

# THE REVIEW OF LITIGATION

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## LEAD ARTICLE

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# Blurring the Lines Between Pleading Doctrines: The Enhanced Rule 8(a)(2) Plausibility Pleading Standard Converges With the Heightened Fraud Pleading Standards Under Rule 9(b) and the PSLRA

Marc I. Steinberg\* and Diego E. Gomez-Cornejo\*\*

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**ABSTRACT**

*This article focuses on the Supreme Court’s recent enhancement of Rule 8(a)(2)’s pleading standard to approach the heightened fraud pleading standards under Rule 9(b) and the Private Securities Litigation Reform Act (PSLRA). The authors posit that the*

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*introduction of a tacit “probability requirement” into the basic pleading standard impedes the heightened fraud pleading standards under Rule 9(b) and the PSLRA from fulfilling the policy rationales for which they were created. By elevating the basic requirements that must be met in any federal civil case for a complaint to be legally sufficient, the Supreme Court has caused an evident convergence of pleading standards that blurs the lines between pleading doctrines. The authors assert that this convergence produces incongruity in the federal civil litigation system by at times treating plaintiffs bringing fraud claims more leniently than those alleging non-fraud claims under Rule 8(a)(2)’s new plausibility pleading standard.*

The modern rules of civil procedure permit defendants to attack both the factual and legal sufficiency of a complaint.<sup>1</sup> Thanks to the liberal “no set of facts” notice pleading standard adopted by the United States Supreme Court in *Conley v. Gibson*,<sup>2</sup> however, Rule 12(b)(6) motions—asking the court to dismiss the complaint “for failure to state a claim upon which relief may be granted”<sup>3</sup>—were rarely granted by federal courts in civil litigation.<sup>4</sup> As noted by Justice Stevens, “[u]nder the relaxed pleading standards of the Federal Rules, the idea was not to keep litigants out of court but rather to keep them in.”<sup>5</sup> The Supreme Court, however, has recently abandoned this liberal pleading standard in favor of plausibility pleading, requiring plaintiffs to plead “enough facts to state a claim to relief that is plausible on its face.”<sup>6</sup> It is not surprising, therefore,

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1. See generally Richard A. Epstein, *Bell Atlantic v. Twombly: How Motions to Dismiss Become (Disguised) Summary Judgments*, 25 WASH. U. J.L. & POL’Y 61, 62 (2007) (examining the legal and factual uncertainty under the present federal rules and arguing that *Twombly* “was a disguised motion for summary judgment that is best defended as properly balancing the relative error costs of stopping too soon or going too far”).

2. 355 U.S. 41, 45–46 (1957).

3. FED. R. CIV. P. 12(b)(6).

4. See, e.g., *Test Masters Educ. Servs., Inc. v. Singh*, 428 F.3d 559, 570 (5th Cir. 2005) (“Motions to dismiss are viewed with disfavor and are rarely granted.”); *Kingwood Oil Co. v. Bell*, 204 F.2d 8, 13 (7th Cir. 1953) (“Motions to dismiss pleadings . . . are to be granted sparingly and with caution.” (quoting CYCLOPEDIA OF FEDERAL PROCEDURE § 15.204 (3d ed. 1951))).

5. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 575 (2007) (Stevens, J., dissenting).

6. *Id.* at 570.

that complaints that would have previously survived motions to dismiss under the notice pleading standard are now dismissed before any opportunity for discovery.<sup>7</sup>

By enhancing the basic pleading standard applicable in every federal civil case, the Supreme Court has elevated the previously liberal Rule 8(a)(2) pleading standard to approach the heightened pleading standards predicated on allegations of fraud—the Rule 9(b) fraud pleading standard<sup>8</sup> and the pleading standard for scienter in securities fraud actions under the PSLRA.<sup>9</sup> This evident convergence of pleading standards blurs the lines between pleading doctrines that were adopted to address different policy concerns, thus creating a federal civil litigation system that is unfair and incongruous.

Part I of this article briefly outlines the new Rule 8(a)(2) plausibility pleading standard, as established under *Twombly*<sup>10</sup> and *Iqbal*;<sup>11</sup> the Rule 9(b) heightened fraud pleading standard; and the PSLRA's pleading standard for scienter in securities fraud, as interpreted in *Tellabs*.<sup>12</sup> Part II posits that the enhanced Rule 8(a)(2) pleading standard espoused by the Supreme Court in *Twombly* and *Iqbal* converges with the heightened pleading standards under Rule 9(b) and the PSLRA. By comparing and contrasting the pleading standards as understood by federal courts, analyzing *Iqbal*'s broadening of the *Twombly* pleading standard, and examining the way in which plaintiffs are affected when opposing inferences have equal weight, it will become apparent that recent Supreme Court

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7. See *Panther Partners, Inc. v. Ikanos Commc'ns, Inc.*, 347 F. App'x 617, 620 (2d Cir. 2009) (dismissing a complaint alleging violations of §§ 11, 12, and 15 of the Securities Act of 1933 because, applying *Twombly*'s plausibility pleading standard, the plaintiffs “did not allege facts sufficient to complete the chain of causation needed to prove that defendants negligently made false statements”).

8. See FED. R. CIV. P. 9(b) (“[I]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.”).

9. See 15 U.S.C. § 78u-4 (2006) (“[T]he complaint shall specify each statement alleged to have been misleading.”).

10. *Twombly*, 550 U.S. at 550–61 (setting forth the “plausibility standard” for pleading conspiracy claims under § 1 of the Sherman Act).

11. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1953 (2009) (finding that the plaintiff pleaded insufficient facts to state a claim for unlawful discrimination and expanding the plausibility pleading standard to all federal civil claims).

12. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 323 (2007) (holding that courts must consider both fraudulent and non-fraudulent plausible inferences of intent in determining whether a securities fraud complaint alleges sufficient facts to meet the “strong inference” requirement under the PSLRA).

decisions blur the lines distinguishing the pleading doctrines. Part III discusses the consequences of this convergence, asserting that it produces incongruity in the federal civil litigation system by at times treating plaintiffs alleging fraud more leniently than those stating a non-fraud claim under Rule 8(a)(2)'s plausibility pleading standard. After briefly examining the different policy concerns behind each pleading standard, Part III proposes that the Supreme Court, seeking in part to deter vexatious litigation, engaged in judicial activism by enhancing the basic pleading requirements for all federal civil suits under Rule 8(a)(2) and failed to consider the repercussions of the convergence of pleading standards, which has effectively disadvantaged plaintiffs bringing forward claims not involving fraud.

#### I. THREE EVOLVING PLEADING STANDARDS: PLAUSIBILITY, PARTICULARITY, AND COGENCY

The simple notice pleading standard adopted in *Conley v. Gibson* has been abandoned in favor of plausibility pleading, as established by the Supreme Court in *Twombly* and *Iqbal*.<sup>13</sup> When fraud is alleged in a complaint, however, the heightened pleading requirements of Rule 9(b) must still be met.<sup>14</sup> And, in the case of private securities litigation, after the Supreme Court's interpretation of the PSLRA's pleading requirements in *Tellabs*, a securities fraud complaint must allege plausible theories of relief through particularized allegations, with the inference of scienter being cogent and at least as compelling as any competing inference.<sup>15</sup> In order to properly discuss the convergence phenomenon proposed in Part II of this article, these three pleading standards will be examined below.

##### A. *Rule 8(a)(2) and the Death of Notice Pleading: Bell Atlantic Corp. v. Twombly and Ashcroft v. Iqbal*

Notice pleading, as understood by federal courts, practitioners, and law students for over fifty years,<sup>16</sup> has been

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13. See discussion *infra* Part I.A.

14. See discussion *infra* Part I.B.

15. See discussion *infra* Part I.C.

16. See, e.g., *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 512 (2002) (holding that an employment discrimination claim need not contain specific facts

effectively overhauled by the U.S. Supreme Court through two recent decisions.<sup>17</sup> The Rule 8(a)(2) pleading standard was embodied in the long accepted rule, established by the Supreme Court in the 1957 decision *Conley v. Gibson*, “that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.”<sup>18</sup> Even though the simplified notice pleading standard adopted in *Conley* was challenged by lower federal courts,<sup>19</sup> this Supreme Court ruling

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to establish a prima facie case, but rather “must simply ‘give the defendant fair notice of what the plaintiff’s claim is and the grounds upon which it rests’” (quoting *Conley v. Gibson*, 335 U.S. 41, 47 (1957)); *Judge v. City of Lowell*, 160 F.3d 67, 72 (1st Cir. 1998) (“In an oft-quoted gloss, the Supreme Court stated over forty years ago that a complaint should not be dismissed for failure to state a claim ‘unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.’” (quoting *Conley*, 335 U.S. at 45–46)); *O’Mara v. Erie Lackawanna R.R. Co.*, 407 F.2d 674, 678 (2d Cir. 1969) (finding the dismissal of a portion of the complaint proper “because it did not give defendants ‘fair notice’ of the basis of plaintiffs’ claim under the [Interstate Commerce] Act”); *Garcia v. Bernabe*, 289 F.2d 690, 692–93 (1st Cir. 1961) (finding the complaint sufficient under *Conley* and explaining that “[t]he Federal Rules of Civil Procedure do not require that a claimant set out in detail the facts upon which he bases his claim.”).

17. *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

18. *Conley*, 335 U.S. at 45–46.

19. *See, e.g., Ascon Props., Inc. v. Mobil Oil Co.*, 866 F.2d 1149, 1155 (9th Cir. 1989) (“[*Conley*] unfortunately provided conflicting guideposts.”); *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1106 (7th Cir. 1984) (explaining that “*Conley* has never been interpreted literally” and finding that complaints require “either direct or inferential allegations respecting all the material elements necessary to sustain a recovery under *some* viable legal theory”) (emphasis in original); Christopher M. Fairman, *Heightened Pleading*, 81 TEX. L. REV. 551, 574–96 (2002) (examining federal cases embracing heightened pleading burdens in contravention of *Conley*); Geoffrey C. Hazard, Jr., *From Whom No Secrets Are Hid*, 76 TEX. L. REV. 1665, 1685 (1998) (noting that the problem with Rule 8(a)(2) is its interpretation by federal courts and arguing that the Supreme Court “turned Rule 8 on its head” in *Conley*); Richard L. Marcus, *The Revival of Fact Pleading Under the Federal Rules of Civil Procedure*, 86 COLUM. L. REV. 433, 463–65 (1986) (examining the tension between the notice pleading standard established in *Conley* and subsequent interpretations of Rule 8(a)(2) by lower federal courts); Matthew A. Josephson, Note, *Some Things Are Better Left Said: Pleading Practice After Bell Atlantic Corp. v. Twombly*, 42 GA. L. REV. 867, 881 (2008) (“[T]he history of notice pleading can be characterized as a tug-of-war between the Supreme Court and the lower federal courts, with the federal courts continually

remained good law for fifty years.<sup>20</sup> In *Bell Atlantic Corp. v. Twombly*,<sup>21</sup> however, the Supreme Court expressly overruled this part of *Conley*'s pleading standard in favor of a stricter plausibility standard, holding that a complaint must provide "enough facts to state a claim to relief that is *plausible on its face*."<sup>22</sup> Although there was some uncertainty about whether the Court's holding in *Twombly* extended beyond the antitrust context,<sup>23</sup> the Supreme Court resolved that issue two years later in *Ashcroft v. Iqbal*,<sup>24</sup> holding that the plausibility standard extends beyond pleadings in the antitrust context and encompasses all civil federal actions.<sup>25</sup>

In 1938, the enactment of the Federal Rules of Civil Procedure replaced the "cumbersome and inelegant" code pleading

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requiring the pleading of more facts and the Supreme Court responding with a 'no facts necessary' interpretation of Rule 8.')

20. See *supra* note 16 and accompanying text.

21. 550 U.S. 544 (2007).

22. *Id.* at 570 (emphasis added).

23. Compare *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 n.2 (2d Cir. 2007) ("We have declined to read *Twombly*'s flexible 'plausibility standard' as relating only to antitrust cases."), and *Ocwen Loan Servicing, LLC Mortg. Servicing Litig.*, 491 F.3d 638, 649 (7th Cir. 2007) ("The present case is not an antitrust case, but the district court will want to determine whether the complaint contains 'enough factual matter (taken as true)' to provide the minimum notice of the plaintiffs' claim that the Court believes a defendant entitled to."), with *Aktieselskabet AF 21. Nov. 2001 v. Fame Jeans Inc.*, 525 F.3d 8, 15 (D.C. Cir. 2008) ("Many courts have disagreed about the import of *Twombly*. We conclude that *Twombly* leaves the long-standing fundamentals of notice pleading intact."), and *McZeal v. Sprint Nextel Corp.*, 501 F.3d 1354, 1356 n.4 (Fed. Cir. 2007) (refusing to apply *Twombly* to a patent infringement claim by arguing that *Twombly* did not change the pleading requirement of Rule 8 as articulated in *Conley*). See also Jason G. Gottesman, *Speculating as to the Plausible: Pleading Practice After Bell Atlantic Corp. v. Twombly*, 17 WIDENER L.J. 973, 1004-05 (2008) (noting how the circuit courts' disparate interpretations of *Twombly* are confusing the legal profession); Douglas G. Smith, *The Twombly Revolution?*, 36 PEPP. L. REV. 1063, 1099 (2009) ("The full scope and effect of *Twombly* has yet to play out in the courts. Nonetheless, faithful adherence to the Court's decision would have potentially sweeping effects."); A. Benjamin Spencer, *Plausibility Pleading*, 49 B.C. L. REV. 431, 494 (2008) ("The new plausibility standard, which is being and will continue to be applied by lower courts outside the antitrust context, bodes ill for plaintiffs who will now have to muster facts showing plausibility when such facts may be unavailable to them.").

24. 129 S. Ct. 1937 (2009).

25. *Id.* at 1953 (explaining that the *Twombly* decision "expounded the pleading standard for 'all civil actions,' and it applies to antitrust and discrimination suits alike").



system and introduced a simplified pleading system, in which “the complaint simply would initiate the action and notify the parties and the court of its nature.”<sup>26</sup> Federal Rule of Civil Procedure 8(a)(2) requires “a short and plain statement of the claim showing that the pleader is entitled to relief.”<sup>27</sup> It was not until 1957, in *Conley v. Gibson*, however, that the Supreme Court interpreted the notice pleading standard.<sup>28</sup> In *Conley*, the Supreme Court interpreted the language of Rule 8(a)(2) as requiring a plaintiff to “give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.”<sup>29</sup> Noting that Rule 8 did not require a plaintiff to provide detailed facts, the Court rejected the view that pleading is simply “a game of skill”<sup>30</sup> and found that the complaint at bar adequately set forth a claim upon which relief could be granted.<sup>31</sup>

The *Conley* decision was long perceived as properly embodying the drafters’ original intent since it reflected the view that “procedural rules should efficiently foster decisions on the merits.”<sup>32</sup>

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26. Spencer, *supra* note 23, at 434 (noting that the new rules introduced a system in which “pleadings were no longer to be a substantial hurdle to be overcome before plaintiffs could gain access to the courts”); see also Robert L. Carter, *Civil Procedure as a Vindicator of Civil Rights: The Relevance of Conley v. Gibson in the Era of “Plausibility Pleading”*, 52 HOW. L.J. 17, 25 (2008) (“The Rules were created, in part, to promote the resolution of lawsuits on the merits, not on procedure. They replaced a cumbersome system that distinguished between ‘ultimate facts’ and ‘evidentiary facts’ or ‘conclusions.’”).

27. FED. R. CIV. P. 8(a)(2).

28. *Conley v. Gibson*, 355 U.S. 41, 47–48 (1957). The Supreme Court refused to dismiss a complaint filed by a group of black railway employees against their union because the complaint properly alleged that the union breached its statutory duty of equal representation of its members. *Id.* at 45–46.

29. *Id.* at 47. The Court explained that this simplified form of pleading was “made possible by the liberal opportunity for discovery and the other pretrial procedures established by the Rules to disclose more precisely the basis of both claim and defense and to define more narrowly the disputed facts and issues.” *Id.* at 47–48.

30. *Id.* at 48; see also Saritha Komatireddy Tice, *A “Plausible” Explanation of Pleading Standards: Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955 (2007), 31 HARV. J.L. & PUB. POL’Y 827, 834 (2008) (explaining that because the pre-*Twombly* interpretation of the Rules focused mainly on simplicity, federal courts “enabled a plaintiff to state his claim without technical finesse”).

31. *Conley*, 355 U.S. at 47.

32. See Carter, *supra* note 26, at 18 (“[The *Conley* decision] emphasized that the Rules were designed to aid the enforcement of substantive justice rather than create hypertechnical traps for the unwary, while serving dual purposes of efficiency and fairness.”).

Moreover, as recently as 2002, in the employment discrimination context, the Supreme Court reiterated that the notice pleading standard established in *Conley* still applied in all civil actions.<sup>33</sup> Nonetheless, as subsequent case law examined below will show, the notice pleading standard has been abandoned in favor of a stricter plausibility standard, in which the plaintiff must provide sufficient factual allegations to move a claim across “the line between possibility and plausibility.”<sup>34</sup>

In *Bell Atlantic Corp. v. Twombly*, decided in 2007, the U.S. Supreme Court was presented with the issue of whether to dismiss an antitrust conspiracy claim brought by a putative class of telephone and internet service subscribers.<sup>35</sup> The subscriber-plaintiffs brought their liability claim under § 1 of the Sherman Act, which prohibits “[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations.”<sup>36</sup> The plaintiffs alleged that various regional telephone service monopolies, called Incumbent Local Exchange Carriers (ILECs), had engaged in a conspiracy to hinder the entrance of competing local companies, referred to as Competitive Local Exchange Carriers (CLECs), into the local telephone and internet service market.<sup>37</sup> More specifically, they argued that the ILECs had conspired to restrain trade by “‘engag[ing] in parallel conduct’ in their respective service areas to inhibit the growth of upstart CLECs” and by entering

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33. See *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 512 (2002) (“This simplified notice pleading standard relies on liberal discovery rules and summary judgment motions to define disputed facts and issues and to dispose of unmeritorious claims.”); see also *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 346 (2005) (relying on *Conley* to find that the plaintiffs’ complaint failed to adequately allege proximate causation and economic loss in a private federal securities fraud action); *Leatherman v. Tarrant Cnty. Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 167–68 (1993) (reaffirming the notice pleading standard established in *Conley* in rejecting the application of a heightened pleading standard to a Fourth Amendment civil rights case alleging municipal liability under 42 U.S.C. § 1983).

34. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 557 (2007).

35. *Id.* at 548–49.

36. 15 U.S.C. § 1 (2006). Section 1 of the Sherman Act only prohibits restraints of trade “effected by a contract, combination, or conspiracy.” *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 775 (1984). “The crucial question,” therefore, is whether the alleged anticompetitive actions stem from “independent decision or from an agreement, tacit or express.” *Theatre Enterprises, Inc. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 540 (1954).

37. *Twombly*, 550 U.S. at 550–51.

into agreements not to compete against each other.<sup>38</sup> These actions, the subscribers alleged, resulted in them having to pay inflated rates for the services provided.<sup>39</sup>

The District Court for the Southern District of New York dismissed the complaint, finding that the subscribers' "allegations of parallel ILEC actions to discourage competition" were inadequate because mere "conscious parallelism" was insufficient to state a claim of conspiracy under § 1 of the Sherman Act.<sup>40</sup> Furthermore, as to the alleged non-compete agreements, the district court found that they were insufficient to infer a conspiracy because the complaint failed to allege facts to suggest that "refraining from competing in other territories as CLECs was contrary to [the ILECs'] apparent economic interests."<sup>41</sup> The Court of Appeals for the Second Circuit reversed, however, holding that "plus factors are not *required* to be pleaded to permit an antitrust claim based on parallel conduct to survive dismissal."<sup>42</sup> The U.S. Supreme Court granted certiorari in order to determine the proper pleading standard for antitrust conspiracy cases based upon allegations of parallel conduct.<sup>43</sup>

The Supreme Court began its analysis by noting that a plaintiff bringing an antitrust conspiracy claim may not proceed by

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38. *Id.* at 550. The complaint alleged the following:

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

*Id.* at 551.

39. *Id.* at 550.

40. *Id.* at 552. Judge Lynch, presiding over the district court, explained that "parallel action is a common and often legitimate phenomenon, because similar market actors with similar information and economic interests will often reach the same business decisions." *Twombly v. Bell Atl. Corp.*, 313 F. Supp. 2d 174, 179 (S.D.N.Y. 2003), *rev'd*, 425 F.3d 99 (2d Cir. 2005), *rev'd sub nom.* *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

41. *Twombly*, 313 F. Supp. 2d at 188.

42. *Twombly*, 425 F.3d at 114.

43. *Twombly*, 550 U.S. at 553.

merely providing evidence of parallel conduct, but rather must provide evidence that properly rules out the possibility of independent action by the defendants.<sup>44</sup> In determining whether the subscribers' complaint had sufficiently pleaded antitrust conspiracy, the majority focused on the notice pleading system established under Federal Rule of Civil Procedure 8(a)(2), as described in *Conley*.<sup>45</sup> Nonetheless, the Court reasoned that factual allegations that would sufficiently "raise a right to relief above the speculative level" were required, rejecting the view that "a formulaic recitation of the elements of a cause of action" would be sufficient.<sup>46</sup> Thus, in holding that a claim under § 1 of the Sherman Act requires a complaint that pleads enough facts to allege that there was an agreement, the Court noted:

Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact[s] to raise a reasonable expectation that discovery will reveal evidence of illegal agreement. And, of course, a well-pleaded complaint may proceed even if it strikes a savvy judge that actual proof of those facts is improbable, and "that a recovery is very remote and unlikely."<sup>47</sup>

Interestingly, in agreeing with the district court's finding that the subscribers failed to state a claim under § 1 of the Sherman Act because the facts alleged did not sufficiently suggest antitrust

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44. *Id.* at 554 ("The inadequacy of showing parallel conduct or interdependence, without more, mirrors the ambiguity of the behavior: consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market.").

45. *Id.* at 554–55.

46. *Id.* at 555. The majority was mainly concerned about the possibility of excessive discovery costs: "[I]t is one thing to be cautious before dismissing an antitrust complaint in advance of discovery, but quite another to forget that proceeding to antitrust discovery can be expensive." *Id.* at 558; *see also* Tice, *supra* note 30, at 830 ("[*Twombly*] reflects a significant shift away from the litigation-promoting mindset embodied in *Conley* and instead solidifies what has been a growing hostility towards litigation.").

47. *Twombly*, 550 U.S. at 556 (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974)).

conspiracy, the Supreme Court emphasized that it was neither applying a heightened pleading standard nor attempting to “broaden the scope of Federal Rule of Civil Procedure 9.”<sup>48</sup> More specifically, the Court explained that it did “not require heightened fact pleading of specifics, but only enough facts to state a claim to relief that is *plausible on its face*,” and that the subscribers’ complaint had to be dismissed because they failed to “nudge[] their claims across the line *from conceivable to plausible*.”<sup>49</sup>

Two years later, in *Ashcroft v. Iqbal*, the U.S. Supreme Court decidedly resolved the question as to whether this stricter plausibility standard applied in civil cases generally or only in antitrust cases.<sup>50</sup> Javaid Iqbal, a Pakistani Muslim, claimed to have been deprived of his constitutional rights after being arrested on criminal charges in the wake of the terrorist attacks of September 11, 2001.<sup>51</sup> Because Iqbal was deemed to be of “high interest” by the FBI, he was held in a maximum security housing unit and, after pleading guilty to criminal fraud and conspiracy charges, was removed to his native country.<sup>52</sup> Iqbal then filed a *Bivens* complaint against Attorney General John Ashcroft and FBI Director Robert Mueller, alleging that the policies adopted by Ashcroft and Mueller unconstitutionally discriminated against him while he was detained.<sup>53</sup> After the District Court for the Eastern District of New York refused to grant the defendants’ motion to dismiss, Mueller and Ashcroft filed an interlocutory appeal to the Court of Appeals for the Second Circuit.<sup>54</sup>

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48. *Twombly*, 550 U.S. at 569 n.14 (“Here, our concern is not that the allegations in the complaint were insufficiently ‘particular[ized]’; rather, the complaint warranted dismissal because it failed *in toto* to render plaintiffs’ entitlement to relief plausible.”).

