment as lead counsel into cash for the lawyers.

Kirby's arguments in favor of including Entwistle & Cappucci's hours prior to the alliance between those firms are the following: (1) that Entwistle & Cappucci was attempting to benefit the class because that firm was attempting to be appointed interim lead counsel and represent the class; (2) that the contestation of the interim appointment is itself a benefit to the class insofar as competition yields the best representative; and (3) that some of Entwistle & Cappucci's hours benefitted the class insofar as the ultimate consolidated complaint incorporated at least in part Entwistle & Cappucci's prior work product.

Lead Counsel's first argument is premised upon an untenable read of the case law that confuses intentions with impact; the work must have actually benefited the class. *See In re Elan Sec. Litig.,* 385 F.Supp.2d 363, 374 (S.D.N.Y.2005) (striking from lodestar unappointed counsel's hours because "their efforts do not appear appreciably to have benefitted the Class"). Accepting Lead Counsel's position would permit various competing firms to extract compensation for duplicative work. Further, it would encourage appointed counsel to choose their co-counsel not for their skill or knowledge but for the portfolio of lodestar-inflating work already completed.

***18** Lead Counsel's second argument actually supports the inclusion of Kirby's hours, but not the inclusion of Entwistle & Cappucci's. The Court agrees that the interim appointment process is necessary to the progress of the action, and that the class benefits from the selection of capable counsel. The Court selected Kirby, the action proceeded, and the class thus benefited from Kirby's efforts to secure appointment. But the Court rejected Entwistle & Cappucci's arguments on behalf of the Funds against Kirby's appointment; Entwistle & Cappucci and its clients even abandoned those arguments in withdrawing their motion for reconsideration. Kirby cannot seriously argue that those unsuccessful efforts to remove Kirby conferred substantial benefits on the class. *See id.* (unappointed counsel had "not establish[ed] why they should be compensated for, among other things, seeking but failing to be appointed lead counsel").

Finally, the third argument is meritorious as a matter of doctrine but not supported on this record. Courts have invoked the common fund doctrine to award unappointed counsel "reasonable compensation" for unique work that in fact benefited the class. *See Victor,* 623 F.3d at 87. But "non-lead counsel is not automatically entitled to an award from a common fund each time one of its claims is utilized in the complaint that lead counsel ultimately files." *Id.* Entwistle & Cappucci has argued that its work on the Funds' complaint was incorporated into the operative consolidated complaint and thus benefitted the class. Neither Entwistle & Cappucci nor Kirby has identified any specific allegations that would not have been included but for Entwistle's pre-appointment efforts; they have only identified many allegations that were included in both the Funds' complaint and the consolidated complaint. Nor, more specifically, have they shown that their efforts added to the complaint a claim that survived the motion to dismiss. Work that is otherwise non-compensable cannot be billed to the class based only on Counsel's say-so that the work conferred an unspecified benefit. Lead Counsel have failed to carry their burden of demonstrating that Entwistle & Cappucci's work prior to those firms' union as co-counsel conferred a substantial benefit on the class.

Accordingly, the Court will strike from the lodestar Entwistle & Cappucci's hours that were not undertaken at Kirby's direction. The impermissible hours are a not-insignificant fraction of the total lodestar. Indeed, Entwistle & Cappucci's pre-appointment lodestar dwarfs even that of Lead Counsel for the same time period. (*See* Pre- and Post–Lead Plaintiff Appointment, Ex. D to Pls.' Resp. to Court's Mar. 1, 2013 Order ("Fee App. Supp."), Dkt. No. 211.) The Court strikes $4 million from the lodestar, which is Entwistle & Cappucci's time for pre-complaint investigation, drafting its complaint, and opposing the appointment of Kirby. (*See* Entwistle Attorney Time Details, Ex. A to Fee App. Supp. (all entries up through Jan. 18, 2011).) To put these hours in perspective, that part of Entwistle & Cappucci's lodestar simply dedicated to seeking appointment and opposing Kirby's appointment—$1.5 million—is more than *double* the lodestar that all plaintiffs' firms spent opposing defendants' later motion to dismiss the complaint. (*See* Court Hearing Preparation & Attendance, Ex. F to Fee App. Supp.; Briefing Time & Lodestar Detail, Ex. K to Fee App. Supp.)

**ii. The post-settlement hours unrelated to settlement matters, totaling $7.5 million in lodestar, were not**

**reasonably expended.**
***19** Objector Frank correctly challenges the reasonableness of thousands of hours expended on document review and discovery-related tasks *after* the parties reached a settlement agreement in principle. Lead Counsel do not dispute that a team of contract attorneys spent many hours reviewing documents after the agreement in principle was arrived at. Nor can they even dispute that many of these attorneys *began* their work on the case at the same time the parties reached the agreement on the settlement amount on or about May 8, 2012.[4] Now, however, Counsel contends that they had not reached a definitive, binding agreement and thus had to be ready to conclude discovery on a short timetable. Therefore, Counsel brought on twenty additional contract attorneys and had them commence extensive document review work. The Court concludes that a reasonable paying client would not have authorized or paid for these hours.

To begin, upon reaching the agreement in principle, the parties represented to the Court that settlement was essentially a *fait accompli.* Further, Lead Counsel's own submissions in support of their fee request similarly reflected their view that the case had been settled. Counsel initially represented that "at the time the parties *reached the Settlement,* there were still over two months remaining before the discovery cutoff set by the Court," including "depositions of numerous additional witnesses"—with all depositions after May 9 cancelled. (Joint Decl. ¶ 77 (emphasis added); *cf.* Stipulation and Revised Scheduling Order dated Feb. 2, 2012, Dkt. No. 150 (discovery cutoff on July 13).) Taking Lead Counsel at its word, "the parties reached the Settlement" by May 8, 2012.

Actions, of course, speak louder than words. Save for the ballooning of contract-attorney hours at issue, Lead Counsel's lodestar report confirms that by May 2012 the parties had little doubt that this case was settling. Most of the Kirby associates and partners, as distinct from separately retained contract attorneys, spent their time after May 8 negotiating a stay of discovery, and then finalizing the settlement and drafting preliminary approval papers (all of which is properly compensable)—or working on other matters. (*See* Kirby Attorney Time Details, Ex. A to Fee App. Supp. (attorney Telias's last entry on May 8); *id.* (attorney Masters's entries after May 8, 2012); *id.* (entries of attorneys Linden, Hume, and McNeela from May 10 to May 15, 2012 concerning stay of discovery).)

With that background, the question is whether a hypothetical paying client would have paid for this work. In analogous circumstances, the *In re AOL Time Warner, Inc. Securities & "ERISA" Litigation* court reduced the lodestar by 5,000 associate hours for document review performed after signing a memorandum of understanding and before a settlement agreement was signed because "few private clients paying hourly fees would absorb the cost of such unabated work over a two-month period." No. 02 Civ. 5575(SWK), 2006 U.S. Dist. LEXIS 78101, at *73 (S.D.N.Y. Sept. 28, 2006) (R & R of Special Master), adopted, 2006 U.S. Dist. LEXIS 77926 (S.D.N.Y. Oct. 25, 2006). This Court has reached the same conclusion regarding the 16,291.8 hours at issue here.

***20** The reality was that a settlement was reached on May 8 and the parties telephoned the Court two days later to report that "in the view of the parties, a settlement was reached subject to the Court's approval and draft documents." (*See* Tr. of Hearing dated Apr. 8, 2013 at 73:24–74:1, Dkt. No. 262.) At the same time, Lead Counsel was hiring a score of new contract attorneys and setting them and other attorneys to work on document review. The hours Lead Counsel expended finalizing the settlement are appropriately included in the lodestar. All other hours after the May 8 agreement, the vast majority of which consist of contract attorneys performing basic document review, serve only to inflate the lodestar .[5] The Court concludes that those hours were not "usefully and reasonably expended." *See Lunday v. City of Albany,* 42 F.3d 131,134 (2d Cir.1994). Accordingly, the Court strikes those 16,291 .8 hours, representing $7.5 million dollars, from the lodestar.

**iii. The lodestar should be reduced for waste and inefficiency.**
In a case of this magnitude, it is inevitable that attorneys will spend more hours than turn out to be necessary on some projects. But it is, or ought to be, far from inevitable that attorneys will attempt to charge those hours to their client. *See Hensley v. Eckerhart,* 461 U.S. 424, 434, 103 S.Ct. 1933, 76 L.Ed.2d 40 (1983) (counsel seeking fee award must exercise "billing judgment," which entails "good faith effort to exclude from a fee request hours that are excessive, redundant, or otherwise unnecessary"). And some instances of waste and inefficiency are so egregious that their inclusion in a motion for fees casts a shadow over all of the hours submitted to the Court—just as the thirteenth stroke of a clock calls into doubt whether any previous stroke was accurate.

Frank highlighted two examples where contract attorneys spent an unacceptable number of hours digesting single-day depositions: 239 hours (for $89,625) on one

and 94.25 hours on another (for $51,837.50). (*See* Supp. Decl. of Theodore H. Frank dated Mar. 15, 2013 ¶ 11, Dkt. No. 218.) Frank contends that the Court should treat these examples as representing consistent practice and drastically cut not only these hours, but all the hours of many attorneys. Lead Counsel agrees that these 333 hours were wasteful and withdraws them from the lodestar without further discussion of inefficiency. Neither approach is appropriate.

Frank is cherry-picking, but Counsel cannot agree to toss out those cherries and pretend no others are ripe for picking. Indeed, the Court's own review reveals a number of similar instances of waste. Two other contract attorneys, for example, appear to have spent over three weeks of eight-hour days each digesting a one-day deposition:157.5 hours (for $66,937.50) for one attorney and 142.5 hours (for $53,437.50) for the other. (*See* Kirby Project Specific Attorney Time Details, Ex. B to Fee App. Supp (review of Brushammar deposition and Marsigliano deposition); Pls.' Counsel Appearing in Depositions, Ex. E to Fee App. Supp. (Investor Relation Head Arthur Tildesley, Jr. being the only two-day deposition).)

***21** Multiple contract attorneys in the lodestar report spent more than a year simply listing "document review" as the task performed all day, every day, for approximately $1.5 million in lodestar for each attorney. (*See, e.g.,* Kirby Project Specific Attorney Time Details (attorney M.B.'s $1.7 million in lodestar and attorney D.F.'s $1.5 million, both listing "document review" every day from Mar. 14, 2011 to July 19, 2012).) Counsel asserts that "document review" was listed merely as an "administrative convenience" instead of reproducing more detailed handwritten records of contract attorneys' hours. (*See* Pls.' Supp. Reply Mem. at 26, Dkt. No. 232.) But whatever time the convenience saved, class counsel cannot present effectively unreviewable hours in the name of convenience. On the other hand, the Court finds, for example, the staffing for depositions and the hours Lead Counsel devoted to court filings and conferences are well within the range of reasonable.

In balancing the evidence of waste and unreviewable hours against the many instances of reasonable charges, the Court concludes that the lodestar should be further cut by 10% to account for waste and inefficiency that a paying client would not accept. To avoid double-counting the cuts, the Court will make this across-the-board adjustment only after all other cuts have been made.

***b. Reasonable hourly rates***

"The lodestar figure should be based on market rates 'in line with those [rates] prevailing in the community for similar services by lawyers of reasonably comparable skill, experience, and reputation.' " *Reiter,* 457 F.3d at 232 (quoting *Blum v. Stenson,* 465 U.S. 886,896 n. 11 (1984)). The Court must determine "the rate a paying client would be willing to pay." *See Arbor Hill Concerned Citizens Neighborhood Ass'n v. Cnty. of Albany,* 522 F.3d 182,190 (2d Cir.2008); *see generally McDaniel v. Cnty. of Schenectady,* 595 F.3d 411, 421–22 (2d Cir.2010) (discussing use of *Arbor Hill*-based lodestar calculation as part of cross-check on common fund percentage award). Because legal services are not a commodity traded on an open market, the price for similar services can vary significantly based not only on the product, but also on the client. Clients with greater bargaining leverage—those that consume the most services and are able to pay for them—are generally able to negotiate more favorable legal rates. In considering the hypothetical paying client, the Second Circuit instructs courts to consider "whether a fully informed group of plaintiffs able to negotiate collectively" would agree to a given rate. *Goldberger,* 209 F.3d at 52. In other words, if the class were a reasonable, paying client free to choose its counsel and negotiate rates, what hourly rate would it accept for the attorneys and other professional staff employed here?

The Court's focus is on the proffered hourly rates for the services of contract attorneys—attorneys who are not permanent employees of the law firm, are hired largely from outside staffing agencies, are not listed on counsel's law firm website or resume, are paid by the hour, and are hired on a temporary basis to complete specific projects related to a particular action. The Court focuses more closely on the contract attorney rates not only because those rates are overstated, but also because the total proposed lodestar for contract attorneys dwarfs that of the firm associates, counsel, and partners: $28.6 million for contract attorneys compared to a *combined* $17 million for *all* other attorneys. (Ltr. of Peter S. Linden dated Apr. 7, 2013 ("Linden Ltr."), Dkt. No. 264.) The Court finds that, on balance, the proposed rates for firm attorneys are reasonable. The blended hourly rate for associates here is $402, and the blended rate for partners and counsel is $632. (*Id.*) These rates are within the range accepted in this district. *See, e.g., In re Telik, Inc. Sec. Litig.,* 576 F.Supp.2d 570, 589 (S.D.N.Y.2008). In addition, the Court finds the rates for support staff, who together make up roughly $6 million of the proposed lodestar, are reasonable.

***22** In attempting to determine the market rate for the services of the contract attorneys here, the Court has been presented with a tale of two extremes. At one extreme, objector Frank suggests that the market rate for

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contract-attorney services is the rate that the law firms, not clients, pay for the services of contract attorneys, and that in any event no reasonable paying client would accept a rate above $100 per hour. Lead Counsel responds that these contract attorneys performed the work of, and have the qualifications of, law firm associates and so should be billed at rates commensurate with the rates of associates of similar experience levels. The proposed contract attorney rates reach as high as $550, with a blended hourly rate of $466—higher than the $402 per hour rate for associates! (Linden Ltr.) The precise truth is unknown, but without doubt lies between these two extremes.

**i. Courts agree that contract-attorney hours are not factually equivalent to associate hours.**

Frank contends (1) that the contract attorneys should be treated as a litigation cost and not included in the lodestar at all, and (2) that, if included, a lodestar multiplier cannot be applied to their work because to do so permits too high a markup. Neither argument prevails. First, courts routinely reject claims that contract attorney labor should be treated as a reimbursable litigation expense. *See Carlson v. Xerox Corp.,* 596 F.Supp.2d 400, 409 (D.Conn.2009) (collecting cases), *aff'd,* 355 F. App'x 523 (2d Cir.).[6] Second, courts have also regularly applied a lodestar multiplier to contract attorneys' hours. "The Court should no more attempt to determine a correct spread between the contract attorney's cost and his or her hourly rate than it should pass judgment on the differential between a regular associate's hourly rate and his or her salary." *In re AOL Time Warner S'holder Derivative Litig.,* No. 02 Civ. 6302(CM), 2010 WL 363113, at *22 (S.D.N.Y. Feb.1, 2010) (Special Master's R & R, adopted as Court's opinion, *id.* at *1). The lodestar multiplier, meanwhile, is determined by factors such as "the risk of the litigation and the performance of the attorneys"; the firm's cost of employing the attorney is not part of the *Goldberger* analysis. *See Goldberger,* 209 F.3d at 47.

Lead Counsel's own position finds no more support in court decisions than Frank's position does. Counsel asserted without reference to a single case that "[a]ll of the authority we have seen supports the practice of billing project attorneys at the market rate for comparable in-house attorneys in calculating fee awards." (*See* Pls.' Reply Mem. at 15.)[7] But Courts seem to agree that a contract attorney's status as a contract attorney—rather than being a firm associate—affects his market rate. Even the authority on which Counsel relies presumes that clients generally pay less for the work of contract attorneys than for that of firm associates. *See In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2004 WL 2591402, at *21 n. 48 (S.D.N.Y. Nov.12, 2004) (finding use of contract attorneys justified because hiring them "was a far more efficient way of proceeding than giving the task to *more highly compensated counsel"* (emphasis added)). More recently, another judge in this district considered the proper billing practices for contract-attorney document-review services and observed as follows:

> ***23** There is little excuse in this day and age for delegating document review (particularly primary review or first pass review) to anyone other than extremely low-cost, low-overhead temporary employees (read, contract attorneys)—and there is absolutely no excuse for paying those temporary, low-overhead employees $40 or $50 an hour and then marking up their pay ten times for billing purposes.

*In re Beacon Assocs. Litig.,* No. 09 Civ. 777(CM), 2013 WL 2450960, at *18 (S.D.N.Y. May 9, 2013). In sum, courts have largely rejected the proposition that the market treats contract attorneys as indistinguishable from firm associates for billing purposes; it does not.

**ii. Paying clients negotiate a wide range of rates for contract-attorney services.**

The question for determination is: what would a reasonable client pay a law firm for the services of "an extremely low-cost, low-overhead temporary employee[ ] (read, contract attorney[ ] )"? *In re Beacon Assocs. Litig.,* 2013 WL 2450960, at *18. To answer that question, the Court may "conduct an empirical inquiry based on the parties' evidence or may rely on the court's own familiarity with the rates if no such evidence is submitted." *Francois v. Mazer,* No. 09 Civ. 3275(KBF), 2012 WL 3245439, at *1 (S.D.N.Y. Aug.6, 2012) (citation omitted), *aff'd,* No. 12–3545–CV, 2013 WL 3185262 (2d Cir. June 25, 2013). "[T]he burden is on the fee applicant to produce satisfactory evidence—in addition to the attorney's own affidavits—that the requested rates are in line with" prevailing market rates. *Savoie v. Merchs. Bank,* 166 F.3d 456, 463 (2d Cir.1999) (citation omitted).

Lead Counsel relies primarily on its own "empirical study" of the rates submitted in fee requests in similar

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cases and the expert declaration of Kenneth Moscaret. Neither persuades the Court that "a fully informed group of plaintiffs able to negotiate collectively would routinely agree to pay" between $350 and $550 per hour for contract attorneys to review documents. Those rates are reasonably applied to associate attorneys, whose duties involve such matters as legal research, drafting legal memoranda and court submissions, preparing for depositions, and drafting settlement documents; contract attorneys are overwhelmingly devoted to document review.

Far from illustrating market practices, Lead Counsel's "empirical study" presents rates that, as the rates under consideration here, were merely *submitted* to courts by plaintiffs' counsel in PSLRA common fund cases as part of a fee request. (*See* Joint Supp. Resp. Decl. ¶ 16; Ex. 39 to Joint Supp. Resp. Decl.) Counsel, for example, lists the rates submitted for contract attorneys and associates in the *UnitedHealth* fee request without disclosing that the court there drastically reduced those proposed rates and the requested fee. *See In re UnitedHealth Grp. Inc. PSLRA Litig.,* 643 F.Supp.2d 1094, 1106 (D.Minn.2009). More often, though, the decisions to which Lead Counsel points awarded fees without opining upon an appropriate differential between associate and contract-attorney rates. *See, e.g., Carlson,* 596 F.Supp.2d at 410 (declining to undertake "gimlet-eyed" review of rate and hour details and finding multiplier reasonable assuming dramatic cuts to lodestar for contract attorneys). As a result, Counsel's "study" of the relationship between associate and contract-attorney rates is, at best, misleading. Moreover, Lead Counsel effectively concedes that the $466 blended rate sought here is inflated by pointing to an average *proposed* rate of $313 in its own selected sample of cases. (*See* Ex. 39 to Joint Supp. Resp. Decl.) *Cf., e.g., Apple, Inc. v. Samsung Elecs. Co.,* No. C 11–1846 LHK (PSG), 2012 WL 5451411, at *3 (N.D.Cal. Nov.7, 2012) (major firm proposing $125 per hour for contract attorneys).

***24** Next, Moscaret's opinion offers minimal evidence of the rate that would have been negotiated in these circumstances.[8] Moscaret opines, in sum, that in the "broad corporate client marketplace," clients accept a wide range of rates for contract attorneys, and that Counsel's proposed scheme is among those accepted. (*See, e.g* ., Decl. of Kenneth M. Moscaret dated Mar. 21, 2013 ¶ 5, Dkt. No. 231.) Though unwilling to offer specifics, he "estimate[s] that a majority of corporate clients" pay "prevailing market rates commensurate with the skill, experience, and abilities of those contract attorneys." (*Id.* ¶ 33.) Even assuming those "prevailing market rates" are equivalent to those of associates, as Counsel asserts, his estimate nonetheless has no application here because of his premise: that the market includes the "5.8 million U .S. companies with 1–99 employees," nearly all of which lack in-house legal departments. (*See id.* ¶ 35.) Moscaret also concedes that most of those small companies on which his opinion is based are not engaged in securities litigation. (*Id.* ¶ 36.) As a result, his sample is materially skewed away from clients like plaintiffs here: a group of highly sophisticated lead plaintiffs able to negotiate collectively to secure appropriate hourly rates from their attorneys. One of the class representatives alone—COPERA—is a pension fund with billions of dollars under management and an in-house legal department. *See* About Colorado PERA Overview, https://www.copera.org/pera/about/overview.htm (last visited July 30, 2013).

Frank, meanwhile, relies on the opinions of William Ruane and John Toothman. Even assuming that Ruane is qualified to provide expert testimony, his opinion that the market rate for contract attorneys' document-review services is between $50 and $70 per hour is of little help because it derives entirely from his experience working for a single company that focused on defense-side products-liability. (Decl. of William J. Ruane dated Mar. 14, 2013, Dkt. No. 217.) One company's experience is not dispositive of prevailing market practices.[9]

Toothman opines that a reasonable client would pay at most the rates of "lower level paralegals." (Decl. of John W. Toothman dated Mar. 15, 2013 ¶ 4, Dkt. No. 224.) His opinion, which is grounded in his expertise on broader market practices, is more helpful but still limited by certain assumptions. Toothman infers from the sometimes cursory time records that all of the work was simplistic. (*See, e.g., id.* ¶¶ 48–49.) As noted above, most of the contract-attorney time is attributed simply to variants of the term "document review," but not all document review is created equal. Many of the documents reviewed here concerned highly complex financial instruments and subtle nuances of circumstantial evidence of scienter. Toothman also ignores that some of these contract attorneys prepared others for, and a few participated in the taking of, depositions. (*See* Pls.' Counsel Appearing in Depositions, Ex. E to Fee App. Supp.) As a result, the adage that "Michelangelo should not charge Sistine Chapel rates for painting a farmer's barn" has force here, but its application is not as simple as Toothman suggests.[10] *See Ursic v. Bethlehem Mines,* 719 F.2d 670, 677 (3d Cir.1983). In sum, Toothman provides evidence that a paying client would negotiate support-staff-level rates for some, but not all, of the hours at issue.

***25** The Court also directed Counsel to produce the

résumés of the contract attorneys here and considered them, and agrees with Counsel that some of these attorneys were particularly well-qualified. The Court further agrees that a paying client surely would have paid something approaching an associate's rate for some number of the hours here. But the Court finds that not all of the contract attorneys had the type of experience—and few performed the type of work—that justifies associate-level rates.[11] Only a very few of the scores of contract attorneys here participated in depositions or supervised others' work, while the vast majority spent their time reviewing documents. *Cf. In re Enron Corp. Sec., Derivative & ERISA Litig.,* 586 F.Supp.2d 732, 781 (S.D.Tex.2008) (relying on fact that contract attorney "had previous trial experience, took more than thirty fact depositions in the underlying case and took some of defendants' experts' depositions").

**iii. The Court concludes that an appropriate blended hourly rate for the contract-attorney services here is $200.**

In the end, the empirical data and other evidence before the Court offer no simple answers. No one number flows inexorably from the record; the Court must exercise its discretion to set the appropriate rate. The Court finds that the hypothetical paying client here is one with significant negotiating leverage, as evidenced by the hard-fought battle for appointment. This is true even though this client may not have the sort of leverage Citigroup, for example, possesses as a deep-pocketed client with a significant stream of litigation business. The Court has taken account of the qualifications and experience of the various contract attorneys here, the largely document-review work they performed, and the wide range of rates accepted in the market. Considering the hypothetical client and the range of services at issue, the Court concludes that a reasonable blended hourly rate for the contract attorneys here is $200.

The Court will apply that rate to the contract-attorney hours remaining after cutting the post-settlement hours, which constitute more than $21 million of the lodestar. (Linden Ltr.) Having applied the Court's rate of $200 to the roughly 45,300 hours at issue, the Court subtracts approximately $12 million from the proposed lodestar.

***c. The proper lodestar for assessing the reasonableness of the proposed award***

To review, Counsel proposed a lodestar of $51.4 million, and the Court has cut $7.5 million in post-settlement discovery work, $4 million of Entwistle & Cappucci's work before joining Lead Counsel, and $12 million based on the reasonable hourly rate for all remaining contract attorney work. After those reductions, $27.9 million remains before cutting 10% ($2.8 million) for waste and inefficiency. Thus, the Court calculates the lodestar in this action to be $25.1 million.

Lead Counsel's proposed lodestar of $51.4 million was, in the Court's judgment, significantly inflated. As revised, the requested $97.5 million fee here would yield a lodestar multiplier of about 3.9, not the 1.9 multiplier that Counsel proposed. The Court will return to the lodestar to use it as a cross-check that takes into account other *Goldberger* factors—for example, the risks involved and the quality of Counsel's work. That analysis aside, Counsel certainly invested an enormous amount of time and energy in this litigation. Thus, the first *Goldberger* factor weighs in favor of a substantial fee award.

