Snell & Wilmer

August 2007

Bell Atlantic Corporation v. Twombly

THE SUPREME COURT UPSETS A 50-YEAR-OLD PLEADING STANDARD . . . BUT NOW WHAT?

by Andrew F. Halaby

Introduction

Federal Rule of Civil Procedure 8(a)(2) requires that a complaint, or any other pleading that sets forth a claim for relief, contain merely "a short and plain statement of the claim showing that the pleader is entitled to relief." Plaintiffs[1] like this rule because, all other things being equal, they want the option of alleging as little factual detail as possible. Every additional alleged fact supplies more information to the defendant. Every additional alleged fact can add to the pleading's cost — in prefiling investigation and in preparation. Every additional fact that must be alleged can delay the pleading's filing — and the onset of the defendant's costs to defend the claim.

But Federal Rule of Civil Procedure 12(b)(6) permits a claim's dismissal if it "fail[s] to state a claim upon which relief can be granted." This rule limits plaintiffs' ability to avoid pleading facts, since the omission of some facts may increase the risk that what remains does not state a claim. For decades, plaintiffs and defendants have fought over where, in their particular cases, to locate the line between "enough" facts under Rule 8(a)(2) and "not enough" facts under Rule 12(b)(6). And for decades, ever since the United States Supreme Court's 1957 decision in *Conley v. Gibson*,[2] plaintiffs had a powerful weapon in that fight: the Court's statement that, generally, "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove *no set of facts* in support of his claim which would entitle him to relief."[3]

With its May 21, 2007 decision in *Bell Atlantic Corporation v. Twombly*,[4] the Supreme Court tore that weapon away, characterizing the *Conley* "no set of facts" standard as having "been questioned, criticized, and explained away for so long" that it had "earned its retirement." To the extent the lower courts treat *Twombly* as having replaced the *Conley* standard with

[1] As I use them here, the terms "plaintiff" and "defendant" include counterclaimants and counterdefendants, respectively.

[2] 355 U.S. 41 (1957).

[3] Emphasis here, and elsewhere in this article, is mine unless otherwise noted.

[4] 127 S. Ct. 1955 (2007).

a new, generally applicable fact pleading standard, this much is clear: the concept of *plausibility* will play a central role. Whether and to what extent the lower courts will do so, however, is less than clear, particularly in light of the Court's decision exactly one month later in *Tellabs, Inc. v. Makor Issues & Rights, Ltd*.[5]

This article briefly examines *Twombly* (and *Tellabs*); offers some educated guesses as to arguments plaintiffs and defendants may make in connection with future Rule 12(b)(6) motions in light of these cases; and offers some other implications of these decisions.

The *Twombly* Case

Twombly involved a Sherman Act § 1 claim brought by telephone and high-speed internet consumers against a group of regional telephone companies. The consumers pled that the companies had acted in parallel to thwart competition from other telecommunications companies. But even were that factual allegation true — the companies *had* acted in parallel — that conduct was equally susceptible to competing inferences. One was that the companies had agreed to do so, which is illegal. The other was that the companies independently had acted in parallel, which is not illegal. The plaintiff consumers, not surprisingly, drew the conspiracy inference, and alleged on information and belief that the companies had "entered into a contract, combination or conspiracy to prevent competitive entry in their respective local telephone and/or high-speed internet services markets" and "ha[d] agreed not to compete with one another and otherwise allocated customers in markets to one another." The district court dismissed the complaint, concluding that the consumers had failed to state a claim upon which relief could be granted. The Second Circuit Court of Appeals reversed.

The Supreme Court considered the governing procedural rules as well as the applicable substantive antitrust law, and held that the district court had properly dismissed the complaint. Procedurally, the Supreme Court observed, "[w]hile a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide the 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." Noting that Rule 8(a)(2) "requires a 'showing,' rather than a blanket assertion, of entitlement to relief," the Court went on: "Without some factual allegation in the complaint, it is hard to see how a claimant could satisfy the requirement of providing not only 'fair notice' of the nature of the claim, but also 'grounds' on which the claim rests."