49. *Id.* at 570 (emphasis added).

50. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1953 (2009).

51. *Id.* at 1942. More specifically, Iqbal contended that he was invidiously discriminated against in contravention of the First and Fifth Amendments to the United States Constitution. *Id.* at 1944.

52. *Id.* at 1943.

53. *Id.* at 1943–44. A *Bivens* action is “an implied private action for damages against federal officers alleged to have violated a citizen’s constitutional rights.” *Corr. Servs. Corp. v. Malesko*, 534 U.S. 61, 66 (2001) (examining *Bivens v. Six Unknown Fed. Narcotics Agents*, 403 U.S. 388 (1971)); *see also* Ryan D. Newman, *From Bivens to Malesko and Beyond: Implied Constitutional Remedies and the Separation of Powers*, 85 TEX. L. REV. 471, 476 (2006) (explaining *Bivens*’s doctrine of implied constitutional damage remedies and arguing that it does not violate separation of powers principles).

54. *Iqbal*, 129 S. Ct. at 1944.

Concluding that the flexible plausibility standard established in *Twombly* “obliges a pleader to amplify a claim with some factual allegations in those contexts where such amplification is needed to render the claim *plausible*,” the court found Iqbal’s pleading adequate since it did not involve one of those contexts where amplification was required.<sup>55</sup>

The Supreme Court granted certiorari to determine whether sufficient facts were pleaded under the Rule 8 plausibility standard for a complaint stating a claim of purposeful and unlawful discrimination to survive dismissal.<sup>56</sup> Examining *Twombly*’s analysis of the plausibility standard under Rule 8(a)(2), the Supreme Court explained that, even though “detailed factual allegations” are not necessary, the Rule 8(a)(2) pleading standard requires “more than an unadorned, the-defendant-unlawfully-harmed-me accusation.”<sup>57</sup> The Court then examined the factual allegations and determined that they failed to “plausibly suggest an entitlement to relief,” since the complaint did not contain facts that would allow the Court to plausibly conclude that the defendants “purposefully adopted a policy of classifying post-September 11 detainees as ‘of high interest’ because of their race, religion, or national origin.”<sup>58</sup> In the end, the Supreme Court not only found that Iqbal’s complaint failed to nudge his claims “across the line from conceivable to plausible,” but also explicitly clarified that *Twombly*’s pleading standard applied to both antitrust and discrimination suits alike, since that decision was primarily based on properly interpreting Rule 8.<sup>59</sup> Thus, *Iqbal* not only expanded the scope of the Rule 8(a)(2) plausibility standard proposed in *Twombly*, but also “changed the

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55. *Iqbal v. Hasty*, 490 F.3d 143, 157–58 (2d Cir. 2007), *rev’d sub nom.* *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009).

56. *Iqbal*, 129 S. Ct. at 1942–43.

57. *Id.* at 1949.

58. *Id.* at 1951–52 (noting that all the complaint plausibly suggests is “that the Nation’s top law enforcement officers, in the aftermath of a devastating terrorist attack, sought to keep suspected terrorists in the most secure conditions available until the suspects could be cleared of terrorist activity,” which was insufficient for a court to properly infer that defendants had purposely adopted an invidiously discriminatory policy).

59. *Id.* at 1951, 1953 (“Though *Twombly* determined the sufficiency of a complaint sounding in antitrust, the decision was based on our interpretation and application of Rule 8. That Rule in turn governs the pleading standard ‘in all civil actions and proceedings in the United States district courts.’” (quoting FED. R. CIV. P. 1)).

landscape for Rule 12(b)(6) motions.”<sup>60</sup>

The liberal notice pleading standard established in *Conley*, therefore, is now obsolete.<sup>61</sup> In the wake of *Twombly* and *Iqbal*, lower federal courts must decipher the scope and reach of the plausibility pleading standard in every civil case.<sup>62</sup> As will be examined later in the article, the problem becomes more acute once the enhanced Rule 8(a)(2) pleading standard is compared and contrasted to the Rule 9(b) heightened fraud pleading standard and the PSLRA’s scienter pleading standard for securities fraud. And, as will be discussed, the new Rule 8(a)(2) plausibility standard converges with the two heightened pleading standards predicated on allegations of fraud.<sup>63</sup>

### B. Rule 9(b) and the “Heightened” Fraud Pleading Standard

Unlike Rule 8(a)(2), which requires “a short and plain

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60. Robert L. Rothman, *Twombly and Iqbal: A License to Dismiss*, LITIG., Spring 2009, at 1, 2; see also *id.* at 1–2 (“[U]nder the guise of explaining the concept of ‘plausibility’ first announced in *Twombly*, the Court imposed a gatekeeper-type duty on the district court that applies even if the allegations of the complaint are well pleaded and thus assumed to be true.”).

61. See *id.* at 1 (“[A]t a minimum, it seems fair to conclude that *Conley* is not merely retired, it is dead and buried.”); Spencer, *supra* note 23, at 431 (“Notice pleading is dead. Say hello to plausibility pleading.”).

62. See, e.g., Amber A. Pelot, Note, *Bell Atlantic Corp. v. Twombly: Mere Adjustment or Stringent New Requirement in Pleading?*, 59 MERCER L. REV. 1371, 1379 (2008) (noting that, except for the heightened pleading standards of Rule 9 and the PSLRA, “the Supreme Court has insisted, and still maintains in *Bell Atlantic Corp.*, that the more forgiving standard of pleading Rule 8(a)(2) is to apply transubstantively to all other types of claims.”).

63. See discussion *infra* Part II. Moreover, those state courts that had their procedural systems modeled after the *Conley* pleading standard and the Federal Rules must now determine whether to move towards the new plausibility standard to maintain procedural uniformity. See Z. W. Julius Chen, *Following the Leader: Twombly, Pleading Standards, and Procedural Uniformity*, 108 COLUM. L. REV. 1431, 1432 (2008) (“[A] state should not abandon *Conley* simply to preserve uniformity between state and federal interpretations of Rules 8(a) and 12(b)(6).”); see also Andrée Sophia Blumstein, *Twombly gets Iqbal-ed: An Update on the New Federal—and Tennessee?—Pleading Standard*, TENN. B.J., July 2009, at 23, 23 (“*Twombly*, of course, controls only federal litigation, but its influence will likely come to be felt in state civil litigation as well.”). This issue, however, is beyond the scope of this article.

statement of the claim” when pleading in a civil action,<sup>64</sup> Rule 9(b) requires the circumstances of an alleged fraud or mistake to be plead with particularity.<sup>65</sup> Federal Rule of Civil Procedure 9(b) states: “In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.”<sup>66</sup>

The term “generally,” however, as discussed by the Supreme Court in *Iqbal*, is relative; to be properly understood, the term must be compared to the particularity requirement of the first sentence of Rule 9(b).<sup>67</sup> Specifically, averments such as the time, place, identity of the parties, and nature of the fraud or mistake must be pleaded in detail.<sup>68</sup> Pleading with absolute particularity, however, is not required by the federal rules. Rather, a balance must be reached between the purported simplicity of Rule 8 and the particularity that Rule 9 demands.<sup>69</sup> As explained by the majority opinion in *Iqbal*, in the invidious discrimination context, “Rule 9 merely excuses a party from pleading discriminatory intent under an elevated pleading standard. It does not give him license to evade the less rigid—though still operative—strictures of Rule 8.”<sup>70</sup> Therefore, even when the Rule 9(b) heightened pleading standard is inapplicable because neither fraud nor mistake is alleged, the complaint must nonetheless meet the basic requirements of the Rule 8(a)(2) plausibility standard,

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64. FED. R. CIV. P. 8(a)(2).

65. FED. R. CIV. P. 9(b).

66. *Id.*

67. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1954 (2009).

68. 5 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1241 (3d ed. 2009); *see also* DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990) (“Although states of mind may be pleaded generally, the ‘circumstances’ must be pleaded in detail. This means the who, what, when, where, and how: the first paragraph of any newspaper story.”).

69. *See* WRIGHT & MILLER, *supra* note 68, § 1298 (“[T]he rule regarding the pleading of fraud does not require absolute particularity or a recital of the evidence, especially when some matters are beyond the knowledge of the pleader and can only be developed through discovery.”). It has also been argued, however, that *Twombly*’s plausibility standard rejects the generalized pleading suggested by the second sentence of Rule 9(b). *See* Spencer, *supra* note 23, at 474 (“Any standard that requires ‘more than labels and conclusions’ and explicitly calls for the pleading of suggestive facts supporting legal assertions such as the existence of an unlawful agreement or conspiracy fails to permit matters to be averred generally.”).

70. *Iqbal*, 129 S. Ct. at 1954.



as established by *Twombly* and *Iqbal*.<sup>71</sup>

The Rule 9(b) heightened pleading standard—more specifically, the pleading fraud with particularity requirement—is aimed primarily at avoiding groundless lawsuits, safeguarding one’s reputation, and supplying defendants with sufficient information in the complaint to allow them to prepare a proper defense.<sup>72</sup> But, as observed by the Supreme Court, some argue that Rule 9(b)’s standard rarely achieves these objectives: “In the absence of [an amendment to the Federal Rules of Civil Procedure], federal courts and litigants must rely on summary judgment and control of discovery to weed out unmeritorious claims sooner rather than later.”<sup>73</sup> This view of Rule 9(b)’s heightened pleading standard, however, may be disputed; the Court of Appeals for the Second Circuit, for example, generally gives a strict interpretation to the Rule 9(b) heightened pleading standard, regularly dismissing complaints alleging fraud that fail to plead fraud with particularity.<sup>74</sup>

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71. See, e.g., Richard D. Bernstein & Frank M. Scaduto, *Court Toughens Application of Rule 8 Pleading Standards for Civil Cases*, N.Y. L.J., July 6, 2009, at 4 (“[T]he heightened pleading standards of *Iqbal/Twombly* apply to allegations of all elements of a claim, including knowledge and intent. [The holding in *Iqbal*] expressly applies even when Rule 9(b) is inapplicable because the plaintiff has not alleged fraud.”).

72. WRIGHT & MILLER, *supra* note 68, § 1296.

73. *Leatherman v. Tarrant Cnty. Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168–169 (1993) (holding that a “heightened pleading standard,” more stringent than the Rule 8(a)(2) standard, was not required of complaints alleging municipal liability under 42 U.S.C. § 1983); see also WRIGHT & MILLER, *supra* note 68, § 1296 (“Rule 9(b) motions often yield no more than litigation delays or slightly amended complaints, and plaintiffs may not be deterred by the rule from instituting an action on the basis of information that may prove to be insufficiently particular.”). Revising or amending the Federal Rules of Civil Procedure, however, would also involve several difficulties. See, e.g., Carter, *supra* note 26, at 20 (arguing that caseload management at the federal court level would be preferable to outright revision of the Rules). “[R]evision of the Rules or their interpretation cannot spring from political attempts to undercut certain classes of individuals who rely solely on the federal courts to vindicate their substantive rights. Modifying the Rules for sociopolitical purposes would be inconsistent with the drafters’ intent.” *Id.*

74. As recently as 2009, the Court of Appeals for the Second Circuit explained that claims of fraud under Rule 9(b) may be based neither on speculation nor conclusory allegations, mainly supporting its position on Rule 9(b)’s threefold purpose: “to provide a defendant with fair notice of a plaintiff’s claim, to safeguard a defendant’s reputation from improvident charges of wrongdoing, and to protect a defendant against the institution of a strike suit.” *Wood ex rel. U.S. v. Applied*

Commentators have also criticized application of the Rule 9(b) heightened fraud pleading standard in cases of securities fraud.<sup>75</sup> Plaintiffs in securities fraud cases are unlikely to have firsthand knowledge of the details involved in a fraudulent transaction, since that kind of information is generally unavailable from public documents, thus making it problematic for these plaintiffs to plead fraud with the particularity required under Rule 9(b).<sup>76</sup> Nonetheless, as will be examined below, the enactment of the PSLRA by Congress, in an attempt to prevent abusive fraud-based shareholder lawsuits, further enhanced the pleading standards for scienter in securities fraud cases.

C. *The PSLRA and the Pleading Standard for Scienter in Securities Fraud: Tellabs, Inc. v. Makor Issues & Rights, Ltd.*

Prior to 1995, any securities complaint that included allegations regarding a defendant's state of mind only had to meet the generality requirement under the second sentence of Rule 9(b), while complaints alleging securities fraud had to meet Rule 9(b)'s particularity requirement.<sup>77</sup> Prompted by the perception that abusive

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Research Assocs., Inc., 328 F. App'x 744, 747 (2d Cir. 2009) (quoting *O'Brien v. Nat'l Prop. Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991) (dismissing a complaint under the False Claims Act because it lacked the particulars required to support the fraud claim)); see also *Wexner v. First Manhattan Corp.*, 902 F.2d 169, 172 (2d Cir. 1990) (dismissing a securities fraud complaint for failure to plead fraud with particularity and noting that, "[a]lthough scienter need not be alleged with great specificity, plaintiffs are still required to plead the factual basis which gives rise to a 'strong inference' of fraudulent intent").

75. See, e.g., Richard G. Himelrick, *Pleading Securities Fraud*, 43 MD. L. REV. 342, 378 (1984) ("While there have undoubtedly been many frivolous securities claims, attempting to deter such claims through specialized pleading that is enforced through dismissal and denial of discovery is in conflict with the intent and format of the federal scheme of pleading."); Note, *Pleading Securities Fraud Claims with Particularity under Rule 9(b)*, 97 HARV. L. REV. 1432, 1432-33 (1984) ("The courts' mechanical application of rule 9(b) to claims brought under investor-protection statutes illustrates their failure to resolve the conflict between the philosophy of notice pleading embodied in rule 8 and the heightened pleading standard of rule 9(b).").

76. Note, *Pleading Securities Fraud Claims with Particularity under Rule 9(b)*, *supra* note 75, at 1436-37.

77. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007) ("Prior to the enactment of the PSLRA, the sufficiency of a complaint for

practices were rampant in private securities litigation, however, Congress decided to enact reforms to deter frivolous litigation while maintaining confidence in the nation's capital markets.<sup>78</sup> As noted in the House Conference Report, Congress had acquired evidence of various forms of abusive litigation practices: routine lawsuits whenever stock prices changed significantly, the "targeting of deep pocket defendants," abusive use of costly discovery requests to encourage settlements, and client manipulation by class-action lawyers.<sup>79</sup> Due to these abusive practices committed in private securities litigation, innocent parties were reportedly being forced to pay exorbitant settlements and qualified people were unwilling to serve in directorial positions for fear of baseless lawsuits.<sup>80</sup> Thus, in 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA),<sup>81</sup> which implemented various procedural protections to curtail frivolous securities lawsuits.<sup>82</sup>

Among the new measures was the imposition of heightened requirements for the pleading of scienter in private securities litigation:

In any private action arising under this chapter in

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securities fraud was governed not by Rule 8, but by the heightened pleading standard set forth in Rule 9(b)."); *see also* Thomas F. Gillespie III, Note, *Dura Pharmaceuticals, Inc. v. Broudo: A Missed Opportunity to Right the Wrongs in the PSLRA and Rebalance the Private Rule 10b-5 Litigation Playing Field*, 3 J. BUS. & TECH. L. 161, 167 (2008) ("Generally speaking, federal civil actions are governed by the Federal Rules of Civil Procedure . . . . However, in 1995 Congress passed the PSLRA, which, among other measures, created heightened pleading requirements in federal securities fraud actions under Rule 10b-5.").

78. H.R. REP. NO. 104-369, at 26 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730.

79. *Id.* at 31.

80. *Id.* at 32.

81. 15 U.S.C. § 78u-4 (2006).

82. Patrick Berarducci & Larry J. Obhof, *Keeping Current: Securities Supreme Court Clarifies Scienter Pleadings*, BUS. L. TODAY, Nov.-Dec. 2007, at 10, 10. Some of the most important substantive and procedural controls imposed by the PSLRA include "procedures for appointment of lead plaintiffs and lead counsel, limitations on damages and attorney fees, a statutory 'safe harbor' for defendants' forward-looking statements, a stay of discovery pending a motion to dismiss, and mandatory sanctions for frivolous lawsuits." *Id.*; *see also* MARC I. STEINBERG, *SECURITIES REGULATION* 442-45, 488-89 (rev. 5th ed. 2009) (examining the changes imposed by the PSLRA regarding the safe harbor for certain forward-looking statements and the PSLRA's effect on issues relating to contribution and proportionate liability).

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.<sup>83</sup>

Based in part on the language of the Second Circuit's pleading standard—"the most stringent pleading standard"<sup>84</sup>—and Rule 9(b)'s particularity requirement for pleading fraud, the PSLRA's scienter pleading standard was intended to create uniformity among the circuit courts.<sup>85</sup> Congress, however, failed to provide guidance regarding the proper interpretation of "strong inference," which led to confusion among lower federal courts trying to determine what facts and circumstances would be sufficient to find a strong inference of scienter.<sup>86</sup> Ultimately, the circuits adopted

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83. 15 U.S.C. § 78u-4(b)(2) (2006). This heightened pleading standard, however, only applies in private litigation; enforcement actions by the Securities and Exchange Commission are not required to meet the additional pleading requirements established under the PSLRA. See *id.* § 78u-4(a)(1) (stating the PSLRA "shall apply in each private action arising under this chapter that is brought as a *plaintiff class action . . .*") (emphasis added).

84. H.R. REP. NO. 104-369, at 41. Even prior to the enactment of the PSLRA, the Second Circuit required plaintiffs "to allege facts that give rise to a strong inference of fraudulent intent." *Shields v. Citytrust Bancorp., Inc.*, 25 F.3d 1124, 1127-28 (2d Cir. 1994) (noting that a complaint making securities fraud allegations under § 10(b) and Rule 10b-5 must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent").

85. H.R. REP. NO. 104-369, at 41 (explaining that the federal courts of appeals had "interpreted Rule 9(b)'s requirement in conflicting ways, creating distinctly different standards among the circuits").

86. *Compare* *Friedberg v. Discreet Logic Inc.*, 959 F. Supp. 42, 49-50 (D. Mass. 1997) (holding that pleading a strong inference of scienter under the PSLRA requires setting forth "specific facts that constitute strong circumstantial evidence of conscious behavior by defendants"), *with* *Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1309 (C.D. Cal. 1996) (finding that recklessness is sufficient to plead scienter because, although in certain specified situations the PSLRA requires "actual knowledge," the higher standard applies only in expressly specified situations). See also *The Supreme Court, 2006 Term—Leading Cases*, 121 HARV. L. REV. 385, 385 (2007) [hereinafter *The Supreme Court*] (noting that even though uniformity was one of the objectives of the PSLRA's pleading

differing standards.<sup>87</sup> Twelve years after the enactment of the PSLRA, the Supreme Court finally resolved the circuit split in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,<sup>88</sup> a decision that had been long-awaited by both the lower federal courts and practitioners.<sup>89</sup>

Tellabs was a manufacturer of specialized equipment used in fiber optic networks and, during the relevant time period, Richard

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standard for scienter in securities litigation, “it instead produced disarray among the circuit courts over how high Congress intended to set the bar for pleading scienter”); Laura R. Smith, Comment, *The Battle Between Plain Meaning and Legislative History: Which Will Decide the Standard for Pleading Scienter After the Private Securities Litigation Reform Act of 1995?*, 39 SANTA CLARA L. REV. 577, 579 (1999) (examining the controversy that arose among courts regarding the various interpretations given to PSLRA’s scienter pleading standard based on the PSLRA’s plain meaning and its legislative history).

87. See, e.g., Geoffrey P. Miller, *Pleading After Tellabs*, 2009 WIS. L. REV. 507, 509–10 (2009) (stating different interpretations of “strong inference” among circuits); John M. Wunderlich, Note, *Tellabs v. Makor Issues & Rights, Ltd.: The Weighing Game*, 39 LOY. U. CHI. L.J. 613, 623–26 (2008) (same). The First Circuit adopted the view that the strong inference test is not met where, “viewed in light of the complaint as a whole, there are legitimate explanations for the behavior that are equally convincing.” *In re Credit Suisse First Boston Corp.*, 431 F.3d 36, 48–49 (1st Cir. 2005). The Sixth Circuit, for example, took a different approach, permitting allegations of scienter to survive motions to dismiss only where they constituted the “most plausible” of the competing inferences. *Fidel v. Farley*, 392 F.3d 220, 227 (6th Cir. 2004). The Seventh Circuit, on the other hand, would only allow complaints to survive the Rule 12(b)(6) motion if they alleged “facts from which, if true, a reasonable person could infer that the defendant acted with the required intent.” *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 437 F.3d 588, 602 (7th Cir. 2006), *vacated*, 551 U.S. 308 (2007).

88. 551 U.S. 308 (2007).

89. The widely-anticipated Supreme Court decision settled the standard for pleading a “strong inference” of scienter under the PSLRA and resolved the split among the circuits on this important legal issue. See *id.* at 317–18, 322–26 (acknowledging circuit split and adopting a uniform standard); James D. Cox, Randall S. Thomas & Lynn Bai, *Do Differences in Pleading Standards Cause Forum Shopping in Securities Class Actions?: Doctrinal and Empirical Analyses*, 2009 WIS. L. REV. 421, 434 (2009) (noting that the Supreme Court decision in *Tellabs* had been “anticipated, and eagerly so, in many quarters,” and arguing that the circuits nonetheless maintained disparate interpretations of the scienter pleading standard under the PSLRA); Steven Wolowitz & Joseph De Simone, *Did ‘Tellabs’ Raise PSLRA Scienter Bar?*, N.Y. L.J., Dec. 3, 2007, at S3 (noting that *Tellabs* “was among the most anticipated opinions of the past Supreme Court term,” with its framework being widely applied by lower federal courts in the five months after the decision was issued).

Notebaert was the company's chief executive officer and president.<sup>90</sup> Shareholder-plaintiffs alleged that they had been induced to buy artificially inflated stock by false statements knowingly made by Notebaert and other executive officers.<sup>91</sup> The shareholders brought a class action under § 10(b) of the Securities Exchange Act of 1934 (the Exchange Act) and SEC Rule 10b-5 in the District Court for the Northern District of Illinois.<sup>92</sup> Finding that the plaintiffs' "conclusory allegations regarding Notebaert d[id] not create a strong inference that he acted with the requisite state of mind under the

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90. *Tellabs*, 551 U.S. at 314.

91. *Johnson v. Tellabs, Inc.*, 303 F. Supp. 2d 941, 946, 950 (N.D. Ill. 2004), *aff'd in part, rev'd in part sub nom. Makor Issues & Rights v. Tellabs*, 437 F.3d 588 (7th Cir. 2006), *vacated*, 551 U.S. 308 (2007). More specifically, the plaintiffs alleged that defendants "made a series of false statements and omissions regarding Tellabs' fourth quarter 2000 financials, Tellabs' products, and its future projects that resulted in the artificial inflation of Tellabs' stock price." *Johnson*, 303 F. Supp. 2d at 946. The Supreme Court only focused on the allegations relating to Notebaert, however, because the claims against the other executives had already been dismissed and therefore were not before the Court. *Tellabs*, 551 U.S. at 315 n.1.

92. *Johnson*, 303 F. Supp. 2d at 950. Section 10(b) of the Exchange Act prohibits 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) (2006). SEC Rule 10b-5 implements § 10(b) by providing that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

17 C.F.R. § 240.10b-5 (2010). Furthermore, the Supreme Court has recognized an implied private right of action for sellers or purchasers of securities injured by a violation of § 10(b). *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005); *see also* MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW § 8.01 (5th ed. 2009) (examining the elements of a private 10b-5 claim); Jerod Neas, *Dura Duress: The Supreme Court Mandates a More Rigorous Pleading and Proof Requirement for Loss Causation Under Rule 10b-5 Class Actions*, 78 U. COLO. L. REV. 347, 351-57 (2007) (same).