***2. The Magnitude and Complexities of the Litigation***

***26** As noted above, this action was highly complex. "Securities class litigation is notably difficult and notoriously uncertain." *In re Merrill Lynch Tyco Research Sec. Litig.* (*"ML Tyco"* ), 249 F.R.D. 124, 138 (S.D.N.Y.2008) (citation and quotation marks omitted). Even among securities actions, the financial instruments involved and the scope of the allegations render this action more challenging than the standard securities class action. This factor weighs in favor of a substantial fee.

***3. The Risk of the Litigation***

Similarly, the class, and by extension Lead Counsel, faced substantial risks that they would not prevail if the parties litigated the action through trial and appeal. Significant risks weigh in favor of substantial compensation above what a paying client would have paid because "[n]o one expects a lawyer whose compensation is contingent upon his success to charge, when successful, as little as he would charge a client who in advance had agreed to pay for his services, regardless of success." *Grinnell,* 495 F.2d at 470.

However, for some time now, virtually all securities actions that survive motions to dismiss the pleadings ultimately settle prior to trial. *See ML Tyco,* 249 F.R.D. at 139. But the factors that traditionally render securities cases most likely to survive a motion to dismiss and, in turn, to settle—such as prior government investigations—are absent here. *Cf. id.* Thus, notwithstanding the likelihood of settlement, the risks involved in undertaking this litigation were real. "In

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numerous class actions ... plaintiffs' counsel have expended thousands of hours and advanced significant out-of-pocket expenses and received no remuneration whatsoever." *In re Marsh & McLennan Cos. Sec. Litig.*, No. 04 Civ. 8144(CM), 2009 WL 5178546, at *18 (S.D.N.Y. Dec.23, 2009). Settlement might be the norm, but it is not guaranteed. This factor also militates in favor of a substantial award.

***4. The Quality of Representation***

"To evaluate the 'quality of the representation,' courts review the recovery obtained and the backgrounds of the lawyers involved in the lawsuit." *ML Tyco,* 249 F.R.D. at 141 (quoting *In re Global Crossing Sec. & ERISA Litig.,* 225 F.R.D. at 467.) Lead Counsel's results are excellent. More than half a billion dollars is a significant and successful recovery under essentially *any* definition of success. The Court's quarrels with the lodestar submission do not detract from the quality of Counsel's work. Given the significant challenges posed by scienter-based fraud claims and the complexity and size of this case, the recovery here is substantial, as the class's overwhelmingly favorable reaction reflects. Further, the Court in appointing Kirby took into account its outstanding reputation as a leading plaintiffs' class action firm. The quality of the representation here weighs in favor of a substantial fee award.

***5. The Requested Fee in Relation to the Settlement***

*27 The requested fee of $97.5 million is 16.5% of the $590 million settlement fund. The inquiry for this factor focuses on whether that percentage is reasonable when compared to fees awarded in similar cases. Lead Counsel and Frank sparred at length over what constitutes a similar case. Each side suggests that the other is inappropriately including or excluding certain cases in order to skew the average fee award up or down, and each side is correct. Based on slightly different ranges, Counsel's experts found the average fee in similar cases was 16.7% (Prof.Coffee) and 17.3% (Prof.Miller), with slightly lower medians of 16.8% and 16.5%. (Coffee Decl. ¶ 17–18; Miller Decl. ¶ 58.) Frank's own selections yielded averages of 15.1% or 12.5%, and medians of 12% or 11.5%. (*See* Objection of Theodore H. Frank at 5, Dkt. No. 222.) This dispute only helps illustrate why "reference to awards in other cases is of limited usefulness ... because fee awards should be assessed based on the unique circumstances of each case." *ML Tyco,* 249 F.R.D. at 141 (citations and quotation marks omitted). While awards in other cases in the same ballpark as this one help to determine a range of reasonableness, the Court need not pass upon each potential comparator. On balance, the requested fee here falls within the range of reasonable fees awarded in generally similar cases, but toward the high end of that range. *See In re Wachovia Preferred Sec. & Bond/Notes Litig.,* No. 09 Civ. 6351(RJS), 2011 U.S. Dist. LEXIS 155622, at *10, *14 (S.D.N.Y. Dec. 30, 2011) (noting awards below 8% of large settlements, and awarding 12% of $627 million settlement). Accordingly, this factor weighs in favor of a substantial fee award, albeit lower than Lead Counsel has requested.

***6. Public Policy Considerations***

"In order to attract well-qualified plaintiffs' counsel who are able to take a case to trial, and who defendants understand are able and willing to do so, it is necessary to provide appropriate financial incentives." *In re WorldCom, Inc. Sec. Litig.,* 388 F.Supp.2d at 359. The fees paid to class counsel thus should be "both fair and rewarding." *ML Tyco,* 249 F.R.D. at 142 (citation omitted). "An award of fees in excess of that required to encourage class litigation, however, does not necessarily serve public policy." *Id.* A significant award is appropriate here.

**C. The Lodestar Cross–Check and the Appropriate Award**

Having considered all the *Goldberger* factors, which together support a substantial fee, the Court returns to the lodestar as a cross-check on the requested fee. By Lead Counsel's experts' own calculations, the 3.9 multiplier—the multiplier based on the reduced lodestar as calculated by the Court—is well above the norm in securities class action settlements of similar size. (*See* Coffee Decl. ¶¶ 17–18 (mean of 2.29 and median of 2.14 for $490–$690 million settlement range); Miller Decl. ¶ 58 (mean of 2.13 and median of 1.70 for $550–$880 million settlement range).) Courts in this Circuit have trended toward awarding lower percentages and lower multipliers for awards from extremely large common funds such as this one. *Compare In re Telik, Inc. Sec. Litig.,* 576 F.Supp.2d at 590 (observing that "lodestar multiples of over 4 are routinely awarded by courts" in context of $5 million settlement), *with In re Merrill Lynch & Co. Research Reports Sec. Litig.,* No. 02 MD 1484(JFK), 2007 WL 313474, at *23 (S.D.N.Y. Feb.1, 2007) (concluding, for $39 million settlement, that request representing multiplier of 2.43 "is excessive," and recognizing that courts since *Goldberger* question multipliers over 2.03). That trend, reflected in the experts' analyses, likely reflects concern about the "danger of

'routine overcompensation' for risk that has troubled [the Second Circuit] in the context of 'mega-fund' class actions." *See McDaniel,* 595 F.3d at 426 (quoting *Goldberger,* 209 F.3d at 57).

***28** The Court concludes that a significant multiplier is justified here, but not one as high as 3.9—the multiplier that would need to be applied to the trimmed lodestar to reach Counsel's requested fee. Indeed, it is well above the multiplier of 3.0 that COPERA negotiated with Entwistle & Cappucci as a cross-check in the event that firm was appointed class counsel. (Reply. Decl. of Andrew J. Entwistle dated Mar. 22,2013 ¶ 6, Dkt. No. 230.) As already discussed at length, Counsel took on a contingency risk, and brought considerable skill and experience to bear on a very complex case. *See Goldberger,* 209 F.3d at 47 (citation omitted) (multiplier is based on "less objective factors, such as the risk of the litigation and the performance of the attorneys," which also help determine correct percentage (quotation marks omitted)); *see also Savoie,* 166 F.3d at 460. On balance, however, the Court concludes, based on its analysis of all the *Goldberger* factors and the lodestar cross-check, that the requested $97.5 million fee—constituting 16.5% of the settlement and a lodestar multiplier of 3.9 based on the revised lodestar—is not reasonable.

The Court concludes that a reasonable fee here is 12% of the $590 million common fund, or $70.8 million dollars. On a properly calculated lodestar, $70.8 million yields a 2.8 multiplier, which in the Court's view is high but not excessive when taking into account all of the *Goldberger* factors. This is a sizeable award that rewards Counsel for years of excellent work. It cannot be forgotten that this is the class's money, and the class is paying its attorneys handsomely for their services.

## VI. REIMBURSEMENT OF LITIGATION EXPENSES

No one has objected to the requested reimbursement for litigation expenses, and the Court is satisfied that these expenses are reasonable. Accordingly, the Court awards Lead Counsel $2,842,841.59 in reimbursable expenses.

## VII. CONCLUSION

The Court finds that the proposed $590 million settlement and the proposed plan of allocation are fair, reasonable, and adequate. The Court further finds that the class was provided with adequate notice of class certification and the settlement. The Court thus grants plaintiffs' motion for final approval of the settlement and plan of allocation.

The Court also grants Lead Counsel's motion for an award of attorneys' fees—albeit a lower fee than requested. The Court awards Lead Counsel $70.8 million in attorneys' fees. Finally, the Court grants Lead Counsel's motion for reimbursement of $2,842,841.59 in litigation expenses.

### Parallel Citations

Fed. Sec. L. Rep. P 97,585

Footnotes

1 The U.S. Supreme Court has since held that securities fraud plaintiffs need not prove that the misrepresentations are material at the class certification stage. *Amgen Inc. v. Conn. Ret. Plans & Trust Funds,* —— U.S. ——, 133 S.Ct. 1184,1191, 185 L.Ed.2d 308 (2013) (abrogating *In re Salomon Analyst Metromedia Litig.,* 544 F.3d 474, 486 n. 9 (2d Cir.2008)).

2 Because Citigroup initially inadvertently provided an incomplete list of stockholders to the appointed claims administrator, the Court adjourned the fairness hearing and ordered extended deadlines and additional notice for class members potentially prejudiced by the error. (*See* Order dated Jan. 2, 2013, Dkt. No. 183; *see also* Supp. Aff. of Stephen J. Cirami dated Mar. 25, 2013 ("Cirami Supp. Aff."), Ex. 36 to Supp. Joint Resp. Decl.)

3 The full class definition, as amended by order dated September 28, 2012 (Dkt. No. 159), reads as follows:

> All persons who purchased or otherwise acquired common stock issued by Citigroup during the period between February 26, 2007 and April 18, 2008, inclusive, or their successor in interest, and who were damaged thereby, excluding (i) the defendants named in the Complaint, (ii) members of the immediate families of the individual defendants named in the Complaint, (iii) any firm, trust, partnership, corporation, present or former officer, director or other individual or entity in which any of the Citigroup Defendants has a controlling interest or which is related to or affiliated with any of the Citigroup Defendants, and (iv) the legal representatives, heirs, successors-in-interest or assigns of any such excluded persons or entities. The Settlement Class includes persons or entities who acquired shares of Citigroup common stock during the Class Period by any method, including but not limited to in the secondary market, in exchange for shares of acquired companies pursuant to a registration statement, or through the exercise of options including options acquired pursuant to employee stock plans, and persons or

entities who acquired shares of Citigroup common stock after the Class Period pursuant to the sale of a put option during the Class Period. Regardless of the identity of the person or entity that beneficially owned Citigroup common stock in a fiduciary capacity or otherwise held Citigroup common stock on behalf of third party clients or any employee benefit plans, such third party clients and employee benefit plans shall not be excluded from the Settlement Class, irrespective of the identity of the entity or person in whose name the Citigroup common stock were beneficially owned, except that any beneficiaries of such third party clients, or beneficiaries of such benefit plans who are natural persons and, who are otherwise excluded above will not share in any settlement recovery. Notwithstanding any other provision of this Agreement, the Citibuilder 401(k) Plan for Puerto Rico and the Citigroup 401(k) Plan shall qualify as members of the Settlement Class. In addition, a person who owns Citigroup common stock shall not be excluded from the settlement class solely because that common stock is held (i) in a registered or unregistered investment company (including a unit investment trust) in which any defendant in the Action has a controlling interest, or serves as an investment manager, investment adviser, or depositor; or (ii)(a) in a life insurance company separate account, or (b) in a segment or subaccount of a life insurance company's general account to the extent associated with insurance contracts under which the insurer's obligation is determined by the investment return and/or market value of the assets held in such segment or subaccount of a life insurance company's general account to the extent associated with insurance contracts under which the insurer's obligation is determined by the investment return and/or market value of the assets held in such segment or subaccount. A defendant shall be deemed to have a "controlling interest" in an entity if such defendant has a beneficial ownership interest, directly or indirectly, in more than 50% of the total outstanding voting power of any class or classes of capital stock that entitle the holders thereof to vote in the election of members of the Board of Directors of such entity. "Beneficial ownership" shall have the meaning ascribed to such term under Rule 13d–3 of the Securities Exchange Act of 1934, as amended, or any successor statute or statutes thereto. Notwithstanding the foregoing, the Settlement Class shall not include Persons whose only acquisition of Citigroup common stock during the Class Period was via gift or inheritance if the Person from which the common stock was received did not themselves acquire the common stock during the Class Period.

4 In response to contentions that it had failed to identify contract attorneys and improperly billed for hours undertaken after settlement was reached, Lead Counsel failed to note anywhere in its detailed descriptions of the work that the "supplemental team" that performed much of this work was not hired until May 2012. (*See, e.g.,* Joint Reply Decl. ¶ 106.) The only way the Court was able to determine that was by noticing that up to twenty newly hired attorneys spent full days reading the complaint in the same week the parties reported their settlement to the Court. (*See, e.g.,* Kirby Project Specific Attorney Time Details, Ex. B to Fee App. Supp. (attorney "began reading the introduction and section I of the amended complaint" on May 5, 2012 and finished on May 9; another began to "read complaint" on May 14, 2012 and finished on May 17).) In a similar vein, Counsel failed to note anywhere that the contract attorneys at issue were contract attorneys hired on an hourly basis for this project rather than being firm associate attorneys. (*See, e.g.,* Kirby McInerney LLP Lodestar Report, Ex. E to Joint Decl.) Counsel then contended, in response to Frank's objection and the Court's questions, that those attorneys' status should have been obvious from the absence of any firm biographies for those attorneys provided with the fee request. Counsel is expected to be more forthcoming.

5 Although the evidence is clear that the parties were confident that they had settled the action in early May, the months of May, June, and July 2012 have the three highest contract-attorney lodestar totals of this five-year litigation. (*See* Kirby Project Specific Attorney Time Details, Ex. B to Fee App. Supp.; Decl. of John W. Toothman dated Mar. 15, 2013 ¶ 92.)

6 In a related attack on the inclusion of contract attorney hours in the lodestar, Frank invokes part of an American Bar Association ethics opinion limiting markup on contract attorney work to "a reasonable allocation of associated overhead" and supervision costs. ABA Comm. on Ethics & Prof'l Responsibility Formal Op. 08–451 (Aug. 5, 2008). But, in context, that rule addresses the situation "[i]f the firm decides to pass [the contract attorney] costs through to the client *as a disbursement.*" *Id.* (emphasis added). This Court is aware of no requirement that a firm do so.

7 When pressed for the referenced authority, Lead Counsel cited cases that stand for the uncontroversial proposition that contract attorneys, as all professional staff, are billed at their market rates—not the proposition that their market rates are equivalent to the rates for comparable associates. In their supplemental reply, Counsel selectively quoted a PSLRA fee award permitting a blended hourly rate of $200 for non-partner attorneys "whether counsel, associate, or contract attorneys." *In re UnitedHealth Grp. Inc. PSLRA Litig.,* 643 F.Supp.2d 1094,1106 (D.Minn.2009). But *UnitedHealth* contradicts Counsel's position. The court was streamlining its crosscheck calculation by collapsing a range of rates, not finding that the prevailing market rate is the same for all counsel, associates, and contract attorneys regardless of their position, experience, and reputation. Indeed, that court recognized that using contract attorneys is efficient precisely because it "reduc[es] the need for associate and partner time." *Id.* at 1105. The implication is that the rates for contract attorneys are lower than for associates—and that those lower rates combined with the higher associate and counsel rates yielded the blended $200 rate. Thus, the accepted market rate for contract attorneys presumably was well below $200.

8 Professor Miller also opines that the rates here generally are reasonable, but his declaration does not mention contract attorneys, nor does it specifically consider the appropriate rates for their services. Counsel has pointed out that bankruptcy court filings on which Miller relied, as well as other filings Counsel later submitted, asserted rates sometimes reaching as high as those here, and

were approved. The Court accords those filings little weight given that the rates asserted were not explicitly analyzed. Moreover, separate from the contract attorney rates, Miller appears not to have considered the proffered hourly rates of Kirby's co-counsel. (*Compare* Miller Decl. ¶ 39, *with* Exs. G & H to Pls.' Joint Decl. (hourly rates for partners).)

9 The amicus submission of the Association of Corporate Counsel ("ACC") is, for related reasons, similarly narrow in its reach. The ACC's letter refers to a survey of its membership. The breadth and validity of that survey, however, is unclear and untested. The survey appears to be limited to the responses of a self-selected fraction of its already self-selected membership, and only a third of those respondents employed contract attorneys. At most, the survey confirms that a number of clients occupy one side of the spectrum that Moscaret acknowledges: that clients often hire contract attorneys directly or pay a relatively small markup. To the extent that Frank purports to offer his own views as an expert on billing practices, the Court finds that he is not qualified to do so.

10 A lodestar report for purposes of a cross-check need not contain the same detail as hourly bills. *Cf. Cassese v. Williams,* 503 F. App'x 55, 59 (2d Cir.2012) (finding that district court acted within discretion in calculating lodestar for cross-check purposes without "exact records"). By the same token, however, Lead Counsel cannot claim to have recorded millions of dollars in lodestar described only with the words "document review" and expect the Court to treat those hours as if they were for taking or defending a deposition or other more complex tasks for purposes of determining what a reasonable client would pay.

11 While the Court adheres to its view that the amount Counsel paid contract attorneys is not the issue, the Court notes that Counsel submitted evidence that at least one of the contract attorneys employed by a firm that assisted Lead Counsel received $15 per hour in wages—belying Counsel's suggestion that a full associate attorney's billing rate was appropriate. (*See* Elan Project Specific Attorney Time Details, Ex. B to Fee App. Supp. (attorney L.C. page for week of Aug. 8, 2011).) This same contract attorney, moreover, was listed as "Of Counsel" elsewhere in the fee request, with a proffered rate of $500 per hour. (*See* Decl. of Kenneth A. Elan dated Nov. 13, 2012 at 3, Ex. I to Joint Decl.)

**End of Document**

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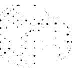
# TAB 2



131 S.Ct. 2541

**Briefs and Other Related Documents**

Related Westlaw Journal Article

Supreme Court of the United States

WAL–MART STORES, INC., Petitioner,
v.
DUKES et al.

No. 10–277. | Argued March 29, 2011. | Decided June 20, 2011.

Synopsis
**Background:** Female employees of retail store chain brought Title VII against employer alleging sex discrimination and seeking injunctive and declaratory relief, back pay, and punitive damages. The United States District Court for the Northern District of California, Martin J. Jenkins, J., 222 F.R.D. 137, granted in part and denied in part plaintiffs' motion for class certification, and the Ninth Circuit Court of Appeals, Pregerson, Circuit Judge, 509 F.3d 1168, affirmed. On rehearing en banc, the Court of Appeals, Michael Daly Hawkins, Circuit Judge, 603 F.3d 571, affirmed in part and remanded in part. Certiorari was granted.

**Holdings:** The Supreme Court, Justice Scalia, held that:

[1] evidence presented by members of putative class did not rise to level of significant proof that company operated under general policy of discrimination, as required to satisfy commonality requirement and to permit certification of plaintiff class;

[2] certification of plaintiff class upon theory that defendant has acted, or refused to act, on grounds that apply generally to class, thereby making final injunctive or declaratory relief appropriate with respect to class as whole, is not appropriate with respect to claims for monetary relief, at least where monetary relief is not incidental to injunctive or declaratory relief; and

[3] necessity of litigation to resolve employer's statutory defenses to claims for backpay asserted by individual members of putative employee class prevented court from treating these backpay claims as "incidental" to claims for declaratory or injunctive relief.

Reversed.

Justice Ginsburg concurred in part and dissented in part and filed opinion, in which Justices Breyer, Sotomayor, and Kagan joined.

West Headnotes (17)

[1] **Federal Civil Procedure**
Class Actions

Class action is exception to the usual rule that litigation is conducted by and on behalf of individual named parties only. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

102 Cases that cite this headnote

[2] **Federal Civil Procedure**
Representation of class; typicality; standing in general

In order to justify a departure from usual rule that litigation is conducted by and on behalf of individual named parties only, class representative must be part of class and possess same interest and suffer same injury as class members. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

216 Cases that cite this headnote

[3] **Federal Civil Procedure**
Impracticability of joining all members of class; numerosity
**Federal Civil Procedure**
Representation of class; typicality; standing in general
**Federal Civil Procedure**
Common interest in subject matter, questions and relief; damages issues

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Numerosity, commonality, typicality, and adequate representation requirements of Federal Rule of Civil Procedure governing class actions ensure that the named plaintiffs are appropriate representatives of class whose claims they wish to litigate by effectively limiting the class claims to those fairly encompassed by named plaintiffs' claims. Fed.Rules Civ.Proc.Rule 23(a), 28 U.S.C.A.

146 Cases that cite this headnote

[4] **Federal Civil Procedure**
Common interest in subject matter, questions and relief; damages issues

Commonality requirement for class certification obligates the named plaintiff to demonstrate that class members have suffered the "same injury," not merely that they have all suffered violation of same provision of law; claims must depend upon a common contention, and that common contention must be of such a nature that it is capable of classwide resolution, meaning that determination of its truth or falsity will resolve issue that is central to validity of each one of the claims in one stroke. Fed.Rules Civ.Proc.Rule 23(a)(2), 28 U.S.C.A.

637 Cases that cite this headnote

[5] **Federal Civil Procedure**
Common interest in subject matter, questions and relief; damages issues

What matters to class certification is not the raising of common questions, even in droves, but rather the capacity of classwide proceeding to generate common answers apt to drive resolution of litigation. Fed.Rules Civ.Proc.Rule 23(a)(2), 28 U.S.C.A.

385 Cases that cite this headnote

[6] **Federal Civil Procedure**
Evidence; pleadings and supplementary material

Federal Rule of Civil Procedure governing class actions does not set forth mere pleading standard; party seeking class certification must affirmatively demonstrate his compliance with Rule, that is, he must be prepared to prove that there are in fact sufficiently numerous parties, and that other requirements of the Rule are met. Fed.Rules Civ.Proc.Rule 23(a), 28 U.S.C.A.

260 Cases that cite this headnote

[7] **Federal Civil Procedure**
Consideration of merits

Class determination generally involves considerations that are enmeshed in factual and legal issues comprising plaintiff's cause of action. Fed.Rules Civ.Proc.Rule 23(a), 28 U.S.C.A.

57 Cases that cite this headnote

[8] **Civil Rights**
Practices prohibited or required in general; elements

Crux of court's inquiry in resolving an individual's Title VII claim is reason for particular employment decision. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.
5 Cases that cite this headnote

[9] **Federal Civil Procedure**
Discrimination and civil rights actions in general

Conceptually, there is wide gap between an individual employee's claim that he or she has been denied promotion on discriminatory grounds and employee's otherwise unsupported allegation, in moving for certification of employee class, that company has policy of discrimination, a conceptual gap that may be

bridged by showing that employer used a biased testing procedure, or by presenting significant proof that employer operated under general policy of discrimination; such proof could conceivably justify a class of both applicants and employees if discrimination manifested itself in hiring and promotion practices in same general fashion, such as through entirely subjective decisionmaking processes. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.; Fed.Rules Civ.Proc.Rule 23(a), 28 U.S.C.A.

25 Cases that cite this headnote

[10] **Federal Civil Procedure**
Sex discrimination actions

Evidence presented by members of putative class, consisting of testimony of sociological expert that employer's corporate culture made it "vulnerable" to gender bias, but without being able to definitively say whether 0.5 percent or 95 percent of employment decisions in company were based on stereotypical thinking, statistical evidence that employer's policy of according discretion to local supervisors over pay and promotion matters had resulted in an overall, sex-based disparity among employees at company's 3,400 stores, and anecdotal evidence of allegedly discriminatory employment decisions did not rise to level of significant proof that company operated under general policy of discrimination, as required to satisfy commonality requirement and to permit certification of plaintiff class, especially given that company's announced policy was to forbid sex discrimination, and that company imposed penalties for denial of equal employment opportunities. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.; Fed.Rules Civ.Proc.Rule 23(a)(2), 28 U.S.C.A.

46 Cases that cite this headnote

[11] **Civil Rights**
Disparate impact
**Federal Civil Procedure**
Discrimination and civil rights actions in general

In appropriate cases, giving discretion to lower-level supervisors can be basis of Title VII liability under disparate-impact theory, since employer's undisciplined system of subjective decisionmaking can have precisely the same effects as system pervaded by impermissible intentional discrimination; however, recognition that this type of Title VII claim "can" exist does not lead to conclusion that every employee in company using such a system of discretion has such a claim in common, for purposes of certifying employee class. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.; Fed.Rules Civ.Proc.Rule 23(a), 28 U.S.C.A.

13 Cases that cite this headnote

[12] **Declaratory Judgment**
Representative or class actions
**Federal Civil Procedure**
Common interest in subject matter, questions and relief; damages issues

Certification of plaintiff class upon theory that defendant has acted, or refused to act, on grounds that apply generally to class, thereby making final injunctive or declaratory relief appropriate with respect to class as whole, is not appropriate with respect to claims for monetary relief, at least where monetary relief is not incidental to injunctive or declaratory relief. Fed.Rules Civ.Proc.Rule 23(b)(2), 28 U.S.C.A.

146 Cases that cite this headnote

[13] **Declaratory Judgment**
Representative or class actions
**Federal Civil Procedure**
Common interest in subject matter, questions and relief; damages issues

Certification of plaintiff class upon theory that defendant has acted, or refused to act, on grounds that apply generally to class, thereby making final injunctive or declaratory relief appropriate with respect to class as whole, is appropriate only when single injunction or

declaratory judgment would provide relief to each member of class; certification is not authorized when each individual class member would be entitled to different injunction or declaratory judgment against defendant, or when each class member would be entitled to individualized award of monetary damages. Fed.Rules Civ.Proc.Rule 23(b)(2), 28 U.S.C.A.