Conley had "puzzl[ed] the profession for 50 years," the *Twombly* Court observed, in part

[5] 127 S. Ct. 2499 (2007).

because its "'no set of facts' language can be read in isolation as saying that any statement revealing the theory of the claim will suffice unless its factual impossibility may be shown from the face of the pleadings." On such a reading, the Court reasoned, "a wholly conclusory statement of claim would survive a motion to dismiss whenever the pleadings left open the possibility that a plaintiff might later establish some 'set of [undisclosed] facts' to support recovery." The "no set of facts" language, the *Twombly* Court concluded, "is best forgotten as an incomplete, negative gloss on an accepted pleading standard: once a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint."

Applying these procedural standards to the antitrust claim before it, the Court held that "stating such a claim requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made," *i.e.*, "allegations *plausibly suggesting* (not merely consistent with) agreement." The Court denied that this new "plausibility" standard "impose[s] a *probability* requirement at the pleading stage." Rather, the Court asserted, "it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement." "[N]othing contained in the complaint invest[ed] either the action or inaction alleged with a *plausible* suggestion of conspiracy," the Court believed, and because "the plaintiffs here ha[d] not nudged their claims across the line from *conceivable* to *plausible*, their complaint must be dismissed."

The Court Revisits "Plausibility" in *Tellabs*

The new "plausibility" concept re-appeared exactly one month later, on June 21, 2007, in *Tellabs*. The issue in that case was the level of fact pleading necessary to satisfy the Private Securities Litigation Reform Act of 1995's requirement that a PSLRA plaintiff's complaint "state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind"; specifically, "scienter," or intention to deceive, manipulate, or defraud. The Supreme Court held that "[i]t does not suffice that a reasonable factfinder *plausibly could* infer from the complaint's allegations the requisite state of mind." "To qualify as 'strong' within the intendment" of the statute, held the Court, "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 non-fraudulent intent."

A group of shareholders in Tellabs sued the company and Richard Notebaert, its CEO and president, under § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. The shareholders alleged that Tellabs and Notebaert had made misleading statements

to the investing public in connection with Tellabs's products and financial performance, causing investors to buy company stock at an inflated price (which later plummeted). The district court having dismissed their complaint once for failure to plead with the particularity required by the PSLRA, the shareholders amended their complaint to include, among other things, "further, more specific, allegations concerning Notebaert's mental state." The district court again dismissed, this time with prejudice, holding that the shareholders had insufficiently alleged that Notebaert had acted with scienter. The Seventh Circuit Court of Appeals reversed, holding that the complaint sufficiently alleged scienter since "it allege[d] facts from which, if true, a reasonable person could infer that the defendant acted with the required intent."

The Supreme Court reversed the Seventh Circuit. In analyzing the "strong inference" standard, the Supreme Court observed that on a Rule 12(b)(6) motion to dismiss a § 10(b) claim, as on any other Rule 12(b)(6) motion, a district court must accept all factual allegations in the complaint as true, and "consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motion to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." The Court also observed that "in determining whether the pleaded facts give rise to a 'strong' inference of scienter," the court "must take into account *plausible* opposing inferences." Indeed, the Court asserted, "[t]he strength of an inference cannot be decided in a vacuum. The inquiry is inherently comparative . . . . To determine whether the plaintiff has alleged facts to 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 Court concluded that "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 . . . 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."

Analysis

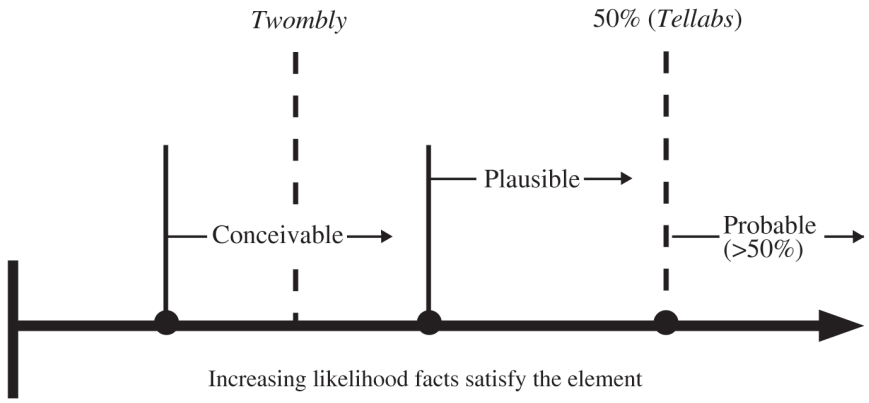
Twombly and *Tellabs* have several things in common. Both arose out of the telecommunications industry. Indeed, both feature Notebaert as a central character — in *Twombly* because one of his statements, as CEO of Qwest, fueled the plaintiffs' allegations that the defendant companies had conspired not to compete.