PSLRA,” the district court dismissed the complaint.<sup>93</sup> The Court of Appeals for the Seventh Circuit, however, reversed in relevant part.<sup>94</sup> After examining the positions taken by other circuit courts, the Seventh Circuit held that a complaint would survive a Rule 12(b)(6) motion to dismiss if “it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent.”<sup>95</sup> Applying this reasonable person standard, the Seventh Circuit found that the facts alleged in the complaint met the PSLRA’s threshold with regard to Notebaert; since he was acting within the scope of his role as chief executive officer, the alleged knowledge of the falsity of Notebaert’s statements was also imputed upon Tellabs.<sup>96</sup>

In 2007, the U.S. Supreme Court granted certiorari in order “to prescribe a workable construction of the ‘strong inference’ standard” and finally solve the split among the federal courts of appeals.<sup>97</sup> The Court began by interpreting the PSLRA heightened pleading standard as requiring a plaintiff to plead “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.’”<sup>98</sup> Rejecting the Seventh Circuit’s “broader and more plaintiff-friendly” interpretation of “strong inference,”<sup>99</sup> the majority found that a comparative evaluation was required: a court must consider not only the inferences provided by the plaintiff, “but also competing inferences rationally drawn from the facts alleged.”<sup>100</sup> The Court explained:

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 [the PSLRA], we hold, an

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93. *Johnson*, 303 F. Supp. 2d at 969.

94. *Makor Issues & Rights Ltd. v. Tellabs, Inc. (Tellabs II)*, 437 F.3d 588, 602 (7th Cir. 2006) (rejecting the position taken by the Sixth Circuit).

95. *Id.*

96. *Id.* at 603.

97. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007).

98. *Id.* at 313 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976)).

99. See *Wolowitz & De Simone*, *supra* note 89, at S3 (examining the holding in *Tellabs* and discussing various questions left unanswered by the Supreme Court).

100. *Tellabs*, 551 U.S. at 314.

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.<sup>101</sup>

After so holding, the Supreme Court reversed and remanded to the Seventh Circuit, which later found that the shareholder-plaintiffs had successfully pleaded scienter as required under the PSLRA.<sup>102</sup>

Although decided prior to *Tellabs*, another relevant U.S. Supreme Court decision interpreting the pleading requirements for a § 10(b) claim—and also providing insight into the Supreme Court’s later reasoning in *Twombly* and *Iqbal*<sup>103</sup>—is *Dura Pharmaceuticals, Inc. v. Bruodo*.<sup>104</sup> Between April 1997 and February 1998, Michael Bruodo and other class members bought stock of Dura Pharmaceuticals, Inc. (Dura), a company dedicated to marketing

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101. *Id.*

102. *Makor Issues & Rights Ltd v. Tellabs, Inc. (Tellabs II)*, 513 F.3d 702 (7th Cir. 2008). The Seventh Circuit interpreted *Tellabs* as a two-prong test: “first the inference must be cogent, and second it must be as cogent as the opposing inference, that is, the inference of lack of scienter.” *Id.* at 705. The court began with the second prong and rejected the opposing inference—that the misstatements were the product of “merely careless mistakes”—as “exceedingly unlikely.” *Id.* at 709. Then it moved to the first prong—whether the inference was cogent—and found that the plaintiff’s hypothesis was cogent because defendant’s explanation of the occurrences was “far less likely than the hypothesis of scienter.” *Id.* at 711; see also John P. Stigi III & Martin White, *Courts Interpret ‘Tellabs’: They Appear to View Case as Heightening Standard for Pleading Scienter*, NAT’L L.J., Mar. 17, 2008, at S1, S4 (examining the Seventh Circuit’s holding and noting that “[Judge] Posner in [*Tellabs II*] addressed the sufficiency of the plaintiff’s confidential source allegations only after reaching his conclusions regarding the comparative strength of the opposing inferences, [thus] effectively collapsing the first prong of the *Tellabs* test into the second prong”).

103. See discussion *infra* Part II.A–C (discussing the effects of the new plausibility standard established in *Twombly* and *Iqbal*); see also Steven R. Paradise & Ari M. Berman, *Pleading the Loss Causation Link*, N.Y. L.J., Dec. 3, 2007, at S4 (discussing the application of *Dura* and *Twombly* on motions to dismiss and noting that “[i]n many ways, *Dura* set the stage for *Twombly*”). As will be discussed in this section, an examination of the Supreme Court’s reasoning in *Dura* provides support for the argument that the new Rule 8(a)(2) plausibility pleading standard converges with the heightened pleading standards under Rule 9(b) and the PSLRA. *Infra* Part

104. 544 U.S. 336 (2005).



niche pharmaceutical drugs.<sup>105</sup> During the class period, Dura allegedly issued materially false statements regarding its drug profits and the future approval of a new asthmatic spray device by the Food and Drug Administration, which artificially inflated Dura's stock price.<sup>106</sup> When the price of Dura's stock subsequently dropped by 47%, the class members brought a consolidated securities fraud class action suit against Dura and its managers and directors in the District Court for the Southern District of California.<sup>107</sup> The district court found that the plaintiffs failed to adequately plead loss causation and dismissed the case.<sup>108</sup> The Court of Appeals for the Ninth Circuit, however, reversed, holding that the plaintiffs, by alleging that they had bought artificially overpriced stock, sufficiently plead loss causation to survive Dura's motion to dismiss.<sup>109</sup> In 2005, in order to solve the confusion among the federal circuits regarding loss causation, the Supreme Court granted Dura's petition for certiorari.<sup>110</sup>

Although mainly addressing the issue of what was required to establish the element of loss causation under § 10(b) of the Exchange

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105. *In re Dura Pharm., Inc. Sec. Litig.*, No. Civ. 99CV0151-L(NLS), 2001 WL 35925887, at \*1 (S.D. Cal. Nov. 2, 2001).

106. *Id.* at \*1–2.

107. *Id.* at \*2. The complaint alleged that the defendants had violated § 10(b) of the Exchange Act, SEC Rule 10b-5, and § 20(a) of the Exchange Act. *Id.* Section 20(a) of the Exchange Act provides for joint and several liability of controlling persons. See 15 U.S.C. § 78t(a) (2006); see also *supra* note 92 (providing further discussion on § 10(b) and Rule 10b-5).

108. *Dura Pharm.*, 2001 WL 35925887, at \*10. The court explained:

The [complaint] does not contain any allegations that the FDA's non-approval had any relationship to the February price drop. Accordingly, the [complaint] does not explain how the alleged misrepresentations and omissions regarding Albuterol Spiros [the new asthmatic spray device] "touched" upon the reasons for the decline in Dura's stock price. Rather, the decline in Dura's stock price was the result of an expected revenue shortfall. Accordingly, the [complaint's] allegations regarding Albuterol Spiros are insufficient to state a claim.

*Id.*

109. *Broudo v. Dura Pharm., Inc.*, 339 F.3d 933, 938, 941 (9th Cir. 2003), *rev'd*, 544 U.S. 336 (2005) ("[L]oss causation does not require pleading a stock price drop following a corrective disclosure or otherwise. It merely requires pleading that the price at the time of purchase was overstated and sufficient identification of the cause.").

110. *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 340 (2005).

Act and SEC Rule 10b-5,<sup>111</sup> the Supreme Court also addressed the loss causation pleading issue.<sup>112</sup> Without embracing a specific standard for the pleading of loss causation, the Court opted to apply the traditional notice pleading standard of Rule 8(a)(2).<sup>113</sup> The majority explained:

We concede that ordinary pleading rules are not meant to impose a great burden upon a plaintiff. But it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. At the same time, allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid.<sup>114</sup>

Thus, finding that the “artificially inflated purchase price” was not itself a relevant economic loss and that the complaint failed to provide notice of either the relevant economic loss or the connection between that loss and the alleged misrepresentations, the Supreme Court found the complaint legally insufficient.<sup>115</sup>

Although the Supreme Court’s language in *Dura* referring to the Rule 8(a)(2) notice pleading standard may have been displaced

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111. *Id.* at 342–46. The element of loss causation may be defined as a “direct causal link between the misstatement and the claimant’s economic loss.” *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 413 (5th Cir. 2001).

112. *Dura*, 544 U.S. at 346–48 (“Our holding about plaintiffs’ need to *prove* proximate causation and economic loss leads us also to conclude that the plaintiffs’ complaint here failed adequately to *allege* these requirements.”).

113. *Id.* at 346–47 (arguing that reaching the heightened pleading standard was unnecessary because the complaint did not even meet the minimum pleading standard under Rule 8(a)(2)); *see also* Gillespie, *supra* note 77, at 170 (examining the holding in *Dura* and noting that “the Court chose not to articulate any particular standard with respect to the proper pleading standard for plaintiff’s loss causation pleadings, again opting for an addition-by-subtraction approach”). In making its decision, the Supreme Court assumed, “at least for argument’s sake, that neither the Rules nor the securities statutes impose any special further requirement in respect to pleading of proximate causation or economic loss.” *Dura*, 544 U.S. at 346.

114. *Dura*, 544 U.S. at 347 (internal citations omitted).

115. *Id.* at 347–48.

by subsequent case law, it may nonetheless imply that the Court believed at that time that notice pleading was a sufficiently challenging standard to meet.<sup>116</sup> Accordingly, the Court's later enhancement of the basic pleading requirements under Rule 8(a)(2) may be seen as misguided. As will be discussed below, by enhancing the basic pleading standard under Rule 8(a)(2), the Supreme Court has elevated it to approach the level set forth by the heightened pleading standards for allegations of fraud.

## II. BLURRING THE LINES BETWEEN PLEADING DOCTRINES

Surviving a Rule 12(b)(6) motion to dismiss used to be customary, but the new plausibility standard established in *Twombly* and *Iqbal* has elevated the basic requirements that must be met in any civil case for a complaint to be legally sufficient under Rule 8(a)(2). Federal courts and legal scholars, however, are still trying to understand this notion of "plausibility" and the extent to which it has enhanced the basic pleading requirements of Rule 8(a)(2).<sup>117</sup> Nonetheless, after *Tellabs* and *Iqbal*, the plausibility pleading standard has been elevated to approach the level of the heightened fraud pleading standard under Rule 9(b) and the scienter pleading standard for securities fraud under the PSLRA, effectively blurring

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116. The Supreme Court examined *Dura* in explaining the policy behind the *Twombly* decision:

We alluded to the practical significance of the Rule 8 entitlement requirement in [*Dura*] when we explained that something beyond the mere possibility of loss causation must be alleged, lest a plaintiff with a "largely groundless claim" be allowed to "take up the time of a number of other people, with the right to do so representing an in terrorem increment of the settlement value." So, when the allegations in a complaint, however true, could not raise a claim of entitlement to relief, "this basic deficiency should . . . be exposed at the point of minimum expenditure of time and money by the parties and the court."

*Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 557–58 (2007) (citations omitted); see also *Spencer*, *supra* note 23, at 451 ("[S]imply offering a complaint that sets forth facts that render liability *possible* must be treated as insufficient given the ability of high-dollar suits to coerce defendants into settlement in the interest of avoiding the expense and uncertainty of discovery.").

117. See *infra* Part II.A.

the lines between the pleading doctrines.<sup>118</sup> Furthermore, when these converging pleading standards balance equivocal inferences— inferences that are equally consistent with liability and non-liability—a tacit “probability requirement” present in the *Twombly/Iqbal* plausibility standard may make it more difficult for plaintiffs alleging non-fraud claims to succeed against a Rule 12(b)(6) motion to dismiss.<sup>119</sup> As will be examined in the final part of this article, this convergence of pleading doctrines creates an incongruent federal civil litigation system because it may at times treat plaintiffs more harshly in the pleading stage under Rule 8(a)(2) than when alleging fraud under Rule 9(b) or the PSLRA.<sup>120</sup>

#### A. What is “Plausible”?

There is little doubt that *Twombly* elevated the pleading requirements a plaintiff’s complaint must meet under Rule 8(a)(2).<sup>121</sup> Nonetheless, the notion of plausibility is still far from being clearly understood.<sup>122</sup> In dismissing the complaint in *Twombly*, the Court noted: “we do not require heightened fact pleading of specifics, but only enough facts to state a claim to relief that is plausible on its face. Because plaintiffs here have not nudged their claims across the line from conceivable to plausible, their complaint must be

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118. See *infra* Part II.B.

119. See *infra* Part II.C.

120. See *infra* Parts III–IV.

121. See, e.g., *Pleading Standards*, 121 HARV. L. REV. 305, 314 (2007) (“There is no doubt that a heightened pleading standard will reduce the costs that discovery imposes generally, because fewer complaints will survive Rule 12(b)(6) motions and reach the discovery phase. Yet the heightened standard might result in the dismissal of some complaints that would be highly socially beneficial if successful.”); Richard M. Steuer, *Plausible Pleading: Bell Atlantic Corp. v. Twombly*, 82 ST. JOHN’S L. REV. 861, 875 (2008) (“The lesson to be learned from *Twombly* is to investigate more thoroughly than ever before filing a complaint. A strong hunch plus the prospect of substantiating that hunch in discovery is no longer enough.”).

122. See, e.g., Colleen McMahon, *The Law of Unintended Consequences: Shockwaves in the Lower Courts After Bell Atlantic Corp. v. Twombly*, 41 SUFFOLK U. L. REV. 851, 853 (2008) (“We district court judges suddenly and unexpectedly find ourselves puzzled over something we thought we knew how to do with our eyes closed: dispose of a motion to dismiss a case for failure to state a claim.”). Judge Colleen McMahon is a District Judge in the United States District Court for the Southern District of New York. *Id.* at 851 n.2.

dismissed.”<sup>123</sup> The Court also indicated that plausibility under Rule 8(a)(2) requires factual allegations that are “enough to raise a right to relief above the speculative level,” with neither labels nor conclusions being sufficient.<sup>124</sup> Furthermore, in *Iqbal*, the Supreme Court explicitly clarified that facial plausibility exists “when the plaintiff pleads *factual content* that allows the court to draw the *reasonable inference* that the defendant is liable for the misconduct alleged.”<sup>125</sup> Under this standard, therefore, courts have the “context-specific task” of determining whether the well-pleaded facts permit a reasonable inference that plausibly—not merely possibly—indicate liability; conclusory allegations are insufficient.<sup>126</sup> Thus, the Supreme Court has determined that claims that are merely “possible,” “conceivable,” or “speculative” are legally insufficient to meet the plausibility standard.<sup>127</sup>

Federal courts of appeals, in interpreting Rule 8(a)(2)’s plausibility pleading standard, generally have followed *Twombly* and *Iqbal*’s definition of plausibility.<sup>128</sup> The Third Circuit, for example,

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123. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007).

124. *See id.* at 555 (noting also that “a formulaic recitation of the elements of a cause of action will not do”).

125. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (emphasis added).

126. *See id.* at 1950 (“Determining whether a complaint states a plausible claim for relief will . . . be a context-specific task.”); *see also* Edward D. Cavanagh, *Twombly: The Demise of Notice Pleading, the Triumph of Milton Handler, and the Uncertain Future of Private Antitrust Enforcement*, 28 REV. LITIG. 1, 15 (2008) (“Once again, trial courts are assigned the task of fathoming the unfathomable—the distinction between allegations that are ‘factual’ and hence valid, and those which are merely ‘conclusory’ and hence deficient.”).

127. According to Merriam Webster’s Collegiate Dictionary, the word “plausible” is defined as: (1) “superficially fair, reasonable, or valuable but often specious”; (2) “superficially pleasing or persuasive”; and (3) “appearing worthy of belief.” MERRIAM WEBSTER’S COLLEGIATE DICTIONARY 892 (10th ed. 1996). The Supreme Court in *Iqbal* correctly applied the term “plausible” when examining the holding in *Twombly*, noting that, “[b]ecause the well-pleaded fact of parallel conduct, accepted as true, did not plausibly suggest an unlawful agreement, the Court held the plaintiffs’ complaint must be dismissed.” *Iqbal*, 129 S. Ct. at 1950.

128. *See, e.g.*, *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 594 (8th Cir. 2009) (“The plausibility standard requires the plaintiff to show at the pleading stage that success on the merits is more than a ‘sheer possibility.’”); *Brooks v. Ross*, 578 F.3d 574, 581–82 (7th Cir. 2009) (finding that equivocal allegations are insufficient to meet the plausibility standard); *Fowler v. UPMC Shadyside*, 578 F.3d 203, 211–12 (3d Cir. 2009) (requiring the complaint to nudge the plaintiff’s claim “across the line from conceivable to plausible”); *Courie v. Alcoa Wheel & Forged Prods.*, 577 F.3d 625, 629–30 (6th Cir. 2009) (noting that a complaint need

in finding that the plaintiff's complaint sufficiently alleged enough facts to plausibly suggest a failure-to-transfer claim under the Rehabilitation Act,<sup>129</sup> explained that, in order to show a plausible claim for relief, "a complaint must do more than allege the plaintiff's entitlement to relief. A complaint has to 'show' such an entitlement with its facts."<sup>130</sup> Similarly, in requiring the plaintiff's legal conclusions to be grounded in a sufficiently plausible factual basis, the Seventh Circuit affirmed the dismissal of a § 1983 due process claim because the allegations were "merely a formulaic recitation of the cause of action" and failed to put the defendants on notice.<sup>131</sup> However, as noted by the Sixth Circuit, the proper interpretation of plausibility is still being fleshed out by federal courts:

[W]hile this new *Iqbal/Twombly* standard screens out the "little green men" cases just as *Conley* did, it is designed to also screen out cases that, while not utterly impossible, are "implausible." Exactly how implausible is "implausible" remains to be seen, as such a malleable standard will have to be worked out in practice.<sup>132</sup>

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only contain sufficient facts to be plausible); *Sinaltrainal v. Coca-Cola Co.*, 578 F.3d 1252, 1270 (11th Cir. 2009) (finding that "vague and conclusory allegations" are insufficient to meet the plausibility standard).

129. The Rehabilitation Act provides: "No otherwise qualified individual with a disability in the United States . . . shall, solely by reason of her or his disability, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance . . ." 29 U.S.C. § 794(a) (2006). After the enactment of the Americans with Disabilities Act (ADA), the Rehabilitation Act was amended to incorporate the ADA's standards for determining whether an employer has engaged in employment discrimination. *Id.* at § 794(d).

130. *Fowler*, 578 F.3d at 211–12 ("Although [the plaintiff's] complaint is not as rich with detail as some might prefer, it need only set forth sufficient facts to support plausible claims.").

131. *Brooks*, 578 F.3d at 581–82.

132. *Courie*, 577 F.3d at 629–30 (citations omitted); see also Nicholas Tymoczko, Note, *Between the Possible and the Probable: Defining the Plausibility Standard After Bell Atlantic Corp. v. Twombly and Ashcroft v. Iqbal*, 94 MINN. L. REV. 505, 521 (noting that even though federal courts quickly began applying the new plausibility standard under Rule 8(a)(2), they generally failed to properly define its requirements). Scholars have similarly struggled with the definition of plausibility and the proper interpretation of the new Rule 8(a)(2) plausibility standard. Professor A. Benjamin Spencer, for example, proposes a presumption-

Thus, while federal courts continue their quest to ascertain the proper definition of “plausibility” and the correct application of the enhanced Rule 8(a)(2) pleading standard, plaintiffs may continue to suffer from an unpredictable system that, as will be examined below, fails to protect their interests by putting them at a disadvantage when bringing forward civil claims not involving fraud.

*B. Pleading Standards Converge After Tellabs and Iqbal*

Although *Twombly* left many pleading questions unanswered, *Iqbal* served to clarify that the plausibility pleading standard would apply in all civil cases.<sup>133</sup> This expansion of the Supreme Court’s holding in *Twombly*, however, may have contributed to the convergence of pleading standards. A strong indication that the Supreme Court went too far in *Iqbal* is the fact that Justice Souter, the author of the *Twombly* opinion,<sup>134</sup> strongly criticized the holding

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based theory of pleading, under which the plausibility standard may be met when a complaint creates a presumption of impropriety by alleging objective facts and supported implications. See A. Benjamin Spencer, *Understanding Pleading Doctrine*, 108 MICH. L. REV. 1, 13–18 (2009) (explaining that, under his descriptive theory of pleading, “legal claims that apply liability to factual scenarios that otherwise do not bespeak wrongdoing will be those that tend to require greater factual substantiation to traverse the plausibility threshold”). Another view is that the plausibility standard may be equated with logical coherence—that in order to meet the requirements of Rule 8(a)(2), a complaint must contain “allegations necessary and sufficient to warrant liability.” See Smith, *supra* note 23, at 1088–89 (arguing that the plausibility pleading requirement “simply requires that plaintiffs include allegations in their complaint that, if believed, are not merely consistent with liability or non-liability, but rather affirmatively establish liability”). A third approach, advocated by Professor Robert G. Bone, is to view *Twombly*’s plausibility pleading standard from a process-based perspective. See Robert G. Bone, *Twombly, Pleading Rules, and the Regulation of Court Access*, 94 IOWA L. REV. 873, 900–10 (2009) (outlining a justification for the *Twombly* standard in terms of balance between fairness to defendants and fairness to plaintiffs). Under this last approach, the plausibility standard “requires no more than that the allegations describe a state of affairs that differs significantly from a baseline of normality and supports a probability of wrongdoing greater than the background probability for situations of the same general type.” *Id.* at 878.

133. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1953 (2009).

134. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 547 (2007). Justice Souter was joined by Chief Justice Roberts and Justices Scalia, Kennedy, Thomas, Breyer, and Alito. *Id.*

in *Iqbal*.<sup>135</sup> Justice Souter's dissent—joined by Justices Stevens, Ginsburg, and Breyer<sup>136</sup>—asserted that “*Twombly* does not require a court at the motion-to-dismiss stage to consider whether the factual allegations are probably true[;]” to the contrary, “a court must take the allegations as true, no matter how skeptical the court may be.”<sup>137</sup> In arguing that *Iqbal*'s complaint satisfied Rule 8(a)(2)'s plausibility pleading standard, Justice Souter explained his disagreement with the majority:

Under *Twombly*, the relevant question is whether, assuming the factual allegations are true, the plaintiff has stated a ground for relief that is plausible. That is, in *Twombly*'s words, a plaintiff must “allege facts” that, taken as true, are “suggestive of illegal conduct.” . . . The difficulty [in *Twombly*] was that the conduct alleged was “consistent with conspiracy, but just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market.” . . . Here, by contrast, the allegations in the complaint are neither confined to naked legal conclusions nor consistent with legal conduct.<sup>138</sup>

As Justice Souter reasons, when presented with a Rule 12(b)(6) motion to dismiss, a court's inquiry is not to determine whether the factual allegations themselves are plausible, since they must be taken as true. Rather, courts must focus on whether the complaint, as a whole, states a claim that is plausible. In other words, courts must ask whether the complaint provides enough facts to raise a reasonable expectation that evidence of actionable misconduct may be revealed through discovery, thus allowing the

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135. *Iqbal*, 129 S. Ct. at 1954–61 (Souter, J., dissenting) (arguing that the majority misapplied the pleading standard in *Twombly*); see also Rothman, *supra* note 60, at 1 (noting that Justice Souter's dissent in *Iqbal* criticized the majority opinion “for taking the holding in *Twombly* far beyond its original intent”).

136. *Iqbal*, 129 S. Ct. at 1954. Justice Breyer also wrote a separate dissenting opinion to point out that “prevent[ing] unwarranted litigation from interfering with ‘the proper execution of the work of the Government’” was an inadequate justification for the majority's interpretation of *Twombly*. *Id.* at 1961.

137. *Id.* at 1959.