293 Cases that cite this headnote

[14] **Declaratory Judgment**
Representative or class actions
**Federal Civil Procedure**
Discrimination and civil rights actions in general

Civil rights cases against parties charged with unlawful, class-based discrimination are prime examples of circumstances under which certification of plaintiff class may be warranted on ground that defendant has acted, or refused to act, on grounds that apply generally to class, thereby making final injunctive or declaratory relief appropriate with respect to class as whole. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.; Fed.Rules Civ.Proc.Rule 23(b)(2), 28 U.S.C.A.

32 Cases that cite this headnote

[15] **Declaratory Judgment**
Representative or class actions
**Federal Civil Procedure**
Sex discrimination actions

Even assuming that "incidental" monetary relief can be awarded to class certified upon theory that defendant has acted, or refused to act, on grounds generally applicable to class, thereby making final injunctive or declaratory relief appropriate with respect to class as whole, necessity of litigation to resolve employer's statutory defenses to claims for backpay asserted by individual members of putative employee class, who were allegedly victims of employer's, or potential employer's, gender-based discrimination, prevented court from treating these backpay claims as "incidental" to claims for declaratory or injunctive relief. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.; Fed.Rules Civ.Proc.Rule 23(b)(2), 28 U.S.C.A.

41 Cases that cite this headnote

[16] **Civil Rights**
Effect of prima facie case; shifting burden
**Civil Rights**
Relief

When plaintiff in employment discrimination case seeks individual relief such as reinstatement or backpay after establishing pattern or practice of discrimination, district court must usually conduct additional proceedings to determine scope of individual relief, and at that phase, burden of proof will shift to employer, but it will have right to raise any individual affirmative defenses that it may have and to demonstrate that individual employee was denied employment opportunity for lawful reasons. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.
14 Cases that cite this headnote

[17] **Federal Civil Procedure**
Sex discrimination actions

Because the Rules Enabling Act forbade interpretation of Federal Rule of Civil Procedure that governs class actions so as to abridge, enlarge or modify any substantive right, employee class could not be certified in employment discrimination action on premise that employer would not be entitled to litigate its statutory defenses to class members' claims for backpay. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.; 28 U.S.C.A. § 2072(b); Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

26 Cases that cite this headnote

***2544 *Syllabus****

Respondents, current or former employees of petitioner Wal–Mart, sought judgment against the company for injunctive and declaratory relief, punitive damages, and backpay, on behalf of themselves and a nationwide class of some 1.5 million female employees, because of Wal–Mart's alleged discrimination against women in violation of Title VII of the Civil Rights Act of 1964. They claim that local managers exercise their discretion over pay and promotions disproportionately in favor of men, which has an unlawful disparate impact on female employees; and that Wal–Mart's refusal to cabin its managers' authority amounts to disparate treatment. The District Court certified the class, finding that respondents satisfied Federal Rule of Civil Procedure 23(a), and Rule 23(b)(2)'s requirement of showing that "the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole." The Ninth Circuit substantially affirmed, concluding, *inter alia,* that respondents met Rule 23(a)(2)'s commonality requirement and that their backpay claims could be certified as part of a (b)(2) class because those claims did not predominate over the declaratory and injunctive relief requests. It also ruled that the class action could be manageably tried without depriving Wal–Mart of its right to present its statutory defenses if the District Court selected a random set of claims for valuation and then extrapolated the validity and value of the untested claims from the sample set.

*Held*:

1. The certification of the plaintiff class was not consistent with Rule 23(a). Pp. 2550 – 2557.

***2545** (a) Rule 23(a)(2) requires a party seeking class certification to prove that the class has common "questions of law or fact." Their claims must depend upon a common contention of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke. Here, proof of commonality necessarily overlaps with respondents' merits contention that Wal–Mart engages in a pattern or practice of discrimination. The crux of a Title VII inquiry is "the reason for a particular employment decision," *Cooper v. Federal Reserve Bank of Richmond,* 467 U.S. 867, 876, 104 S.Ct. 2794, 81 L.Ed.2d 718, and respondents wish to sue for millions of employment decisions at once. Without some glue holding together the alleged reasons for those decisions, it will be impossible to say that examination of all the class members' claims will produce a common answer to the crucial discrimination question. Pp. 2550 – 2553.

(b) *General Telephone Co. of Southwest v. Falcon,* 457 U.S. 147, 102 S.Ct. 2364, 72 L.Ed.2d 740, describes the proper approach to commonality. On the facts of this case, the conceptual gap between an individual's discrimination claim and "the existence of a class of persons who have suffered the same injury," *id.,* at 157–158, 102 S.Ct. 2364, must be bridged by "[s]ignificant proof that an employer operated under a general policy of discrimination," *id.,* at 159, n. 15, 102 S.Ct. 2364. Such proof is absent here. Wal–Mart's announced policy forbids sex discrimination, and the company has penalties for denials of equal opportunity. Respondents' only evidence of a general discrimination policy was a sociologist's analysis asserting that Wal–Mart's corporate culture made it vulnerable to gender bias. But because he could not estimate what percent of Wal–Mart employment decisions might be determined by stereotypical thinking, his testimony was worlds away from "significant proof" that Wal–Mart "operated under a general policy of discrimination." Pp. 2553 – 2554.

(c) The only corporate policy that the plaintiffs' evidence convincingly establishes is Wal–Mart's "policy" of giving local supervisors discretion over employment matters. While such a policy could be the basis of a Title VII disparate-impact claim, recognizing that a claim "can" exist does not mean that every employee in a company with that policy has a common claim. In a company of Wal–Mart's size and geographical scope, it is unlikely that all managers would exercise their discretion in a common way without some common direction. Respondents' attempt to show such direction by means of statistical and anecdotal evidence falls well short. Pp. 2554 – 2557.

2. Respondents' backpay claims were improperly certified under Rule 23(b)(2). Pp. 2557 – 2561.

(a) Claims for monetary relief may not be certified under Rule 23(b)(2), at least where the monetary relief is not incidental to the requested injunctive or declaratory relief. It is unnecessary to decide whether monetary claims can ever be certified under the Rule because, at a minimum, claims for individualized relief, like backpay, are excluded. Rule 23(b)(2) applies only when a single, indivisible remedy would provide relief to each class member. The Rule's history and structure indicate that individualized monetary claims belong instead in Rule 23(b)(3), with its procedural protections of predominance, superiority, mandatory notice, and the right to opt out. Pp. 2557 – 2559.

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(b) Respondents nonetheless argue that their backpay claims were appropriately ***2546** certified under Rule 23(b)(2) because those claims do not "predominate" over their injunctive and declaratory relief requests. That interpretation has no basis in the Rule's text and does obvious violence to the Rule's structural features. The mere "predominance" of a proper (b)(2) injunctive claim does nothing to justify eliminating Rule 23(b)(3)'s procedural protections, and creates incentives for class representatives to place at risk potentially valid monetary relief claims. Moreover, a district court would have to reevaluate the roster of class members continuously to excise those who leave their employment and become ineligible for classwide injunctive or declaratory relief. By contrast, in a properly certified (b)(3) class action for backpay, it would be irrelevant whether the plaintiffs are still employed at Wal–Mart. It follows that backpay claims should not be certified under Rule 23(b)(2). Pp. 2559 – 2561.

(c) It is unnecessary to decide whether there are any forms of "incidental" monetary relief that are consistent with the above interpretation of Rule 23(b)(2) and the Due Process Clause because respondents' backpay claims are not incidental to their requested injunction. Wal–Mart is entitled to individualized determinations of each employee's eligibility for backpay. Once a plaintiff establishes a pattern or practice of discrimination, a district court must usually conduct "additional proceedings ... to determine the scope of individual relief." *Teamsters v. United States,* 431 U.S. 324, 361, 97 S.Ct. 1843, 52 L.Ed.2d 396. The company can then raise individual affirmative defenses and demonstrate that its action was lawful. *Id.,* at 362, 97 S.Ct. 1843. The Ninth Circuit erred in trying to replace such proceedings with Trial by Formula. Because Rule 23 cannot be interpreted to "abridge, enlarge or modify any substantive right," 28 U.S.C. § 2072(b), a class cannot be certified on the premise that Wal–Mart will not be entitled to litigate its statutory defenses to individual claims. Pp. 2561.

603 F.3d 571, reversed.

SCALIA, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, THOMAS, and ALITO, JJ., joined, and in which GINSBURG, BREYER, SOTOMAYOR, and KAGAN, JJ., joined as to Parts I and III. Ginsburg, J., filed an opinion concurring in part and dissenting in part, in which BREYER, SOTOMAYOR, and KAGAN, JJ., joined.

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**Opinion**

Justice SCALIA delivered the opinion of the Court.

We are presented with one of the most expansive class actions ever. The District Court and the Court of Appeals approved the certification of a class comprising about one and a half million plaintiffs, current and former female employees of petitioner Wal–Mart who allege that the discretion exercised by their local supervisors over pay and promotion matters violates Title VII by discriminating against women. In addition to injunctive and declaratory relief, the plaintiffs seek an award of backpay. We consider whether the certification of the plaintiff class was consistent with Federal Rules of Civil Procedure 23(a) and (b)(2).

## I

### A

Petitioner Wal–Mart is the Nation's largest private employer. It operates four types of retail stores throughout the country: Discount Stores, Supercenters, Neighborhood Markets, and Sam's Clubs. Those stores are divided into

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seven nationwide divisions, which in turn comprise 41 regions of 80 to 85 stores apiece. Each store has between 40 and 53 separate departments and 80 to 500 staff positions. In all, Wal–Mart operates approximately 3,400 stores and employs more than one million people.

Pay and promotion decisions at Wal–Mart are generally committed to local managers' broad discretion, which is exercised "in a largely subjective manner." 222 F.R.D. 137, 145 (N.D.Cal.2004). Local store managers may increase the wages of hourly employees (within limits) with only limited corporate oversight. As for salaried employees, such as store managers and their deputies, higher corporate authorities have discretion to set their pay within preestablished ranges.

Promotions work in a similar fashion. Wal–Mart permits store managers to apply their own subjective criteria when selecting candidates as "support managers," which is the first step on the path to management. Admission to Wal–Mart's management training program, however, does require that a candidate meet certain objective criteria, including an above-average performance rating, at least one year's tenure in the applicant's current position, and a willingness to relocate. But except for those requirements, regional and district managers have discretion to use their own judgment when selecting candidates for management training. Promotion to higher office—*e.g.,* assistant manager, co-manager, or store manager—is similarly at the discretion of the employee's superiors after prescribed objective factors are satisfied.

### B

The named plaintiffs in this lawsuit, representing the 1.5 million members of the certified class, are three current or former Wal–Mart employees who allege that the company discriminated against them on the basis of their sex by denying them equal pay or promotions, in violation of Title VII of the Civil Rights Act of 1964, 78 Stat. 253, as amended, 42 U.S.C. § 2000e–1 *et seq.*[1]

Betty Dukes began working at a Pittsburgh, California, Wal–Mart in 1994. She started as a cashier, but later sought and ***2548** received a promotion to customer service manager. After a series of disciplinary violations, however, Dukes was demoted back to cashier and then to greeter. Dukes concedes she violated company policy, but contends that the disciplinary actions were in fact retaliation for invoking internal complaint procedures and that male employees have not been disciplined for similar infractions. Dukes also claims two male greeters in the Pittsburgh store are paid more than she is.

Christine Kwapnoski has worked at Sam's Club stores in Missouri and California for most of her adult life. She has held a number of positions, including a supervisory position. She claims that a male manager yelled at her frequently and screamed at female employees, but not at men. The manager in question "told her to 'doll up,' to wear some makeup, and to dress a little better." App. 1003a.

The final named plaintiff, Edith Arana, worked at a Wal–Mart store in Duarte, California, from 1995 to 2001. In 2000, she approached the store manager on more than one occasion about management training, but was brushed off. Arana concluded she was being denied opportunity for advancement because of her sex. She initiated internal complaint procedures, whereupon she was told to apply directly to the district manager if she thought her store manager was being unfair. Arana, however, decided against that and never applied for management training again. In 2001, she was fired for failure to comply with Wal–Mart's timekeeping policy.

These plaintiffs, respondents here, do not allege that Wal–Mart has any express corporate policy against the advancement of women. Rather, they claim that their local managers' discretion over pay and promotions is exercised disproportionately in favor of men, leading to an unlawful disparate impact on female employees, see 42 U.S.C. § 2000e–2(k). And, respondents say, because Wal–Mart is aware of this effect, its refusal to cabin its managers' authority amounts to disparate treatment, see § 2000e–2(a). Their complaint seeks injunctive and declaratory relief, punitive damages, and backpay. It does not ask for compensatory damages.

Importantly for our purposes, respondents claim that the discrimination to which they have been subjected is common to *all* Wal–Mart's female employees. The basic theory of their case is that a strong and uniform "corporate culture" permits bias against women to infect, perhaps subconsciously, the discretionary decisionmaking of each one of Wal–Mart's thousands of managers—thereby making every woman at the company the victim of one common discriminatory practice. Respondents therefore wish to litigate the Title VII claims of all female employees at Wal–Mart's stores in a nationwide class action.

### C

Class certification is governed by Federal Rule of Civil Procedure 23. Under Rule 23(a), the party seeking certification must demonstrate, first, that:

"(1) the class is so numerous that joinder of all members is impracticable,

"(2) there are questions of law or fact common to the class,

"(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and

"(4) the representative parties will fairly and adequately protect the interests of the class" (paragraph breaks added).

Second, the proposed class must satisfy at least one of the three requirements listed in Rule 23(b). Respondents rely on Rule 23(b)(2), which applies when "the party opposing the class has acted or refused to ***2549** act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole."[2]

Invoking these provisions, respondents moved the District Court to certify a plaintiff class consisting of " '[a]ll women employed at any Wal–Mart domestic retail store at any time since December 26, 1998, who have been or may be subjected to Wal–Mart's challenged pay and management track promotions policies and practices.' " 222 F.R.D., at 141–142 (quoting Plaintiff 's Motion for Class Certification in case No. 3:01–cv–02252–CRB (ND Cal.), Doc. 99, p. 37). As evidence that there were indeed "questions of law or fact common to" all the women of Wal–Mart, as Rule 23(a)(2) requires, respondents relied chiefly on three forms of proof: statistical evidence about pay and promotion disparities between men and women at the company, anecdotal reports of discrimination from about 120 of Wal–Mart's female employees, and the testimony of a sociologist, Dr. William Bielby, who conducted a "social framework analysis" of Wal–Mart's "culture" and personnel practices, and concluded that the company was "vulnerable" to gender discrimination. 603 F.3d 571, 601 (C.A.9 2010) (en banc).

Wal–Mart unsuccessfully moved to strike much of this evidence. It also offered its own countervailing statistical and other proof in an effort to defeat Rule 23(a)'s requirements of commonality, typicality, and adequate representation. Wal–Mart further contended that respondents' monetary claims for backpay could not be certified under Rule 23(b)(2), first because that Rule refers only to injunctive and declaratory relief, and second because the backpay claims could not be manageably tried as a class without depriving Wal–Mart of its right to present certain statutory defenses. With one limitation not relevant here, the District Court granted respondents' motion and certified their proposed class.[3]

**D**

A divided en banc Court of Appeals substantially affirmed the District Court's certification order. 603 F.3d 571. The majority concluded that respondents' evidence of commonality was sufficient to "raise the common question whether Wal–Mart's female employees nationwide were subjected to a single set of corporate policies (not merely a number of independent discriminatory acts) that may have worked to unlawfully discriminate against them in violation of Title VII." *Id.,* at 612 (emphasis deleted). It also agreed with the District Court that the named plaintiffs' claims were sufficiently typical of the class ***2550** as a whole to satisfy Rule 23(a)(3), and that they could serve as adequate class representatives, see Rule 23(a)(4). *Id,* at 614–615. With respect to the Rule 23(b)(2) question, the Ninth Circuit held that respondents' backpay claims could be certified as part of a (b)(2) class because they did not "predominat[e]" over the requests for declaratory and injunctive relief, meaning they were not "superior in strength, influence, or authority" to the nonmonetary claims. *Id.,* at 616 (internal quotation marks omitted).[4]

Finally, the Court of Appeals determined that the action could be manageably tried as a class action because the District Court could adopt the approach the Ninth Circuit approved in *Hilao v. Estate of Marcos,* 103 F.3d 767, 782–787 (1996). There compensatory damages for some 9,541 class members were calculated by selecting 137 claims at random, referring those claims to a special master for valuation, and then extrapolating the validity and value of the untested claims from the sample set. See 603 F.3d, at 625–626. The Court of Appeals "s[aw] no reason why a similar procedure to that used in *Hilao* could not be employed in this case." *Id.,* at 627. It would allow Wal–Mart "to present individual defenses in the randomly selected 'sample cases,' thus revealing the approximate percentage of class members whose unequal pay or nonpromotion was due to something other than gender discrimination." *Ibid.,* n. 56 (emphasis deleted).

We granted certiorari. 562 U.S. ——, 131 S.Ct. 795, 178 L.Ed.2d 530 (2010).

II

[1] [2] [3] The class action is "an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only." *Califano v. Yamasaki,* 442 U.S. 682, 700–701, 99 S.Ct. 2545, 61 L.Ed.2d 176 (1979). In order to justify a departure from that rule, "a class representative must be part of the class and 'possess the same interest and suffer the same injury' as the class members." *East Tex. Motor Freight System, Inc. v. Rodriguez,* 431 U.S. 395, 403, 97 S.Ct. 1891, 52 L.Ed.2d 453 (1977) (quoting *Schlesinger v. Reservists Comm. to Stop the War,* 418 U.S. 208, 216, 94 S.Ct. 2925, 41 L.Ed.2d 706 (1974)). Rule 23(a) ensures that the named plaintiffs are appropriate representatives of the class whose claims they wish to litigate. The Rule's four requirements—numerosity, commonality, typicality, and adequate representation—"effectively 'limit the class claims to those fairly encompassed by the named plaintiff's claims.' " *General Telephone Co. of Southwest v. Falcon,* 457 U.S. 147, 156, 102 S.Ct. 2364, 72 L.Ed.2d 740 (1982) (quoting *General Telephone Co. of Northwest v. EEOC,* 446 U.S. 318, 330, 100 S.Ct. 1698, 64 L.Ed.2d 319 (1980)).

A

[4] [5] The crux of this case is commonality—the rule requiring a plaintiff to show that "there are questions of law or fact ***2551** common to the class." Rule 23(a)(2).[5] That language is easy to misread, since "[a]ny competently crafted class complaint literally raises common 'questions.' " Nagareda, Class Certification in the Age of Aggregate Proof, 84 N.Y.U.L.Rev. 97, 131–132 (2009). For example: Do all of us plaintiffs indeed work for Wal–Mart? Do our managers have discretion over pay? Is that an unlawful employment practice? What remedies should we get? Reciting these questions is not sufficient to obtain class certification. Commonality requires the plaintiff to demonstrate that the class members "have suffered the same injury," *Falcon, supra,* at 157, 102 S.Ct. 2364. This does not mean merely that they have all suffered a violation of the same provision of law. Title VII, for example, can be violated in many ways—by intentional discrimination, or by hiring and promotion criteria that result in disparate impact, and by the use of these practices on the part of many different superiors in a single company. Quite obviously, the mere claim by employees of the same company that they have suffered a Title VII injury, or even a disparate-impact Title VII injury, gives no cause to believe that all their claims can productively be litigated at once. Their claims must depend upon a common contention—for example, the assertion of discriminatory bias on the part of the same supervisor. That common contention, moreover, must be of such a nature that it is capable of classwide resolution—which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke.

> "What matters to class certification ... is not the raising of common 'questions'—even in droves—but, rather the capacity of a classwide proceeding to generate common *answers* apt to drive the resolution of the litigation. Dissimilarities within the proposed class are what have the potential to impede the generation of common answers." Nagareda, *supra,* at 132.

[6] [7] Rule 23 does not set forth a mere pleading standard. A party seeking class certification must affirmatively demonstrate his compliance with the Rule—that is, he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc. We recognized in *Falcon* that "sometimes it may be necessary for the court to probe behind the pleadings before coming to rest on the certification question," 457 U.S., at 160, 102 S.Ct. 2364, and that certification is proper only if "the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied," *id.,* at 161, 102 S.Ct. 2364; see *id.,* at 160, 102 S.Ct. 2364 ("[A]ctual, not presumed, conformance with Rule 23(a) remains ... indispensable"). Frequently that "rigorous analysis" will entail some overlap with the merits of the plaintiff's underlying claim. That cannot be helped. " '[T]he ***2552** class determination generally involves considerations that are enmeshed in the factual and legal issues comprising the plaintiff's cause of action.' " *Falcon, supra,* at 160, 102 S.Ct. 2364 (quoting *Coopers & Lybrand v. Livesay,* 437 U.S. 463, 469, 98 S.Ct. 2454, 57 L.Ed.2d 351 (1978); some internal quotation marks omitted).[6] Nor is there anything unusual about that consequence: The necessity of touching aspects of the merits in order to resolve preliminary matters, *e.g.,* jurisdiction and venue, is a familiar feature of litigation. See *Szabo v. Bridgeport Machines, Inc.,* 249 F.3d 672, 676–677 (C.A.7 2001) (Easterbrook, J.).

[8] In this case, proof of commonality necessarily overlaps with respondents' merits contention that Wal–Mart engages in a *pattern or practice* of discrimination.[7] That is so because, in resolving an individual's Title VII claim, the crux of the inquiry is "the reason for a particular employment decision," *Cooper v. Federal Reserve Bank of Richmond,* 467 U.S. 867, 876, 104 S.Ct. 2794, 81 L.Ed.2d 718 (1984). Here respondents wish to sue about literally millions of employment decisions at once. Without some glue holding the alleged *reasons* for all

those decisions together, it will be impossible to say that examination of all the class members' claims for relief will produce a common answer to the crucial question *why was I disfavored.*

### B

[9] This Court's opinion in *Falcon* describes how the commonality issue must be ***2553** approached. There an employee who claimed that he was deliberately denied a promotion on account of race obtained certification of a class comprising all employees wrongfully denied promotions and all applicants wrongfully denied jobs. 457 U.S., at 152, 102 S.Ct. 2364. We rejected that composite class for lack of commonality and typicality, explaining:

> "Conceptually, there is a wide gap between (a) an individual's claim that he has been denied a promotion [or higher pay] on discriminatory grounds, and his otherwise unsupported allegation that the company has a policy of discrimination, and (b) the existence of a class of persons who have suffered the same injury as that individual, such that the individual's claim and the class claim will share common questions of law or fact and that the individual's claim will be typical of the class claims." *Id.,* at 157–158, 102 S.Ct. 2364.

*Falcon* suggested two ways in which that conceptual gap might be bridged. First, if the employer "used a biased testing procedure to evaluate both applicants for employment and incumbent employees, a class action on behalf of every applicant or employee who might have been prejudiced by the test clearly would satisfy the commonality and typicality requirements of Rule 23(a)." *Id*, at 159, n. 15, 102 S.Ct. 2364. Second, "[s]ignificant proof that an employer operated under a general policy of discrimination conceivably could justify a class of both applicants and employees if the discrimination manifested itself in hiring and promotion practices in the same general fashion, such as through entirely subjective decisionmaking processes." *Ibid.* We think that statement precisely describes respondents' burden in this case. The first manner of bridging the gap obviously has no application here; Wal–Mart has no testing procedure or other companywide evaluation method that can be charged with bias. The whole point of permitting discretionary decisionmaking is to avoid evaluating employees under a common standard.

[10] The second manner of bridging the gap requires "significant proof" that Wal–Mart "operated under a general policy of discrimination." That is entirely absent here. Wal–Mart's announced policy forbids sex discrimination, see App. 1567a–1596a, and as the District Court recognized the company imposes penalties for denials of equal employment opportunity, 222 F.R.D., at 154. The only evidence of a "general policy of discrimination" respondents produced was the testimony of Dr. William Bielby, their sociological expert. Relying on "social framework" analysis, Bielby testified that Wal–Mart has a "strong corporate culture," that makes it " 'vulnerable' " to "gender bias." *Id.,* at 152. He could not, however, "determine with any specificity how regularly stereotypes play a meaningful role in employment decisions at Wal–Mart. At his deposition ... Dr. Bielby conceded that he could not calculate whether 0.5 percent or 95 percent of the employment decisions at Wal–Mart might be determined by stereotyped thinking." 222 F.R.D. 189, 192 (N.D.Cal.2004). The parties dispute whether Bielby's testimony even met the standards for the admission of expert testimony under Federal Rule of Civil Procedure 702 and our *Daubert* case, see *Daubert v. Merrell Dow Pharmaceuticals, Inc.,* 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993).[8] The District Court concluded ***2554** that *Daubert* did not apply to expert testimony at the certification stage of class-action proceedings. 222 F.R.D., at 191. We doubt that is so, but even if properly considered, Bielby's testimony does nothing to advance respondents' case. "[W]hether 0.5 percent or 95 percent of the employment decisions at Wal–Mart might be determined by stereotyped thinking" is the essential question on which respondents' theory of commonality depends. If Bielby admittedly has no answer to that question, we can safely disregard what he has to say. It is worlds away from "significant proof" that Wal–Mart "operated under a general policy of discrimination."

### C

The only corporate policy that the plaintiffs' evidence convincingly establishes is Wal–Mart's "policy" of *allowing discretion* by local supervisors over employment matters. On its face, of course, that is just the opposite of a uniform employment practice that would provide the commonality needed for a class action; it is a policy *against having* uniform employment practices. It is also a very common and presumptively reasonable way of doing business—one that we have said "should itself raise no inference of discriminatory conduct," *Watson v. Fort Worth Bank & Trust,* 487 U.S. 977, 990, 108 S.Ct. 2777, 101 L.Ed.2d 827 (1988).