More significantly, from a legal analysis standpoint, both *Twombly* and *Tellabs*

involved the sufficiency of pleading "state of mind" allegations — at least in a broad sense. In *Twombly*, the issue was whether and to what extent the plaintiffs' factual allegations gave rise to an inference of agreement. In *Tellabs*, the issue was whether the plaintiffs' factual allegations gave rise to a "strong inference" of scienter.

The most legally significant element common to the two cases, however, is the concept of "plausibility." To demonstrate that concept's role, envision a continuum (shown in Figure 1) in which the likelihood that the alleged facts satisfy the claim element at issue increases from left to right.

Figure 1



To the left on this continuum lies a point beyond which it is "conceivable" that the facts satisfy that element.[6] To the right of that point lies another, beyond which it is "plausible" that they do. In *Twombly*, the Court held, the alleged facts made it "conceivable," but not "plausible," that the defendant companies had illegally agreed, and thus did not suffice for the plaintiff consumers' claim to survive a Rule 12(b)(6) motion.

Still further to the right on the continuum lies a third point, where it is equally likely that the alleged facts satisfy the element at issue and that they do not. Beyond that point, it is "probable" — *i.e.*, more likely than not — that the alleged facts establish the element. Arguably, at least, *Twombly* disclaimed that this degree of likelihood is ever required to survive a Rule 12(b)(6) motion.[7] But here *Tellabs* comes into play. For the *Tellabs* shareholders' factual allegations to survive

[6] To the left of this point, theoretically, it is inconceivable that the facts satisfy the element.

[7] As the Court put it, "Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of illegal agreement."

a Rule 12(b)(6) motion, the Court held, they would have to give rise to an inference of scienter "at least as compelling" as any competing inference. At least at the pleading stage, then, a 50 percent likelihood would suffice to survive a Rule 12(b)(6) motion.

The combined impact of *Twombly* and *Tellabs* on future Rule 12(b)(6) motion practice — and, for that matter, on pleading practice in light of Rule 8(a)(2) — is unclear. Defendants likely will cite *Twombly* for the proposition that a mere recitation of a claim's elements will not do — if it ever should have. Defendants likely will also argue from *Twombly* that any inference of a claim element to be drawn from other, explicitly-pleaded facts must be at least "plausible." It follows, defendants likely will argue, that *Twombly* authorizes — or compels — the trial court to weigh competing inferences from the explicitly-pleaded facts in deciding a Rule 12(b)(6) motion. Given the demise of *Conley*'s "no set of facts" standard, that argument may have some force.

Plaintiffs, on the other hand, likely will attempt to confine *Twombly* to its antitrust context. As a practical matter, if not a legal one, such attempts may succeed. Consider the Supreme Court's 1986 decision in *Matsushita Electric Industrial Company v. Zenith Radio Corporation*.[8] *Matsushita* is often cited, along with *Anderson v. Liberty Lobby*[9] and *Celotex Corporation v. Catrett*,[10] as establishing the modern standard for entry of summary judgment under Federal Rule of Civil Procedure 56. But anecodotally, at least, the substantive basis of *Matsushita*'s summary judgment ruling — that the plaintiff's liability theory had to be economically rational, but wasn't — has not been widely applied outside the antitrust context. Moreover, the *Twombly* Court explicitly granted review "to address the proper standard for pleading an antitrust conspiracy through allegations of parallel conduct." The significance of conscious parallelism, as opposed to agreed parallelism, had been frequently litigated; indeed, the Court had addressed it, in other procedural contexts, in at least three previous decisions. Those decisions established that the evidence in a parallel conduct case must tend to rule out independent action.