138. *Id.* at 1959–60 (citations omitted).



court to draw a reasonable inference that the defendant is liable and plausibly suggesting an entitlement to relief.<sup>139</sup>

Moreover, the majority in *Iqbal* adopted a two-pronged approach to determining whether the allegations in the complaint allowed a reasonable inference of liability to be drawn and thereby satisfy the plausibility standard.<sup>140</sup> The Supreme Court explained that a reviewing court must begin its analysis by identifying which allegations in the complaint are factual allegations, which must be taken as true, and which are legal conclusions, which do not enjoy the presumption of truth.<sup>141</sup> Under the second prong, the reviewing court must examine the factual allegations and determine if the well-pleaded facts plausibly suggest that the plaintiff is entitled to relief.<sup>142</sup> This approach comports with Rule 8(a)(2)'s two-pronged requirement, as characterized by the Supreme Court in *Twombly*: "the requirement of providing not only 'fair notice' of the nature of the claim but also 'grounds' on which the claim rests."<sup>143</sup> Hence, the Rule 8(a)(2) plausibility pleading standard, as adopted in *Twombly* and expanded by *Iqbal*, may be somewhat easier to meet than the fraud pleading standard under Rule 9(b) and the PSLRA's scienter pleading standard for securities fraud. But, as will be discussed later,

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139. See generally *supra* Part II.A (discussing the meaning of "plausible").

140. See Blumstein, *supra* note 63, at 24–25 (arguing that *Iqbal* requires the reviewing court to (1) "weed out the legal conclusions" and (2) "evaluate the factual allegations").

141. *Iqbal*, 129 S. Ct. at 1950–51. In rejecting *Iqbal*'s allegations of invidious discrimination, the Court notes that they are not being rejected because they are "unrealistic or nonsensical," but because of their "conclusory nature." *Id.* at 1951.

142. *Id.* at 1951. See Elizabeth Thornburg, *Law, Facts, and Power*, 114 PENN. ST. L. REV. PENN. STATIM 1, 2 (2010), <http://pennstatelawreview.org/114/114Penn%20Statim%201.pdf> ("The Supreme Court's opinion in *Ashcroft v. Iqbal* is wrong in many ways, [including] the Court's single-handed return to a pleading system that requires lawyers and judges to distinguish between pleading facts and pleading law.").

143. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 n.3 (2007). Under the new plausibility pleading standard, however, plaintiffs must engage in a delicate balancing test when determining how much detail to include in the complaint, since pleading facts too comprehensively or too technically may result in dismissal of the complaint. See Tice, *supra* note 30, at 839–40 (explaining the risk of plaintiffs pleading themselves out of court under *Twombly* and noting that "[p]laintiffs should thus be careful in their pleading of detail and take comfort in knowing that an error of less detail is rectifiable through a motion for a more definitive statement, whereas too much detail risks summary dismissal altogether").

the way balances are weighed is different, which may lead to different results for plaintiffs depending on whether their claims involve fraud.<sup>144</sup>

Interestingly, the PSLRA's strong inference requirement for pleading scienter in securities fraud cases may sometimes be satisfied merely by meeting the plausibility requirement of Rule 8(a)(2), further suggesting the convergence of pleading standards. Under *Tellabs*, the Supreme Court established that the PSLRA—by requiring the pleading of sufficient facts to establish a strong inference of scienter—required that a complaint allege facts that would allow a reasonable person to draw an inference of scienter that is “cogent and at least as compelling as any opposing inference.”<sup>145</sup> The PSLRA's cogency requirement establishes a plausibility baseline that must be met by every inference of scienter to survive a motion to dismiss: “to be cogent, an inference of scienter must be substantial, even if not strong enough to compel a reasonable jury to find in the plaintiff's favor.”<sup>146</sup> And, in order for an inference to be compelling, a balancing test—in which plausible culpable and non-culpable explanations are examined—must be performed, after which the inference must be found to be “strong in light of other explanations.”<sup>147</sup> Thus, the inference of scienter need only be “at least as likely as any plausible opposing inference.”<sup>148</sup>

Furthermore, given a strict interpretation of plausibility pleading and fraud pleading, these pleading standards may also appear to be nearly equivalent.<sup>149</sup> In *Iqbal*, by expanding the plausibility pleading standard to all elements of a claim, the Supreme Court required allegations of falsity and culpability to meet the plausibility pleading standard, even where Rule 9(b)'s specificity

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144. See *infra* Part II.C.

145. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007).

146. Miller, *supra* note 87, at 514–15 (advocating the view that the cogency standard should fall between a preponderance standard—the inference of scienter being sufficiently strong for a reasonable jury to be able to find for the plaintiff if the facts alleged are proved at trial—and a summary judgment standard).

147. *Tellabs*, 551 U.S. at 323–24; see also Berarducci & Obhof, *supra* note 82, at 10 (arguing that *Tellabs* gave “significant teeth” to the statutory language of the PSLRA).

148. *Tellabs*, 551 U.S. at 328–29 (emphasis added).

149. See, e.g., Spencer, *supra* note 23, at 473–75 (arguing that *Twombly*'s plausibility requirement “is tantamount to a particularity requirement”).

requirement does not apply.<sup>150</sup> Rule 9(b)'s second sentence, however, allows conditions of the mind to be averred generally, but *Twombly*'s new plausibility standard—requiring the pleading of facts enough to raise a reasonable expectation of entitlement to relief—seems to be analogous to the particularity requirement in the first sentence of Rule 9(b).<sup>151</sup> This view is further reinforced when examining the Supreme Court's explanation that, even though "generally" in the context of Rule 9(b) is a relative term that must be compared to the particularity pleading requirement for fraud, the plausibility pleading requirements of Rule 8(a)(2) must still be met.<sup>152</sup> The Court explicitly noted, "the Federal Rules do not require courts to credit a complaint's conclusory statements without reference to its factual context."<sup>153</sup> Thus, in requiring a plaintiff to plead specific facts to state a claim that is facially plausible, thereby allowing the court to make a reasonable inference of liability, the Supreme Court seems to be elevating the basic pleading requirements of Rule 8(a)(2) to approach a particularity pleading standard equivalent to Rule 9(b)'s heightened fraud pleading standard.<sup>154</sup> This finding becomes even more relevant when examined in conjunction with the scienter pleading requirement for securities fraud examined above, which was governed by Rule 9(b), rather than Rule 8(a)(2), prior to the enactment of the PSLRA.<sup>155</sup>

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150. Blumstein, *supra* note 63, at 24; *see also* Bernstein & Scaduto, *supra* note 71, at 4 (noting that, in securities litigation, "*Iqbal/Twombly* will require the pleading of factual content that makes allegations such as causation, falsity, and negligence plausible, even when fraud is not alleged").

151. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007); *see also* Spencer, *supra* note 23, at 475–77 (examining the pleading standard rejected by the Supreme Court in *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506 (2002) to argue that "plausibility pleading is heightened particularized pleading plain and simple").

152. *See* *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1954 (2009) ("Rule 8 does not empower respondent to plead the bare elements of his cause of action, affix the label 'general allegation,' and expect his complaint to survive a motion to dismiss.").

153. *Id.*

154. *See, e.g.*, *ABC Arbitrage Plaintiffs Group v. Tchuruk*, 291 F.3d 336, 349 (5th Cir. 2002) (equating Rule 9(b)'s fraud pleading standard to the PSLRA's pleading standard).

155. *See* *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319–20 (2007) ("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)."). Moreover, the Fifth Circuit Court of Appeals, for example, has equated Rule 9(b)'s fraud pleading standard to the PSLRA's

Therefore, even though meeting the scienter pleading standard's strong inference requirement in cases of securities fraud under the PSLRA and the heightened fraud pleading standard's particularity requirement in civil fraud cases under Rule 9(b) places a higher burden on plaintiffs, Rule 8(a)(2)'s plausibility requirement is not far from requiring cogency and particularity. Furthermore, as will be examined below, the way in which these pleading standards weigh inferences that are equally consistent with liability and non-liability affects plaintiffs differently, in a manner that is counterintuitive and incongruent with the purpose of the pleading doctrines.

### C. *Ties Make a Difference*<sup>156</sup>

In *Twombly*, the Supreme Court suggested that equally weighing inferences would be insufficient to meet the plausibility pleading standard: "The need at the pleading stage for allegations plausibly suggesting (not merely consistent with) [unlawful conduct] reflects the threshold requirement of Rule 8(a)(2) . . . ."<sup>157</sup> The complaint, therefore, must contain sufficient factual allegations to allow a reasonable inference that the defendant is liable, which may be viewed as analogous to a preponderance of the evidence standard (even though the Supreme Court seemingly rejects any notion that a "probability requirement" is being imposed by the plausibility

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pleading standard for misleading statements and omissions in securities litigation. *ABC Arbitrage*, 291 F.3d at 348–50; *In re Fleming Cos. Inc. Sec. & Derivative Litig.*, No. CivA503MD1530TJW, 2004 WL 5278716, at \*6 (E.D. Tex. June 16, 2004).

156. Unlike in baseball—where participants follow the unwritten rule that a "tie goes to the runner"—a tie goes to the defendant under the new Rule 8(a)(2) plausibility pleading standard when there are equally weighing inferences at the pleading stage. See Tim McClelland, *Ask the Umpire*, MLB.COM, [http://mlb.mlb.com/mlb/official\\_info/umpires/feature.jsp?feature=mcclellandqa](http://mlb.mlb.com/mlb/official_info/umpires/feature.jsp?feature=mcclellandqa) (last visited Nov. 11, 2010) (explaining that, although no "tie goes to the runner" rule exists in the books, "the runner must beat the ball to first base, and so if he doesn't beat the ball," he is called out).

157. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 557 (2007); see also Spencer, *supra* note 23, at 445 (explaining that a plaintiff's complaint may no longer survive a motion to dismiss if it contains equivocal facts, "meaning the allegations are consistent both with the asserted legality and with an innocent alternate explanation").

standard).<sup>158</sup> This position is further developed in *Iqbal*, where the majority explains:

The plausibility standard is not akin to a “probability requirement,” but it asks for more than a sheer possibility that a defendant has acted unlawfully. Where a complaint pleads facts that are “merely consistent with” a defendant’s liability, it “stops short of the line between possibility and plausibility of ‘entitlement to relief.’”<sup>159</sup>

Thus, under the Rule 8(a)(2) plausibility standard, if the allegations contained in the plaintiff’s complaint raise equivocal inferences, the defendant may be successful in dismissing the complaint by a Rule 12(b)(6) motion to dismiss.<sup>160</sup> In other words, under the *Iqbal/Twombly* Rule 8(a)(2) plausibility pleading standard, a tie goes to the defendant.

On the other hand, under the PSLRA’s scienter pleading standard for securities fraud, a tie goes to the plaintiff. In *Tellabs*, the Supreme Court clarified that, in order to survive a motion to dismiss, a plaintiff alleging securities fraud was required to plead sufficient facts to suggest a strong inference of scienter—a cogent inference that is “at least as compelling as any opposing inference of non-fraudulent intent.”<sup>161</sup> Moreover, writing for the majority, Justice Ginsburg explained that plausible opposing inferences of culpability and non-culpability must be taken into account when determining

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158. See *Twombly*, 550 U.S. at 556 (“Asking for plausible grounds to infer an agreement does not impose a probability requirement at the pleading stage; it simply calls for enough fact[s] to raise a reasonable expectation that discovery will reveal evidence of illegal agreement.”). The preponderance of the evidence standard requires a plaintiff to demonstrate that the factual allegations more likely than not suggest liability. *Metro. Stevedore Co. v. Rambo*, 521 U.S. 121, 137 n.9 (1997).

159. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009).

160. *E.g.*, *Brooks v. Ross*, 578 F.3d 574, 581–82 (7th Cir. 2009) (affirming the dismissal of a complaint containing equivocal allegations). The court in *Brooks* stated, “The behavior [the plaintiff] has alleged that the defendants engaged in is just as consistent with lawful conduct as it is with wrongdoing. Without more, [the plaintiff’s] allegations are too vague to provide notice to defendants of the contours of his § 1983 due process claim.” *Id.*

161. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007) (emphasis added).

whether an inference of scienter is “strong” under the PSLRA.<sup>162</sup> The inference of culpability “need not be irrefutable . . . or even the ‘most plausible of competing inferences,’” but it must be at least as compelling as opposing inferences of non-culpability.<sup>163</sup> Thus, at the pleading stage, a plaintiff is only required to demonstrate that the inference of scienter is “*at least as likely as* any plausible opposing inference[;]” it is not until the actual trial stage that the plaintiff must prove his case by a preponderance of the evidence—in other words, that “it is *more likely* than not that the defendant acted with scienter.”<sup>164</sup>

Hence, upon examining the convergence of pleading standards after *Tellabs* and *Iqbal*, the Supreme Court has elevated the basic Rule 8(a)(2) pleading standard to approach the level of Rule 9(b)’s fraud pleading standard and the PSLRA’s scienter pleading standard.<sup>165</sup> Moreover, when the plausibility pleading standard and the scienter pleading standard under the PSLRA are compared, an apparent probability requirement in Rule 8(a)(2)’s plausibility pleading standard makes it an unduly onerous standard towards plaintiffs. As will be further discussed below, although these pleading standards converge, the plaintiff is affected differently in the case of a tie depending on which pleading standard the complaint is required to meet.<sup>166</sup> This convergence creates

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162. *Id.* at 323–24 (“The strength of an inference cannot be decided in a vacuum.”). Concurring in the judgment, Justice Scalia asserted the following:

I fail to see how an inference that is merely “at least as compelling as any opposing inference,” can conceivably be called what the statute here at issue requires: a “strong inference.” 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.

*Id.* at 329 (Scalia, J., concurring). Justice Ginsburg defends the majority’s standard against Justice Scalia’s argument by noting that “an inference at least as likely as competing inferences can, in some cases, warrant recovery.” *Id.* at 324 n.5 (citing *Summers v. Tice*, 199 P.2d 1, 3–5 (Cal. 1948)).

163. *Tellabs*, 551 U.S. at 324.

164. *Id.* at 328–29.

165. *See supra* Part II.B.

166. Although not examined in this article, convergence may also suggest that the heightened pleading standards predicated on allegations of fraud may be

incongruity in the federal civil litigation system because, under the recent Supreme Court decisions examined above, plaintiffs may be treated as harshly when pleading non-fraud claims as when pleading fraud, especially when compared to claims of securities fraud under the PSLRA.

### III. JUDICIAL ACTIVISM MAY PLAUSIBLY RESULT IN HARSHER TREATMENT OF PLAINTIFFS PLEADING NON-FRAUDULENT CLAIMS

The lines between pleading doctrines have been blurred by the Supreme Court's recent introduction of a tacit "probability requirement" into the basic pleading standard under *Twombly* and *Iqbal*, making it more difficult for plaintiffs alleging non-fraudulent claims to survive motions to dismiss under Rule 12(b)(6). This result is especially disturbing due to the fact that each pleading standard was influenced by different policy concerns, which explains why there should be different levels of pleading depending on the nature of the claims.<sup>167</sup> Moreover, the convergence of pleading standards has produced incongruity in the federal civil litigation system by at times treating plaintiffs more leniently when bringing fraud claims under the PSLRA than when stating non-fraudulent claims under the enhanced Rule 8(a)(2) plausibility pleading standard.<sup>168</sup> Therefore, it appears as if the Supreme Court, while heightening the basic pleading standard for all federal civil cases, engaged in judicial activism by overturning fifty years of precedent and bypassing the proper rule amendment process in order to protect litigants from extravagant discovery costs and to deter vexatious litigation.<sup>169</sup> Although there may be merit to the Supreme Court's concern with abusive litigation, the basic pleading standard under

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superfluous. See, e.g., Neil Pandey-Jorin, *A Case for Amending the Private Securities Litigation Reform Act: Why Increasing Shareholders' Rights to Sue Will Help Prevent the Next Financial Crisis and Better Inform the Investing Public*, BUS. L. BRIEF, Spring 2009, at 15, 18 (arguing that *Twombly* and Rule 9 "already encompass many of the concerns that Congress contemplated when it passed the PSLRA in 1995, and such requirements in the Act are duplicative and unfairly burden plaintiffs when pleading their case").

167. See *infra* Part III.A.

168. See *infra* Part III.B.

169. See *infra* Part III.C.

Rule 8(a)(2) should nonetheless be nowhere near the level of the heightened pleading standards predicated on allegations of fraud.

A. *Differing Policy Concerns Lead to Different Pleading Standards*

Rule 8 should be understood in light of the entire federal procedural system, in which the main function of pleadings is to provide notice.<sup>170</sup> But although the original policy concern when enacting Rule 8(a)(2) may have been to prevent the premature dismissal of meritorious claims,<sup>171</sup> the Supreme Court in *Twombly* abandoned the notice pleading standard and adopted the plausibility pleading standard, primarily because of its concern with the risk of astronomical discovery costs being used to force litigants into settling cases.<sup>172</sup> Relying on *Dura*, the Supreme Court rejected various arguments before concluding that application of the plausibility pleading standard was probably the only way “to avoid the potentially enormous expense of discovery in cases with no ‘reasonably founded hope that the [discovery] process will reveal

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170. See Fairman, *supra* note 19, at 556–58 (explaining that pleadings have an important dual function: providing notice to litigants while also encouraging determination of claims on the merits).

171. See ADVISORY COMM. ON RULES FOR CIVIL PROCEDURE, 1955 REP. OF THE ADVISORY COMM. PROPOSED AMENDMENTS TO THE RULES OF CIVIL PROCEDURE FOR THE U.S. DISTRICT COURTS (1955), reprinted in 12A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE app. F at 655 (3d ed. 2010) (“The intent and effect of the rules is to permit the claim to be stated in general terms; the rules are designed to discourage battles over mere form of statement and to sweep away the needless controversies which the codes permitted that served either to delay trial on the merits or to prevent a party from having a trial because of mistakes in statement.”); see also Charles B. Campbell, *A “Plausible” Showing After Bell Atlantic Corp. v. Twombly*, 9 NEV. L.J. 1, 10–21 (2008) (examining the evolution of the basic pleading standard under Rule 8(a)(2)); Cavanagh, *supra* note 126, at 19 (noting that the drafters’ goal was to allow meritorious claims to easily move to trial and to prevent technical pleading rules from blocking legitimate claims); Epstein, *supra* note 1, at 98–99 (arguing for the application of a mini-summary judgment at the motion-to-dismiss stage where the full record fails to support any plausible factual inference of liability and noting that “[t]he current provisions of the Federal Rules of Civil Procedure were designed in an earlier era for litigation that on average has been far simpler than litigation today”).

172. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 558–60 (2007).



relevant evidence' to support an inference of liability."<sup>173</sup> The majority noted that it was concerned with the increasing costs of modern federal antitrust litigation and asserted that judicial supervision, clear jury instructions, and increased scrutiny of evidence at the summary judgment stage would all be insufficient to combat discovery abuse.<sup>174</sup> Thus, the Court chose to err on the side of dismissal rather than acquiescing in the specter of defendants being "forced" to settle due to the high costs of discovery.<sup>175</sup>

Justice Stevens, however, dissenting from the majority opinion in *Twombly*, argued that the "transparent policy concern" driving the majority's decision was the interest in protecting wealthy corporate defendants from the high costs of pretrial discovery in federal antitrust litigation.<sup>176</sup> Similarly, Justice Breyer, in his *Iqbal* dissent, expressed his disagreement with using the new plausibility pleading standard "to prevent unwarranted litigation from interfering with 'the proper execution of the work of the Government'" because the law provides for other legal weapons to protect the government against unwarranted interference.<sup>177</sup> Thus, as discussed below, the Supreme Court elevated the basic pleading standard seemingly due

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173. *Id.* at 559 (quoting *Dura Pharm., Inc. v. Bruodo*, 544 U.S. 336, 347 (2005)); see also *Pleading Standards*, *supra* note 121, at 312–13 (noting that the Supreme Court appeared to be "motivated by a desire to increase efficiency by allowing judges to dismiss the cases in which discovery seems least likely to be fruitful," and arguing that the Court acted under the assumption that "procedural rules should ultimately be normatively evaluated under a social welfare calculus").

174. *Id.* at 559 (noting that, if left unresolved, "the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching [the proposed] proceedings").

175. In examining the possibility of allowing discovery, Justice Scalia emphasized the expense of the discovery process:

How much money do you think it would have cost the defendants by then to assemble all of the documents that you're going to be interested in looking at? How many buildings will have to be rented to store those documents and how many years will be expended in, in gathering all the materials?

Transcript of Oral Argument at 54, *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007) (No. 05-1126), 2006 WL 3422211.

176. *Twombly*, 550 U.S. at 596–97 (Stevens, J., dissenting).

177. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1961 (2009) (Breyer, J., dissenting) (noting that, for example, "where a Government defendant asserts a qualified immunity defense, the trial court . . . can structure discovery in ways that diminish the risk of imposing unwarranted burdens on public officials").

to its concern with vexatious litigation and excessive discovery costs.<sup>178</sup>

Unlike with Rule 8(a)(2)'s new plausibility standard, various policy reasons have been offered to justify the inclusion of the particularity requirement of Rule 9(b) from its inception.<sup>179</sup> Because of the implication of moral turpitude inherent in fraud claims, the desire to protect a potential defendant's reputation has historically been the strongest justification for the particularity requirement.<sup>180</sup> Rule 9(b) has also been justified as an adequate strike-suit and frivolous-claim deterrent due to the higher pleading burden imposed upon plaintiffs.<sup>181</sup> Yet another policy reason behind Rule 9(b)'s heightened fraud pleading standard is the reluctance of courts to

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178. Dating back to 1975, the Supreme Court has confined the scope of the federal securities laws due to its concern with strike suit litigation. *E.g.*, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 769 (1975). Dissenting in *Blue Chip Stamps*, Justice Blackmun stated:

[T]he greater portion of the Court's opinion is devoted to its discussion of the 'danger of vexatiousness' that accompanies litigation under Rule 10b-5 and that is said to be 'different in degree and in kind from that which accompanies litigation in general.' It speaks of harm from the 'very pendency of the lawsuit,' something like the recognized dilemma of the physician sued for malpractice; of the 'disruption of normal business activities which may accompany a lawsuit'; and of 'proof . . . which depend(s) almost entirely on oral testimony,' as if all these were unknown to lawsuits taking place in America's courthouses every day.

*Id.* (Blackmun, J., dissenting) (citations omitted).

179. WRIGHT & MILLER, *supra* note 68, § 1296; *see also* Fairman, *supra* note 19, at 563-65 (discussing the four most popular reasons supporting the imposition of a particularity requirement in cases of fraud); William M. Richman, Donald E. Lively & Patricia Mell, *The Pleading of Fraud: Rhymes without Reason*, 60 S. CAL. L. REV. 959, 961-65 (1987) (examining and criticizing the different policy reasons behind Rule 9(b)).

180. WRIGHT & MILLER, *supra* note 68, § 1296; *see* Fairman, *supra* note 19, at 563-64 (arguing that the protection-of-reputation rationale is important because of the potential damage to a defendant's reputation). *But see* Richman et al., *supra* note 179, at 962 (arguing that reputation-saving may be an inadequate justification for the particularity requirement because Rule 9(b)'s pleading standard does not cover claims such as malpractice and wrongful death, which may also be damaging to reputation or involve moral turpitude).