[11] To be sure, we have recognized that, "in appropriate cases," giving discretion to lower-level supervisors can be

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the basis of Title VII liability under a disparate-impact theory—since "an employer's undisciplined system of subjective decisionmaking [can have] precisely the same effects as a system pervaded by impermissible intentional discrimination." *Id.,* at 990–991, 108 S.Ct. 2777. But the recognition that this type of Title VII claim "can" exist does not lead to the conclusion that every employee in a company using a system of discretion has such a claim in common. To the contrary, left to their own devices most managers in any corporation—and surely most managers in a corporation that forbids sex discrimination—would select sex-neutral, performance-based criteria for hiring and promotion that produce no actionable disparity at all. Others may choose to reward various attributes that produce disparate impact—such as scores on general aptitude tests or educational achievements, see *Griggs v. Duke Power Co.,* 401 U.S. 424, 431–432, 91 S.Ct. 849, 28 L.Ed.2d 158 (1971). And still other managers may be guilty of intentional discrimination that produces a sex-based disparity. In such a company, demonstrating the invalidity of one manager's use of discretion will do nothing to demonstrate the invalidity of another's. A party seeking to certify a nationwide class will be unable to show that all the employees' Title VII claims will in fact depend on the answers to common questions.

Respondents have not identified a common mode of exercising discretion that ***2555** pervades the entire company—aside from their reliance on Dr. Bielby's social frameworks analysis that we have rejected. In a company of Wal–Mart's size and geographical scope, it is quite unbelievable that all managers would exercise their discretion in a common way without some common direction. Respondents attempt to make that showing by means of statistical and anecdotal evidence, but their evidence falls well short.

The statistical evidence consists primarily of regression analyses performed by Dr. Richard Drogin, a statistician, and Dr. Marc Bendick, a labor economist. Drogin conducted his analysis region-by-region, comparing the number of women promoted into management positions with the percentage of women in the available pool of hourly workers. After considering regional and national data, Drogin concluded that "there are statistically significant disparities between men and women at Wal–Mart ... [and] these disparities ... can be explained only by gender discrimination." 603 F.3d, at 604 (internal quotation marks omitted). Bendick compared work-force data from Wal–Mart and competitive retailers and concluded that Wal–Mart "promotes a lower percentage of women than its competitors." *Ibid.*

Even if they are taken at face value, these studies are insufficient to establish that respondents' theory can be proved on a classwide basis. In *Falcon,* we held that one named plaintiff's experience of discrimination was insufficient to infer that "discriminatory treatment is typical of [the employer's employment] practices." 457 U.S., at 158, 102 S.Ct. 2364. A similar failure of inference arises here. As Judge Ikuta observed in her dissent, "[i]nformation about disparities at the regional and national level does not establish the existence of disparities at individual stores, let alone raise the inference that a company-wide policy of discrimination is implemented by discretionary decisions at the store and district level." 603 F.3d, at 637. A regional pay disparity, for example, may be attributable to only a small set of Wal–Mart stores, and cannot by itself establish the uniform, store-by-store disparity upon which the plaintiffs' theory of commonality depends.

There is another, more fundamental, respect in which respondents' statistical proof fails. Even if it established (as it does not) a pay or promotion pattern that differs from the nationwide figures or the regional figures in *all* of Wal–Mart's 3,400 stores, that would still not demonstrate that commonality of issue exists. Some managers will claim that the availability of women, or qualified women, or interested women, in their stores' area does not mirror the national or regional statistics. And almost all of them will claim to have been applying some sex-neutral, performance-based criteria—whose nature and effects will differ from store to store. In the landmark case of ours which held that giving discretion to lower-level supervisors can be the basis of Title VII liability under a disparate-impact theory, the plurality opinion *conditioned* that holding on the corollary that merely proving that the discretionary system has produced a racial or sexual disparity *is not enough.* "[T]he plaintiff must begin by identifying the specific employment practice that is challenged." *Watson,* 487 U.S., at 994, 108 S.Ct. 2777; accord, *Wards Cove Packing Co. v. Atonio,* 490 U.S. 642, 656, 109 S.Ct. 2115, 104 L.Ed.2d 733 (1989) (approving that statement), superseded by statute on other grounds, 42 U.S.C. § 2000e–2(k). That is all the more necessary when a class of plaintiffs is sought to be certified. Other than the bare existence of delegated discretion, respondents have identified no "specific employment practice"—much less one that ties all their 1.5 million claims ***2556** together. Merely showing that Wal–Mart's policy of discretion has produced an overall sex-based disparity does not suffice.

Respondents' anecdotal evidence suffers from the same defects, and in addition is too weak to raise any inference that all the individual, discretionary personnel decisions are discriminatory. In *Teamsters v. United States,* 431

U.S. 324, 97 S.Ct. 1843, 52 L.Ed.2d 396 (1977), in addition to substantial statistical evidence of company-wide discrimination, the Government (as plaintiff) produced about 40 specific accounts of racial discrimination from particular individuals. See *id.,* at 338, 97 S.Ct. 1843. That number was significant because the company involved had only 6,472 employees, of whom 571 were minorities, *id.,* at 337, 97 S.Ct. 1843, and the class itself consisted of around 334 persons, *United States v. T.I.M.E.-D.C., Inc.,* 517 F.2d 299, 308 (C.A.5 1975), overruled on other grounds, *Teamsters, supra.* The 40 anecdotes thus represented roughly one account for every eight members of the class. Moreover, the Court of Appeals noted that the anecdotes came from individuals "spread throughout" the company who "for the most part" worked at the company's operational centers that employed the largest numbers of the class members. 517 F.2d, at 315, and n. 30. Here, by contrast, respondents filed some 120 affidavits reporting experiences of discrimination—about 1 for every 12,500 class members—relating to only some 235 out of Wal–Mart's 3,400 stores. 603 F.3d, at 634 (Ikuta, J., dissenting). More than half of these reports are concentrated in only six States (Alabama, California, Florida, Missouri, Texas, and Wisconsin); half of all States have only one or two anecdotes; and 14 States have no anecdotes about Wal–Mart's operations at all. *Id.,* at 634–635, and n. 10. Even if every single one of these accounts is true, that would not demonstrate that the entire company "operate [s] under a general policy of discrimination," *Falcon, supra,* at 159, n. 15, 102 S.Ct. 2364, which is what respondents must show to certify a companywide class.[9]

The dissent misunderstands the nature of the foregoing analysis. It criticizes our focus on the dissimilarities between the putative class members on the ground that we have "blend[ed]" Rule 23(a)(2)'s commonality requirement with Rule 23(b)(3)'s inquiry into whether common questions "predominate" over individual ones. See *post,* at 2550 – 2552 (GINSBURG, J., concurring in part and dissenting in part). That is not so. We quite agree that for purposes of Rule 23(a)(2) " '[e]ven a single [common] question' " will do, *post,* at 2566, n. 9 (quoting Nagareda, The Preexistence Principle and the Structure of the Class Action, 103 Colum. L.Rev. 149, 176, n. 110 (2003)). We consider dissimilarities not in order to determine (as Rule 23(b)(3) requires) whether common questions *predominate,* but in order to determine (as Rule 23(a)(2) requires) whether there *is* "[e]ven a single [common] question." And there is not here. Because respondents provide no convincing proof of a companywide discriminatory pay and promotion policy, we have concluded that they have ***2557** not established the existence of any common question.[10]

In sum, we agree with Chief Judge Kozinski that the members of the class:

> "held a multitude of different jobs, at different levels of Wal–Mart's hierarchy, for variable lengths of time, in 3,400 stores, sprinkled across 50 states, with a kaleidoscope of supervisors (male and female), subject to a variety of regional policies that all differed .... Some thrived while others did poorly. They have little in common but their sex and this lawsuit." 603 F.3d, at 652 (dissenting opinion).

## III

[12] We also conclude that respondents' claims for backpay were improperly certified under Federal Rule of Civil Procedure 23(b)(2). Our opinion in *Ticor Title Ins. Co. v. Brown,* 511 U.S. 117, 121, 114 S.Ct. 1359, 128 L.Ed.2d 33 (1994) *(per curiam)* expressed serious doubt about whether claims for monetary relief may be certified under that provision. We now hold that they may not, at least where (as here) the monetary relief is not incidental to the injunctive or declaratory relief.

### A

[13] Rule 23(b)(2) allows class treatment when "the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole." One possible reading of this provision is that it applies *only* to requests for such injunctive or declaratory relief and does not authorize the class certification of monetary claims at all. We need not reach that broader question in this case, because we think that, at a minimum, claims for *individualized* relief (like the backpay at issue here) do not satisfy the Rule. The key to the (b)(2) class is "the indivisible nature of the injunctive or declaratory remedy warranted—the notion that the conduct is such that it can be enjoined or declared unlawful only as to all of the class members or as to none of them." Nagareda, 84 N.Y.U.L.Rev., at 132. In other words, Rule 23(b)(2) applies only when a single injunction or declaratory judgment would provide relief to each member of the class. It does not authorize class certification when each individual class member would be entitled to a *different* injunction or declaratory judgment against the defendant. Similarly, it does not authorize

class certification when each class member would be entitled to an individualized award of monetary damages.

[14] That interpretation accords with the history of the Rule. Because Rule 23 "stems from equity practice" that predated its codification, *Amchem Products, Inc. v. Windsor,* 521 U.S. 591, 613, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997), in determining its meaning we have previously looked to the historical models on which the Rule was based, *Ortiz v. Fibreboard Corp.,* 527 U.S. 815, 841–845, 119 S.Ct. 2295, 144 L.Ed.2d 715 (1999). As we observed in *Amchem,* "[c]ivil rights cases against parties charged with unlawful, class-based discrimination are prime examples" of what (b)(2) is meant to capture. ***2558** 521 U.S., at 614, 117 S.Ct. 2231. In particular, the Rule reflects a series of decisions involving challenges to racial segregation—conduct that was remedied by a single classwide order. In none of the cases cited by the Advisory Committee as examples of (b)(2)'s antecedents did the plaintiffs combine any claim for individualized relief with their classwide injunction. See Advisory Committee's Note, 39 F.R.D. 69, 102 (1966) (citing cases); *e.g., Potts v. Flax,* 313 F.2d 284, 289, n. 5 (C.A.5 1963); *Brunson v. Board of Trustees of Univ. of School Dist. No. 1, Clarendon Cty.,* 311 F.2d 107, 109 (C.A.4 1962) *(per curiam)*; *Frasier v. Board of Trustees of N.C.,* 134 F.Supp. 589, 593 (NC 1955) (three-judge court), aff'd, 350 U.S. 979, 76 S.Ct. 467, 100 L.Ed. 848 (1956).

Permitting the combination of individualized and classwide relief in a (b)(2) class is also inconsistent with the structure of Rule 23(b). Classes certified under (b)(1) and (b)(2) share the most traditional justifications for class treatment—that individual adjudications would be impossible or unworkable, as in a(b)(1) class,[11] or that the relief sought must perforce affect the entire class at once, as in a (b)(2) class. For that reason these are also mandatory classes: The Rule provides no opportunity for (b)(1) or (b)(2) class members to opt out, and does not even oblige the District Court to afford them notice of the action. Rule 23(b)(3), by contrast, is an "adventuresome innovation" of the 1966 amendments, *Amchem,* 521 U.S., at 614, 117 S.Ct. 2231 (internal quotation marks omitted), framed for situations "in which 'class-action treatment is not as clearly called for'," *id.,* at 615, 117 S.Ct. 2231 (quoting Advisory Committee's Notes, 28 U.S.C.App., p. 697 (1994 ed.)). It allows class certification in a much wider set of circumstances but with greater procedural protections. Its only prerequisites are that "the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Rule 23(b)(3). And unlike (b)(1) and (b)(2) classes, the (b)(3) class is not mandatory; class members are entitled to receive "the best notice that is practicable under the circumstances" and to withdraw from the class at their option. See Rule 23(c)(2)(B).

Given that structure, we think it clear that individualized monetary claims belong in Rule 23(b)(3). The procedural protections attending the (b)(3) class—predominance, superiority, mandatory notice, and the right to opt out—are missing from (b)(2) not because the Rule considers them unnecessary, but because it considers them unnecessary *to a (b)(2) class*. When a class seeks an indivisible injunction benefitting all its members at once, there is no reason to undertake a case-specific inquiry into whether class issues predominate or whether class action is a superior method of adjudicating the dispute. Predominance and superiority are self-evident. But with respect to each class member's individualized claim for money, that is not so—which ***2559** is precisely why (b)(3) requires the judge to make findings about predominance and superiority before allowing the class. Similarly, (b)(2) does not require that class members be given notice and opt-out rights, presumably because it is thought (rightly or wrongly) that notice has no purpose when the class is mandatory, and that depriving people of their right to sue in this manner complies with the Due Process Clause. In the context of a class action predominantly for money damages we have held that absence of notice and opt-out violates due process. See *Phillips Petroleum Co. v. Shutts,* 472 U.S. 797, 812, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985). While we have never held that to be so where the monetary claims do not predominate, the serious possibility that it may be so provides an additional reason not to read Rule 23(b)(2) to include the monetary claims here.

### B

Against that conclusion, respondents argue that their claims for backpay were appropriately certified as part of a class under Rule 23(b)(2) because those claims do not "predominate" over their requests for injunctive and declaratory relief. They rely upon the Advisory Committee's statement that Rule 23(b)(2) "does not extend to cases in which the appropriate final relief relates *exclusively or predominantly* to money damages." 39 F.R.D., at 102 (emphasis added). The negative implication, they argue, is that it *does* extend to cases in which the appropriate final relief relates only partially and nonpredominantly to money damages. Of course it is the Rule itself, not the Advisory Committee's description of it, that governs. And a mere negative inference does not in

our view suffice to establish a disposition that has no basis in the Rule's text, and that does obvious violence to the Rule's structural features. The mere "predominance" of a proper (b)(2) injunctive claim does nothing to justify elimination of Rule 23(b)(3)'s procedural protections: It neither establishes the superiority of *class* adjudication over *individual* adjudication nor cures the notice and opt-out problems. We fail to see why the Rule should be read to nullify these protections whenever a plaintiff class, at its option, combines its monetary claims with a request—even a "predominating request"—for an injunction.

Respondents' predominance test, moreover, creates perverse incentives for class representatives to place at risk potentially valid claims for monetary relief. In this case, for example, the named plaintiffs declined to include employees' claims for compensatory damages in their complaint. That strategy of including only backpay claims made it more likely that monetary relief would not "predominate." But it also created the possibility (if the predominance test were correct) that individual class members' compensatory-damages claims would be *precluded* by litigation they had no power to hold themselves apart from. If it were determined, for example, that a particular class member is not entitled to backpay because her denial of increased pay or a promotion was *not* the product of discrimination, that employee might be collaterally estopped from independently seeking compensatory damages based on that same denial. That possibility underscores the need for plaintiffs with individual monetary claims to decide *for themselves* whether to tie their fates to the class representatives' or go it alone—a choice Rule 23(b)(2) does not ensure that they have.

The predominance test would also require the District Court to reevaluate the roster of class members continually. The Ninth Circuit recognized the necessity for this when it concluded that those plaintiffs ***2560** no longer employed by Wal–Mart lack standing to seek injunctive or declaratory relief against its employment practices. The Court of Appeals' response to that difficulty, however, was not to eliminate *all* former employees from the certified class, but to eliminate only those who had left the company's employ by the date the complaint was filed. That solution has no logical connection to the problem, since those who have left their Wal–Mart jobs *since* the complaint was filed have no more need for prospective relief than those who left beforehand. As a consequence, even though the validity of a (b)(2) class depends on whether "final injunctive relief or corresponding declaratory relief is appropriate respecting the class *as a whole,*" Rule 23(b)(2) (emphasis added), about half the members of the class approved by the Ninth Circuit have no claim for injunctive or declaratory relief at all. Of course, the alternative (and logical) solution of excising plaintiffs from the class as they leave their employment may have struck the Court of Appeals as wasteful of the District Court's time. Which indeed it is, since if a backpay action were properly certified for class treatment under *(b)(3),* the ability to litigate a plaintiff's backpay claim as part of the class would not turn on the irrelevant question whether she is still employed at Wal–Mart. What follows from this, however, is not that some arbitrary limitation on class membership should be imposed but that the backpay claims should not be certified under Rule 23(b)(2) at all.

Finally, respondents argue that their backpay claims are appropriate for a (b)(2) class action because a backpay award is equitable in nature. The latter may be true, but it is irrelevant. The Rule does not speak of "equitable" remedies generally but of injunctions and declaratory judgments. As Title VII itself makes pellucidly clear, backpay is neither. See 42 U.S.C. § 2000e–5(g)(2)(B)(i) and (ii) (distinguishing between declaratory and injunctive relief and the payment of "backpay," see § 2000e–5(g)(2)(A)).

### C

[15] In *Allison v. Citgo Petroleum Corp.,* 151 F.3d 402, 415 (C.A.5 1998), the Fifth Circuit held that a (b)(2) class would permit the certification of monetary relief that is "incidental to requested injunctive or declaratory relief," which it defined as "damages that flow directly from liability to the class *as a whole* on the claims forming the basis of the injunctive or declaratory relief." In that court's view, such "incidental damage should not require additional hearings to resolve the disparate merits of each individual's case; it should neither introduce new substantial legal or factual issues, nor entail complex individualized determinations." *Ibid.* We need not decide in this case whether there are any forms of "incidental" monetary relief that are consistent with the interpretation of Rule 23(b)(2) we have announced and that comply with the Due Process Clause. Respondents do not argue that they can satisfy this standard, and in any event they cannot.

Contrary to the Ninth Circuit's view, Wal–Mart is entitled to individualized determinations of each employee's eligibility for backpay. Title VII includes a detailed remedial scheme. If a plaintiff prevails in showing that an employer has discriminated against him in violation of the

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statute, the court "may enjoin the respondent from engaging in such unlawful employment practice, and order such affirmative action as may be appropriate, [including] reinstatement or hiring of employees, with or without backpay ... or any other equitable relief as the court deems appropriate." § 2000e–5(g)(1). But if the employer can show that it took an adverse employment action against an employee for any ***2561** reason other than discrimination, the court cannot order the "hiring, reinstatement, or promotion of an individual as an employee, or the payment to him of any backpay." § 2000e–5(g)(2)(A).

[16] We have established a procedure for trying pattern-or-practice cases that gives effect to these statutory requirements. When the plaintiff seeks individual relief such as reinstatement or backpay after establishing a pattern or practice of discrimination, "a district court must usually conduct additional proceedings ... to determine the scope of individual relief." *Teamsters,* 431 U.S., at 361, 97 S.Ct. 1843. At this phase, the burden of proof will shift to the company, but it will have the right to raise any individual affirmative defenses it may have, and to "demonstrate that the individual applicant was denied an employment opportunity for lawful reasons." *Id.,* at 362, 97 S.Ct. 1843.

[17] The Court of Appeals believed that it was possible to replace such proceedings with Trial by Formula. A sample set of the class members would be selected, as to whom liability for sex discrimination and the backpay owing as a result would be determined in depositions supervised by a master. The percentage of claims determined to be valid would then be applied to the entire remaining class, and the number of (presumptively) valid claims thus derived would be multiplied by the average backpay award in the sample set to arrive at the entire class recovery—without further individualized proceedings. 603 F.3d, at 625–627. We disapprove that novel project. Because the Rules Enabling Act forbids interpreting Rule 23 to "abridge, enlarge or modify any substantive right," 28 U.S.C. § 2072(b); see *Ortiz,* 527 U.S., at 845, 119 S.Ct. 2295, a class cannot be certified on the premise that Wal–Mart will not be entitled to litigate its statutory defenses to individual claims. And because the necessity of that litigation will prevent backpay from being "incidental" to the classwide injunction, respondents' class could not be certified even assuming, *arguendo,* that "incidental" monetary relief can be awarded to a 23(b)(2) class.

* * *

The judgment of the Court of Appeals is

*Reversed.*

Justice GINSBURG, with whom Justice BREYER, Justice SOTOMAYOR, and Justice KAGAN join, concurring in part and dissenting in part.

The class in this case, I agree with the Court, should not have been certified under Federal Rule of Civil Procedure 23(b)(2). The plaintiffs, alleging discrimination in violation of Title VII, 42 U.S.C. § 2000e *et seq.,* seek monetary relief that is not merely incidental to any injunctive or declaratory relief that might be available. See *ante,* at 2557 – 2561. A putative class of this type may be certifiable under Rule 23(b)(3), if the plaintiffs show that common class questions "predominate" over issues affecting individuals—*e.g.,* qualification for, and the amount of, backpay or compensatory damages—and that a class action is "superior" to other modes of adjudication.

Whether the class the plaintiffs describe meets the specific requirements of Rule 23(b)(3) is not before the Court, and I would reserve that matter for consideration and decision on remand.[1] The Court, ***2562** however, disqualifies the class at the starting gate, holding that the plaintiffs cannot cross the "commonality" line set by Rule 23(a)(2). In so ruling, the Court imports into the Rule 23(a) determination concerns properly addressed in a Rule 23(b)(3) assessment.

## I

### A

Rule 23(a)(2) establishes a preliminary requirement for maintaining a class action: "[T]here are questions of law or fact common to the class."[2] The Rule "does not require that all questions of law or fact raised in the litigation be common," 1 H. Newberg & A. Conte, Newberg on Class Actions § 3.10, pp. 3–48 to 3–49 (3d ed.1992); indeed, "[e]ven a single question of law or fact common to the members of the class will satisfy the commonality requirement," Nagareda, The Preexistence Principle and the Structure of the Class Action, 103 Colum. L.Rev. 149, 176, n. 110 (2003). See Advisory Committee's 1937 Notes on Fed. Rule Civ. Proc. 23, 28 U.S.C.App., p. 138 (citing with approval cases in which "there was only a

question of law or fact common to" the class members).

A "question" is ordinarily understood to be "[a] subject or point open to controversy." American Heritage Dictionary 1483 (3d ed.1992). See also Black's Law Dictionary 1366 (9th ed.2009) (defining "question of fact" as "[a] disputed issue to be resolved ... [at] trial" and "question of law" as "[a]n issue to be decided by the judge"). Thus, a "question" "common to the class" must be a dispute, either of fact or of law, the resolution of which will advance the determination of the class members' claims.[3]

**B**

The District Court, recognizing that "one significant issue common to the class may be sufficient to warrant certification," 222 F.R.D. 137, 145 (N.D.Cal.2004), found that the plaintiffs easily met that test. Absent an error of law or an abuse of discretion, an appellate tribunal has no warrant to upset the District Court's finding of commonality. See *Califano v. Yamasaki,* 442 U.S. 682, 703, 99 S.Ct. 2545, 61 L.Ed.2d 176 (1979) ("[M]ost issues arising under Rule 23 ... [are] committed in the first instance to the discretion of the district court.").

The District Court certified a class of "[a]ll women employed at any Wal–Mart domestic retail store at any time since December 26, 1998." 222 F.R.D., at 141–143 (internal quotation marks omitted). The named plaintiffs, led by Betty Dukes, propose to litigate, on behalf of the class, allegations that Wal–Mart discriminates on the basis of gender in pay and promotions. ***2563** They allege that the company "[r]eli[es] on gender stereotypes in making employment decisions such as ... promotion[s][and] pay." App. 55a. Wal–Mart permits those prejudices to infect personnel decisions, the plaintiffs contend, by leaving pay and promotions in the hands of "a nearly all male managerial workforce" using "arbitrary and subjective criteria." *Ibid.* Further alleged barriers to the advancement of female employees include the company's requirement, "as a condition of promotion to management jobs, that employees be willing to relocate." *Id.*, at 56a. Absent instruction otherwise, there is a risk that managers will act on the familiar assumption that women, because of their services to husband and children, are less mobile than men. See Dept. of Labor, Federal Glass Ceiling Commission, Good for Business: Making Full Use of the Nation's Human Capital 151 (1995).

Women fill 70 percent of the hourly jobs in the retailer's stores but make up only "33 percent of management employees." 222 F.R.D., at 146. "[T]he higher one looks in the organization the lower the percentage of women." *Id.*, at 155. The plaintiffs' "largely uncontested descriptive statistics" also show that women working in the company's stores "are paid less than men in every region" and "that the salary gap widens over time even for men and women hired into the same jobs at the same time." *Ibid.*; cf. *Ledbetter v. Goodyear Tire & Rubber Co.,* 550 U.S. 618, 643, 127 S.Ct. 2162, 167 L.Ed.2d 982 (2007) (GINSBURG, J., dissenting).

The District Court identified "systems for ... promoting in-store employees" that were "sufficiently similar across regions and stores" to conclude that "the manner in which these systems affect the class raises issues that are common to all class members." 222 F.R.D., at 149. The selection of employees for promotion to in-store management "is fairly characterized as a 'tap on the shoulder' process," in which managers have discretion about whose shoulders to tap. *Id.,* at 148. Vacancies are not regularly posted; from among those employees satisfying minimum qualifications, managers choose whom to promote on the basis of their own subjective impressions. *Ibid.*

Wal–Mart's compensation policies also operate uniformly across stores, the District Court found. The retailer leaves open a $2 band for every position's hourly pay rate. Wal–Mart provides no standards or criteria for setting wages within that band, and thus does nothing to counter unconscious bias on the part of supervisors. See *id.*, at 146–147.