On the other hand, the *Twombly* Court did not explicitly limit its treatment of Rules 8(a)(2) and 12(b)(6) to the antitrust context. *Conley* was not an antitrust case. Neither was *Erickson v. Pardus*,[11] in which the Supreme Court applied *Twombly* just two weeks later. And the *Twombly* Court referred to its 2005 decision in *Dura Pharmaceuticals v. Broudo*[12] — which was not an antitrust case — as having "alluded to the practical significance

[8] 475 U.S. 574 (1986).

[9] 477 U.S. 242 (1986).

[10] 477 U.S. 317 (1986).

[11] 127 S. Ct. 2197 (2007).

[12] 544 U.S. 336 (2005).

of the Rule 8 entitlement requirement" and "explained that something beyond the mere possibility of loss causation must be alleged, lest a plaintiff with ''a largely groundless claim'' be allowed to ''take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value.''" Arguably, at least, that same reference to *Dura Pharmaceuticals* obstructs another basis on which plaintiffs might attempt to distinguish *Twombly*: that even if *Twombly*'s holding is not confined to the antitrust setting, it should apply only to mental state inferences. Loss causation, after all, is not a mental state issue. Finally, plaintiffs are likely to note that *Twombly* explicitly disavowed establishing a probability requirement at the pleading stage.

Plaintiffs may point to *Tellabs* in response to defendants' invocation of *Twombly*. According to *Tellabs*, plaintiffs may argue, any pro-liability inference that is "at least as compelling" as an innocent one is a "strong inference." But plaintiffs would have to reconcile that argument with the "plausible" standard that appears common to *Twombly* and *Tellabs*. Plaintiffs may also attempt to draw defendants into attempting to distinguish conceivable inferences from plausible inferences, and plausible inferences from strong inferences, in the hope that the court will err on the side of denial consistent with habits long shaped by *Conley*.[13]

Defendants, on the other hand, may argue that *Tellabs* applies only to the unique, statutory "strong inference" standard at issue in that case. This argument would seem to be a strong one, but viscerally, at least, it may be difficult to make that argument while at the same time asserting that *Twombly* transcends its antitrust context. Somewhat similarly, defendants invoking *Twombly* and attempting to distinguish *Tellabs* likely will note that were there no statutory "strong inference" standard, the shareholder plaintiffs would have had to satisfy Federal Rule of Civil Procedure 9(b)'s particularity requirement rather than Rule 8(a)(2)'s notice pleading requirement, meaning (so the argument would go) that *Tellabs* cannot shape the contours of the Rule 8(a)(2) requirement. Finally, defendants attempting to distinguish *Tellabs* may argue that the case's holding applies only to the mental state inference. But as discussed above, *Twombly* is subject to a very similar argument. All things considered, given that case's treatment of *Conley*, a defendant likely would rather invoke *Twombly* and deal with *Tellabs* than have both distinguished by the trial court.

---

[13] The Court in *Erickson* cited *Twombly* for the proposition that "[s]pecific facts are not necessary" under Rule 8(a)(2). It is true that *Twombly* held, among other things, that "a complaint . . . does not need detailed factual allegations," though it also held that "[f]actual allegations must be enough to raise a right to relief above the speculative level."

Conclusion

It is too early to tell with any certainty how *Twombly*, as arguably tempered by *Tellabs*, will change pleading and dismissal motion practice. To the extent *Twombly* is applied more broadly, it may lead plaintiffs to allege more, and more specific, facts, if only on information and belief. One corresponding result may be more Rule 11 practice since the plaintiff, having to plead more facts, will have to satisfy Rule 11 as to each. The form complaints appended to the Federal Rules of Civil Procedure will have to be considered in light of these decisions. While most would appear to state a claim upon which relief can be granted even under a broad reading of *Twombly*, the patent infringement claim of Form 16 appears close to the mere "formulaic recitation of the elements of a cause of action," that the *Twombly* Court said "will not do." It may be that civil plaintiffs will have to invest more time, effort and money in pre-filing investigation than before, particularly in cases addressing relatively complex subjects, such as science and technology or economics. That may be exactly what the Supreme Court had in mind.

* * *

Andrew F. Halaby
602.382.6277
ahalaby@swlaw.com

Andrew Halaby is a partner in Snell & Wilmer's Phoenix office. His practice is concentrated in litigation and business counseling, including emerging business issues. He focuses on intellectual property, commercial (including complex commercial), and professional liability and disciplinary matters.