181. Fairman, *supra* note 19, at 564; Richman et al., *supra* note 179, at 962-63; *see also* WRIGHT & MILLER, *supra* note 68, § 1296 (noting the frequent misuse of fraud or mistake allegations solely as nuisances or to encourage settlements and arguing that "unfounded fraud claims should be identified and disposed of early").

reopen completed transactions.<sup>182</sup> Finally, the particularized pleading required under Rule 9(b) has probably been most commonly justified by the need to provide the defendant with fair and adequate notice of the substance of the claim, due mainly to the “intrinsic amorphousness” of fraud claims and because they may reach back many years and implicate a large number of defendants.<sup>183</sup>

The PSLRA, on the other hand, is of more recent vintage, and the drafters’ intent is easier to ascertain. In prescribing a workable construction of the PSLRA’s scienter pleading standard in *Tellabs*, the Supreme Court explained that its interpretation of the “strong inference” standard was based on the PSLRA’s two main goals: “to curb frivolous, lawyer-driven litigation, while preserving investor’s ability to recover on meritorious claims.”<sup>184</sup> Yet the Court emphasized that the scienter pleading requirements “are but one constraint among many the PSLRA installed to screen out frivolous suits, while allowing meritorious actions to move forward.”<sup>185</sup> The House Report, however, clarifies that, because Rule 9(b)’s particularity requirement had failed to thwart private litigants’ abuse of the securities laws, the Conference Committee’s intention in enacting the heightened scienter pleading standard was to “strengthen the existing pleading requirements.”<sup>186</sup> Thus, Congress passed the PSLRA to protect litigants from being forced to settle meritless claims due to excessive litigation and discovery costs inherent in securities claims.<sup>187</sup>

The policy concerns that inspired the Supreme Court’s heightening of the basic pleading standard through *Twombly* and *Iqbal* seem to be the same as those that motivated Congress to pass the PSLRA in 1995. It should therefore come as no surprise that the standards converge. The original intent behind Rule 8(a)(2),

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182. WRIGHT & MILLER, *supra* note 68, § 1296; Fairman, *supra* note 19, at 564–65; Richman et al., *supra* note 179, at 964–65.

183. Fairman, *supra* note 19, at 565; Richman et al., *supra* note 179, at 963–64.

184. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007).

185. *Id.* at 324.

186. H.R. REP. NO. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730, 1995 WL 709276.

187. See *supra* notes 78–83 and accompanying text; see also Wunderlich, *supra* note 87, at 654 (“Congress was concerned that plaintiffs file frivolous lawsuits in an effort to find a sustainable claim, not yet alleged in the complaint, through the discovery process.”).

however, was not to deter vexatious litigation, but rather to provide defendants with adequate notice and prevent early dismissal of meritorious claims.<sup>188</sup> Hence, the pleading standards that were originally adopted with different policy concerns in mind now converge, thus plausibly discriminating against those plaintiffs bringing forward non-fraud claims in federal courts.

*B. The Convergence of Pleading Standards Creates an Incongruous and Unfair Federal Civil Litigation System*

Even if the costs of litigation and abusive discovery practices are reduced by enhancing the basic pleading standard for federal civil litigation, there are various social costs and benefits that must be weighed.<sup>189</sup> One of the costs apparently not considered by the Supreme Court in adopting the plausibility pleading standard is that the inclusion of a tacit “probability requirement” at the pleading stage is unfair to allegedly aggrieved plaintiffs, especially when compared to the requirements for pleading scienter in securities fraud cases under the PSLRA. As discussed above, the PSLRA requires an inference of scienter to be at least as compelling as any opposing inference,<sup>190</sup> rather than requiring enough facts to allow the reviewing court to make a reasonable inference of liability at the motion-to-dismiss stage, as is the case under the Rule 8(a)(2) enhanced plausibility pleading standard.<sup>191</sup>

Prior to the establishment of the plausibility pleading standard in *Twombly*, there were four main aspects to the Rule 8(a)(2) pleading doctrine: the complaint served a notice function; factual detail was unnecessary; only when the absence of a claim was certain was dismissal warranted; and other pretrial procedures,

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188. See *supra* note 171 and accompanying text.

189. See *Pleading Standards*, *supra* note 121, at 314 (“[E]ven if the Court’s new pleading standard weeds out numerous meritless claims, it might still be detrimental to social welfare if it results in the dismissal of valid claims whose benefits would exceed the costs of meritless claims.”).

190. See *Tellabs*, 551 U.S. at 314 (“[A]n 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.”); see also *supra* notes 78–102 and accompanying text.

191. See *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 556 (2007) (discussing that a probability requirement is not required at the pleading stage).

rather than the pleadings, were the proper tools to screen out unmeritorious claims.<sup>192</sup> In abandoning the notice pleading standard adopted in *Conley*, the Supreme Court deviated from these basic tenets and elevated the basic pleading standard for all federal civil cases to a point where it now converges with the two heightened pleading standards predicated on allegations of fraud.

In raising the basic pleading standard to approach the scienter pleading standard required under the PSLRA for cases of securities fraud, the Supreme Court has put plaintiffs alleging non-fraudulent claims at a disadvantage. It has been argued, however, that the practical effect of the difference between having a pleading standard that requires the inference of culpability to be at least as likely as an opposing inference and one that requires the inference of culpability to be more plausible than the inference of innocence is probably small, because “federal courts are unlikely to see a deluge of cases where the inference of scienter is exactly as plausible as the inference of innocence.”<sup>193</sup> Nonetheless, the enhanced plausibility pleading standard under Rule 8(a)(2) will likely be harsher towards plaintiffs putting forward claims in which evidence of actionable misconduct is harder to obtain at the motion-to-dismiss stage, such as discrimination, conspiracy, and certain securities claims.<sup>194</sup> This may be true even where there are no allegations of fraud in the complaint:

[P]roducts liability, civil conspiracy, antitrust, and civil rights claims, for example, are more challenging

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192. Spencer, *supra* note 23, at 438–39; see also WRIGHT & MILLER, *supra* note 68, § 1202 (noting that the four major functions of pleadings have historically been “(1) giving notice of the nature of a claim or defense; (2) stating the facts each party believes to exist; (3) narrowing the issues that must be litigated; and (4) providing a means for speedy disposition of sham claims and insubstantial defenses”).

193. Berarducci & Obhof, *supra* note 82, at 11; see also *The Supreme Court*, *supra* note 86, at 392 (examining the Supreme Court’s opinion in *Tellabs* and noting that “both Justice Alito and Justice Scalia seemed to believe that the change from the majority’s ‘at least as compelling’ rule to Justice Scalia’s ‘more compelling’ rule would not make much of a practical difference”).

194. See Spencer, *supra* note 23, at 459 (“Although *Twombly*’s plausibility pleading standard does not just apply to antitrust cases, it is probably correct to say that the standard will be more demanding in the context of claims in which direct evidence supporting the wrongdoing is difficult for plaintiffs to identify at the complaint stage.”).

to allege because each claim requires the proffering of a supposition of some sort to turn what happened into an actionable event. . . . It thus appears that if a claim places liability on occurrences or omissions for which objective facts make the implication of wrongdoing apparent, that claim will require less factual detail than a claim that depends on subjective motivations or concealed activities.<sup>195</sup>

In the case of securities litigation, there are numerous claims that were subject to the flexible Rule 8(a)(2) notice pleading standard that are now subject to *Twombly*'s plausibility pleading standard; for example, claims brought under § 11 of the Securities Act of 1933 (the Securities Act),<sup>196</sup> claims brought under § 12(a) of the Securities Act,<sup>197</sup> as well as claims brought under § 14(a) of the Exchange Act.<sup>198</sup> But these claims are now at risk of being prematurely dismissed under the plausibility pleading standard due to the inherent difficulty in providing evidence at the motion-to-dismiss stage in securities cases—even those in which there are no allegations of

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195. Spencer, *supra* note 132, at 33–34.

196. 15 U.S.C. § 77k (2006). Section 11 of the Securities Act provides a private right of action for materially false or misleading statements contained in a registration statement. See STEINBERG, *supra* note 82, at 309–20 (examining the statutory framework and the elements of the § 11 right of action).

197. 15 U.S.C. § 77i (2006). Section 12(a)(1) of the Securities Act provides purchasers of securities with an express private right of action against the seller, if such seller offers or sells the security in violation of § 5 of the Securities Act. See STEINBERG, *supra* note 82, at 362 (explaining how a violation of § 5 generally imposes strict liability against the seller of the security). Section 12(a)(2) of the Securities Act provides purchasers of securities with an express private right of action against the seller where the purchasers acquired the securities by means of a prospectus or oral communication that contained a material misstatement or omission. See STEINBERG, *supra* note 82, at 362–84 (examining the meaning of “seller” under § 12(a)(2), the Supreme Court’s limitation of § 12(a)(2)’s scope to public offerings, the “in pari delicto” and reasonable care defenses, and whether there is a right of action for either indemnification or contribution under § 12(a)(2)).

198. 15 U.S.C. § 78n (2006). Section 14(a) of the Exchange Act prohibits the solicitation of proxies containing any materially false or misleading statement. See STEINBERG, *supra* note 82, at 517–37 (explaining the manner in which § 14(a) “regulate[s] the solicitation of proxies with respect to securities registered under § 12 of the Exchange Act”).

fraud.<sup>199</sup> As noted by Professor Spencer:

[G]etting past neutral facts to those suggestive of liability will be more difficult in those cases where suppositions about the defendants' subjective motivations or concealed activities are needed to overcome the presumption of propriety. When such information is unknown or unknowable from the plaintiff's perspective at the pleading stage, the doctrine is too unforgiving and unaccommodating, leaving plaintiffs with potentially valid claims with no access to the system.<sup>200</sup>

Similarly, the plausibility standard should not resemble the heightened fraud pleading standard under Rule 9(b), which clearly creates an exception to Rule 8(a)(2) by imposing a particularity

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199. See, e.g., *Panther Partners, Inc. v. Ikanos Commc'ns, Inc.*, 347 F. App'x 617, 620 (2d Cir. 2009) (dismissing a complaint alleging violation of §§ 11, 12, and 15 of the Securities Act because the plaintiffs failed to allege sufficient facts under *Twombly's* plausibility pleading standard to complete the chain of causation required to prove that false statements were negligently made by defendants); *In re Thornburg Mortg., Inc. Sec. Litig.*, 683 F. Supp. 2d 1236, 1261 (D.N.M. 2010) (granting underwriter/defendants' motion to dismiss where purchasers failed to adequately allege that the offering documents contained false or misleading statements or omissions); *In re Morgan Stanley Tech. Fund Sec. Litig.*, 643 F. Supp. 2d 366, 380–81 (S.D.N.Y. 2009) (granting defendants' motion to dismiss after holding that, even if the court had accepted the plaintiffs' "conclusory allegations" that the mutual funds["']" prospectus materials were materially misleading, plaintiffs nonetheless failed to plead sufficient facts to show that defendants owed a duty to disclose); see also *Pleading Securities Fraud with Particularity under Rule 9(b)*, *supra* note 76, at 1436 (discussing the difficulty in pleading securities fraud even before the PSLRA enhanced the scienter pleading requirements, and noting that, "[b]ecause the plaintiff in a securities fraud case is likely to have little first-hand knowledge about the particulars of a fraudulent transaction, such a plaintiff will typically have greater difficulty pleading fraud with particularity than will a plaintiff alleging common law fraud"). The difficulty in pleading securities claims, however, is not restricted to those including allegations of fraud. See generally Michael C. Tu & Lucy E. Buford, *Supreme Court's Twombly Ruling Will Mean Higher Pleading Requirements for Some Securities Litigation Claims*, SEC. REFORM ACT LITIG. REP. (2007), <http://www.orrick.com/fileupload/1203.pdf> (discussing the difficulty in pleading securities claims under *Twombly*).

200. See Spencer, *supra* note 132, at 36.

requirement.<sup>201</sup> Requiring particularity at the pleading stage in every civil case would not only make the mandate of Rule 9(b) superfluous, but would impose an undue burden upon plaintiffs and violate one of the basic objectives of Rule 8—preventing civil cases from turning on technicalities.<sup>202</sup>

Thus, by enhancing the basic pleading requirements for all federal civil suits under Rule 8(a)(2), the Supreme Court has put plaintiffs at a disadvantage by including a hidden “probability requirement” at the pleading stage that will effectively reduce their chances of surviving a Rule 12(b)(6) motion to dismiss when there exist equally plausible inferences of liability as there are of non-liability.<sup>203</sup> Yet, this convergence of pleading standards does not only have the potential of being unfair towards plaintiffs, but may also create a federal civil litigation system that is incongruous. Even though Rule 8(a)(2) of the Federal Rules of Civil Procedure was designed to facilitate access to the courts and allow claims to be resolved on the merits, the new plausibility pleading standard focuses primarily on deterring vexatious litigation (for which purpose the system has already imposed heightened pleading requirements for different types of claims).<sup>204</sup> Moreover, as will be discussed below, the Supreme Court sidestepped the appropriate rule amendment process and overturned fifty years of precedent, suggesting that the Court engaged in judicial rulemaking.

### C. *The Supreme Court’s Judicial Activism*

After examining the different policy concerns that motivated

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201. See FED. R. CIV. P. 9(b) (“In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.”); see also *Pleading Standards*, *supra* note 121, at 311 (“Rule 9 creates clear exceptions to the rule that facts do not need to be pleaded with any specificity; thus, the action to which Rule 9 is inapplicable must not require particularized pleading of facts.”).

202. WRIGHT & MILLER, *supra* note 68, § 1215.

203. See, e.g., Cavanagh, *supra* note 126, at 25–26 (noting that dismissing claims at the pleading stage before any discovery “puts prospective plaintiffs at a severe disadvantage because it denies them equal access to proof”); Spencer, *supra* note 23, at 447 (“[T]he Court’s rejection of *Conley*’s ‘no set of facts’ standard is a clear indication of the fact that the Court’s plausibility pleading is a new, more stringent pleading standard that deprives plaintiffs the benefits of inferences in their favor when the pleaded facts are consistent with alternative explanations that do not involve wrongdoing.”) (internal quotations omitted).

204. See *supra* notes 170–88 and accompanying text.



the creation of different pleading standards and how these pleading standards are now converging—the plausibility pleading standard approaching the level of the heightened pleadings standards predicated on allegations of fraud under Rule 9(b) and the PSLRA—one question remains: Was the Supreme Court<sup>205</sup> heightening the basic pleading standard for all federal civil cases in order to deter vexatious litigation? If so, the Court has engaged in judicial activism by overturning fifty years of precedent and bypassing the proper procedures set forth to amend the Federal Rules of Civil Procedure.<sup>206</sup>

There are various ways in which judicial behavior may be considered “activist,”<sup>207</sup> and judicial activism is not restricted to judges of a specific ideology.<sup>208</sup> As noted by Dean Erwin Chemerinsky, “[c]onservative justices are happy to be activists when it serves their ideological agenda.”<sup>209</sup> But judicial activism from the

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205. The opinion in *Twombly* was authored by Justice Souter and joined by Chief Justice Roberts and Justices Scalia, Kennedy, Thomas, Breyer, and Alito. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 547 (2007). The opinion in *Iqbal* was authored by Justice Kennedy and joined by Chief Justice Roberts and Justices Scalia, Thomas, and Alito. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1941 (2009).

206. See Kimberly Atkins, *Congress Questions Pleading Decisions: Lawmakers, Witnesses Discuss Impact of ‘Iqbal’, ‘Twombly’ Rulings*, LAWS. USA, Oct. 28, 2009, available at <http://www.allbusiness.com/legal/evidence-witnesses/13363806-1.html> (discussing the congressional reaction to the *Twombly* and *Iqbal* decisions). Some commentators, however, defend the *Twombly* decision as flowing from prior holdings. See, e.g., Smith, *supra* note 23, at 1091–97 (“*Twombly* must be viewed as part of a broader trend in which the Court recognizes the importance of imposing real and meaningful judicial scrutiny at the pleading stage, particularly as cases become more costly and complex to litigate.”).

207. See Ernest A. Young, *Judicial Activism and Conservative Politics*, 73 U. COLO. L. REV. 1139, 1144–61 (2002) (describing six broad categories of activist behavior).

208. See *id.* at 1141 (“[W]hile we may plausibly describe different aspects of judicial acts as either ‘activist’ or ‘restrained,’ such terminology will rarely yield persuasive on-balance characterizations of decisions, much less of particular judges or courts.”) (emphasis added).

209. See Erwin Chemerinsky, Op-Ed., *Conservatives Embrace Judicial Activism in Campaign Finance Ruling*, L.A. TIMES, Jan. 22, 2010, available at <http://articles.latimes.com/2010/jan/22/opinion/la-oe-chemerinsky22-2010jan22> (discussing the Supreme Court’s recent holding in *Citizens United v. Federal Election Commission* and noting that “[t]here is no way to see this other than as the conservative justices using judicial review to advance the traditional conservative ideological agenda”); see also Sherrilyn A. Ifill, *Judicial Activism from the Right*, THE ROOT.COM (Jan. 24, 2010), <http://www.theroot.com/views/judicial-activism-right> (noting how the conservative five-justice majority in *Citizens United v.*

right is not a new trend;<sup>210</sup> there have been numerous rulings coming from the Supreme Court's conservative majority in recent years that are inconsistent with the view that judicial activism is a tool used exclusively to advance liberal ideologies.<sup>211</sup> Most recently, in *Citizens United v. Federal Election Commission*,<sup>212</sup> the Supreme Court held that corporations and labor unions are not limited in the amount of money they can spend on election campaigns.<sup>213</sup> The opinion, authored by Justice Kennedy and joined by Chief Justice Roberts and Justices Thomas, Scalia, and Alito,<sup>214</sup> is considered a strident example of modern judicial activism by many

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*Federal Election Commission* “reversed over 100 years of jurisprudence in which the court had affirmed Congress’ authority to regulate corporate campaign speech, and directly overturned several key precedents”).

210. See Adam Cohen, Editorial, *Psst . . . Justice Scalia . . . You Know, You’re an Activist Judge, Too*, N.Y. TIMES, Apr. 19, 2005, available at [http://www.nytimes.com/2005/04/19/opinion/19tue3.html?\\_r=1](http://www.nytimes.com/2005/04/19/opinion/19tue3.html?_r=1) (“The idea that liberal judges are advocates and partisans while judges like Justice Scalia are not is being touted everywhere these days, and it is pure myth. . . . The conservative partisans leading the war on activist judges are just as inconsistent: they like judicial activism just fine when it advances their own agendas.”); see also Ian Frederick Finseth, *Conservative Judicial Activism*, COMMONWEAL INST. (Apr. 21, 2005), <http://www.commonwealinstitute.org/archive/conservative-judicial-activism> (“What we’ve seen in recent years, however, is a sharp rise in conservative judicial activism, with federal jurists appointed by Republican Presidents exerting power from the bench much more aggressively.”) (emphasis omitted).

211. See, e.g., *Bush v. Gore*, 531 U.S. 98, 100–03 (2000) (finding the Florida Supreme Court’s ballot recounting scheme for the 2000 presidential election unconstitutional); *United States v. Morrison*, 529 U.S. 598, 601, 617–19 (2000) (invalidating the civil damages provisions of the Federal Violence Against Women Act and holding that Congress may not regulate noneconomic, violent criminal conduct based solely on that conduct’s aggregate effect on interstate commerce); *United States v. Lopez*, 514 U.S. 549, 551 (1995) (finding the Gun-Free School Zones Act of 1990 invalid as exceeding the authority of Congress under the Commerce Clause); see also Larry D. Kramer, *The Supreme Court v. Balance of Powers*, N.Y. TIMES, Mar. 3, 2001, at A13 (“For nearly a decade, the court’s five conservative justices have steadily usurped the power to govern by striking down or weakening federal and state laws regulating issues as varied as gun sales, the environment and patents . . .”).

212. 130 S. Ct. 876 (2010).

213. *Id.* at 913–14 (finding that the government is not allowed to suppress political speech of corporations and that the federal statute prohibiting independent corporate expenditures for electioneering communications was unconstitutional).

214. *Id.* at 886. Justice Thomas joined as to all but Part IV, and Justices Ginsburg, Breyer, Stevens, and Sotomayor joined only as to Part IV.

commentators,<sup>215</sup> who argue that the conservative majority failed to defer to the elected branches of government by striking down the McCain–Feingold Bipartisan Campaign Reform Act of 2002.<sup>216</sup>

By downplaying the requirements imposed by Congress when enacting Rule 8(a)(2), the Supreme Court has managed to elevate the basic pleading standard for all federal civil cases to approach the level of the heightened pleading standards of Rule 9(b) and the PSLRA. These latter provisions were purposefully designed to be stricter in order to provide adequate notice in cases alleging fraud, protect the reputation of innocent defendants, and curb abusive litigation practices (which frequently involve securities fraud claims due to their high nuisance value).<sup>217</sup> Thus, it appears as if the

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215. See, e.g., Chemerinsky, *supra* note 209 (noting that, even though conservatives have generally argued that judicial restraint entails deference to the elected branches of government, “[n]o such deference was evident when the court’s five most conservative justices struck down this provision of the McCain-Feingold law”); Ifill, *supra* note 209 (“[*Citizens United*] marks a new level of brazen determination by the court’s conservative majority to reach the conclusions it wants by any means necessary.”); Thomas E. Mann, *Commentary: Citizens United v. FEC Is an Egregious Exercise of Judicial Activism*, MCCLATCHY (Jan. 26, 2010), <http://www.mcclatchydc.com/opinion/story/82982.html> (“In spite of its imperative to rule on ‘cases and controversies’ brought to the Court, to defer to the legitimate lawmaking authority of the Congress and other democratically elected legislatures, and to not allow simple disagreement with past judicial decisions to overrule precedent (stare decisis), the Roberts Court ruled unconstitutional the ban on corporate treasury funding of independent political campaigns.”).

216. See Bipartisan Campaign Reform Act of 2002, H.R. 2356, 107th Cong. (2002) (amending the Federal Election Campaign Act of 1976, which regulates the financing of political campaigns).

217. See *supra* notes 179–88 and accompanying text. Even Congress has recently taken notice of the Supreme Court’s recent redefinition of pleading doctrines and has begun taking steps to restore the notice pleading standard that the Court’s conservative majority retired through *Twombly* and *Iqbal*. Senator Arlen Specter has introduced a bill into the Senate to reinstate the *Conley* notice pleading standard. Titled “Notice Pleading Restoration Act of 2009,” the bill provides:

Except as otherwise expressly provided by an Act of Congress or by an amendment to the Federal Rules of Civil Procedure which takes effect after the date of enactment of this Act, a Federal court shall not dismiss a complaint under rule 12(b)(6) or (e) of the Federal Rules of Civil Procedure, except under the standards set forth by the Supreme Court of the United States in *Conley v. Gibson*, 355 U.S. 41 (1957).

Court, in enhancing the basic Rule 8(a)(2) pleading requirements, has inappropriately bypassed the proper process for amending the Federal Rules of Civil Procedure because of its concern with abusive litigation and excessive discovery costs, notwithstanding the fact that the system already has two heightened pleading standards designed to address similar issues.<sup>218</sup>

#### IV. CONCLUSION

The plausibility pleading standard under Rule 8(a)(2) should be nowhere near the heightened pleading standards under Rule 9(b) and the PSLRA. By heightening the basic pleading standard for all federal civil cases, the Supreme Court has not only made it more difficult for disgruntled plaintiffs to meet the basic pleading requirements when bringing forward complex claims,<sup>219</sup> but has also introduced a measure of incongruity in a legal system that was based upon rules that were designed to encourage the resolution of claims on the merits.<sup>220</sup> The way in which these different pleading standards weigh inferences that are equally consistent with liability and non-liability may lead to different results for plaintiffs, in a way that is incongruent with the purpose of the pleading doctrines.

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Notice Pleading Restoration Act of 2009, S. 1504, 111th Cong. (2009). Representative Jerrold Nadler has also introduced a bill to restore the notice pleading standard that includes specific language from *Conley*, titled "Open Access to Courts Act of 2009." Open Access to Courts Act of 2009, H.R. 4115, 111th Cong. (2009). At a hearing before the House Judiciary Committee, Representative Nadler criticized the decision in *Iqbal* as being "judicial activism at its worst." See Atkins, *supra* note 206.

218. The *Twombly* decision has also been considered to be motivated by a desire to reduce tort litigation. See Cavanagh, *supra* note 126, at 26–27 ("The solution offered by the majority in *Twombly* makes little sense unless it had another goal in mind: tort reform through reduction in the number of private civil enforcement suits in the federal courts. Tort reform is the unspoken principle at the heart of the *Twombly* decision.").

219. See Spencer, *supra* note 23, at 494 ("Ultimately, *Twombly* raises the pleading bar to a point where it will inevitably screen out claims that could have been proven if given the chance.").