Wal–Mart's supervisors do not make their discretionary decisions in a vacuum. The District Court reviewed means Wal–Mart used to maintain a "carefully constructed ... corporate culture," such as frequent meetings to reinforce the common way of thinking, regular transfers of managers between stores to ensure uniformity throughout the company, monitoring of stores "on a close and constant basis," and "Wal–Mart TV," "broadcas[t] ... into all stores." *Id.*, at 151–153 (internal quotation marks omitted).

The plaintiffs' evidence, including class members' tales of their own experiences,[4] suggests that gender bias suffused Wal–Mart's company culture. Among illustrations, ***2564** senior management often refer to female associates as "little Janie Qs." Plaintiffs' Motion for Class Certification in No. 3:01–cv–02252–CRB (ND Cal.), Doc. 99, p. 13 (internal quotation marks omitted). One manager told an employee that "[m]en are here to make a career and women aren't." 222 F.R.D., at 166 (internal quotation marks omitted). A committee of

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female Wal–Mart executives concluded that "[s]tereotypes limit the opportunities offered to women." Plaintiffs' Motion for Class Certification in No. 3:01–cv–02252–CRB (ND Cal.), Doc. 99, at 16 (internal quotation marks omitted).

Finally, the plaintiffs presented an expert's appraisal to show that the pay and promotions disparities at Wal–Mart "can be explained only by gender discrimination and not by ... neutral variables." 222 F.R.D., at 155. Using regression analyses, their expert, Richard Drogin, controlled for factors including, *inter alia,* job performance, length of time with the company, and the store where an employee worked. *Id.*, at 159.[5] The results, the District Court found, were sufficient to raise an "inference of discrimination." *Id.*, at 155–160.

### C

The District Court's identification of a common question, whether Wal–Mart's pay and promotions policies gave rise to unlawful discrimination, was hardly infirm. The practice of delegating to supervisors large discretion to make personnel decisions, uncontrolled by formal standards, has long been known to have the potential to produce disparate effects. Managers, like all humankind, may be prey to biases of which they are unaware.[6] The risk of discrimination is heightened when those managers are predominantly of one sex, and are steeped in a corporate culture that perpetuates gender stereotypes.

The plaintiffs' allegations resemble those in one of the prototypical cases in this area, *Leisner v. New York Tel. Co.,* 358 F.Supp. 359, 364–365 (S.D.N.Y.1973). In deciding on promotions, supervisors in that case were to start with objective measures; but ultimately, they were to "look at the individual as a total individual." *Id.*, at 365 (internal quotation marks omitted). The final question they were to ask and answer: "Is this person going to be successful in our business?" *Ibid.* (internal quotation marks omitted). It is hardly surprising that for many managers, the ideal candidate was someone with characteristics similar to their own.

We have held that "discretionary employment practices" can give rise to Title ***2565** VII claims, not only when such practices are motivated by discriminatory intent but also when they produce discriminatory results. See *Watson v. Fort Worth Bank & Trust,* 487 U.S. 977, 988, 991, 108 S.Ct. 2777, 101 L.Ed.2d 827 (1988). But see *ante,* at 2555 ("[P]roving that [a] discretionary system has produced a ... disparity *is not enough.*"). In *Watson,* as here, an employer had given its managers large authority over promotions. An employee sued the bank under Title VII, alleging that the "discretionary promotion system" caused a discriminatory effect based on race. 487 U.S., at 984, 108 S.Ct. 2777 (internal quotation marks omitted). Four different supervisors had declined, on separate occasions, to promote the employee. *Id.,* at 982, 108 S.Ct. 2777. Their reasons were subjective and unknown. The employer, we noted "had not developed precise and formal criteria for evaluating candidates"; "[i]t relied instead on the subjective judgment of supervisors." *Ibid.*

Aware of "the problem of subconscious stereotypes and prejudices," we held that the employer's "undisciplined system of subjective decisionmaking" was an "employment practic[e]" that "may be analyzed under the disparate impact approach." *Id.,* at 990–991, 108 S.Ct. 2777. See also *Wards Cove Packing Co. v. Atonio,* 490 U.S. 642, 657, 109 S.Ct. 2115, 104 L.Ed.2d 733 (1989) (recognizing "the use of 'subjective decision making' " as an "employment practic[e]" subject to disparate-impact attack).

The plaintiffs' allegations state claims of gender discrimination in the form of biased decisionmaking in both pay and promotions. The evidence reviewed by the District Court adequately demonstrated that resolving those claims would necessitate examination of particular policies and practices alleged to affect, adversely and globally, women employed at Wal–Mart's stores. Rule 23(a)(2), setting a necessary but not a sufficient criterion for class-action certification, demands nothing further.

## II

### A

The Court gives no credence to the key dispute common to the class: whether Wal–Mart's discretionary pay and promotion policies are discriminatory. See *ante,* at 2551 ("Reciting" questions like "Is [giving managers discretion over pay] an unlawful employment practice?" "is not sufficient to obtain class certification."). "What matters," the Court asserts, "is not the raising of common 'questions,' " but whether there are "[d]issimilarities within the proposed class" that "have the potential to impede the generation of common answers." *Ante,* at 2551 (quoting Nagareda, Class Certification in the Age of Aggregate Proof, 84 N.Y.U.L.Rev. 97, 132 (2009); some internal quotation marks omitted).

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The Court blends Rule 23(a)(2)'s threshold criterion with the more demanding criteria of Rule 23(b)(3), and thereby elevates the (a)(2) inquiry so that it is no longer "easily satisfied," 5 J. Moore et al., Moore's Federal Practice § 23.23[2], p. 23–72 (3d ed.2011).[7] Rule 23(b)(3) certification ***2566** requires, in addition to the four 23(a) findings, determinations that "questions of law or fact common to class members predominate over any questions affecting only individual members" and that "a class action is superior to other available methods for ... adjudicating the controversy."[8]

The Court's emphasis on differences between class members mimics the Rule 23(b)(3) inquiry into whether common questions "predominate" over individual issues. And by asking whether the individual differences "impede" common adjudication, *ante,* at 2551 – 2552 (internal quotation marks omitted), the Court duplicates 23(b)(3)'s question whether "a class action is superior" to other modes of adjudication. Indeed, Professor Nagareda, whose "dissimilarities" inquiry the Court endorses, developed his position in the context of Rule 23(b)(3). See 84 N.Y.U.L.Rev., at 131 (Rule 23(b)(3) requires "some decisive degree of similarity across the proposed class" because it "speaks of common 'questions' that 'predominate' over individual ones").[9] "The Rule 23(b)(3) predominance inquiry" is meant to "tes[t] whether proposed classes are sufficiently cohesive to warrant adjudication by representation." *Amchem Products, Inc. v. Windsor,* 521 U.S. 591, 623, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997). If courts must conduct a "dissimilarities" analysis at the Rule 23(a)(2) stage, no mission remains for Rule 23(b)(3).

Because Rule 23(a) is also a prerequisite for Rule 23(b)(1) and Rule 23(b)(2) classes, the Court's "dissimilarities" position is far reaching. Individual differences should not bar a Rule 23(b)(1) or Rule 23(b)(2) class, so long as the Rule 23(a) threshold is met. See *Amchem Products,* 521 U.S., at 623, n. 19, 117 S.Ct. 2231 (Rule 23(b)(1)(B) "does not have a predominance requirement"); *Yamasaki,* 442 U.S., at 701, 99 S.Ct. 2545 (Rule 23(b)(2) action in which the Court noted that "[i]t is unlikely that differences in the factual background of each claim will affect the outcome of the legal issue"). For example, in *Franks v. Bowman Transp. Co.,* 424 U.S. 747, 96 S.Ct. 1251, 47 L.Ed.2d 444 (1976), a Rule 23(b)(2) class of African–American truckdrivers complained that the defendant had ***2567** discriminatorily refused to hire black applicants. We recognized that the "qualification[s] and performance" of individual class members might vary. *Id.*, at 772, 96 S.Ct. 1251 (internal quotation marks omitted). "Generalizations concerning such individually applicable evidence," we cautioned, "cannot serve as a justification for the denial of [injunctive] relief to the entire class." *Ibid.*

B

The "dissimilarities" approach leads the Court to train its attention on what distinguishes individual class members, rather than on what unites them. Given the lack of standards for pay and promotions, the majority says, "demonstrating the invalidity of one manager's use of discretion will do nothing to demonstrate the invalidity of another's." *Ante,* at 2554.

Wal–Mart's delegation of discretion over pay and promotions is a policy uniform throughout all stores. The very nature of discretion is that people will exercise it in various ways. A system of delegated discretion, *Watson* held, is a practice actionable under Title VII when it produces discriminatory outcomes. 487 U.S., at 990–991, 108 S.Ct. 2777; see *supra,* at 2564 – 2565. A finding that Wal–Mart's pay and promotions practices in fact violate the law would be the first step in the usual order of proof for plaintiffs seeking individual remedies for company-wide discrimination. *Teamsters v. United States,* 431 U.S. 324, 359, 97 S.Ct. 1843, 52 L.Ed.2d 396 (1977); see *Albemarle Paper Co. v. Moody,* 422 U.S. 405, 415–423, 95 S.Ct. 2362, 45 L.Ed.2d 280 (1975). That each individual employee's unique circumstances will ultimately determine whether she is entitled to backpay or damages, § 2000e–5(g)(2)(A) (barring backpay if a plaintiff "was refused ... advancement ... for any reason other than discrimination"), should not factor into the Rule 23(a)(2) determination.

* * *

The Court errs in importing a "dissimilarities" notion suited to Rule 23(b)(3) into the Rule 23(a) commonality inquiry. I therefore cannot join Part II of the Court's opinion.

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112 Fair Empl.Prac.Cas. (BNA) 769, 94 Empl. Prac. Dec. P 44,193, 180 L.Ed.2d 374, 79 USLW 4527, 161 Lab.Cas. P 35,919, 78 Fed.R.Serv.3d 1460, 11 Cal. Daily Op. Serv. 7485, 2011 Daily Journal D.A.R. 8986, 22 Fla. L. Weekly Fed. S 1167

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

1 The complaint included seven named plaintiffs, but only three remain part of the certified class as narrowed by the Court of Appeals.

2 Rule 23(b)(1) allows a class to be maintained where "prosecuting separate actions by or against individual class members would create a risk of" either "(A) inconsistent or varying adjudications," or "(B) adjudications ... that, as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impeded their ability to protect their interests." Rule 23(b)(3) states that a class may be maintained where "questions of law or fact common to class members predominate over any questions affecting only individual members," and a class action would be "superior to other available methods for fairly and efficiently adjudicating the controversy." The applicability of these provisions to the plaintiff class is not before us.

3 The District Court excluded backpay claims based on promotion opportunities that had not been publicly posted, for the reason that no applicant data could exist for such positions. 222 F.R.D. 137, 182 (N.D.Cal.2004). It also decided to afford class members notice of the action and the right to opt-out of the class with respect to respondents' punitive-damages claim. *Id.,* at 173.

4 To enable that result, the Court of Appeals trimmed the (b)(2) class in two ways: First, it remanded that part of the certification order which included respondents' punitive-damages claim in the (b)(2) class, so that the District Court might consider whether that might cause the monetary relief to predominate. 603 F.3d, at 621. Second, it accepted in part Wal–Mart's argument that since class members whom it no longer employed had no standing to seek injunctive or declaratory relief, as to them monetary claims must predominate. It excluded from the certified class "those putative class members who were no longer Wal–Mart employees *at the time Plaintiffs' complaint was filed,*" *id.,* at 623 (emphasis added).

5 We have previously stated in this context that "[t]he commonality and typicality requirements of Rule 23(a) tend to merge. Both serve as guideposts for determining whether under the particular circumstances maintenance of a class action is economical and whether the named plaintiff's claim and the class claims are so interrelated that the interests of the class members will be fairly and adequately protected in their absence. Those requirements therefore also tend to merge with the adequacy-of-representation requirement, although the latter requirement also raises concerns about the competency of class counsel and conflicts of interest." *General Telephone Co. of Southwest v. Falcon,* 457 U.S. 147, 157–158, n. 13, 102 S.Ct. 2364, 72 L.Ed.2d 740 (1982). In light of our disposition of the commonality question, however, it is unnecessary to resolve whether respondents have satisfied the typicality and adequate-representation requirements of Rule 23(a).

6 A statement in one of our prior cases, *Eisen v. Carlisle & Jacquelin,* 417 U.S. 156, 177, 94 S.Ct. 2140, 40 L.Ed.2d 732 (1974), is sometimes mistakenly cited to the contrary: "We find nothing in either the language or history of Rule 23 that gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." But in that case, the judge had conducted a preliminary inquiry into the merits of a suit, not in order to determine the propriety of certification under Rules 23(a) and (b) (he had already done that, see *id.,* at 165, 94 S.Ct. 2140), but in order to shift the cost of notice required by Rule 23(c)(2) from the plaintiff to the defendants. To the extent the quoted statement goes beyond the permissibility of a merits inquiry for any other pretrial purpose, it is the purest dictum and is contradicted by our other cases.

Perhaps the most common example of considering a merits question at the Rule 23 stage arises in class-action suits for securities fraud. Rule 23(b)(3)'s requirement that "questions of law or fact common to class members predominate over any questions affecting only individual members" would often be an insuperable barrier to class certification, since each of the individual investors would have to prove reliance on the alleged misrepresentation. But the problem dissipates if the plaintiffs can establish the applicability of the so-called "fraud on the market" presumption, which says that all traders who purchase stock in an efficient market are presumed to have relied on the accuracy of a company's public statements. To invoke this presumption, the plaintiffs seeking 23(b)(3) certification must prove that their shares were traded on an efficient market, *Erica P. John Fund, Inc. v. Halliburton Co.,* 563 U.S. ——, ——, 131 S.Ct. 2179, 2185, 180 L.Ed.2d 24, 2011 WL 2175208 (2011) (slip op., at 5), an issue they will surely have to prove *again* at trial in order to make out their case on the merits.

7 In a pattern-or-practice case, the plaintiff tries to "establish by a preponderance of the evidence that ... discrimination was the company's standard operating procedure[,] the regular rather than the unusual practice." *Teamsters v. United States,* 431 U.S. 324,

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358, 97 S.Ct. 1843, 52 L.Ed.2d 396 (1977); see also *Franks v. Bowman Transp. Co.,* 424 U.S. 747, 772, 96 S.Ct. 1251, 47 L.Ed.2d 444 (1976). If he succeeds, that showing will support a rebuttable inference that all class members were victims of the discriminatory practice, and will justify "an award of prospective relief," such as "an injunctive order against the continuation of the discriminatory practice." *Teamsters,supra,* at 361, 97 S.Ct. 1843.

8 Bielby's conclusions in this case have elicited criticism from the very scholars on whose conclusions he relies for his social-framework analysis. See Monahan, Walker, & Mitchell, Contextual Evidence of Gender Discrimination: The Ascendance of "Social Frameworks," 94 Va. L.Rev. 1715, 1747 (2008) ("[Bielby's] research into conditions and behavior at Wal–Mart did not meet the standards expected of social scientific research into stereotyping and discrimination"); *id.,* at 1745, 1747 ("[A] social framework necessarily contains only general statements about reliable patterns of relations among variables ... and goes no further .... Dr. Bielby claimed to present a social framework, but he testified about social facts specific to Wal–Mart"); *id.,* at 1747–1748 ("Dr. Bielby's report provides no verifiable method for measuring and testing any of the variables that were crucial to his conclusions and reflects nothing more than Dr. Bielby's 'expert judgment' about how general stereotyping research applied to all managers across all of Wal–Mart's stores nationwide for the multi-year class period").

9 The dissent says that we have adopted "a rule that a discrimination claim, if accompanied by anecdotes, must supply them in numbers proportionate to the size of the class." *Post,* at 2563, n. 4 (GINSBURG, J., concurring in part and dissenting in part). That is not quite accurate. A discrimination claimant is free to supply as few anecdotes as he wishes. But when the claim is that a company operates under a general policy of discrimination, a few anecdotes selected from literally millions of employment decisions prove nothing at all.

10 For this reason, there is no force to the dissent's attempt to distinguish *Falcon* on the ground that in that case there were " '*no* common questions of law or fact' between the claims of the lead plaintiff and the applicant class" *post,* at 2565 – 2566, n. 7 (quoting *Falcon,* 457 U.S., at 162, 102 S.Ct. 2364 (BURGER, C.J., concurring in part and dissenting in part)). Here also there is nothing to unite all of the plaintiffs' claims, since (contrary to the dissent's contention, *post,* at 2565 – 2566, n. 7), the same employment practices do not "touch and concern all members of the class."

11 Rule 23(b)(1) applies where separate actions by or against individual class members would create a risk of "establish[ing] incompatible standards of conduct for the party opposing the class," Rule 23(b)(1)(A), such as "where the party is obliged by law to treat the members of the class alike," *Amchem Products, Inc. v. Windsor,* 521 U.S. 591, 614, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997), or where individual adjudications "as a practical matter, would be dispositive of the interests of the other members not parties to the individual adjudications or would substantially impair or impede their ability to protect their interests," Rule 23(b)(1)(B), such as in " 'limited fund' cases, ... in which numerous persons make claims against a fund insufficient to satisfy all claims," *Amchem, supra,* at 614, 117 S.Ct. 2231.

1 The plaintiffs requested Rule 23(b)(3) certification as an alternative, should their request for (b)(2) certification fail. Plaintiffs' Motion for Class Certification in No. 3:01–cv–02252–CRB (ND Cal.), Doc. 99, p. 47.

2 Rule 23(a) lists three other threshold requirements for class-action certification: "(1) the class is so numerous that joinder of all members is impracticable"; "(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class." The numerosity requirement is clearly met and Wal–Mart does not contend otherwise. As the Court does not reach the typicality and adequacy requirements, *ante,* at 2551, n. 5, I will not discuss them either, but will simply record my agreement with the District Court's resolution of those issues.

3 The Court suggests Rule 23(a)(2) must mean more than it says. See *ante,* at 2550 – 2552. If the word "questions" were taken literally, the majority asserts, plaintiffs could pass the Rule 23(a)(2) bar by "[r]eciting ... questions" like "Do all of us plaintiffs indeed work for Wal–Mart?" *Ante,* at 2551. Sensibly read, however, the word "questions" means disputed issues, not any utterance crafted in the grammatical form of a question.

4 The majority purports to derive from *Teamsters v. United States,* 431 U.S. 324, 97 S.Ct. 1843, 52 L.Ed.2d 396 (1977), a rule that a discrimination claim, if accompanied by anecdotes, must supply them in numbers proportionate to the size of the class. *Ante,* at 17–18. *Teamsters,* the Court acknowledges, see *ante,* at 2556, n. 9, instructs that statistical evidence alone may suffice, 431 U.S., at 339, 97 S.Ct. 1843; that decision can hardly be said to establish a numerical floor before anecdotal evidence can be taken into account.

5 The Court asserts that Drogin showed only average differences at the "regional and national level" between male and female employees. *Ante,* at 2555 (internal quotation marks omitted). In fact, his regression analyses showed there were disparities *within* stores. The majority's contention to the contrary reflects only an arcane disagreement about statistical method—which the District Court resolved in the plaintiffs' favor. 222 F.R.D. 137, 157 (N.D.Cal.2004). Appellate review is no occasion to disturb a trial court's handling of factual disputes of this order.

6 An example vividly illustrates how subjective decisionmaking can be a vehicle for discrimination. Performing in symphony orchestras was long a male preserve. Goldin and Rouse, Orchestrating Impartiality: The Impact of "Blind" Auditions on Female Musicians, 90 Am. Econ. Rev. 715, 715–716 (2000). In the 1970's orchestras began hiring musicians through auditions open to all comers. *Id.*, at 716. Reviewers were to judge applicants solely on their musical abilities, yet subconscious bias led some reviewers to disfavor women. Orchestras that permitted reviewers to see the applicants hired far fewer female musicians than orchestras that conducted blind auditions, in which candidates played behind opaque screens. *Id.*, at 738.

7 The Court places considerable weight on *General Telephone Co. of Southwest v. Falcon,* 457 U.S. 147, 102 S.Ct. 2364, 72 L.Ed.2d 740 (1982). *Ante,* at 2553. That case has little relevance to the question before the Court today. The lead plaintiff in *Falcon* alleged discrimination evidenced by the company's failure to promote him and other Mexican–American employees and failure to hire Mexican–American applicants. There were "*no* common questions of law or fact" between the claims of the lead plaintiff and the applicant class. 457 U.S., at 162, 102 S.Ct. 2364 (Burger, C. J., concurring in part and dissenting in part) (emphasis added). The plaintiff-employee alleged that the defendant-employer had discriminated against him intentionally. The applicant class claims, by contrast, were "advanced under the 'adverse impact' theory," *ibid.*, appropriate for facially neutral practices. "[T]he only commonality [wa]s that respondent is a Mexican–American and he seeks to represent a class of Mexican–Americans." *Ibid.* Here the same practices touch and concern all members of the class.

8 "A class action may be maintained if Rule 23(a) is satisfied and if:

"(1) prosecuting separate actions by or against individual class members would create a risk of ... inconsistent or varying adjudications ... [or] adjudications with respect to individual class members that, as a practical matter, would be dispositive of the interests of the other members ...;

"(2) the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief ... is appropriate respecting the class as a whole; or

"(3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." Fed. Rule Civ. Proc. 23(b) (paragraph breaks added).

9 Cf. *supra,* at 2545 (Rule 23(a) commonality prerequisite satisfied by "[e]ven a single question ... common to the members of the class" (quoting Nagareda, The Preexistence Principle and the Structure of the Class Action, 103 Colum. L.Rev. 149, 176, n. 110 (2003).

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# TAB 3

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United States District Court,
N.D. California.

DUKES, et al., Plaintiffs,
v.
WAL–MART STORES, INC., Defendant.

No. C 01–02252 CRB. | Sept. 21, 2012.

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**Opinion**

**ORDER DENYING MOTION TO DISMISS**

CHARLES R. BREYER, District Judge.

**INTRODUCTION**

*1 More than a decade ago, this class action was filed alleging gender discrimination by Wal–Mart against female employees, but the claims have yet to be tried. Instead, the focus of this Court, the Ninth Circuit sitting *en Banc,* and most recently the Supreme Court has been on whether a nationwide class action is an appropriate vehicle for the adjudication of the plaintiffs' claims. The Supreme Court held that it is not.

Plaintiffs have since amended their complaint for the fourth time. Those amendments cut down the proposed size of the class from 1.5 million to somewhere between one and several-hundred thousand prospective members, added information about Wal–Mart's corporation management structure, and alleged specific examples of discriminatory conduct. Wal–Mart now moves to dismiss, arguing chiefly that the newly proposed class suffers—albeit on a smaller scale—from the same kinds of problems that the Supreme Court said barred nationwide class certification.

With rare exceptions, the appropriate vehicle for testing the sufficiency of class allegations is a motion for class certification. This case is not one of the exceptions. Because Plaintiffs have proposed a class that could be certified if a showing consistent with the Supreme Court's decision were made, this Order reserves for later determination whether Plaintiffs' evidence suffices under Rule 23.

**I. FACTUAL & PROCEDURAL BACKGROUND**

This case began in June 2001, when Plaintiffs brought suit on behalf of a nationwide class of female employees against Wal–Mart, alleging widespread gender discrimination. This Court certified a nationwide class, which the Ninth Circuit, sitting *en Banc,* affirmed in large part. The Supreme Court reversed the certification of the nationwide class on June 20, 2011. *Wal–Mart Stores, Inc. v. Dukes,* — U.S. ——, 131 S.Ct. 2541, 180 L.Ed.2d 374 (2011).

The Supreme Court found that Plaintiffs had provided insufficient evidence of commonality among the 1.5 million female class members to satisfy FRCP 23(a). *Wal–Mart Stores, Inc. v. Dukes,* — U.S. ——, —— – ——, ——, 131 S.Ct. 2541, 2555–56, 2561, 180 L.Ed.2d 374 (2011). Pertinent here, the Court held that plaintiffs alleging a "pattern or practice" of discrimination "conceivably could" satisfy Rule 23's commonality requirement by offering "significant proof that an employer operate[s] under a general policy of discrimination ... if the discrimination manifested itself in hiring and promotion practices in the same general fashion, such as through entirely subjective decisionmaking processes," but found Plaintiffs' sociological evidence on that issue wanting. *Id.* at 2553–54.

As for Plaintiffs' "disparate impact" claims, the Court identified specific shortcomings in Plaintiffs'

evidence—shortcomings which could, in theory, be addressed. For example, the statistical evidence identified disparities at the regional and national levels, but not the store and district levels. *Id.* at 2555. Additionally, the number of anecdotes amassed was relatively small relative to the size of the class. *Id.* at 2556.

***2** Importantly, the Court emphasized that plugging the statistical and anecdotal holes would be necessary but not sufficient. Plaintiffs had also failed to identify a "specific employment practice" besides delegated discretion that established a "common mode of exercising discretion that pervade[d] the entire company." *Id.* at 2554–55. On that point, the Court rejected Plaintiffs' sociological expert's claim that Wal–Mart had a "strong corporate culture" making it vulnerable to gender bias, finding unacceptable the expert's concession that he could not say "whether 0.5 percent or 95 percent of the employment decisions at WalMart might be determined by stereotyped thinking." *Id.* at 2554–55.

The Court's second major holding determined that Plaintiffs' claims for backpay were improperly certified under Federal Rule of Civil Procedure 23(b)(2). The Court held that claims for monetary relief may not be certified under Rule 23(b)(2) "when the monetary relief is not incidental to the injunctive or declaratory relief." *Id.* at 2557. The Court explained that "Rule 23(b)(2) applies only when a single injunction or declaratory judgment would provide relief to each member of the class .... it does not authorize class certification when each class member would be entitled to an individualized award of monetary damages." *Id.*

Following the Supreme Court's decision, Plaintiffs narrowed the scope of the proposed classes to present and former female Wal–Mart employees who have been subjected to gender discrimination within four regions largely based in California, in contrast to the 41 regions that comprised the nationwide class. *Compare* Fourth Amendment Complaint ("FAC") ¶ ¶ 15, 31 *with Dukes,* 222 F.R.D. at 145. According to the FAC, in these four regions "[m]ost of these districts [are] comprised entirely of California stores." FAC ¶ 31. Plaintiffs have also excluded women holding Store Manager positions and licensed pharmacists from the proposed classes. *Id.* ¶ 15.

## II. LEGAL STANDARD

Wal–Mart now moves to dismiss or strike the class allegations from the FAC. A plaintiff must plead "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). "Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* A Rule 12(b)(6) motion considers whether the allegations are "sufficient to cross the federal court's threshold," not whether plaintiffs "will ultimately prevail" on their Title VII claim. *Skinner v. Switzer,* —— U.S. ——, ——, 131 S.Ct. 1289, 1296, 179 L.Ed.2d 233 (2011) (citations and internal quotations omitted).

A motion to dismiss must be denied where plaintiffs plead " 'enough facts to state a claim to relief that is plausible on its face,' " which requires pleading "factual content that allows the court to draw the reasonable inferences that the defendant is liable for the misconduct alleged." *Haggarty v. Wells Fargo Bank,* No. 10–02416, 2011 WL 445183, at *2 (N.D.Cal. Feb.2, 2011) (quoting *Ashcroft,* 556 U.S. at 678).

***3** Although a complaint "may not simply recite the elements of a cause of action," in order to credit its allegations, the complaint only needs to "contain sufficient allegations of underlying facts to give fair notice and to enable the opposing party to defend itself effectively." *Starr v. Baca,* 652 F.3d 1202, 1216 (9th Cir.2011) (as amended); *accord Haggarty,* 2011 WL 445183, at *2 (court "must presume all factual allegations of the complaint to be true and draw all reasonable inferences in favor of the nonmoving party" (internal citations and quotations omitted)). "[T]he factual allegations that are taken as true must plausibly suggest an entitlement to relief, such that it is not unfair to require the opposing party to be subjected to the expense of discovery and continued litigation." *Starr,* 652 F.3d at 1216.

Rule 23 requires more than adequate pleading. *See Dukes,* 131 S.Ct. at 2551 ("A party seeking class certification must affirmatively demonstrate his compliance with the Rule-that is he must be prepared to prove that there are *in fact* sufficiently numerous parties, common questions of law or fact, etc."). Accordingly, the Ninth Circuit recognizes that "the better and more advisable practice for a District Court to follow is to afford the litigants an opportunity to present evidence as to whether a class action was maintainable," because "often the pleadings alone will not resolve the question of class certification." *Vinole v. Countrywide Home Loans, Inc.,* 571 F.3d 935, 942 (9th Cir.2009) (quoting *Doninger v. Pac. Nw. Bell, Inc.,* 564 F.2d 1304, 1313 (9th Cir.1977)).

Rule 12(f) of the Federal Rules of Civil Procedure states a district court "may strike from a pleading an insufficient

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defense or any redundant, immaterial, impertinent, or scandalous matter." Fed.R.Civ.P. 12(f). "When considering a motion to strike, a court must view the pleadings in the light most favorable to the non-moving party." *Collins,* 2010 WL 3077671, at *2. A court must deny a motion to strike if there is any doubt whether the allegations in the pleadings might be relevant to the action. *In re 2TheMart.com, Inc. Sec. Lit.,* 114 F.Supp.2d 955, 965 (C.D.Cal.2000).

Motions to strike class allegations are disfavored and rarely granted, see *In re Wal–Mart Stores, Inc. Wage & Hour Litig.,* 505 F.Supp.2d 609, 615 (N.D.Cal.2007); Wright et al., *Federal Practice & Procedure* § 1785.3 at n. 34 (2d ed.2002), though claims may be stricken or dismissed "if it is clear from the complaint that the class claims cannot be maintained." *Collins v. Gamestop Corp.,* No. 10–1210, 2010 WL 3077671, at *2 (N.D.Cal. Aug.6, 2010) (citing *Sanders v. Apple, Inc.,* 672 F.Supp.2d 978, 990–91 (N.D.Cal.2009)).

Wal–Mart contends that the unique posture of this case—ten years of litigation, an opportunity at discovery already provided, and a Supreme Court decision rejecting a larger version of the proposed class—brings it within the small group of cases warranting a ruling on the class allegations prior to a motion for certification. Plaintiffs cannot, however, be faulted for failing to anticipate a significant development in the Supreme Court's class-action jurisprudence, and so long as discovery might permit them to meet the Rule 23 obligations clarified by the Supreme Court's ruling, this Court is not prepared to deny them an opportunity to marshal and present evidence in support of their class allegations.

## III. DISCUSSION

*4 Wal–Mart argues: (1) the Supreme Court's mandate forecloses the proposed certification; (2) the class allegations do not satisfy Rule 23(a); (3) *American Pipe* tolling no longer applies to the class claims; (4) the Plaintiffs' coattailing arguments are insufficient to satisfy Title VII's EEOC charge filing requirements; and (5) the proposed class violates Title VII's particularized venue requirements.

### A. Class Allegations and Rule 23(a) Commonality

Wal–Mart makes two arguments regarding commonality and the class allegations in the Motion to Dismiss. First, Wal–Mart argues that the Supreme Court decision itself prevents relitigation of the certification issue as a violation of the mandate of that decision. Second, Wal–Mart argues that even if the allegations are considered, the Supreme Court decision precludes a finding of commonality under the new allegations in the FAC because there is still no "common question" holding the purported class together.

#### 1. Mandate

Wal–Mart says that since the Supreme Court did not remand the case for any further class proceedings, all that remains is for this Court to adjudicate the individual claims of the Named Plaintiffs. Justice Ginsburg stated in her dissent that she would reserve the matter of whether Plaintiffs met Rule 23(b)(3) requirements for consideration and decision on remand. 131 S.Ct. at 2561 (Ginsburg, J., concurring in part and dissenting in part). Wal–Mart, citing *Clemons v. Mississippi,* 494 U.S. 738, 759 n. 3, 110 S.Ct. 1441, 108 L.Ed.2d 725 (1990), argues that the majority's failure to remand the case was a rejection of that position.

Rule 23 "confers broad discretion to determine whether a class should be certified, and to revisit that certification throughout the legal proceedings before the court." *Kanawi v. Bechtel Corp.,* 254 F.R.D. 102, 106–107 (N.D.Cal.2008) (quoting *Armstrong v. Davis,* 275 F.3d 849, 872 n. 28 (9th Cir.2001). Rule 23(c)(1)(c) provides that "[a]n order that grants or denies class certification may be altered or amended before final judgment." The Supreme Court has stated that when a court denies certification of a class it would expect that court to reassess and revise such an order in response to events "occurring in the ordinary course of litigation." *Gulfstream Aerospace Corp. v. Mayacamas Corp.,* 485 U.S. 271, 277, 108 S.Ct. 1133, 99 L.Ed.2d 296 (1988). Accordingly, it is not uncommon for district courts to permit renewed certification motions that set out a narrower class definition or that rely upon different evidence or legal theories. *E.g., The Apple iPod iTunes Antitrust Litig.,* No. 05–0037, 2011 WL 5864036, at *1–2, *4 (N.D.Cal. Nov.22, 2011).

An appellate ruling rejecting class certification does not change this ability to consider a renewed certification motion. For example, in *In re Initial Public Offering Securities Litigation,* 483 F.3d 70, 73 (2d Cir.2007), the Second Circuit stated that its earlier order reversing certification of broad classes without further instruction did not bar the district court from considering different or narrower proposed classes in the same action, because district courts "have ample discretion to consider (or decline to consider) a revised class certification motion after an initial denial." *See also Ellis v. Costco Wholesale Corp.,* 657 F.3d 970, 987–88 (9th Cir.2011) (reversing

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certification but noting district court may consider whether a different type of class could be certified).

*5 Wal–Mart responds that in those cases the court explicitly allowed a remand, which the Supreme Court did not do here. The Supreme Court mandate stated the "judgment of the Court of Appeals is *Reversed.*" *Dukes,* 131 S.Ct. at 2561. Wal–Mart argues this settles the matter, and there are no more Rule 23 issues for this Court to resolve. Reply (dkt.795) at 2.

That argument is in conflict with this Circuit's precedent. "According to the rule of mandate, although lower courts are obliged to execute the terms of a mandate, they are free as to anything not foreclosed by the mandate, and, under certain circumstances, an order issued after remand may deviate from the mandate if it is not counter to the spirit of the circuit court's decision." *United States v. Kellington,* 217 F.3d 1084, 1092–93 (9th Cir.2000) (internal quotation marks, ellipses, and citations omitted). The "rule of mandate is designed to permit flexibility where necessary, not to prohibit it," *id.* at 1095 n. 12, and the "ultimate task is to distinguish matters that have been decided on appeal, and are therefore beyond the jurisdiction of the lower court, from matters that have not." *Id.* at 1093.

The failure of the Supreme Court to explicitly remand the case is not dispositive. The Ninth Circuit has expressly held that failure to explicitly remand the case does not necessarily curtail the discretion of the district court. *See, e.g., United States v. Cote,* 51 F.3d 178, 181–83 (9th Cir.1995); *Lindy Pen Co., Inc. v. Bic Pen Corp.,* 982 F.2d 1400, 1404–05 (9th Cir.1993); *Caldwell v. Puget Sound Electrical Apprenticeship & Training* Trust, 824 F.2d 765, 767 (9th Cir.1987).

The Supreme Court decided whether Plaintiffs' evidence established that there was a general policy of discrimination throughout Wal–Mart's operations nationwide. The answer was no. Plaintiffs now bring a narrower class-action claim, which the Supreme Court has yet to consider and did not foreclose.

**2. Commonality and the FAC**

In Wal–Mart's view, the Supreme Court rejected Plaintiffs' theory that delegated discretion and disparate impact could support a nationwide class claim under any of Plaintiffs' causes of action, and the FAC simply rehashes these same theories with a slightly smaller, but still fatally heterogenous, subgroup.

To be sure, the basic theory of Plaintiffs' claims has changed little, but for both the pattern or practice and disparate impact claims, the Supreme Court's decision rested not on a total rejection of plaintiffs' theories, but on the inadequacy of their proof. *See Dukes,* 131 S.Ct. at 2553 ("significant proof ... entirely absent"); *id.* at 2554–55 (no "common mode of exercising discretion" identified without rejected sociological evidence); *see also Ellis v. Costco Wholesale Corp.,* 657 F.3d 970, 983 (9th Cir.2011) ("If there is no *evidence* that the entire class was subject to the same allegedly discriminatory practice, there is no question common to the class." (emphasis added) (citing *Dukes,* 131 S.Ct. at 2553)).

*6 Plaintiffs say they can now provide that proof. The FAC alleges a culture and philosophy of gender bias shared by the relevant decisionmakers. *See* FAC ¶¶ 71–82. For example, Plaintiffs say that all California store managers are required to attend centralized management training where they are told that the gender disparity in senior management is attributable to men being "more aggressive in achieving those levels of responsibility," and are cautioned that efforts to promote women could lead to the selection of less qualified candidates. *Id.* ¶ 74. Plaintiffs also allege that at a meeting of all District Managers, WalMart's CEO made statements that could be interpreted as communicating that men had traits that were more likely to make them successful. *Id.* ¶ 75.

Wal–Mart argues with some force that the persisting heterogeneity of the proposed class makes unlikely a showing of commonality under any theory. The class encompasses the "California Regions," which by definition includes distinct regional policies. While Plaintiffs have focused their challenge on the allegedly biased decisions made by a group of Regional, District and Store Managers, they still must prove that every decisionmaker in that group-perhaps four hundred or so under the corporate structure alleged, *see* FAC ¶ ¶ 24, 29, 30, 31, 35–operated under a common policy or mode of decisionmaking. But Plaintiffs have not yet had an opportunity to present their evidence on these issues, which do not fail as a matter of law.

**B. *American Pipe* Tolling**

The parties dispute whether the Supreme Court's decertification of the national class prevents the absent members of the FAC's proposed class from continuing to benefit from the tolling of the statute of limitations. The law on this issue is unsettled. The Supreme Court has held that the filing of a purported class action in federal court tolls the running of the statute of limitations as to the claims of all putative class members until a decision is reached whether to certify the class. *See Am. Pipe &*

*Const. Co. v. Utah,* 414 U.S. 538, 554, 94 S.Ct. 756, 38 L.Ed.2d 713 (1974); *see also Crown, Cork & Seal Co., Inc. v. Parker,* 462 U.S. 345, 353–54, 103 S.Ct. 2392, 76 L.Ed.2d 628 (1983). It is clear that once a proposed class is rejected or decertified, absent members of the rejected class may preserve their claims by intervening in the original suit or by filing separate actions. *Crown,* 462 U.S. at 354.

Less clear is whether the absent class members' claims can be tolled by the pursuit of a follow-on class action. Some circuits, noting the potential for infinite "stacking" of classactions, have categorically refused to permit tolling in subsequent class actions by putative members of the original asserted class. *E.g., Griffin v. Singletary,* 17 F.3d 356 (11th Cir.1994). Others scrutinize more closely the reason for the failure of the first class, and permit tolling where the denial of the first class certification was "based on deficiencies of a class representative, and not on the validity of the class itself." *Yang v. Odom,* 392 F.3d 97, 107 (3d Cir.2004).

*7 The controlling Ninth Circuit case, *Catholic Soc. Servs., Inc. v. I.N.S ("CSS" ),* 232 F.3d 1139 (9th Cir.2000) (en banc), leaves room for debate. The case's procedural history was complex: the district court certified a class and granted judgment for the plaintiffs (*CSS I* ), and the Ninth Circuit affirmed (*CSS II* ), but the Supreme Court vacated on ripeness grounds (*CSS III* ); the Ninth Circuit then remanded the case back to the district court for proceedings consistent with the Supreme Court's opinion (*CSS IV* ). *Id.* at 1143.

The district court (acting on a seventh amended complaint) certified a new class, but a Ninth Circuit panel reversed based on a recent statutory enactment that stripped the courts of jurisdiction over certain claims, and remanded to the district court with instructions to dismiss the suit with prejudice (*CSS V* ). The plaintiffs then filed a new class action in the district court, and the district court certified the new class, finding the claims not time barred. On appeal, a Ninth Circuit panel reversed and held the claims time barred (*CSS VI* ), but the *en Banc* court vacated the panel opinion and took up the issue. *Id.* at 1145.

As a threshold matter, the *en Banc* court said the timeliness question could have been avoided if the prior appellate panel (*CSS V* ), instead of remanding to the district court with instructions to dismiss that complaint, had remanded "to allow amendment of the complaint to deal with the new reality that had been created by the [recent statutory enactment] while the case was on appeal." *Id.* at 1146. The court noted that "[i]f the panel in *CSS V* had allowed such amendment, there would be no tolling and class certification issues." *Id.*

Moving on to the merits, the court agreed with other circuits that subsequent class actions that "seek[ ] to relitigate the correctness" of the earlier class action decision were improper. *Id.* at 1147. Finding it significant that the second class action had been narrowed "for reasons unrelated to Rule 23"—*i.e .,* ripeness and a new statute—and was not seeking to relitigate any prior adverse decision, the court held that the claims of the plaintiffs in the second class action were not time barred. *Id.* at 1149.

Plaintiffs here say that because their amended complaint is a continuation of the same case, and not a second class-action filed after an initial attempt at certification has been definitively rejected through dismissal, *Catholic Social Services* instructs that "no tolling issues ... arise." Wal–Mart makes no attempt to argue that the substantive import of that language in *Catholic Social Services* is something besides what plaintiffs suggest; instead, Wal–Mart says it is *dicta* that should be ignored, Reply Br. at 10, because amending an initial complaint and filing a new suit "present the same concerns." Supp. Mot. at 4 n. 2 (citing *Fleck v. Cablevision VII, Inc.,* 807 F.Supp. 824, 827 (D.D.C.1992)).

*8 The Court is less sanguine about the wisdom of ignoring the (*en Banc* ) Ninth Circuit's discussion of this very issue. This was not a sentence fragment tucked away in a footnote, but a full paragraph positioned at the introduction the opinion's analysis of the tolling issue, framed as a exhortation to future courts:

> We believe that it would have been by far the better course for the panel in *CSS V* to remand with instructions to allow amendment of the complaint to satisfy requirements imposed for the first time while the case was on appeal. If the panel in *CSS V* had allowed such amendment, there would be no tolling and class certification issues. But because the panel ordered the dismissal of the action in *CSS V,* plaintiffs were obliged to file a new action rather than allowed to continue their pending action.

232 F.3d at 1146. Indeed, the court reiterated the point later in its analysis. *Id.* at 1149 ("Doubtless, [plaintiffs]

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would also have amended their complaint promptly ... if the panel in *CSS V* had given them an opportunity to do so.").

Nor is it true that that a second attempt at certification via amended complaint and a second, separately filed action are functionally identical. *Cf. Fleck,* 807 F.Supp. at 827. In the former situation, the *court* decides whether plaintiffs should be permitted to amend the complaint and proceed, while a rule permitting tolling whenever *plaintiffs* decide to file a new action leaves more room for abuse. *Accord In re Initial Pub. Offering Sec. Litig.,* 617 F.Supp.2d 195, 199–200 (S.D.N.Y.2007); *Coleman v. GMAC,* 220 F.R.D. 64, 96–97 (M.D.Tenn.2004); *cf. Andrews v. Orr,* 851 F.2d 146, 150 (6th Cir.1988) (leaving open possibility that renewed certification motion would toll statute), *overruled on other grounds,* 662 F.3d 745, 749–50 (6th Cir.2011).

The Supreme Court's rationale for permitting the tolling of absent class members' claims rested on a balancing of the values underlying Rule 23 (efficiency and economy of litigation) and statutes of limitations (prejudice to defense and unfair surprise). *Catholic Social Services,* 232 F.3d at 1146–47. Where, as here, plaintiffs are permitted to amend a complaint to address deficiencies that precluded an initial attempt at certification, and the newly proposed class is a subset of claims that defendants had notice of, the goals of avoiding multiplicitous litigation and unfair surprise continue to be served by tolling the claims of the members of the subsequent putative class. *Cf.* Wasserman, *Tolling: The* American Pipe *Tolling Rule And Successive Class Actions,* 58 Fla. L.Rev. 803, 858 (2006).

**C. EEOC Charge Coattailing**

Wal–Mart's argument that class members cannot benefit from the "single filing" or "coattailing" doctrine following class decertification fails for the same reasons. *E.g., McDonald v. Sec'y of Health & Human Servs.,* 834 F.2d 1085, 1092 (1st Cir.1987) (*American Pipe* tolling principles applicable to administrative exhaustion issues). Under those doctrines, "so long as one plaintiff timely files an administrative complaint, a class of similarly-situated plaintiffs may 'piggyback' on that complaint, thereby satisfying the exhaustion requirement." *Harris v. County of Orange,* 682 F.3d 1126, 1136 (9th Cir.2012). This Court need not express any view on the propriety of coattailing in a second action filed on the heels of the dismissal of a rejected class suit, *cf. Ruehl v. Viacom, Inc.,* 500 F.3d 375 (3d Cir.2007), because this is not such a case.

*9 Wal–Mart's fallback position is that even if coattailing in general is still permissible in this case, the putative class members can no longer rely on the administrative charge filed by former named plaintiff Stephanie Odle because she has since filed a separate gender discrimination class action against Wal–Mart in Texas. *See Odle v. Wal–Mart Stores, Inc.,* No. 3:11–CV–02954–O (N.D.Tex. Oct. 28, 2011).

This Court ruled some ten years ago that absent class members and other named plaintiffs who had not filed individual administrative complaints could rely on the timely charge filed by Odle. Order Granting Pls.' Mot. Amend (dkt.81) at 4, 15–16. At the time of that ruling, Odle had been dismissed as a named plaintiff for venue reasons but remained a member of the putative class. *Id.* at 3–4.

The purpose of the filing requirement is to give prompt notice to the employer of the nature and scope of potential liability and to allow the EEOC to attempt to conciliate with the wrongdoer rather than go to court. *E.g., Zipes v. Trans World Airlines, Inc.,* 455 U.S. 385, 398, 102 S.Ct. 1127, 71 L.Ed.2d 234 (1982); *Domingo v. New England Fish Co.,* 445 F.Supp. 421, 427 (W.D.Wash.1977). The Court's prior ruling reasoned that the notice provided to Wal–Mart by Odle's charge was not negated by her later dismissal as a named plaintiff, dkt. 81 at 15–16; likewise, where other named plaintiffs filled in and continued to press the class claims in court, no conciliatory purpose would be served by adopting a rule encouraging redundant EEOC filings regarding class members' claims.

Wal–Mart says that Ninth Circuit case law prohibits class members from coattailing on an administrative complaint filed by a plaintiff pursuing an individual claim in a separate suit. *See Inda v. United Air Lines, Inc.,* 565 F.2d 554, 559 (9th Cir.1977). Perhaps, but like Wal–Mart's tolling contentions, that argument rests on a characterization of the FAC as new action distinct from the action Odle initially filed. It is not. *Cf. Harris,* 682 F.3d at 1137 (*Inda* holding limited to class reliance on complaint of individual from "a separate individual lawsuit").

Administrative exhaustion is a ticket to bringing suit in the first place, 42 U.S.C. § 2000e–5(e)–(f), and the single filing rule provides that one ticket can reserve seats for an entire similarly situated class. Once the train has left the station, the conductor does not return every now and then to make sure that the person who bought the group ticket remains on the train until the last stop. That would serve no purpose where, as here, Odle's decision to bring a separate action no more unrung the notice bell or made

conciliation more likely in this 2001 suit than did her dismissal from the position of named plaintiff.

In sum, this Court already ruled that the putative members of the originally proposed class were entitled to coattail on Odle's charge, and the subset of them that continue in this action may still rely on that ruling.[1]

**D. Venue**

***10** Wal–Mart also seeks to reopen an issue this Court addressed early on in the litigation regarding Title VII's venue requirements. *See* Order at 3–5 (dkt.36). It now argues that absent class members must satisfy the statute's venue requirements. This Court previously held that all named representatives of the class must satisfy the statutory venue requirements. *Id.* That ruling, as discussed in the order, analyzed the significance to named plaintiffs of a line of cases holding that the status of absent class members was not material to venue. *Id.* Wal–Mart cites not a single case, binding or otherwise, that has held the contrary, and the Court declines Wal–Mart's invitation to revisit the reasoning from those cases implicitly adopted in this Court's previous order.

**IV. CONCLUSION**

For the forgoing reasons, the Court DENIES the motion to strike or dismiss the class claims. Plaintiffs are ordered to submit their motion for class certification no later than January 11, 2013, which will be heard at 10 a.m. in this Court on February 15, 2013.

**IT IS SO ORDERED.**

**Parallel Citations**

116 Fair Empl.Prac.Cas. (BNA) 111, 96 Empl. Prac. Dec. P 44,631

Footnotes

1 *Cf. E.E.O.C. v. Watkins Motor Lines, Inc.,* 553 F.3d 593, 597 (7th Cir.2009) ("Many a defendant would love to decapitate a class after the statute of limitations has run by paying off the sole representative plaintiff ...."); *McDonald v. United Air Lines, Inc.,* 587 F.2d 357, 361 n. 12 (7th Cir.1978) ("[T]he fact that [the plaintiffs] later settled their individual claims [does not] mean[ ] that their EEOC filings cannot be preserved as the event which tolled the statute for the class of which they were members."); *Cronas v. Willis Group Holdings Ltd.,* No. 06 Civ. 15295, 2007 WL 2739769 GEL, at *2–5, (S.D.N.Y. Sept. 17, 2007).