220. See Cavanagh, *supra* note 126, at 19 ("The goal of the drafters was to facilitate moving meritorious claims to trial and to make certain that technical rules of pleading would no longer be a stumbling block for a legitimate claim, as had been the case under the codes and at common law, where the goal had been to avoid trial.").

Moreover, the notion of justice that is the foundation of our legal system requires that any system of civil litigation provide litigants a fair opportunity to bring forward meritorious claims without having to jump through complicated procedural hoops.<sup>221</sup> The most basic pleading standard for all federal civil cases should not converge with heightened pleading standards that are more stringent due to special policy concerns.

As observed by Justice Stevens, those complaints that traditionally failed to provide sufficient notice to a defendant portrayed the type of “bareness” that the Federal Rules of Civil Procedure were designed to dismiss.<sup>222</sup> On the other hand, “[a] plaintiff’s inability to persuade a district court that the allegations actually included in her complaint are ‘plausible’ is an altogether different kind of failing, and one that should not be fatal at the pleading stage.”<sup>223</sup> In order to fulfill the policy rationales for which they were created, the heightened pleading standards under Rule 9(b) and the PSLRA should be markedly more stringent than the basic pleading standard under Rule 8(a)(2). It is imperative that particularity and cogency remain challenging standards to meet; there should be no doubt as to their stringency. The plausibility standard, on the other hand, although it is now more onerous to meet than the previous notice pleading standard, should nonetheless be focused on its main objectives of providing adequate notice and serving as a filter for unmeritorious claims, rather than addressing other policy concerns that would be better handled through the legislative rulemaking process that created the rules in the first place.

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221. See WRIGHT & MILLER, *supra* note 68, § 1202 (“[T]he simplified pleading standard expressed in [Rule 8(a)(2)] is reinforced by the mandate in Rule 8(f) that ‘all pleadings shall be so construed as to do substantial justice.’”); see also Carter, *supra* note 26, at 25–26 (explaining that one of the purposes of the Federal Rules of Civil Procedure was to promote the disposition of cases on the merits rather than on procedure).

222. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 580 n.6 (2007) (Stevens, J., dissenting).

223. *Id.*



# Majority of Class Action Publication Notices Fail to Satisfy Rule 23 Requirements

Shannon R. Wheatman, Ph.D. and Terri R. LeClercq, Ph.D.\*

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On December 1, 2003, Federal Rule of Civil Procedure 23 (Rule 23) was amended to require that class action notices in federal court “clearly and concisely state in plain, easily understood language” the information that class members need to make an informed decision.<sup>1</sup> In 2000, the Advisory Committee on Civil

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1. FED. R. CIV. P. 23(c)(2)(B).

Rules of the Judicial Conference of the United States had solicited assistance from the Federal Judicial Center (FJC), the research and education agency of the federal judicial system, to draft model notices that would satisfy the plain language requirement.<sup>2</sup>

In this article, notice expert Dr. Shannon R. Wheatman and legal writing expert Dr. Terri R. LeClercq, who worked with the FJC for a number of years to develop the model notices, explain the continuing problems with poorly worded and poorly designed notices.<sup>3</sup> Wheatman and LeClercq report findings from a study of 511 class action notices that were published after the plain language amendment took effect. The research uncovers many shortcomings and the authors offer advice on improving the design and content of class action notice.

Notice has progressed in the years since the passage of the plain language amendment, but it still has a long way to go to realize the Advisory Committee's goals that "notice be couched in plain, easily understood language" and that practitioners "work unremittingly at the difficult task of communicating with class members."<sup>4</sup> However, class members cannot benefit from Rule 23 if practitioners are not held accountable.

## I. WHAT IS PLAIN LANGUAGE, AND WHY IS IT NECESSARY?

Plain language is clear and direct. It relies on principles of clarity, organization, layout, and design. Plain language writers "let their audience concentrate on the message instead of being distracted by complicated language."<sup>5</sup> Thus, plain language communicates effectively with laypersons. This is critical because only 28% of U.S. adults have graduated from college.<sup>6</sup> In fact, a 2003 literacy

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2. More information on the research that was done by the FJC on the model notice project can be found at [www.fjc.gov](http://www.fjc.gov).

3. The team working on the model notices included the authors, Todd Hilsee, Tom Willging, and Bob Niemic.

4. FED. R. CIV. P. 23 advisory committee's note.

5. Robert Eagleson, *Short Definition of Plain Language*, PLAIN LANGUAGE, <http://www.plainlanguage.gov/whatisPL/definitions/eagleson.cfm> (last visited Oct. 4, 2010).

6. SARAH R. CRISSEY, U.S. CENSUS BUREAU, EDUCATIONAL ATTAINMENT IN THE UNITED STATES: 2007, 2 (Jan. 2009), available at <http://www.census.gov/prod/2009pubs/p20-560.pdf>.



study found that less than 15% of U.S. adults were proficient in “integrating, synthesizing, and analyzing multiple pieces of information located in complex documents.”<sup>7</sup>

Empirical research has shown that redrafting legal documents into plain language increases reader comprehension and is more persuasive.<sup>8</sup> On the other hand, failure to write in plain language can have serious consequences because if readers cannot understand the content of a document, they will stop reading.<sup>9</sup> In the class-action notice context, that means due process will be thwarted and class members will remain uninformed of important rights they are giving up.

## II. DEVELOPMENT OF THE MODEL PLAIN LANGUAGE NOTICES

The FJC conducted research to determine the best way to write class action notices to allow laypersons to easily understand all of their rights and options. The model plain language notices (“model notices”) include examples for two settlement classes

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7. MARK KUTNER ET AL., NATIONAL CENTER FOR EDUCATIONAL STATISTICS, LITERACY IN EVERYDAY LIFE: RESULTS FROM THE 2003 NATIONAL ASSESSMENT OF ADULT LITERACY 4, 13 (Apr. 2007), available at <http://www.nces.ed.gov/Pubs2007/2007480.pdf> (finding 13% of adults demonstrated ability to perform these skills).

8. See Joseph Kimble, *Answering the Critics of Plain Language*, 5 SCRIBES J. LEGAL WRITING 51, 62–65, 73 (1996) (listing a number of studies conducted on plain language and concluding that plain language is more persuasive and comprehensible to readers than standard legal writing); see generally Robert Charrow & Veda Charrow, *Making Legal Language Understandable: A Psycholinguistic Study of Jury Instructions*, 79 COLUM. L. REV. 1306 (1979) (arguing that systematic rewriting of jury instructions can measurably increase reader comprehension); Veda Charrow, *Readability vs. Comprehensibility: A Case Study in Improving a Real Document*, in LINGUISTIC COMPLEXITY AND TEXT COMPREHENSION: READABILITY ISSUES RECONSIDERED 85 (Alice Davison & Georgia M. Green eds., 1988) (rewriting automobile recall letters for readability increases comprehension among study sample); Michael Masson & Mary Ann Waldron, *Comprehension of Legal Contracts by Non-experts: Effectiveness of Plain Language Redrafting*, 8 APPLIED COGNITIVE PSYCHOL. 67 (1994) (reporting enhanced comprehension of legal documents after three stages of simplification).

9. See WILLIAM H. DUBAY, THE PRINCIPLES OF READABILITY 1 (Aug. 25, 2004), available at <http://www.impact-information.com/impactinfo/readability02.pdf> (“When texts exceed the reading ability of readers, they usually stop reading.”).

(including a securities settlement and a personal injury/product liability settlement) as well as a model notice for an unrestricted certification involving an employment case on a trial track. To aid judges and practitioners, the FJC has posted the model notices at [www.fjc.gov](http://www.fjc.gov).

The model notices were not created in a vacuum but were developed through a thoughtful, multi-stage process that culminated with an empirical study. The empirical study on the FJC's securities notice proved that the plain language versions of the model notices were exponentially more understandable than the typical legalistic notices that are still common today.<sup>10</sup> The notice project involved real-world testing that included focus groups composed of laypersons of average education. The first author of this report tested securities model notices on shareholders in investment clubs across the country.<sup>11</sup>

Most of the focus group participants displayed a very general knowledge of class action lawsuits.<sup>12</sup> At the same time, most participants were relatively unfamiliar with class action notices.<sup>13</sup> Participants' "preconceived notion[s] of a notice [were] almost totally negative; they expected to find wordy legalese that would be difficult or impossible to understand."<sup>14</sup> Most notices today continue to live down to this expectation.<sup>15</sup>

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10. See Shannon R. Wheatman, *The Effects of Plain Language Drafting on Layperson's Comprehension of Class Action Notices* 21, 55 (Sept. 25, 2001) (unpublished Ph.D. dissertation, University of Georgia) (on file with author) (revealing poor overall comprehension of a sample of class action notices by laypersons—between 45% to 65%). This empirical study also found that comprehension for the rewritten securities plain language notice was over 90%. *Id.* (listing findings that comprehension of plain language notices ranged from 15.99 to 16.17 out of a possible score of 17).

11. *Id.* at 35 (explaining the FJC securities notices study involved 229 volunteer participants who were members of 27 investment clubs).

12. *Detailed Discussion of Methodology*, FED. JUD. CENTER, [http://www.fjc.gov/public/home.nsf/autoframe?openform&url\\_l=/public/home.nsf/inavgeneral?openpage&url\\_r=/public/home.nsf/pages/816](http://www.fjc.gov/public/home.nsf/autoframe?openform&url_l=/public/home.nsf/inavgeneral?openpage&url_r=/public/home.nsf/pages/816) (last visited Sept. 24, 2010).

13. *Id.*

14. *Id.*

15. See *infra* Part IV.B–C.

### III. WHERE ARE WE NOW?

With the passage of the plain language amendment, the hope was that the world of class action notice would be turned on its head and lawyers would take great strides to ensure that class members could finally understand all of their rights and options. The real question: how far has class action notice come in the past six years? Well, if you turn to the pages of many major newspapers and periodicals, you will probably find a typical class action notice—that is, if you can see it. Many notices continue to be written in small, fine print;<sup>16</sup> the notice often features the court's official-looking case caption,<sup>17</sup> which does not provide any incentive for actual class members to read it.<sup>18</sup> If readers can get past the design features that deter reading, they will likely be met with large blocks of jargon-filled text that are unintelligible to many laypersons.<sup>19</sup>

### IV. CURRENT STUDY

To determine empirically whether class action notices are complying with the plain language requirement of Rule 23, the authors reviewed 511 class action notices published between 2004 and 2009.<sup>20</sup> The sample included 176 notices filed in state court (representing forty-two states) and 335 notices filed in federal court (representing fifty-four federal district courts).<sup>21</sup> The sample included 477 settlement notices and thirty-four certification notices. The lawsuits involved a variety of subject matters including antitrust, banking and finance, consumer, employment, environmental, human

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16. See *infra* Part IV.C.

17. See *infra* Part IV.C–D.

18. See *infra* Part IV.B.

19. See *infra* Part IV.G.

20. The notices were published in *The Austin American Statesman*, *Better Homes & Gardens*, *Cosmopolitan*, *The Detroit News*, *Financial Times*, *Jet*, *National Geographic*, *Newsweek*, *The North Penn Reporter*, *Oakland Tribune*, *Parade*, *People*, *The Philadelphia Inquirer*, *Reader's Digest*, *Spirit Flight*, *Sports Illustrated*, *The Sunday Voice*, *TV Guide*, *USA Today*, *USA Weekend*, *The Wall Street Journal*, and *The Wall Street Journal Sunday*.

21. Half of the notices were filed in California (19%), New York (16%), Illinois (8%) and New Jersey (7%).

rights, insurance, pharmaceutical, privacy, securities, and telecommunications.

Both authors evaluated the content of each notice.<sup>22</sup> They evaluated the notices on design attributes, content, and overall readability. The layout or design of a notice includes the headline, font size, ad size, and the techniques used to highlight important information. The content of the notice includes information about the lawsuit, the class definition, settlement details, attorneys' fees, how to file a claim, how to be excluded, how to object, deadlines, hearing date, and the binding effect of any settlement or judgment. Readability was based on whether the notice was concise, avoided legalese, and was written in plain language.

The authors found significant differences in securities and non-securities notices and therefore present the overall findings for each group separately.

#### A. *Key Findings*

- Over 90% of securities notices used an uninformative case caption in the header of the notice.
- Most notices did not include a noticeable and informative headline to capture the attention of potential class members.
- Over 60% of notices were written in less than an 8-point font.
- The majority of notices failed to clearly inform class members of the binding effect of the settlement.
- Over two-thirds of the notices with an opt-out right did not inform the class member that they could opt out of the litigation or settlement.
- Over 75% of the notices did not tell class members they had the right to appear through an attorney.
- Over two-thirds of the notices failed to satisfy the concise, plain language requirement of Rule 23.

#### B. *Notice Design*

There is more to a notice than just words on a page. The design or layout of a notice influences readability. The FJC study

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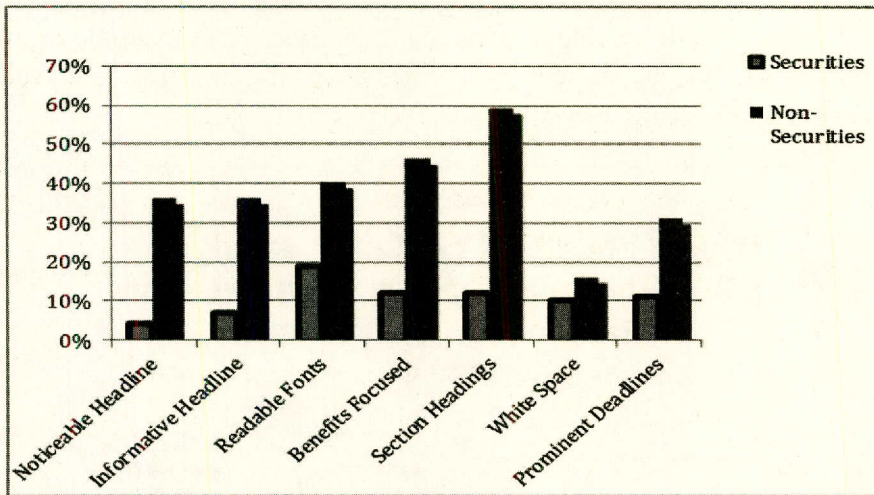
22. The percentage of agreement between the two authors was high at 92%. The average score was used when there was disagreement.

found that comprehension of class action notices could be significantly improved through deliberate changes in “language, organizational structure, formatting, and presentation of the notice.”<sup>23</sup>

The design of a notice will determine whether anyone will even attempt to read it. The notice must be designed using a reader-friendly format that will entice class members to want to take time to review it. A well-designed notice will incorporate readable fonts, a noticeable and informative headline, section headings, adequate white space, and proper highlighting techniques such as using bold headlines and avoiding all capital letters (CAPs).

Figure 1 reveals that a clear majority of class action notices in the study did not heed the sage advice of *The Manual for Complex Litigation*, which recommends that an author take steps to get the attention of class members: “Published notice should be designed to catch the attention of the class members to whom it applies. . . . Headlines and formatting should draw the reader’s attention to key features of the notice.”<sup>24</sup>

Figure 1: Percentage of sample publication notices using appropriate design features.



23. Detailed Discussion of Methodology, supra note 12.

24. FEDERAL JUDICIAL CENTER, MANUAL FOR COMPLEX LITIGATION (FOURTH) § 21.31 (2004), available at <http://public.resource.org/scribd/8763868.pdf>.

### C. *Headline*

Advertising research has found that the eyes and consciousness of most readers never make it past the headline.<sup>25</sup> A court's formal case caption (inappropriately used in 38% of non-securities and 91% of securities notices) will never provide an adequate headline for a class action notice because it does not alert the reader to the subject matter. The case caption is meaningless to any class member who is not a named party.

The size of the headline is also important. It is doubtful that attorneys would use a tiny font size to advertise their law firm. However, the majority of notices in the study (61% of non-securities and 74% of securities notices) had a headline or heading a few point sizes smaller than the text in this article. Fifty-nine percent of notices used the same size font for the headline and the body of the notice. The headline needs to stand out from the body of the text and should be in a much larger font in order to catch the attention of potential class members. A recent study found that an easy-to-read font is more likely to get people to act because it is more appealing, easier to handle, and more efficient.<sup>26</sup>

A carefully crafted headline should be noticeable and should quickly persuade readers that they have a stake in the class action and that they will be able to understand it. Here is an example of an attention-getting headline from the securities model notice (the full size notice is attached as Appendix A):

**LEGAL NOTICE**

**If you bought XYZ Corp. stock in  
1999, you could get a payment from  
a class action settlement.**

**Para una notificación en Español, llamar o visitar nuestro website.**

<p><small>A settlement has been proposed in a class action lawsuit about the price of XYZ Corporation stock. The settlement will provide \$6.99 million to pay claims from XYZ investors who bought the company's stock during 1999. If you qualify, you may send in</small></p>	<p><small>all of the details about the proposed settlement. Your share of the fund will depend on the number of valid claim forms that Class Members send in, how many shares of XYZ stock you bought, and when you bought and sold them. Gener-</small></p>
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25. See KENNETH ROMAN & JANE MAAS, HOW TO ADVERTISE, 110 (1st ed. 1976) (“[M]ost readers never reach the text or body copy”).

26. See Hyunjin Song & Norbert Schwarz, *If it's Easy to Read, it's Easy to do, Pretty, Good, and True*, 23 THE PSYCHOLOGIST, 108, 108 (2010) (suggesting that font type leads readers to predict ease or difficulty of reading, informing their decision to act).

The large, noticeable font will capture the attention of potential class members, and the benefit focus of the headline will motivate them to read the notice.

#### D. *Organization, Internal Cues, and White Space*

Information is well-organized if it is easy for readers to navigate. Writers can accomplish this by using appropriate headings and sub-headings. The notice should tell the story of the litigation. Unnecessarily long sentences and lengthy paragraphs in many of the sample notices became even more cumbersome because many notices failed to incorporate section headings (41% of non-securities and 88% of securities notices). Section headings should serve as guideposts to the information in each section and improve readability by breaking up large blocks of text.<sup>27</sup>

In addition, a large majority of sample notices (84% of non-securities and 97% of securities notices) included wall-to-wall words with little to no white space around the paragraphs and headings. Focus groups in the FJC study found that density off-putting.<sup>28</sup> One notice in the study was the size of four postage stamps. There is absolutely no way something that small can attract the attention of potential class members, let alone provide the information required by Rule 23.

#### E. *Appropriate Highlighting Techniques*

Furthermore, the model notices show that appropriate highlighting of key information (e.g., bolding important deadlines) also breaks up the text and lets readers know what is important. Appropriate highlighting of important information appeared in one out of ten securities notices and about one-third of non-securities notices. Another common design flaw is the use of all capital letters

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27. JoAnn Syverson & Holly Littlefield, *Informative Headings Improve Readability*, U. MINN. CENTER FOR WRITING (Apr. 11, 2003), <http://www.writing.umn.edu/tww/disciplines/business/resources/BA3033headings.html>.

28. See *Detailed Discussion of Methodology*, *supra* note 12 (“Even small changes in format and presentation . . . appeared to increase a reader’s motivation to read and understand the notice.”).

in long strings of text. Some writers may innocently believe this is a good way to provide a class definition or to give warnings. However, PEOPLE RECOGNIZE WORDS BASED ON THEIR SHAPE, NOT THE ACTUAL LETTERS IN THE WORDS.<sup>29</sup> ALL CAPS ARE HARD TO READ, CAUSING THE READER TO STRUGGLE TO MAKE OUT THE WORDS. Many of the notices in the study used too many CAPs (the average numbers of words in CAPs was 28 in non-securities and 41 in securities notices). One notice had 391 words in CAPs, which made a very short notice quite difficult to read. Writers should stay away from all CAPs and instead use bold, italics, or both to make important information stand out. However, in order not to overwhelm readers, writers should use this highlighting in moderation.

#### F. *Content of the Notice*

Rule 23 requires that specific content be written in plain language.<sup>30</sup> The notice must clearly describe (1) the nature of the case, claims, issues or defenses, (2) the class definition, (3) certain rights and options available to class members (such as appearing in court, objecting to the settlement, or opting out of the class), and (4) the binding nature of any judgment on anyone who remains in the class.<sup>31</sup> Rule 23 also recommends that class members be notified of an attorney fee motion by class counsel, and be given an opportunity to object to it.<sup>32</sup>

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29. Kevin Larson, *The Science of Word Recognition: or How I Learned to Stop Worrying and Love the Bauma*, MICROSOFT CORP. (July 2004), <http://www.microsoft.com/typography/ctfonts/wordrecognition.aspx>.

30. See FED. R. CIV. P. 23(c)(2)(B) ("The notice must clearly and concisely state in plain, easily understood language . . .").

31. *Id.*; *In re Nissan Motor Corp. Antitrust Litig.*, 552 F.2d 1088, 1104–05 (5th Cir. 1977) ("Surely 'the best notice practicable under the circumstances' cannot stop with . . . generalities. It must also contain an adequate description of the proceedings written in objective, neutral terms, that . . . may be understood by the average absentee class member." (quoting *Robinson v. Union Carbide Corp.*, 544 F.2d 1258, 1263–65 (5th Cir. 1977))).

32. FED. R. CIV. P. 23(h)(1)–(2). The Advisory Committee notes that the 2003 amendments state that "it would be important to require the filing of at least the initial motion in time for inclusion of information about the motion in the notice to the class about the proposed settlement that is required by Rule 23(e)." FED. R. CIV. P. 23 advisory committee's notes.



*The Manual for Complex Litigation* also recommends that the notice should include deadlines for taking action, describe essential terms of the settlement (including information that will allow class members to calculate their benefit), indicate the time and place of the fairness hearing, and prominently display how to get more information.<sup>33</sup>

Figure 2: Percentage of sample publication notices containing important information.

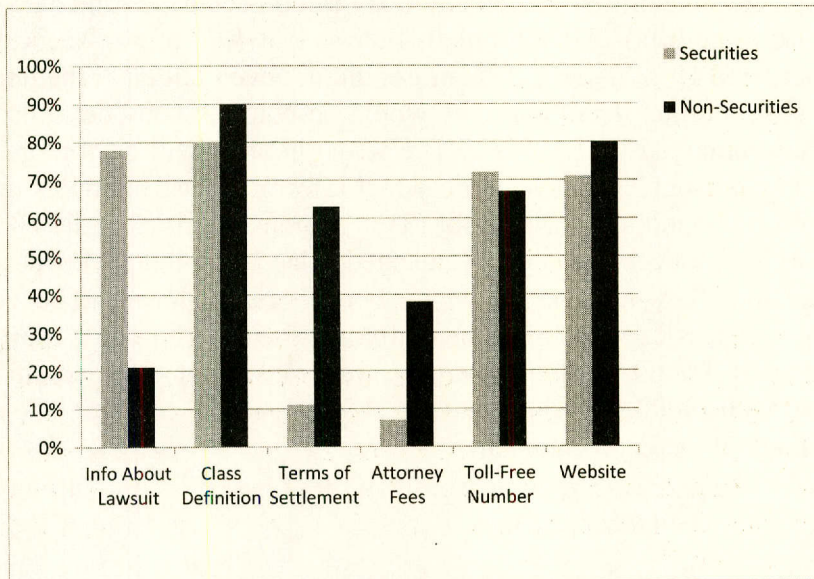


Figure 2 shows that some notices provide so few details that it is unlikely class members would recognize that they might benefit from reading it; it is also unlikely that those class members would learn enough from the information to decide what to do. Most securities notices failed to tell class members details about the lawsuit, the terms of the settlement, or how much attorneys stand to make from the settlement. Non-securities notices were better on most counts, but the number of notices that did not clearly tell class members what they needed to know was still high. The most

33. FEDERAL JUDICIAL CENTER, MANUAL FOR COMPLEX LITIGATION (FOURTH) § 21.312 (2004), available at <http://public.resource.org/scribd/8763868.pdf>.