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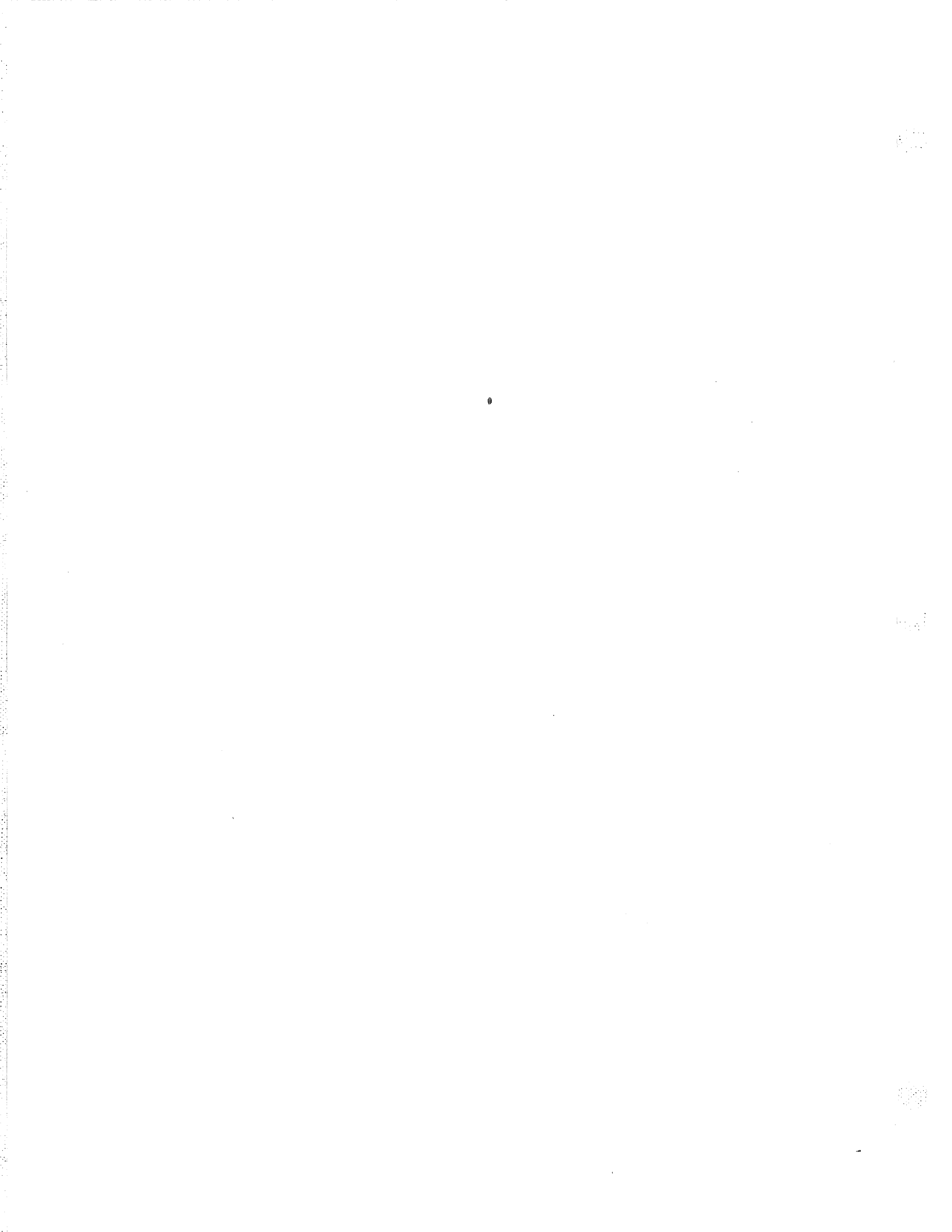
# TAB 4



127 S.Ct. 2499
Supreme Court of the United States

TELLABS, INC., et al., Petitioners,
v.
MAKOR ISSUES & RIGHTS, LTD., et al.

No. 06–484. | Argued March 28, 2007. | Decided June 21, 2007.

Synopsis
**Background:** Investors brought securities fraud class action against corporation and its chief executive officer (CEO). The United States District Court for the Northern District of Illinois, Amy J. St. Eve, J., dismissed action. Investors appealed. The United States Court of Appeals for the Seventh Circuit, 437 F.3d 588, reversed. Certiorari was granted.

**Holdings:** The Supreme Court, Justice Ginsburg, held that:

[1] in determining whether securities fraud complaint gives rise to "strong inference" of scienter, within meaning of Private Securities Litigation Reform Act (PSLRA), court must consider competing inferences, and

[2] plaintiff alleging fraud in § 10(b) action must plead facts rendering inference of scienter at least as likely as any plausible opposing inference.

Vacated and remanded.

Justices Scalia and Alito filed opinions concurring in the judgment.

Justice Stevens filed dissenting opinion.

West Headnotes (7)

[1] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

To establish liability under § 10(b) and Rule 10b–5, private plaintiff must prove that defendant acted with scienter, a mental state embracing intent to deceive, manipulate, or defraud. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

187 Cases that cite this headnote

[2] **Federal Civil Procedure**
Matters deemed admitted; acceptance as true of allegations in complaint

On motion to dismiss § 10(b) action for failure to state claim on which relief can be granted, court must accept all factual allegations in complaint as true. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

734 Cases that cite this headnote

[3] **Federal Civil Procedure**
Matters considered in general

On motion to dismiss § 10(b) action for failure to state claim on which relief can be granted, court must consider complaint in its entirety, as well as other sources courts ordinarily examine when ruling on such motions, in particular, documents incorporated into complaint by reference, and matters of which court may take judicial notice; inquiry is whether all of the facts alleged, taken collectively, give rise to strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

1651 Cases that cite this headnote

[4] **Securities Regulation**
Scienter

In determining whether securities fraud complaint gives rise to "strong inference" of scienter, within meaning of Private Securities Litigation Reform Act (PSLRA), court must consider competing inferences; to determine whether plaintiff has alleged facts that give rise to requisite "strong inference" of scienter, court must consider plausible nonculpable explanations for defendant's conduct, as well as inferences favoring plaintiff. Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

1068 Cases that cite this headnote

[5] **Securities Regulation**
Scienter

Inference of scienter in securities fraud complaint must be more than merely "reasonable" or "permissible" to satisfy Private Securities Litigation Reform Act (PSLRA); it must be cogent and compelling, thus strong in light of other explanations, and complaint will survive only if 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. Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

986 Cases that cite this headnote

[6] **Securities Regulation**
Scienter

While motive can be relevant consideration, and personal financial gain may weigh heavily in favor of finding that securities fraud complaint gives rise to "strong inference" of scienter, within meaning of Private Securities Litigation Reform Act (PSLRA), absence of motive allegation is not fatal. Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

193 Cases that cite this headnote

[7] **Jury**
Restriction or Invasion of Functions of Jury

In determining whether securities fraud complaint gives rise to "strong inference" of scienter, within meaning of Private Securities Litigation Reform Act (PSLRA), court's comparative assessment of plausible inferences, while constantly assuming plaintiff's allegations to be true, does not impinge upon Seventh Amendment right to jury trial. U.S.C.A. Const.Amend. 7; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

215 Cases that cite this headnote

****2501 *308 *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 PSLRA 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, and n. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668. 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 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 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 ***309** 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 ****2502** 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. 2506 – 2513.

(a) Setting a uniform pleading standard for § 10(b) actions was among 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." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit,* 547 U.S. 71, 81, 126 S.Ct. 1503. 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. No. 104–369, p. 41, Courts of Appeals have diverged in construing the term "strong inference." Among the uncertainties, should courts consider competing inferences in determining 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. 2506 – 2509.

(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. *Sec ond,* ***310** 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, 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 ****2503** 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. 2509 – 2510.

(c) Tellabs contends that when competing inferences are considered, Notebaert's evident lack of 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 assess all the allegations holistically.

Pp. 2511 – 2512.

(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 of—including the pleading and ***311** 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. 2511 – 2513.

(e) Neither the District Court nor the Court of Appeals had 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. 2513.

437 F.3d 588, vacated and remanded.

GINSBURG, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, SOUTER, THOMAS, and BREYER, JJ., joined. SCALIA, J., *post*, p. 2513, and ALITO, J., p. 2515, filed opinions concurring in the judgment. STEVENS, J., filed a dissenting opinion, *post*, p. 2516.

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**Opinion**

Justice GINSBURG delivered the opinion of the Court.

***313** 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 Pharmaceuticals, 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). 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

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measures Congress included in the PSLRA. The PSLRA 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, and n. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976); see 15 U.S.C. § 78u–4(b)(1), (2). ***314** 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 "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). 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 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 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 ***315** 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]

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 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 ***316** 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 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 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 (N.D.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. The Shareholders had sufficiently pleaded that Notebaert's statements were misleading, the ***317** 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 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 (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 competing inferences in determining whether a securities fraud complaint ***318** gives rise to a "strong inference" of scienter.[2] 549 U.S. 1105, 127 S.Ct. 853, 166 L.Ed.2d 681 (2007).

****2507 II**

[1] 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) 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.

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 Pharmaceuticals,* 544 U.S., at 341, 125 S.Ct. 1627. See also *id.*, at 345, 125 S.Ct. 1627 ("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 (private securities fraud actions provide "a most effective weapon in the enforcement" of securities laws and ***319** are "a necessary supplement to Commission action"). To establish liability under § 10(b) and Rule 10b–5, a private plaintiff must prove that the defendant acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst,* 425 U.S., at 193–194, and n. 12, 96 S.Ct. 1375.[3]

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). 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 Pharmaceuticals,* 544 U.S., at 346, 125 S.Ct. 1627 (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 (C.A.1 1992) (Breyer, J.) (collecting cases). Rule 9(b) applies to "all averments of fraud or mistake"; 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 saying that scienter existed," **2508 *In re GlenFed, Inc. Securities Litigation,* 42 F.3d 1541, 1546–1547 (C.A.9 1994) (en banc), or were they required to allege with particularity facts giving rise to an *320 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) (quoting *Denny v. Barber,* 576 F.2d 465, 470 (C.A.2 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 (quoting H.R. Conf. Rep. No. 104–369, p. 31 (1995), U.S.Code Cong. & Admin.News 1995, p. 730 (hereinafter H.R. Conf. Rep.))—the PSLRA installed both substantive and procedural controls.[4] Notably, Congress prescribed new procedures *321 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), U.S.Code Cong. & Admin.News 1995, pp. 679, 690. Congress also "limit[ed] recoverable damages and 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 pending resolution of any motion to dismiss." *Dabit,* 547 U.S., at 81, 126 S.Ct. 1503. 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.*

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 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 2506, 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 2506.

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 *322 [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 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

[2] We establish the following prescriptions: *First,* 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). On this point, the parties agree. See Reply Brief 8; Brief for Respondents 26; Brief for United States as *Amicus Curiae* 8, 20, 21.

[3] *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 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 ***323** 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 (C.A.5 2002); *Gompper v. VISX, Inc.,* 298 F.3d 893, 897 (C.A.9 2002). See also Brief for United States as *Amicus Curiae* 25.

[4] *Third,* 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 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), 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 (C.A.8 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 or statements"; "reasoning from something known or assumed to something else which follows from it").

[5] 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? To determine whether the plaintiff ***324** 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 (C.A.6 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 2508, and n. 4. Yet 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 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.[5]

### **2511 *325 B

[6] 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."). 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 2509 – 2510, 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 2505. But they failed, Tellabs 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 ***326** alleged by the Shareholders, including specifications as to timing). We agree that omissions and ambiguities count against inferring scienter, for plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." § 78u–4(b)(2). We reiterate, however, that the court's job is not to scrutinize each allegation in isolation but to assess all the allegations holistically. See *supra,* at 2509 – 2510; 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 opposing inference?[6]

## IV

[7] 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 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 ***327** the plaintiff's allegations to be true, we think it plain, does not impinge upon the Seventh Amendment right to jury trial.[8]

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 (both recognizing that heightened pleading requirements can be established by Federal Rule, citing Fed. Rule Civ. Proc. 9(b), which requires that fraud or mistake be pleaded with particularity).[9]

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 ***328** 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 (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. 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 court 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 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 ****2513** *Walker v. New Mexico & Southern Pacific R. Co.,* 165 U.S. 593, 596, 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, 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. A plaintiff alleging fraud 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 ***329** 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 2509 – 2511, 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.*

Justice SCALIA, concurring in the judgment.

I fail to see how an inference that is merely "at least as compelling as any opposing inference," *ante,* at 2505, 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.*

***330** The Court's explicit rejection of this reading, *ante,* at 2510, 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 2510, n. 5 (citing *Summers v. Tice,* 33 Cal.2d 80, 84–87, 199 P.2d 1, 3–5 (1948)). *Summers* is a famous case, however, because it sticks 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 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.

***331** 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 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 2510 – 2511, n. 5; *post,* at 2517, n. 1 (STEVENS, 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 ***332** 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 2510. As for the dissent, it asserts that the statute cannot possibly have a natural and discernible ****2515** meaning, since "Courts of Appeals" and "Members of this Court" "have divided" over the question. *Post,* at 2517, n. 1. 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. 457, 479, 127 S.Ct. 1397, 167 L.Ed.2d 190 (2007) (STEVENS, J., dissenting), even though the Courts of Appeals and Members of this Court divided over the question, *id.,* at 470, n. 5, 127 S.Ct. 1397. Was plain meaning then, as the dissent claims it is today, *post,* at 2517, n. 1, "in the eye of the beholder"?

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 2516 – 2517. 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. Natural Resources Defense Council, Inc.,* 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.

***333** Even 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 2509, 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,' " *ante,* at 2509, 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 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, ***334** in the 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 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 2511. 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 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.

***335 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 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.

Justice STEVENS, dissenting.

As the Court explains, when Congress enacted a heightened pleading requirement for private actions to enforce the federal securities laws, it "left the key term 'strong inference' undefined." ****2517** *Ante,* at 2504 – 2505. 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 ***336** cases. Because of its intrusive nature, discovery may also invade the privacy interests of the 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]

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 2509 (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 ***337** 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

*Scientific–Atlanta, Inc.,* 374 F.3d 1015, 1018 (C.A.11 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 (C.A.5 2004), the Shareholders do not contest the Seventh Circuit's determination, and we do not disturb it.

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 (C.A.6 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).

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.

* The Court suggests that "the owner of the precious falcon would find the inference of guilt as to B quite strong." *Ante,* at 2510, 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.Rep. 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.

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 2514 (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 2504 – 2505, 2508 – 2509, 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.

2 The "channel stuffing" allegations in ¶¶ 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 2511, 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, ¶ 67 ("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 2513 (opinion of the Court) (quoting 15 U.S.C. § 78u–4(b)(2)).

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another unrelated reason.

If, using that same methodology, we assume (as we must, see *ante,* at 2509 – 2510, 2511) 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 executive officer "acted with the required intent," as the Seventh Circuit held.[2] 437 F.3d 588, 602 (2006).

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

**Parallel Citations**

127 S.Ct. 2499, 168 L.Ed.2d 179, 75 USLW 4462, Fed. Sec. L. Rep. P 94,335, 07 Cal. Daily Op. Serv. 7139, 2007 Daily Journal D.A.R. 9258, 20 Fla. L. Weekly Fed. S 374

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

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."

2 See, *e.g.,* 437 F.3d 588, 602 (C.A.7 2006) (decision below); *Brown v. Credit Suisse First Boston Corp.,* 431 F.3d 36, 49, 51 (C.A.1 2005); *Ottmann v. Hanger Orthopedic Group, Inc.,* 353 F.3d 338, 347–349 (C.A.4 2003); *Pirraglia v. Novell, Inc.,* 339 F.3d 1182, 1187–1188 (C.A.10 2003); *Gompper v. VISX, Inc.,* 298 F.3d 893, 896–897 (C.A.9 2002); *Helwig v. Vencor, Inc.,* 251 F.3d 540, 553 (C.A.6 2001) (en banc).

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.

4 Nothing in the PSLRA, 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).

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 2513 (opinion concurring in judgment) (emphasis in original). We 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) (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 2514 – 2515.

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 2516 (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).

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.*

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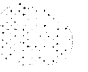
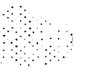
# TAB 5

264 F.3d 131
United States Court of Appeals,
Second Circuit.

Richard L. KALNIT, Plaintiff–Appellant,
v.
Frank M. EICHLER, Robert L. Crandall, Charles P. Russ, III, Pierson M. Grieve, Louis A. Simpson, Allan D. Gilmour, Charles M. Lillis, Grant A. Dove, John Slevin, Kathleen A. Cote, Daniel W. Yohannes and Mediaone Group, Inc., Defendants–Appellees.

Docket No. 00–7487. | Argued: Dec. 12, 2000. | Decided: Sept. 5, 2001.

Investor brought uncertified securities fraud class action against corporation and its directors, alleging that defendants fraudulently failed to disclose circumstances related to proposed acquisition of corporation, which artificially depressed selling price of corporation's shares. The United States District Court for the Southern District of New York, 99 F.Supp.2d 327, Shira A. Scheindlin, J., dismissed complaint without leave to amend, and investor appealed. The Court of Appeals, F.I. Parker, Circuit Judge, held that: (1) investor's allegations of officers' motive to defraud failed to establish scienter required under the Private Securities Litigation Reform Act (PSLRA); (2) any intent on officers' part to defraud proposed acquiring corporation could not be conflated with an intent to defraud investors; (3) investor could not establish scienter by combining inadequate allegations of motive with inadequate allegations of recklessness; and (4) defendants' failure to disclose was not conscious misbehavior or recklessness.

Affirmed.

West Headnotes (17)

[1] **Federal Courts**
Trial de novo
**Federal Courts**
Pleadings

Courts of Appeals review de novo a district court's dismissal of a complaint pursuant to a motion to dismiss for failure to state a claim upon which relief can be granted, accepting all factual allegations in the complaint as true and drawing all reasonable inferences in the plaintiff's favor. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

20 Cases that cite this headnote

[2] **Federal Courts**
Extent of Review Dependent on Nature of Decision Appealed from

A dismissal is upheld on review only if it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.

6 Cases that cite this headnote

[3] **Securities Regulation**
Manipulative, Deceptive or Fraudulent Conduct

To state a cause of action for securities fraud under section 10(b) and Rule 10b–5, a plaintiff must plead that the defendant made a false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused plaintiff injury. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

60 Cases that cite this headnote

[4] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

To establish the requisite state of mind, or scienter, in a securities fraud action under section 10(b) and Rule 10b–5, the plaintiff must allege an intent to deceive, manipulate, or defraud. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); 17

C.F.R. § 240.10b–5.

52 Cases that cite this headnote

[5] **Securities Regulation**
Pleading

A complaint asserting securities fraud must satisfy the heightened pleading requirement of rule requiring fraud to be alleged with particularity. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

4 Cases that cite this headnote

[6] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

A securities fraud plaintiff can establish scienter sufficient to give rise to a strong inference of fraudulent intent, under the Private Securities Litigation Reform Act (PSLRA), either by alleging: (1) facts to show that defendants had both motive and opportunity to commit fraud, or (2) facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

236 Cases that cite this headnote

[7] **Securities Regulation**
Scienter

For purposes of pleading scienter in securities fraud under the Private Securities Litigation Reform Act (PSLRA), sufficient motive allegations entail concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

37 Cases that cite this headnote

[8] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

Allegations of motives that are generally possessed by most corporate directors and officers do not suffice to plead scienter under the Private Securities Litigation Reform Act (PSLRA) in a securities fraud case; instead, plaintiffs must assert a concrete and personal benefit to the individual defendants resulting from the fraud. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

127 Cases that cite this headnote

[9] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

To allege a motive sufficient under the Private Securities Litigation Reform Act (PSLRA) to support the inference of fraudulent intent, for purposes of a securities fraud case, a plaintiff must do more than merely charge that executives aim to prolong the benefits of the positions they hold. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

12 Cases that cite this headnote

[10] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

Investor's allegations of corporate officers'

motive to defraud failed to establish scienter required under the Private Securities Litigation Reform Act (PSLRA), in uncertified securities fraud class action against corporation and its officers, alleging that defendants fraudulently failed to disclose circumstances related to proposed merger, where allegations that officers' motive was to protect their lucrative compensation could have been imputed to all corporate officers, that it was to avoid personal liability was too speculative since there was no reason to expect proposed acquiring corporation to sue officers individually, and that it was to ensure that a more lucrative offer was obtained was nonsensical since investors would also benefit from a superior offer. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

47 Cases that cite this headnote

[11] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

Allegation that corporate officers' avoidance of personal liability provided motive for their alleged fraudulent acts is too speculative and conclusory to support scienter required under the Private Securities Litigation Reform Act (PSLRA) in a securities fraud case. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

3 Cases that cite this headnote

[12] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

Any intent on corporate officers' part to defraud proposed acquiring corporation could not be conflated with an intent to defraud shareholders of corporation to be acquired, for purposes of establishing motive to defraud sufficient to establish scienter required under the Private Securities Litigation Reform Act (PSLRA) in investor's uncertified securities fraud class action against corporation and its officers, because achieving superior merger benefitted all investors, and desire to achieve most lucrative acquisition proposal could be attributed to every corporation seeking to be acquired. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

25 Cases that cite this headnote

[13] **Securities Regulation**
Scienter

Investor could not show motive to defraud on part of corporation's officers sufficient to establish scienter, as required under the Private Securities Litigation Reform Act (PSLRA) in a securities fraud case, by merely combining inadequate allegations of motive with inadequate allegations of recklessness. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

5 Cases that cite this headnote

[14] **Securities Regulation**
Pleading

A plaintiff cannot base securities fraud claims on speculation and conclusory allegations. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

9 Cases that cite this headnote

[15] **Securities Regulation**
Scienter

Where motive is not apparent, it is still possible to plead scienter under the Private Securities Litigation Reform Act (PSLRA) in a securities fraud case by identifying circumstances indicating conscious behavior by the defendant, though the strength of the circumstantial allegations must be correspondingly greater. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

87 Cases that cite this headnote

[16] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

To survive dismissal under the "conscious misbehavior" theory, the plaintiffs in a securities fraud case must show that they alleged reckless conduct by the defendants, which is at the least conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

113 Cases that cite this headnote

[17] **Securities Regulation**
Scienter, Intent, Knowledge, Negligence or Recklessness

Corporation's duty to disclose that its largest shareholder had been released from standstill agreement so that he could attempt to obtain more lucrative merger offer was not so clear as to render corporation and its officers' failure to disclose reckless, as would establish scienter required under the Private Securities Litigation Reform Act (PSLRA) in investor's uncertified securities fraud class action against corporation and its officers, where public was aware that corporation could accept a superior proposal, and defendants made no affirmative misstatements regarding ongoing merger discussions. Securities Exchange Act of 1934, §§ 10(b), 21D, as amended, 15 U.S.C.A. §§ 78j(b), 78u–4(b)(2); 17 C.F.R. § 240.10b–5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

6 Cases that cite this headnote

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Dennis J. Block, Cadwalader, Wickersham & Taft, New York, N.Y. (Jason M. Halper, Jennifer L. Hurley, on the brief) for Defendants–Appellees.

Before: FEINBERG, CARDAMONE, and F.I. PARKER, Circuit Judges.

**Opinion**

F.I. PARKER, Circuit Judge:

In this uncertified securities fraud class action, plaintiff Richard L. Kalnit, on behalf of himself and all others similarly situated, alleges that defendants violated section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1994) ("section 10(b)") and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5 (2001) ("Rule 10b–5"), by fraudulently failing ***135** to disclose material information in connection with a proposed merger between MediaOne Group, Inc. ("MediaOne") and Comcast Corporation ("Comcast"). Kalnit and the purported class members sold shares of MediaOne stock during the period from March 31, 1999 through April 22, 1999, inclusive, at an allegedly artificially deflated price due to defendants' alleged fraud.

The United States District Court for the Southern District of New York (Shira A. Scheindlin, *Judge* ) dismissed plaintiff's amended complaint for failure to allege the element of scienter with adequate particularity. *See Kalnit v. Eichler,* 99 F.Supp.2d 327, 344 (S.D.N.Y.2000) ("*Kalnit II* "). The district court dismissed plaintiff's first complaint for the same reason, but granted plaintiff leave to amend. *See Kalnit v. Eichler,* 85 F.Supp.2d 232, 245–46 (S.D.N.Y.1999) ("*Kalnit I* "). Plaintiff appeals the district court's second dismissal, contending that his amended complaint adequately set forth scienter

allegations.

For the reasons set forth below, we affirm the decision of the district court to dismiss plaintiff's complaint without leave to amend.

## I. BACKGROUND

### A. *Factual Background*

Mindful that we are reviewing a dismissal pursuant to Federal Rule of Civil Procedure 12(b)(6), the following facts are contained in the plaintiff's amended complaint and are assumed to be true. *See Press v. Chem. Inv. Servs.,* 166 F.3d 529, 534 (2d Cir.1999).

Plaintiff-appellant Richard Kalnit was an investor in MediaOne, who sold 1,820 shares of MediaOne stock on April 16, 1999. He purports to represent a class comprised of those who sold shares of MediaOne stock during the period between March 31, 1999 and April 22, 1999.[1]

Defendant-appellee, MediaOne, is a Delaware corporation with its principal place of business in Colorado. MediaOne provides telecommunications services, including local, long distance and cellular telephone services. The 11 individual defendants-appellees were, at the time relevant to this action, MediaOne officers or members of MediaOne's board of directors. Defendant Lillis was the Chairman of the Board, President and Chief Executive Officer, and a director. Defendant Eichler was MediaOne's Executive Vice President, General Counsel and Secretary.

In 1996, MediaOne acquired a company called Continental Cablevision ("Continental"). As part of this acquisition, MediaOne entered into a publicly-disclosed shareholder's agreement with Amos Hostetter, Continental's co-founder. This agreement included a "standstill" provision which limited Hostetter's ability to propose mergers, directly or indirectly, involving MediaOne (the "standstill restriction"). At all times relevant to this suit, Hostetter owned 56.3 million shares, or approximately 9.3% of all outstanding MediaOne shares, and was MediaOne's largest shareholder. Hostetter also possessed considerable clout in the telecommunications industry.

On March 22, 1999, MediaOne announced that it had entered into a "definitive Merger Agreement" with Comcast, whereby Comcast would acquire MediaOne for approximately $48 billion. Pursuant to this agreement, each MediaOne shareholder would receive 1.1 shares of Comcast common stock for each share of MediaOne ***136** common stock. The agreement allowed MediaOne forty-five days to accept a superior proposal, subject to payment of a $1.5 billion termination fee to Comcast. This agreement also contained a provision that prohibited defendants from directly or indirectly soliciting acquisition proposals that would compete with the Comcast proposal. This provision, section 6.03 of the agreement, also referred to as the "No Shop" provision, stated:

> From the date hereof until the termination hereof, MediaOne will not, and will cause the MediaOne Subsidiaries and the officers, directors, employees ... or advisors of MediaOne and the MediaOne Subsidiaries not to, directly or indirectly: (i) take any action to solicit, initiate, facilitate or encourage the submission of any Acquisition Proposal; and (ii) other than in the ordinary course of business and not related to an Acquisition Proposal, engage in any discussions or negotiations with, or disclose any non-public information relating to MediaOne or any MediaOne Subsidiary or afford access to the properties, books or records of MediaOne or any MediaOne Subsidiary to, any Person who is known by MediaOne to be considering making or has made, an Acquisition Proposal.

Section 10.1 of the agreement provided that Comcast could terminate if MediaOne breached its "no shop" obligation. In short, MediaOne could accept a superior offer within forty-five days, but could not directly or indirectly solicit such offers.