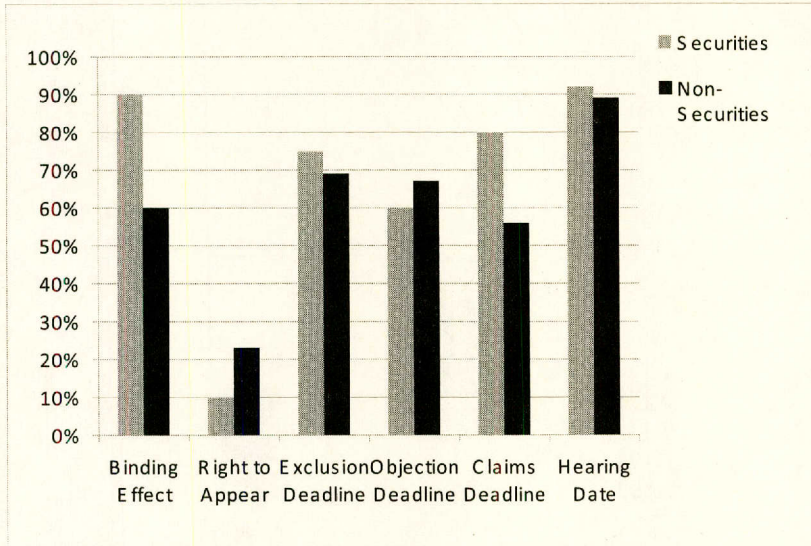
astounding finding was that 10% of non-securities notices and 20% of securities notices did not provide a definition of the class.

Figure 3 provides even more troubling findings. The basic rights afforded class members under Rule 23 are often omitted from publication notices. The most common omission was notice of the right to appear, which was absent in 77% of non-securities notices and 90% of securities notices. Many notices did not inform class members that they had the right to object to a settlement (33% of non-securities and 40% of securities notices) or that they could opt out of the litigation or settlement (25% of non-securities and 31% of securities notices). Most problematic was that 40% of non-securities notices and 10% of securities notices did not even tell class members the all-important detail that they would be bound by any court order if they remained in the class. The term “bound” will be foreign to most laypersons. Of those notices that informed class members they would be bound, only a handful (31% of non-securities and 14% of securities notices) properly educated class members, in easily understood language, as to what “bound” really meant. The FJC model notices explain what this really means: “If you don’t want to be legally bound by the settlement, you must exclude yourself by **Month 00, 0000**, or you won’t be able to sue, or continue to sue, XYZ about the legal claims in this case.”<sup>34</sup>

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34. See *infra* App. A.

Figure 3: Percentage of sample publication notices containing important rights and deadlines.



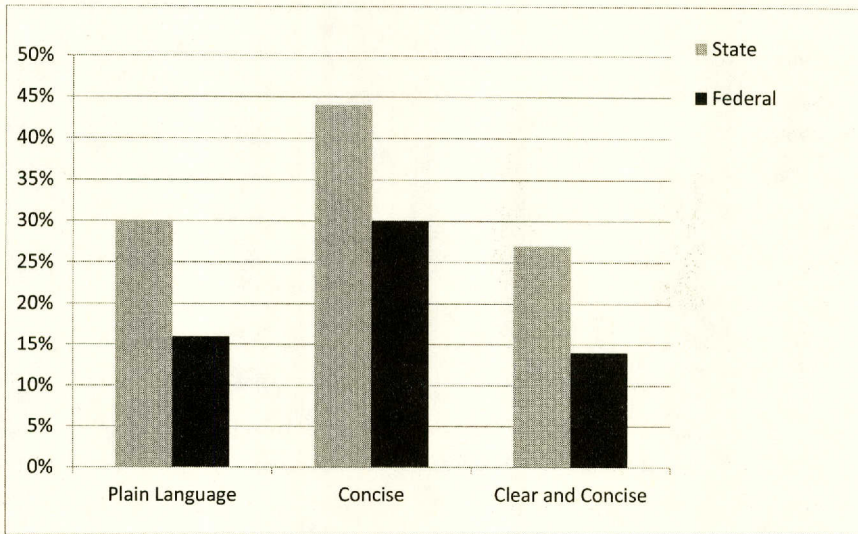
G. Readability

“The purpose of [readability] is to close the gap between the reading level of the [notice] and the reading ability of [class members].”<sup>35</sup> Figures 4 and 5 show that many notices in the study failed to close that gap. Overall, only 14% of notices filed in federal court were concise and written in plain language. In contrast, although only four of the fifty states require plain language in their class actions statutes,<sup>36</sup> the state court class action notices in the study were easier to understand than the federal class action notices, with 28% satisfying the concise, plain language requirement.

35. IMPACT INFORMATION, WORKING WITH PLAIN LANGUAGE 29 (2008), available at [www.impact-information.com/Resources/plainlanguage.ppt](http://www.impact-information.com/Resources/plainlanguage.ppt) (last visited October 1, 2010).

36. See generally AMERICAN BAR ASSOCIATION, SURVEY OF STATE CLASS ACTION LAW 2009 (Dennis K. Egan et al. eds., 2009), available at <http://www.abanet.org/litigation/mo/premium-lt/articles/classactions/state-survey-2009.pdf> (subscription required) (examining each state class action rule and finding only Arkansas, Minnesota, New Jersey, and Texas have adopted Rule 23’s requirement for plain language).

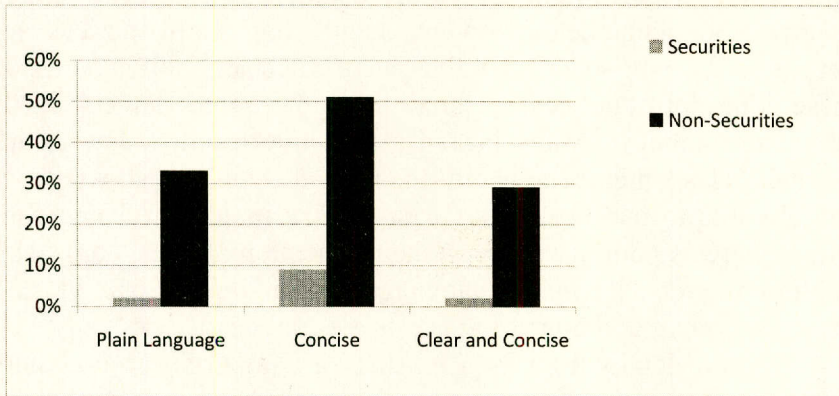
Figure 4: Percentage of sample publication notices written in plain and/or concise language in federal and state class actions.



Further analysis revealed that the securities cases in the study were causing the great disparity between federal and state court notices. Specifically, in non-securities cases, 27% of federal class action notices and 31% of state class action notices were clear and concise. In contrast, only 2% of the 170 notices filed in federal securities cases provided class members with a clear, concise recitation of their rights. These findings, albeit not very surprising, seem to provide one explanation of why billions of dollars are left unclaimed in securities cases.<sup>37</sup>

37. Adam Savett, *A Billion Here, A Billion There: Solving the Historical Data Problem and Recouping More in Securities Litigation*, RISKMETRICS GROUP, 2, [http://www.riskmetrics.com/system/files/private/SCAS\\_billion-here-billion-there.pdf](http://www.riskmetrics.com/system/files/private/SCAS_billion-here-billion-there.pdf) (last visited Sept. 19, 2010) (“[A]ccording to a series of academic studies conducted over the last decade, as well as anecdotal evidence from market participants, anywhere from 30%–70% of investors that are eligible to participate in a given settlement fail to file a claim form . . .”).

Figures 5: Percentage of sample publication notices in securities and non-securities cases that are written in plain and/or concise language.



Plain language is produced by reducing or eliminating writing that frustrates even the most motivated readers: legal jargon, unfamiliar or abstract words, negatively modified sentences, words with double meanings, verbs as nouns, misplaced phrases, and prepositional phrases.<sup>38</sup> The active voice and personal pronouns aid comprehension.<sup>39</sup> Eliminating extraneous information and keeping sentences and paragraphs short helps notices fulfill the concision requirement and increases comprehension in the process.<sup>40</sup> It is important for practitioners to keep in mind that a notice needs only to meet the content requirements of Rule 23; it is not necessary to include every detail from the class action complaint or settlement agreement. Two legal commentators understood this concept quite well when they remarked that “[m]uch of what lawyers write . . . including many class action notices, is incomprehensible to average citizens. The lawyerly concern for completeness and accuracy may conflict with the objective of intelligibility.”<sup>41</sup>

38. KINSELLA MEDIA, LLC & RUST CONSULTING, INC., PLAIN LANGUAGE PRIMER FOR CLASS ACTION NOTICE 1, 11–12, available at <http://www.kinsellamedia.com/portals/1/media/pdf/PlainLanguagePrimer.pdf> (last visited Sept. 19, 2010).

39. *Id.* at 11.

40. *Id.* at 9.

41. Arthur R. Miller & David Crump, *Jurisdiction and Choice of Law in Multistate Class Actions After Phillips Petroleum Co. v. Shutts*, 96 YALE L.J. 1, 22 (1986).

Many practitioners may believe that it is not necessary to meet the requirements of Rule 23 in a publication notice because that information can be found in a more detailed notice. The authors disagree, but nonetheless reviewed 50 long form notices (16 securities, 34 non-securities) that were filed in 2008 and 2009. These long form notices suffered from the same defects as the publication notices. Many lacked a readable headline, few clearly informed class members about their rights, and most would be unintelligible to the average layperson. The majority of long form notices were as poorly written as the publication notices—only 18% satisfied the concise, plain language requirement (26% of non-securities notices and none of the securities notices).

A few details from the FJC study are important to note here. Some securities practitioners may mistakenly believe that a simple notice is not necessary for an educated class. The study on the FJC's securities notices found that even shareholders were less likely to understand a legalistic class action notice than a plain language notice.<sup>42</sup> To read a dense, legalistic notice, a reader must not only be educated, but also possess the time and motivation required to wade through a sea of legal jargon. The FJC study found that even the most intelligent readers will pass over a notice in small print and stop reading when they encounter unfamiliar legalese.<sup>43</sup>

## V. KEEPING IT READABLE

Documents with legal content should not be burdensome reading to their intended audience. Writers should assume that class action notices will be read by a vast array of consumers who shop, buy, work, and live their lives without needing to know court names and case numbers. When writers choose their words, they need to focus on common equivalents of legal jargon. Most readers will stop reading “a claim for declaratory relief” before they learn that “relief” was indeed their goal. If a legal or technical term is necessary, it needs to be defined: “exclusion means... .”

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42. See Wheatman, *supra* note 10, at 55 (reporting higher overall comprehension for a plain language notice versus a legalistic notice).

43. See *id.* at 44 (finding that only 2% of shareholder participants would read a legalistic notice carefully whereas 57% reported they would carefully read a plain language notice).

Plain language is more than merely simple words; embedded in the term is sentence length, subject/verb order, unambiguous modifiers, and even the active voice. Rule 23 is not asking authors to use baby talk, but it does insist that the notice be stated in “plain, easily understood language.”<sup>44</sup> If sentences average more than fifteen words, the legal content may confuse some intended readers. If interrupting clauses separate verbs from their subjects, the legal content may puzzle many readers. If a sentence is a mish-mash of floating modifiers that do not logically fit next to their antecedents, most readers will be perplexed. The passive voice is also a problem: “The service contract has been claimed to be unlawful . . . class members will be bound by the determination . . . .” Who is claiming? Who is binding them? No one can unravel and reconstruct those vague sentences comfortably. Readers who are uncomfortable will stop reading, and the purpose of providing notice has been frustrated. Without plain language, the notice is moot. Courts should not approve notices that fail to meet Rule 23’s plain language requirement.

A notice need to be clear and succinct, so an average reader can go through it once and understand its general message. Few readers will take the time to re-read, again and again, a legal notice that appears inside their newspaper or magazine. Potential class members should be caught up by the headline and mention of the product; they should be able to grasp the point of the notice at first glance. If not, writers of the notice have disregarded the purpose of the notice—to inform class members about the rights and options they have in the case.

## VI. CONCLUSION

No one can affect class action notice as effectively as the judges who review them. Judges must be the standard-bearer and stringently enforce Rule 23’s requirements. Attorneys and judges can use the FJC model notices as a template or outline, which will allow them to see that it is possible to get all of the necessary information into a noticeable, succinct, plain language format. Satisfying Rule 23 will protect the interests of the class; only then

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44. FED. R. CIV. P. 23(c)(2)(B).

can due process be served. To assist judges and practitioners, the authors have developed a notice checklist, attached as Appendix B.



## VII. APPENDIX A—FEDERAL JUDICIAL CENTER MODEL NOTICE

## LEGAL NOTICE

## If you bought XYZ Corp. stock in 1999, you could get a payment from a class action settlement.

**Para una notificación en Español, llamar o visitar nuestro website.**

A settlement has been proposed in a class action lawsuit about the price of XYZ Corporation stock. The settlement will provide \$6.99 million to pay claims from XYZ investors who bought the company's stock during 1999. If you qualify, you may send in a claim form to get benefits, or you can exclude yourself from the settlement, or object to it.

The United States District Court for the District of State authorized this notice. Before any money is paid, the Court will have a hearing to decide whether to approve the settlement.

### Who's Included?

You are a Class Member and could get benefits if you bought shares of XYZ stock during 1999. You are a Class Member only if you bought shares of XYZ stock individually, not simply through a mutual fund. If you sold XYZ stock during 1999, you are a Class Member only if those shares you sold were purchased in 1999. XYZ officers and directors, as well as immediate family members of directors of XYZ during 1999, are not Class Members.

Contact your broker to see if you had shares of XYZ stock. If you're not sure you are included, you can get more information, including a detailed notice, at [www.XYZsettlement.com](http://www.XYZsettlement.com) or by calling toll free 1-800-000-0000.

### What's This About?

The lawsuit claimed that XYZ and its Chief Executive Officer, Anne Adams, misled investors by intentionally overstating the profits that the company expected to earn in the future. The lawsuit also claimed XYZ issued false and misleading information about income and earnings per share for 1999, and that XYZ executives sold their personal shares at inflated prices during that time. XYZ and Ms. Adams deny they did anything wrong. The Court did not decide which side was right. But both sides agreed to the settlement to resolve the case and get benefits to investors. The two sides disagree on how much money could have been won if the investors had won at a trial.

### What Does the Settlement Provide?

XYZ agreed to create a fund of \$6.99 million to be divided among all Class Members who send in valid claim forms. A Settlement Agreement, available at the website below, describes

all of the details about the proposed settlement.

Your share of the fund will depend on the number of valid claim forms that Class Members send in, how many shares of XYZ stock you bought, and when you bought and sold them. Generally, if you bought more shares and have more Net Recognized Losses (as explained in the detailed notice), you will get more money. If you bought fewer shares and have fewer Net Recognized Losses, you will get less. All of the \$6.99 million will be paid out.

If every eligible Class Member sends in a valid claim form, the average payment will be 17½ cents for each share of stock bought in 1999. The number of claimants who send in claims varies widely from case to case. If less than 100% of the Class sends in a claim form, you could get more money.

### How Do You Ask for a Payment?

A detailed notice and claim form package contains everything you need. Just call or visit the website below to get one. To qualify for a payment, you must send in a claim form. **Claim forms are due by Month 00, 0000.**

### What Are Your Other Options?

If you don't want to be legally bound by the settlement, you must exclude yourself by **Month 00, 0000**, or you won't be able to sue, or continue to sue, XYZ about the legal claims in this case. If you exclude yourself, you can't get money from this settlement. If you stay in the settlement, you may object to it by **Month 00, 0000**. The detailed notice explains how to exclude yourself or object.

The Court will hold a hearing in this case (*North v. XYZ Corp.*, Case No. CV-00-5678) on **Month 00, 0000**, to consider whether to approve the settlement and request by the lawyers representing all Class Members (Lawfirm LLP, of City, ST) for \$3,010,000 (7½ cents per share) in attorneys' fees and costs, for investigating the facts, litigating the case, and negotiating the settlement. The fees and costs won't reduce the settlement fund. You may ask to appear at the hearing, but you don't have to. For more information, call toll free 1-800-000-0000, visit the website [www.XYZsettlement.com](http://www.XYZsettlement.com), or write to XYZ Settlement, P.O. Box 000, City, ST 0000-0000.

**1-800-000-0000**

**[www.XYZsettlement.com](http://www.XYZsettlement.com)**

## VIII. APPENDIX B—NOTICE CHECKLIST

Design

- Noticeable headline (stands out from the body of the text)
- Informative headline (who should read it and why)
- Readable fonts
- Adequate white space
- Appropriate highlighting of important information (e.g., bold deadlines)
- Avoids all CAPS
- Logical sequence of content.
- Sub-headings to break up text
- Lists that simplify complex information

Content*Information about lawsuit*

- Information on nature of case, claims, issues or defenses
- Class definition
- Terms of settlement
- Attorneys' fees

*Rights and Options*

- Right/How to opt-out
- Right/How to object
- Right to appear
- How to file a claim
- Binding effect of judgment

*Dates and Deadlines*

- Opt out deadline
- Objection deadline
- Claims deadline
- Hearing date

*Getting More Information*

- Website
- Toll-Free Number
- Mailing Address

Concise

- Short paragraphs
- Short sentences (average length less than 15-20 words)
- No extraneous information (case caption, names of attorneys, etc.)
- Can read through once, and a layman will understand rights and options

Plain Language

- Written for the layperson
- Uses words that are common to your target audience
- Uses personal pronouns
- Avoids legal jargon and defines technical terms
- Uses consistent words throughout to refer to the same thing
- Uses mainly active voice
- Uses logically structured sentences (subject-verb-object)
- Avoids double negatives
- Avoids misplaced phrases and prepositional phrases and prepositional phrases



# Resolving The Principal Place of Business Conundrum: Adopting A Single Test For Federal Diversity Jurisdiction

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## I. INTRODUCTION

*“In today’s regulatory environment, it’s virtually impossible to violate rules.”<sup>2</sup>*

*~ Bernie Madoff*

As every first-year law student quickly learns, federal rules restrict access to federal courts, allowing subject matter jurisdiction only when the matter raises federal questions or when the parties to the lawsuit are diverse (i.e., citizens of different states).<sup>3</sup> For diversity purposes, corporations are citizens of the state in which

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2. Erik Luna, *The Curious Case of Corporate Criminality*, 46 AM. CRIM. L. REV. 1507, 1517 n.42 (2009) (quoting *Factbox: Bernard Madoff quotes*, REUTERS, Dec. 17, 2008, <http://www.reuters.com/article/ousiv/idUSTRE4BG0C120081217>).

3. 28 U.S.C. § 1332 (2006).

they are incorporated and the state in which they have their principal place of business.<sup>4</sup>

Determining a corporation's principal place of business is, therefore, a necessary prerequisite to federal diversity jurisdiction.<sup>5</sup> As courts of limited jurisdiction, federal courts must carefully guard against those who would improperly seek federal redress.<sup>6</sup> While it is a relatively simple matter to determine the state of incorporation, determining a corporation's principal place of business is anything but straightforward.<sup>7</sup>

To answer the federal diversity question, the federal courts have developed three jurisdictional tests: the nerve center test, the corporate activity test, and the total activity test.<sup>8</sup> In determining a

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4. *Id.*

5. *Id.* § 1332(c)(1); see also *Hawes v. Cart Prods., Inc.*, 386 F. Supp. 2d 681, 684 (D.S.C. 2005) (“In a suit against a corporate defendant, the corporation’s place of incorporation and location of the principal place of business are critical because both locations determine the states in which the corporation is a citizen for diversity purposes.”).

6. Once a case is removed to federal court, the removal court is required to determine the validity of the removal and “[i]f at any time before final judgment it appears that the district court lacks subject matter jurisdiction, the case shall be remanded.” 28 U.S.C. § 1447(c) (2006); see also Lindsey D. Saunders, Note, *Determining a Corporation’s Principal Place of Business: A Uniform Approach to Diversity Jurisdiction*, 90 MINN. L. REV. 1475, 1497 (2006) (“Congress’s intent in amending § 1332 was to further limit federal jurisdiction . . .”).

7. See *Hertz Corp. v. Friend*, 130 S. Ct. 1181, 1190 (2010) (“[T]he phrase ‘principal place of business’ has proved more difficult to apply than its originators likely expected.”); see also P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 53 (1985) (“Incredible difficulties have been encountered by the courts in localizing this single principal place of business and at least five difficult and contradictory tests have been used—nerve-center, center-of-operations, place-of-acting or physical assets, maximum-public-visibility, and totality-of-corporate-activity tests.”).

8. See Dawn Levy, *Where Do Dead Corporations Live?: Determining the Citizenship of Inactive Corporations for Diversity Jurisdiction Purposes*, 62 BROOK. L. REV. 663, 673 (1996) (“Some jurisdictions . . . apply the ‘nerve center’ test which defines the principal place of business as the site of executive and administrative functions. Other jurisdictions utilize a ‘place of activities’ test which looks to the corporation’s center of production or service activities in determining its principal place of business. Lastly, some jurisdictions use a ‘total activity test’ which first considers the general rules of the two previous tests in light of the particular circumstances of a corporation’s organization, and then balances the facts of each case to determine the location of the corporation’s principal place of business”); see also *Diaz-Rodriguez v. Pep Boys Corp.*, 410 F.3d 56, 59 (1st Cir. 2005) (“We have identified three tests for determining a

corporation's principal place of business, the nerve center test looks to the location of the corporation's decision-makers, the corporate activity test focuses on the place of the bulk of the corporation's activities, and the total activity test blends the nerve center and corporate activity tests.<sup>9</sup>

Confusion and uncertainty are an unhappy consequence of having multiple tests in jurisdictional analysis.<sup>10</sup> It is well established that a corporation can have only one principal place of business.<sup>11</sup> It is, therefore, an unfortunate anomaly that, depending on the jurisdictional test employed, a corporation can be found to have multiple principal places of business.<sup>12</sup>

The malleable—some may say manipulable—nature of these tests is problematic from both a legal and a business perspective. From a jurisprudential point of view, “[n]onuniformity encourages forum shopping at the federal level, breeds uncertainty, and, in many cases, serves to thwart Congress’s intent to limit federal

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corporation's principal place of business: One is the 'nerve center' test which searches for the location from where the activities of the corporation are controlled and directed. The two other tests are the 'center of corporate activity' test, i.e., where the corporation's day-to-day management takes place; and the 'locus of the operations of the corporation' test, i.e., where the bulk of the corporation's actual physical operations are located.” (quoting *Topp v. CompAir Inc.*, 814 F.2d 830, 834 (1st Cir. 1987)).

9. See discussion *infra* Part II (explaining tests in greater detail).

10. Patrick L. Sealey, *An Alternative Approach to Diversity Jurisdiction for Corporations: Parent-Subsidiary Corporations*, 20 J. CORP. L. 497, 505 n.78 (1995) (citing *J.A. Olson Co. v. City of Winona*, 818 F.2d 401, 406–13 (5th Cir. 1987) as “providing an example of the confusion and deliberation needed to determine a corporation’s principal place of business”).

11. See *Davis v. HSBC Bank Nevada, N.A.*, 557 F.3d 1026, 1032 (9th Cir. 2009) (Kleinfeld, J. concurring) (“There can be only one ‘principal place of business’ for diversity purposes, which of course is what the word ‘principal’ implies.”); *Century Bus. Servs. v. Bryant*, 69 F. App’x 306, 313 (6th Cir. 2003) (“[A] corporation can have only one principal place of business for purposes of establishing its state of citizenship.”); *J.A. Olson Co.*, 818 F.2d at 406 (“[E]very corporation has one and only one principal place of business.”); *Bailey v. Grand Trunk Lines of New England*, 805 F.2d 1097, 1100 (2d Cir. 1986) (noting the “overwhelming consensus of authority that a corporation may have only one principal place of business”); *Campbell v. Associated Press*, 223 F. Supp. 151, 153–54 (E.D. Pa. 1963) (“[I]t is evident that Congress intended a corporation, for diversity purposes, can have only one principal place of business.”).