On March 25, 1999, Hostetter sent a letter to the defendants, expressing his dissatisfaction with the terms of the Comcast Agreement, and seeking to be released from the 1996 standstill restriction to permit him to develop a superior proposal. On March 31, 1999, defendant Eichler, on behalf of all defendants, wrote to Hostetter and agreed to waive the 1996 standstill restriction. Eichler informed Hostetter that MediaOne had "no objection to [his] speaking with third parties about participating in any Superior Proposal." Additionally, Eichler confirmed an agreement of March 30, 1999,

between MediaOne and Hostetter that Hostetter would not "make any public announcement of [his] efforts to develop a Superior Proposal without the Board's written consent, and to respond with 'no comment' if a press inquiry is made."

In the meantime, on March 30, 1999, MediaOne filed its Annual Report (Form 10K) with the Securities & Exchange Commission ("SEC") for the fiscal year ending December 31, 1998. This report included information about the Comcast Agreement, similar to the information previously released to the public, but did not disclose the Hostetter letter or defendants' response.

On April 5, 1999, MediaOne filed a Proxy Statement pursuant to section 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a) (1994 & Supp. V 1999), informing shareholders that a special meeting regarding the proposed Comcast merger would likely occur. This statement did not disclose any of the communications between Hostetter and MediaOne's Board of Directors.

On April 16, 1999, plaintiff-appellant Kalnit sold 1,820 shares of MediaOne stock at approximately $65.44 per share, with no knowledge about Hostetter's release from the 1996 standstill restriction or about his desire to seek a superior proposal.

On April 22, 1999, AT & T Corporation ("AT & T") publicly proposed to acquire MediaOne in a transaction valued at $58 billion, approximately $9 billion more than the value of the Comcast proposal. Also on April 22, Hostetter filed a Schedule 13D with the SEC, disclosing, for the first time, ***137** MediaOne's waiver of the 1996 standstill restriction. The Schedule 13D also revealed that Hostetter had discussed with AT & T, among others, the possibility of a superior proposal for MediaOne and that AT & T's current proposal resulted from these discussions.

On April 23, 1999, MediaOne's stock opened at $79 per share and closed at $77.375 per share, up from a value of $69.50 per share on April 22, 1999. Four days later, MediaOne's stock closed at $81.8125 per share.

On May 1, 1999, MediaOne's Board voted unanimously in favor of terminating the Comcast agreement in order to accept AT & T's proposal. A few days later, AT & T and Comcast negotiated a transaction where Comcast would not interfere with AT & T efforts to acquire MediaOne, and AT & T and Comcast would exchange certain cable properties resulting in a net increase in Comcast's cable subscribers.

On May 6, 1999, MediaOne officially terminated the Comcast agreement. Appellant filed his complaint that same day.

**B. *Proceedings Below***
Kalnit filed this complaint as a class action, purporting to represent himself and all others who sold MediaOne securities during the period from March 31, 1999 through April 22, 1999 inclusive. He asserted claims under sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a), alleging that defendants fraudulently failed to disclose Hostetter's March 25, 1999 letter and their subsequent decision to release Hostetter from the 1996 standstill restriction.

On December 22, 1999, the district court granted defendants' motion to dismiss the original complaint, concluding that the complaint failed to plead scienter adequately. *See Kalnit I,* 85 F.Supp.2d at 242. The court granted plaintiff leave to amend his complaint to cure the noted deficiency. *See id.* at 246.[2]

On January 2, 2000, Kalnit filed an amended complaint, containing added scienter allegations. Defendants again moved to dismiss this complaint, contending that the amended complaint failed to cure the defects noted in the original complaint. The district court agreed and concluded that the amended complaint still failed to "give rise to a 'strong inference' of defendants' intent to deceive, manipulate or defraud MediaOne shareholders." *Kalnit II,* 99 F.Supp.2d at 336. The district court also declined, on futility grounds, to give plaintiff leave to amend the complaint a second time. *See id.* at 344.

Judgment was entered on April 11, 2000, and plaintiff's appeal followed.

## II. DISCUSSION

Kalnit argues on appeal that the district court's dismissal was in error because his complaint adequately alleged scienter.[3]

**A. *Standard of Review***
[1] [2] "We review de novo a district court's dismissal of a complaint pursuant to Rule 12(b)(6), accepting all factual allegations ***138** in the complaint as true and drawing all reasonable inferences in the plaintiff's favor." *Ganino v.*

*Citizens Utilities Co.,* 228 F.3d 154, 161 (2d Cir.2000). A dismissal is upheld only if "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.* (citation omitted).

**B. *Scienter***

[3] [4] "To state a cause of action under section 10(b) and Rule 10b–5, a plaintiff must plead that the defendant made a false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused plaintiff injury." *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.,* 75 F.3d 801, 808 (2d Cir.1996) (citing *In re Time Warner Inc. Secs. Litig.,* 9 F.3d 259, 264 (2d Cir.1993)).[4] The requisite state of mind, or scienter, in an action under section 10(b) and Rule 10b–5, that the plaintiff must allege is " 'an intent to deceive, manipulate or defraud.' " *Ganino,* 228 F.3d at 168 (quoting *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 n. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976)).

[5] A complaint asserting securities fraud must also satisfy the heightened pleading requirement of Federal Rule of Civil Procedure 9(b), which requires fraud to be alleged with particularity. *Ganino,* 228 F.3d at 168; *see also* Fed.R.Civ.P. 9(b) ("In all averments of fraud ..., the circumstances constituting fraud ... shall be stated with particularity."). Additionally under Rule 9(b), however, "[m]alice, intent, knowledge and other condition of mind of a person may be averred generally." Fed.R.Civ.P. 9(b).

In 1995, Congress enacted the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), Pub.L. No. 104–67, 109 Stat. 737, which, among other things, imposed heightened pleading requirements for plaintiffs in securities fraud actions. The PSLRA's scienter provision provides:

> In any private action arising under this chapter 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 chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. § 78u–4(b)(2) (1994 & Supp. V 1999) (codifying PSLRA § 101(b), 109 Stat. at 747).

[6] The PSLRA's language echoed this Court's scienter standard. Before the PSLRA's enactment, we held that, to be adequate, scienter allegations must "give rise to a strong inference of fraudulent intent." *Novak v. Kasaks,* 216 F.3d 300, 307 (2d Cir.2000). A plaintiff can establish this intent " 'either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness.' " *Acito v. IMCERA Group, Inc.,* 47 F.3d 47, 52 (2d Cir.1995) (quoting *Shields v. Citytrust Bancorp, Inc.,* 25 F.3d 1124, 1128 (2d Cir.1994)).

In *Novak,* we concluded that the PSLRA "did not change the basic pleading standard for scienter in this circuit." *Novak,* 216 F.3d at 310. Thus, both options for demonstrating scienter, either with motive and opportunity allegations or with allegations constituting strong circumstantial ***139** evidence of conscious misbehavior or recklessness, survive the PSLRA. *See Ganino,* 228 F.3d at 169–70. We therefore examine Kalnit's complaint under both methods of establishing scienter.

**1. *Motive and Opportunity***

As the district court noted, "it is undisputed that the individual defendants, as Directors of MediaOne, had the opportunity to commit fraudulent acts." *Kalnit II,* 99 F.Supp.2d at 335. The central issue, therefore, is whether plaintiff has sufficiently alleged motive.

Plaintiff points to several allegations in the complaint in his attempt to demonstrate defendants' motive to defraud the MediaOne shareholders. First, plaintiff contends that, by failing to disclose the Hostetter release, defendants (1) were allowed to obtain another $12.00 per share when MediaOne entered into the agreement with AT & T, Appellant's Br. at 16; (2) "protected the significant change of control payments that would be jeopardized if it became known that Defendants violated" the Comcast Agreement, Appellant's Br. at 17; and (3) protected defendants Lillis and Eichler specifically, because they had lucrative provisions in the Comcast Agreement, including a large lump sum payment and vested pension benefits, Appellant's Br. at 17–18. Second, plaintiff asserts that defendants were motivated by a desire to avoid personal liability for the breach of the Comcast Agreement. Finally, plaintiff alleges that defendants were motivated by a desire to ensure that Hostetter would be able to obtain a superior proposal, because disclosure of

the Hostetter release would jeopardize this possibility.

[7] [8] Sufficient motive allegations " 'entail concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged.' " *Novak,* 216 F.3d at 307 (quoting *Shields,* 25 F.3d at 1130). Motives that are generally possessed by most corporate directors and officers do not suffice; instead, plaintiffs must assert a concrete and personal benefit to the individual defendants resulting from the fraud. *Novak,* 216 F.3d at 307–08. Insufficient motives, we have held, can include (1) the desire for the corporation to appear profitable and (2) the desire to keep stock prices high to increase officer compensation. *Id.* (citing cases). On the other hand, we have held motive sufficiently pleaded where plaintiff alleged that defendants misrepresented corporate performance to inflate stock prices while they sold their own shares. *Id.* (citing cases).

[9] "To allege a motive sufficient to support the inference [of fraudulent intent], a plaintiff must do more than merely charge that executives aim to prolong the benefits of the positions they hold." *Shields,* 25 F.3d at 1130. Noting the absence of insider trading allegations, in *Shields,* we rejected as insufficient plaintiffs' allegations that the defendants concealed and misrepresented the corporation's financial condition to inflate the price of the common stock and to maintain artificially high prices in order to protect their executive positions and compensation. *Id.* Such motive allegations, we observed, were common to all corporate executives and, thus, too generalized to demonstrate scienter. *Id.*

Likewise, in *Acito v. IMCERA Group, Inc.,* 47 F.3d 47, 54 (2d Cir.1995), we rejected as insufficient motive allegations plaintiff's assertion that the officers were motivated to inflate the value of stock to increase their executive compensation. We concluded:

> Plaintiffs' allegation that defendants were motivated to defraud the public ***140** because an inflated stock price would increase their compensation is without merit. If scienter could be pleaded on that basis alone, virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions. "[I]ncentive compensation can hardly be the basis on which an allegation of fraud is predicated."

*Id.* (alteration in original) (quoting *Ferber v. Travelers Corp.,* 785 F.Supp. 1101, 1107 (D.Conn.1991)). Again, plaintiffs' motive allegations were too generalized to demonstrate defendants' "concrete and personal benefit" from the alleged fraud.

In *Chill v. General Electric Co.,* 101 F.3d 263, 267 (2d Cir.1996), plaintiffs alleged that "GE's interest in justifying to its shareholders its over $1 billion investment in [its subsidiary] gave GE a motive to willfully blind itself to facts casting doubt on [the subsidiary's] purported profitability." We held that this allegation did not sufficiently demonstrate GE's motive to defraud shareholders. *Id.* at 268. We stated that "such a generalized motive, one which could be imputed to any publicly-owned, for-profit endeavor, is not sufficiently concrete for purposes of inferring scienter." *Id.; see also San Leandro,* 75 F.3d at 814 (company's desire to maintain a high bond or credit rating does not qualify as sufficient motive, because this desire can be imputed to all companies). Other courts have rejected similar generalized motives in other cases. *See, e.g., Phillips v. LCI Int'l, Inc.,* 190 F.3d 609, 622 (4th Cir.1999) (in merger context, plaintiffs' allegations that director sought to depress the stock price to assure the success of a merger to retain a position on the board and obtain a higher price for his stock did not constitute an adequate motive); *Leventhal v. Tow,* 48 F.Supp.2d 104, 115 (D.Conn.1999) (plaintiff's allegations that defendants had a motive to artificially inflate stock price to get more favorable terms in stock-for-stock transactions and debentures are too generalized to establish scienter).

[10] [11] These cases lead us to agree with the district court's conclusion that plaintiff's motive allegations are insufficient. First, plaintiff's allegation that defendants were motivated to conceal the Hostetter communications to protect the lucrative compensation provisions in the Comcast agreement are too generalized to support scienter adequately. As we made clear in *Acito,* an allegation that defendants were motivated by a desire to maintain or increase executive compensation is insufficient because such a desire can be imputed to all corporate officers. *Acito,* 47 F.3d at 54. Second, the avoidance of personal liability motive is too speculative and conclusory to support scienter. *See San Leandro,* 75 F.3d at 813 ("Plaintiffs do not ... enjoy a license to base claims of fraud on speculation and conclusory allegations."). As the district court explained, there is no reason to expect that Comcast would sue MediaOne's directors individually for breach of the No Shop provision. *Kalnit II,* 99 F.Supp.2d at 341. Third, plaintiff's allegation that defendants were motivated to conceal the Hostetter release to ensure that Hostetter would be able to obtain the AT & T agreement is not only conclusory and speculative, but nonsensical as well. Achieving a superior agreement with AT & T does not demonstrate defendants' intent to benefit themselves at the expense of the shareholders because the shareholders themselves would benefit from a superior transaction. It is

also for this reason that plaintiff's argument that the defendants wanted to depress MediaOne's stock price to make the AT & T agreement "appear more valuable" likewise makes no sense and is similarly insufficient. Where " 'plaintiff's view of the facts defies economic reason, ... [it] does ***141** not yield a reasonable inference of fraudulent intent.' " *Shields,* 25 F.3d at 1130 (quoting *Alt. Gypsum Co. v. Lloyds Int'l Corp.,* 753 F.Supp. 505, 514 (S.D.N.Y.1990)).

[12] Plaintiff also argues that, because the district court stated that the motive allegations were sufficient to show that the defendants had "defrauded Comcast," the allegations sufficiently demonstrate an intent to defraud the shareholders, because "just as Comcast would want to know the information which Defendants concealed, investors would also want to know the same information". Appellant's Br. at 33 (citing *Kalnit II,* 99 F.Supp.2d at 339). We disagree. We note that this Court has ruled that stock price manipulation in the acquisition context may be sufficient to establish scienter, and has rejected the proposition that "the desire to consummate any corporate transaction cannot ever be a motive for securities fraud." *Rothman v. Gregor,* 220 F.3d 81, 93–94 (2d Cir.2000) (citing *Time Warner,* 9 F.3d at 270). In this situation, however, any intent to defraud Comcast cannot be conflated with an intent to defraud the shareholders. As we noted earlier, achieving a superior merger benefitted all shareholders, including the defendants. Additionally, the desire to achieve the most lucrative acquisition proposal can be attributed to virtually every company seeking to be acquired. Such generalized desires do not establish scienter. *See, e.g., San Leandro,* 75 F.3d at 814.

[13] Plaintiff acknowledges that mere ownership of stock or protection of executive compensation are insufficient to establish motive, but argues that *Acito,* which held that "the existence, *without more,* of executive compensation dependent upon stock value does not give rise to a strong inference of scienter," 47 F.3d at 54 (emphasis added), supports the sufficiency of his scienter allegations. Plaintiff contends that his scienter allegations are "strong" because defendants had actual knowledge of the Hostetter letter and release, and thus his allegations amount to more than mere protection of executive compensation. Plaintiff misunderstands what "more," under *Acito,* is required to allege motive adequately. Here, plaintiff seeks to combine inadequate allegations of motive with inadequate allegations of recklessness, as described *infra,* to demonstrate scienter. Plaintiff offers no support for his approach, and we decline to accept it.[5]

Our prior cases holding scienter allegations to give rise to a strong inference of fraudulent intent illuminate what is necessary. In *Time Warner,* 9 F.3d at 269, we held sufficient plaintiffs' allegations that "defendants were motivated to misrepresent the status of ... alliance negotiations to avoid jeopardizing talks with prospective partners, and to withhold disclosure of consideration of the rights offering to maintain a high stock price prior to announcement of the new rights offering in order to lessen the dilutive effect." In *Stevelman v. Alias Research, Inc.,* 174 F.3d 79, 85 (2d Cir.1999), we held that plaintiff sufficiently pleaded motive where the defendants' misrepresentations were accompanied by insider trading, because "[t]he allegation supports the inference that [defendant] withheld disclosures that would depress his stock until he had profitably sold his shares." Similarly, in *Hollin v. Scholastic Corp. (In re Scholastic Corp.* ***142** *Securities Litigation),* 252 F.3d 63, 74–75 (2d Cir.2001), we concluded that plaintiff sufficiently alleged motive where the allegedly fraudulent statements were quickly followed by defendant's sale of 80% of his holdings for a substantial profit.

[14] Here, by contrast, plaintiffs have not pointed to any specific benefit that would inure to the defendants that would not be either generalized to all corporate directors or beneficial to all shareholders, not just the defendant directors specifically. Additionally, plaintiff's motive allegations regarding avoidance of personal liability and ensuring Hostetter's ability to obtain that AT & T agreement are too conclusory to support scienter. A plaintiff cannot base securities fraud claims on speculation and conclusory allegations. *Chill,* 101 F.3d at 267. Thus, we affirm the district court's conclusion that Kalnit did not sufficiently allege motive.

### 2. *Circumstantial Evidence of Conscious Misbehavior or Recklessness*

[15] [16] Having concluded that Kalnit failed to allege scienter adequately by demonstrating motive and opportunity to defraud, we next turn to whether Kalnit's allegations demonstrate "strong circumstantial evidence" of defendants' "conscious misbehavior or recklessness." *Shields,* 25 F.3d at 1128. "Where motive is not apparent, it is still possible to plead scienter by identifying circumstances indicating conscious behavior by the defendant, though the strength of the circumstantial allegations must be correspondingly greater." *Beck v. Mfrs. Hanover Trust Co.,* 820 F.2d 46, 50 (2d Cir.1987) (citations omitted), *overruled on other grounds by United States v. Indelicato,* 865 F.2d 1370 (2d Cir.1989) (en banc).

To survive dismissal under the "conscious misbehavior" theory, the appellants must show that

they alleged reckless conduct by the appellees, which is "at the least, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."

*Honeyman v. Hoyt (In Re Carter–Wallace, Inc. Secs. Litig.),* 220 F.3d 36, 39 (2d Cir.2000) (citation omitted). Although this is a highly fact-based inquiry, generalities can be drawn.

> [S]ecurities fraud claims typically have sufficed to state a claim based on recklessness when they have specifically alleged defendants' knowledge of facts or access to information contradicting their public statements. Under such circumstances, defendants knew or, more importantly, should have known that they were misrepresenting material facts related to the corporation.

*Novak,* 216 F.3d at 308.

Plaintiff argues that defendants' knowledge of, but failure to disclose, the Hostetter release suffices to show conscious misbehavior or recklessness. He cites to our decision in *Novak,* 216 F.3d at 311–12, for support. In that case, shareholders claimed that defendants had "knowingly and intentionally ... overstated [AnnTaylor, Inc.'s] financial condition by accounting for inventory that they knew to be obsolete and nearly worthless at inflated values and by deliberately failing to adhere to the Company's publicly stated markdown policy." *Novak,* 216 F.3d at 304. We concluded that plaintiffs' scienter allegation was adequate, emphasizing that plaintiffs alleged also that the defendants had, after discussion, made a conscious decision not to mark down inventory specifically because of the effect on AnnTaylor Stores Corporation. *Id.* at 311–12. In making this decision, defendants "knowingly sanctioned procedures that violated ***143** the Company's own markdown policy, as stated in the Company's public filings ... [and] caused those filings to be materially misleading in that the disclosed policy no longer reflected actual practice." *Id.* at 311.

Plaintiff also relies on our decision in *Rothman,* 220 F.3d at 90–91. In *Rothman,* we found allegations that defendant had, for a full year, failed to expense royalty advances for poorly selling products when the defendant knew (because of quarterly assessments) that these products were selling poorly to be sufficient recklessness allegations. The *Rothman* plaintiffs had pointed to defendants' pleadings in other lawsuits which sought to recover royalty payments as evidence of defendants' knowledge that these products were not selling. *Id.* at 91. We noted that the large size of the eventual write-off taken by defendants "renders less credible the proposition that ... [defendant] believed it likely that it could recover those royalty advances." *Id.* at 92.

[17] The nondisclosure allegations here do not rise to the level of recklessness as did those in *Novak* or *Rothman.* In those cases, the defendants' duty to disclose the concealed information was not seriously disputed. Both cases involved a corporation's financial statements and its publicly known accounting policies. Thus, that the *Novak* or *Rothman* defendants were reckless (or consciously misbehaving) in not disclosing their inventory losses was more clear and this failure to disclose amounted to, at the least, reckless behavior. As the district court here pointed out, the duty to disclose the Hostetter letter was not so clear, especially given that the public was aware that MediaOne could accept a superior proposal within forty-five days. *Kalnit I,* 85 F.Supp.2d at 245. Therefore, defendants' recklessness cannot be inferred from the failure to disclose. Further, because plaintiff has failed to demonstrate that defendants had a motive to defraud the shareholders, he must produce a stronger inference of recklessness. *Beck,* 820 F.2d at 50. This he has not done.

Plaintiff cites two district court cases involving merger negotiations as support. The first, *Buxbaum v. Deutsche Bank, A.G.,* 2000 U.S. Dist. LEXIS 5838, at *42 (S.D.N.Y. March 7, 2000), involved public statements by a chairman of the acquiring bank denying the existence of takeover discussions, where less than a month later, defendants announced a merger. In the interim, the price of the target bank's stock was depressed. Plaintiffs, shareholders who had sold the target bank's stock following defendants' statement, alleged that the merger talks had been going on prior to the public interview and claimed that the statement denying these discussions was false when made. *Id.* at *42–*46. The court found that plaintiffs sufficiently alleged scienter, noting that the facts alleged "clearly suggest that takeover talks were well under way ..., that [defendant] was personally involved in those talks, and that he falsely and knowingly denied the existence of those talks." *Id.* at *51.

The second case, *In re MCI Worldcom, Inc. Securities Litigation,* 93 F.Supp.2d 276 (E.D.N.Y.2000), involved similar facts. Sellers of the target corporation's shares who sold during the three day period between the date of

a misleading statement by defendants (asserting that its registration of an internet domain name matching the name of the target company was not an indication of an intention to acquire the company) and the date of the merger announcement, brought suit alleging securities fraud. *Id.* at 279–80. The court found that the plaintiffs' allegations sufficed to plead conscious misbehavior or recklessness, noting that the statement in controversy had also affirmatively misrepresented ***144** that the domain name registration was the product of one employee acting alone, but plaintiffs offered a New York Times article indicating that the company itself registered the domain. *Id.* at 285.

These cases are distinguishable from this case. First, both *Buxbaum* and *MCI* involve affirmative misstatements, not merely a failure to disclose merger discussions. There can be no question that a corporation's public statements must be truthful. Here, however, plaintiff's claim lies in non-disclosure. Because, as discussed earlier, this case does not present facts indicating a clear duty to disclose, plaintiff's scienter allegations do not provide *strong* evidence of conscious misbehavior or recklessness. Also, both *Buxbaum* and *MCI* involve misstatements about merger discussions that were ongoing, where the allegations here concern MediaOne's failure to disclose its waiver of a then three year old standstill provision. The recklessness of this behavior is not apparent from the facts alleged by plaintiff. We therefore conclude that plaintiff's allegations are inadequate to demonstrate strong circumstantial evidence of defendants' conscious misbehavior or recklessness.

Plaintiff has failed to allege scienter adequately, through either method. Accordingly, plaintiff's complaint fails to assert a securities fraud claim properly.

### C. *Alternative Grounds for Dismissal*

We agree with the district court's conclusion that plaintiff has failed to plead scienter adequately, and we affirm the district court's dismissal on that ground. We, therefore, need not and do not reach defendants' arguments alleging other deficiencies in the plaintiff's complaint. Specifically, we do not reach whether plaintiff sufficiently pleaded materiality, defendants' duty to disclose, or reliance.

## III. CONCLUSION

For the reasons outlined above, plaintiff has failed to include in his complaint allegations giving rise to a strong inference of fraudulent intent. We therefore affirm the district court's dismissal of plaintiff's complaint.

Footnotes

1 The district court did not certify the class under Fed.R.Civ.P. 23. Therefore, this opinion pertains only to Kalnit for res judicata purposes. *See Press,* 166 F.3d at 532 n. 1.

2 The district court also dismissed plaintiff's section 20(a) claims that sought to hold defendants liable as 'control persons' for alleged omissions and misrepresentations, noting that, under plaintiff's theory, defendants would actually be liable (if at all) as primary violators rather than as control persons. *Kalnit I,* 85 F.Supp.2d at 246. Plaintiff does not raise any section 20(a) issues on appeal.

3 We note that Kalnit does not contend on appeal that the district court abused its discretion in denying him leave to amend his complaint.

4 Congress's amendments to section 10, passed in 2000, do not affect the merits of this appeal. *See* Consolidated Appropriations–FY 2001 (2000), Pub.L. No. 106–554, Appendix E H.R. 5660, 114 Stat. 2763, 2763A–365 (2000).

5 To the extent that plaintiff argues that our decision in *Novak,* 216 F.3d at 311, created a third method of demonstrating scienter, we reject such a contention. Instead, what plaintiff contends is a third method, showing that defendants had actual knowledge of facts contradicting their public statements, is part of the second method of demonstrating scienter, by setting forth allegations that demonstrate strong circumstantial evidence of conscious misbehavior or recklessness.

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IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED, AND IN THE MATTER OF A PLAN OF COMPRISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Commercial Court File No.: CV-12-9667-00CL

The Trustees of the Labourer's Pension Fund of Central and Eastern Canada, et al.
Plaintiffs

and

Sino-Forest corporation, et al.
Defendants

Court File No: CV-11-431153-00CP

***ONTARIO***
**SUPERIOR COURT OF JUSTICE**

Proceeding commenced at Toronto

**BRIEF OF AUTHORITIES OF THE U.S. CLASS ACTION PLAINTIFFS**
**(Approval of U.S. Counsel Fees, returnable December 13, 2013)**

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