12. See *Soto-Velez v. BCBG Max Azria, Inc.*, 589 F. Supp. 2d 147, 150 (D.P.R. 2008) (“These tests may lead to different locations being identified as the principal place of business of a defendant corporation.”).

jurisdiction.”<sup>13</sup> Commercially, “[u]ncertainty and unpredictability result [in] an undesirable state of affairs . . . . Lack of certainty about the probable outcome of litigation not only makes transactional planning more complex and costly, but may also encourage litigation . . . .”<sup>14</sup>

The Supreme Court recently addressed this uncertainty in *Hertz Corp. v. Friend*, seeking to narrow the discussion by mandating the application of a single jurisdictional test.<sup>15</sup> The remainder of this article examines the wisdom and practical consequences of *Hertz*.

Part II examines the development and purpose of the three jurisdictional tests: the nerve center test, the corporate activity test, and the total activity test. Part III analyzes the *Hertz* mandate and the reasons supporting the Court’s decision. Finally, Part IV addresses potential solutions to the jurisdictional problems that will likely result from *Hertz*.

## II. PRINCIPAL PLACE OF BUSINESS BEFORE HERTZ

*“Litigation is the basic legal right that guarantees every corporation its decade in court.”*<sup>16</sup>

~ David Porter

The three jurisdictional tests were created to facilitate and regularize the jurisdictional analysis.<sup>17</sup> While “[a]ll three tests tend

13. Saunders, *supra* note 6, at 1475.

14. Stephen M. Bainbridge, *Contractarianism in the Business Associations Classroom: Kovacik v. Reed and the Allocation of Capital Losses in Service Partnerships*, 34 GA. L. REV. 631, 665–66 (2000); see also F. Scott Kieff, *An Inconvenient School of Thought*, 61 ALA. L. REV. 591, 596 (2010) (“Business can deal well with factual uncertainty—in fact many forms of business thrive on it (think options, futures, insurance, etc.)—but the one type of uncertainty that is particularly bad for business overall is the uncertainty caused by having the underlying legal rules of the game enforced as a function of fashion and politics. But this is what you get when the enforcement mechanism (the details of the particular framework of the legal institutional design) is a matter of flexible discretion.”).

15. *Hertz Corp. v. Friend*, 130 S. Ct. 1181, 1192 (2010).

16. PAUL SHARP, OF THE SHARKS, BY THE SHARKS, FOR THE SHARKS: THE DEATH OF JUSTICE 89 (2006).

17. As one appellate court has stated:



often to merge and overlap,”<sup>18</sup> they are not simply interchangeable and, “depending on [which test we apply], we reach different conclusions as to [a corporation’s] principal place of business.”<sup>19</sup>

A. *Nerve Center Test*

“We tend to think of the mind of an organization residing in the CEO and the organization’s top managers . . . but that is not really how an organization thinks.”<sup>20</sup>

~ Kevin Kelly

The nerve center test, first formulated in *Scot Typewriter Co. v. Underwood Corp.*,<sup>21</sup> “makes the ‘home office,’ or place where the

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This court has recognized that there are three distinct, but not necessarily inconsistent tests for determining a corporation’s principal place of business. One is the “nerve center” test which searches for the location from where the activities of the corporation are controlled and directed. The two other tests are the “center of corporate activity” test, *i.e.*, where the corporation’s day-to-day management takes place; and the “locus of the operations of the corporation” test, *i.e.*, where the bulk of the corporation’s actual physical operations are located.

*Topp v. CompAir Inc.*, 814 F.2d 830, 834 (1st Cir. 2005) (citations omitted); *see also J.A. Olson Co. v. City of Winona*, 818 F.2d 401, 410 (5th Cir. 1987) (“The [center of corporate activity test and the locus of the operations of the corporation test] are . . . not mutually exclusive but rather complementary.”).

18. *Topp*, 814 F.2d at 834; *see also Gafford v. Gen. Elec. Co.*, 997 F.2d 150, 162 (6th Cir. 1993) (“[N]either the ‘nerve center’ nor the ‘place of activity’ test inflexibly dictates the corporation’s principal place of business. Rather the tests simply stand for general rules regarding the determination of a particular corporation’s principal place of business: the principal place of business of a far-flung corporation will generally be its nerve center; the principal place of business of a corporation with significant administrative authority and activity in one state and lesser executive offices but principal operations in another state is generally the district of the former; and the principal place of business of a corporation with its corporate headquarters in one state and its single activity in another will generally be in the state of its operations.” (quoting *J.A. Olson Co.*, 818 F.2d at 409–10 (citations omitted))).

19. *Ortiz Mercado v. P.R. Marine Mgmt., Inc.*, 736 F. Supp. 1207, 1211 (D.P.R. 1990).

corporation's officers direct, control, and coordinate its activities, determinative."<sup>22</sup>

Upon removal to federal court, Scot sought remand to state court arguing that because the bulk of its activities were located in Connecticut, it was a citizen of Connecticut, not New York, and therefore, diversity was lacking. The court rejected Scot's call for an activities-based jurisdictional test because "[i]f it is to engage in profitable operations, an equally important and essential function is the promotion and sale of the manufactured product in the furtherance of the corporate interest."<sup>23</sup>

Even though most of Scot's sales were shipped from Connecticut, the largest volume of sales took place in California.<sup>24</sup> Moreover, it is not uncommon for manufacturers to move production and distribution facilities based on economic concerns.<sup>25</sup> An economic move should not, therefore, mean that a manufacturer's principal place of business had changed.<sup>26</sup> Something more certain is required.<sup>27</sup> Finding that certainty in the nerve center test, the court affirmed Scot's citizenship in New York because "policy determinations are made in New York; direction and control of corporate affairs . . . appears to be carried out by executives in New York . . . and encompasses every phase of the defendant's activities—production, sales, distribution, advertising, public relations and all other related facets."<sup>28</sup>

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20. Joe Flower, *The Structure of Organized Change: A Conversation with Kevin Kelly*, 28 THE HEALTHCARE F. J. 1, 34-41 (1995), available at <http://www.well.com/~bbear/kellyart.html>.

21. *Scot Typewriter Co. v. Underwood Corp.*, 170 F. Supp. 862, 864-65 (S.D.N.Y. 1959) (observing that all corporate decisions were made in New York at the corporate office and thus the principal place of business for jurisdictional purposes was in New York and not at the manufacturing plant in Connecticut); see also *J.A. Olson*, 818 F.2d at 406 (noting that *Scot Typewriter* "coined" the nerve center test).

22. *Mullins v. Beatrice Pocahontas Co.*, 489 F.2d 260, 262 (4th Cir. 1974).

23. *Scot Typewriter*, 170 F. Supp. at 865.

24. *Id.*

25. *Id.*

26. *Id.*

27. See *id.* (explaining that relocating manufacturing activities is not dispositive in determining a corporation's principal place of business under the nerve center test).

28. *Id.*

Certainty and ease of application are the hallmarks of the nerve center test.<sup>29</sup> As the Seventh Circuit explained:

Since certainty of jurisdiction is a desideratum too—the parties ought to know definitely what court they belong in, and not face the prospect that their litigation may be set at naught because they made a wrong guess about jurisdiction—this circuit has long used a simple “nerve center” test for principal place of business.<sup>30</sup>

The corporation’s nerve center is ordinarily found “where the corporation has its headquarters.”<sup>31</sup> While simple in design, the nerve center test is not meant to be a wooden test. Rather, it seeks to best determine the place from which the corporation is directed.<sup>32</sup> Accordingly, as part of the nerve center analysis, courts have looked at “the place where corporate decisions are made, where the corporation is funded, where its general counsel, directors, officers and shareholders are located, where the primary bank account exists, and the place of its principal office and corporate headquarters.”<sup>33</sup>

One of the unfortunate drawbacks to the nerve center test, in the sense of breadth of application, is its self-imposed limitation to corporations with “far-flung and varied activities”<sup>34</sup>:

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29. See *Dimmitt & Owens Fin., Inc. v. United States*, 787 F.2d 1186, 1191 (7th Cir. 1986) (“[T]his circuit has long used a simple ‘nerve center’ test for principal place of business.”); see also *Chamberlain Mfg. Corp. v. Maremont Corp.*, 828 F. Supp. 589, 594 (N.D. Ill. 1993) (“Similarly, in the instant case, the hundreds of pages of discovery and briefing on this issue extols the Seventh Circuit’s selection of the ‘nerve center’ test, which should be a more straightforward inquiry.”).

30. *Dimmitt*, 787 F.2d at 1191.

31. *Wis. Knife Works v. Nat’l Metal Crafters*, 781 F.2d 1280, 1282 (7th Cir. 1986).

32. See *Ferrell v. Express Check Advance of S.C., L.L.C.*, 591 F.3d 698, 706 (4th Cir. 2010) (“[T]he ‘nerve center’ test . . . makes determinative the home office or place where the corporation’s officers direct, control, and coordinate its activities . . .”).

33. *Ratner v. Hecht*, 621 F. Supp. 378, 380 (D.C. Ill. 1985).

34. *Scot Typewriter Co. v. Underwood Corp.*, 170 F. Supp. 862, 865 (S.D.N.Y. 1959).

Where a corporation is engaged in far-flung and varied activities which are carried on in different states, its principal place of business is the nerve center from which it radiates out to its constituent parts and from which its officers direct, control and coordinate all activities without regard to locale, in the furtherance of the corporate objective. The test applied by our Court of Appeals, is that place where the corporation has an "office from which its business was directed and controlled"—the place where "all of its business was under the supreme direction and control of its officers."<sup>35</sup>

Accordingly, "[s]ince *Scot*, the 'nerve center' test appears to have been limited to similar facts, that is to 'corporation[s] . . . engaged in far-flung and varied activities which are carried on in different states.'"<sup>36</sup> To militate against this limitation, the Seventh Circuit looks for the "corporation's brain, and ordinarily find[s] it where the corporation has its headquarters."<sup>37</sup> Another inherent weakness to the nerve center test is the fact that the "'home office' test in itself may be variously applied, depending on whether the court looks to the executive offices, at which general policy decisions are made, or to the place where day-to-day control of the business is exercised."<sup>38</sup> In sum, while the nerve center test offers certainty and efficiency, it does so at a cost—the one-size fits all test means that some, and perhaps many, corporations will be forced to accept an unfair result. Courts have therefore created other tests, tests that seek to apply a more holistic approach to the jurisdictional analysis.

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35. *Id.*

36. *J.A. Olson Co. v. City of Winona Miss.*, 818 F.2d 401, 407 (5th Cir. 1987) (quoting *Scot Typewriter*, 170 F. Supp. 862 at 865).

37. *Wis. Knife Works v. Nat'l Metal Crafters*, 781 F.2d 1280, 1282 (7th Cir. 1986).

38. *Am. Found., Inc. v. Mountain Lake Corp.*, 454 F.2d 200, 201 (5th Cir. 1972).

### B. Corporate Activity Test

*“A corporation is organized as a system—it has this department, that department, that department. They don’t have any meaning separately; they only can function together.”*<sup>39</sup>

~ David Bohm

The second commonly-applied jurisdictional test is the corporate activity test.<sup>40</sup> First coined in *Kelly v. U.S. Steel Corp.*,<sup>41</sup> the corporate activity test “considers the principal place of business to be the location of the corporation’s production and service activities.”<sup>42</sup>

In *Kelly*, the defendant corporation had its largest production plant and a plurality of its employees in one state, Pennsylvania. Further, key officers with responsibility for operations were stationed in Pennsylvania. Based on these factors the court in *Kelly* found that although final executive authority and policy-making officers were located in New York, Pennsylvania was the corporation’s principal place of business.<sup>43</sup>

Accordingly, it is the business activities “[that] indicate the principal place of business’ . . . not ‘where . . . final decisions are made on corporate policy,’ but rather where the corporation ‘conducts its affairs.’”<sup>44</sup>

Courts using this test prefer a “functional approach” in determining principal place of business.<sup>45</sup> “Rather than looking to

39. DAVID BOHM, THOUGHT AS A SYSTEM 18 (1994).

40. *Kelly v. U.S. Steel Corp.*, 284 F.2d 850, 854 (3d Cir. 1960); *see also* *Amoco Rocmount Co. v. Anschutz Corp.*, 7 F.3d 909, 915 (10th Cir. 1993) (“The ‘corporate activities’ test [also known as the ‘place of operations’ or ‘place of activities’ test] ‘focuses on the state where a substantial portion of the corporation’s business is located.’” (quoting *Danjaq, S.A. v. Pathe Comm’n’s Corp.*, 979 F.2d 772, 776 (9th Cir. 1992))).

41. *Kelly*, 284 F.2d at 854; *see also* *Grand Union Supermarkets of the V.I., Inc. v. H.E. Lockhart Mgmt., Inc.*, 316 F.3d 408, 411 (3d Cir. 2003) (“For additional guidance on this question, we look to *Kelly* . . . where we first interpreted the phrase ‘principal place of business.’”).

42. *Capitol Indem. Corp. v. Russellville Steel Co.*, 367 F.3d 831, 837 (8th Cir. 2004).

43. *North Star Hotels Corp. v. Mid-City Hotel Assocs.*, 696 F. Supp. 1265, 1270 (D. Minn. 1988) (citing *Kelly*, 284 F.2d at 854).

44. *Grand Union*, 316 F.3d at 411 (quoting *Kelly*, 284 F.2d at 854).

45. *See Mennen Co. v. Atl. Mut. Ins. Co.*, 147 F.3d 287, 292 (3d Cir. 1998) (rejecting proposed method of determining a corporation’s principal place of

the location of the highest level of policymaking as dispositive, we looked to the location of production and ‘the headquarters of day-to-day corporate activity and management.’”<sup>46</sup> Courts applying this test rely on such factors as “where the corporation is most visible, where it has most contact with the public, where the corporation believes it is a citizen, where business operations were carried out and where it employs people.”<sup>47</sup>

The corporate activity test rests on “pragmatic” considerations<sup>48</sup> based on the perception that a corporation ought to be a citizen of the state in which it has a substantial production capacity: “we think it is the activities rather than the occasional meeting of policy-making Directors which indicate the principal place of business.”<sup>49</sup>

A serious drawback to the corporate activity test arises in the context of an inactive corporation. Here, the question is “whether an inactive corporation can be deemed to have a ‘principal place of business’ at all.”<sup>50</sup> Answering that question in the negative, the Third Circuit explained:

Inasmuch as we consider the actual business activities of the corporation to be determinative of the corporation's principal place of business, we conclude that as a general matter, an “inactive” corporation (that is, a corporation conducting no business activities) has no principal place of business, and is instead a citizen of its state of incorporation only.<sup>51</sup>

While the Second and Fifth Circuits take an opposite view,<sup>52</sup> the concern that the corporate activity test may effectively leave a substantial population of corporate citizens with inadequate access to

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business and instead retaining multi-factor approach embraced by earlier holdings).

46. *Id.* (quoting *Kelly*, 284 F.2d at 854).

47. *Frontier Energy Corp. v. Broda*, 882 F. Supp. 82, 83 (N.D. W. Va. 1995).

48. *See Mennen*, 147 F.3d at 292 (noting that the corporate activity test, as laid out in *Kelly*, focuses on “the pragmatic facts of corporate life as opposed to more formal lines of inquiry”).

49. *Kelly*, 284 F.2d at 854.

50. *Midlantic Nat’l Bank v. Hansen*, 48 F.3d 693, 696 (3d Cir. 1995).

51. *Id.*

52. *Id.*

the federal courts is troubling.<sup>53</sup> A parallel concern is the lack of any objective standard for determining which activities are dispositive. While flexibility is frequently desirable, the law, to mean anything, must mean something specific.

### C. Total Activity Test

The total activity test, originally set out in *White v. Halstead Indus.*,<sup>54</sup> is a combination of the nerve center and corporate activity tests.<sup>55</sup> In *White*, Chief Judge Eisele described the advantages of this combined test:

This test provides the best approach because it determines each case on an individual basis. The test considers a variety of factors, such as the location of the corporation's nerve center, administrative offices, production facilities, employees, etc., and it balances these factors in light of the facts of each case.<sup>56</sup>

Flexibility is the keystone of the total activity test.<sup>57</sup> Courts are free to use the nerve center test or the corporate activity test as the needs of the moment dictate:

When no one state is clearly the center of corporate activity or accounts for the majority of the

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53. Of course, courts applying the nerve center or total activity test could reach the same result. If a corporation is inactive, it has no brain and, therefore, no nerve center.

54. *White v. Halstead Indus.*, 750 F. Supp. 395, 398 (D. Ark. 1990); see also David A. Greher, *The Application of 28 U.S.C. § 1332(C)(1) to Alien Corporations: A Dual Citizenship Analysis*, 36 VA. J. INT'L L. 233, 235 n.7 (1995) (stating that the total activity test was "first advocated by" *White*).

55. See *J.A. Olson Co. v. City of Winona Miss.*, 818 F.2d 401, 406 (5th Cir. 1987) ("[W]e have observed that the 'total activity' test applied in this circuit combines considerations of both the nerve center and the place of activity of the corporation in question.").

56. *White*, 750 F. Supp. at 398.

57. See *Domaine Serene Vineyards & Winery, Inc. v. Rynders*, No. 08-CV-5060(JMR/AJB), 2009 WL 81079, at \*3 (D. Minn. Jan. 9, 2009) ("The Eighth Circuit noted the total activity test allowed for flexibility, and focused on the 'most appropriate' considerations." (citing *Capitol Indem. Corp. v. Russellville Steel Co.*, 367 F.3d 831, 835 (8th Cir. 2004))).

corporation's income, employees or facilities, the location of the corporate headquarters and policy-making functions take on greater importance. Conversely, when virtually all of the corporate business is conducted in one state, but the headquarters and policy-making functions are situated in another state, the location of the corporation's business operations assumes greater importance.<sup>58</sup>

"The total activity test recognizes that the nature of a corporation's activities will impact the relative importance of production activities, service activities, and corporate decision-making. Accordingly, the total activity test looks at all corporate activities."<sup>59</sup> It is this "realistic, flexible and nonformalistic approach to determining a corporation's principal place of business through a balancing of all relevant factors"<sup>60</sup> that many find attractive:

Several methods for determining a corporation's principal place of business exist. The "nerve center" test emphasizes the situs of corporate decision-making authority and overall control, while the "corporate activities/place of activity" test emphasizes the location of production activities or service activities. This court has suggested that the "total activity" test, combining both of the foregoing inquiries, is more appropriate, since the "approach to determining a corporation's principal place of business will vary with the facts of each case."<sup>61</sup>

While flexibility is the hallmark, fairness is a strong runner-up. By providing the courts with a flexible framework, forum

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58. *White*, 750 F. Supp. at 398 (citation omitted).

59. *Capitol Indem. Corp. v. Russellville Steel Co.*, 367 F.3d 831, 837 (8th Cir. 2004).

60. *North Star Hotels Corp. v. Mid-City Hotel Assocs.*, 696 F. Supp. 1265, 1270 (D. Minn. 1988).

61. *Century Bus. Servs., Inc. v. Bryant*, 69 F. App'x 306, 313 (6th Cir. 2003) (quoting *Gafford v. Gen. Elec. Co.*, 997 F.2d 150, 162 (6th Cir. 1993)).



shopping will be reduced.<sup>62</sup> Under the nerve center test, a corporation can choose its own principal place of business by choosing where to establish a single executive office. Similarly, under the corporate activities test, the corporation can choose its principal place of business by choosing where to locate its central production facility.<sup>63</sup> “In contrast, under the total activity test, the court can make its own determination and prevent the corporation from disguising its true form.”<sup>64</sup>

One substantial downside to the total activity test is the cost of implementation.<sup>65</sup> Flexibility is, by nature, time-consuming. Because of the substantial body of factors to be analyzed, courts and attorneys will be required to allocate additional resources to the jurisdictional calculus.<sup>66</sup> As the cost of litigation is one of the major barriers that must be overcome for many to gain access to the courthouse, a system that reduces these costs ought to be a welcome relief.<sup>67</sup> While flexibility and fairness are good and noble goals, they are poor consolation to those left out in the cold.

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62. See Saunders, *supra* note 6, at 1498 (noting total activity test “will ensure that the corporation cannot escape the local courts when the controversy is truly local”).

63. *Id.*

64. *Id.*

65. See *id.* at 1502 (“[T]he total activity test, or a version thereof—although probably more time consuming and expensive overall—produces a more accurate and reliable result . . .”).

66. *Id.*

67. See Colette Cuijpers, *ICT and Employer-Employee Power Dynamics: A Comparative Perspective of United States' and Netherlands' Workplace Privacy in Light of Information and Computer Technology Monitoring and Positioning of Employees*, 25 J. MARSHALL J. COMPUTER & INFO. L. 37, 61 (2007) (“Another problem that needs to be resolved . . . is that of access to the courts. The main barriers are the cost of litigation and the uncertainty with regard to the award of damages.”); see also Morris E. Lasker, *The Court Crunch: A View from the Bench*, 76 F.R.D. 245, 250 (1977) (“The greater financial burden has at least two results: First: It means that the litigant who is already unjustly delayed has to pay more—sometimes a lot more—for the privilege. Second: (and perhaps of greater importance) the resulting high cost of litigation effectively bars access to the courts for many, perhaps most Americans.”).

### III. PRINCIPAL PLACE OF BUSINESS FOLLOWING HERTZ

*“What five members of the Supreme Court say the law is may be something vastly different from what Congress intended the law to be.”*<sup>68</sup>

~ Benjamin F. Fairless

With a sweeping stroke of its corporate pen, the Supreme Court mandated the use of a single test—the nerve center test.<sup>69</sup> And of course, “[w]hen the Supreme Court speaks, it . . . supercedes our prior case law.”<sup>70</sup> This principle is not, however, as draconian as it may first appear, for it presumes that the Supreme Court must speak “clearly” on the issue.<sup>71</sup> A pronouncement that is too vague or too broad to follow is not an effective law.

#### A. Policy Reasons for the Nerve Center Test

*“I never had a policy; I have just tried to do my very best each and every day.”*<sup>72</sup>

~ Abraham Lincoln

While the Supreme Court’s view of the nerve center test is not identical to that described above,<sup>73</sup> it is substantively the same:

[W]e conclude that the phrase “principal place of business” refers to the place where the corporation’s high level officers direct, control, and coordinate the

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68. *Benjamin F. Fairless Quotes*, THINKEXIST.COM, [http://en.thinkexist.com/quotes/Benjamin\\_F.\\_Fairless](http://en.thinkexist.com/quotes/Benjamin_F._Fairless) (last visited on October 3, 2010). Benjamin F. Fairless was the Chairman of the Board of the United States Steel Corporation. George W. Stocking, *The Rule of Reason, Workable Competition, and Monopoly*, 64 *Yale L.J.* 1107, 1129 (1955).

69. *Hertz Corp. v. Friend*, 130 S. Ct. 1181, 1192 (2010).

70. *Hydro Res., Inc. v. U.S. EPA*, 608 F.3d 1131, 1163 (10th Cir. 2010).

71. *See Cervantes v. Guerra*, 651 F.2d 974, 981 (5th Cir. 1981) (“But when the Supreme Court speaks clearly, we are bound to obey.”); *see also United States v. Consol. Wounded Knee Cases*, 389 F. Supp. 235, 240 (D. Neb. 1975) (“When the Supreme Court speaks clearly, I must honor the statement or be as unfaithful to my duty to the law as the United States has been to its promises to the American Indians.”).

72. JEREMY L. PATRICK & JUSTIN L. HELMS, *THE BOOK OF ACTION* 66 (2006).

73. *See supra* Part II.A.

corporation's activities. Lower federal courts have often metaphorically called that place the corporation's "nerve center." We believe that the "nerve center" will typically be found at a corporation's headquarters.<sup>74</sup>

Mindful of the potential forum shopping problem—that is, that a corporation may choose its principal place of business so as to either avoid or mandate a particular forum—the Court further explained that while a corporation's principal place of business "should normally be the place where the corporation maintains its headquarters," a bare office is not enough.<sup>75</sup> The principal place of business must be the "actual center of direction, control, and coordination, *i.e.*, the 'nerve center,' and not simply an office where the corporation holds its board meetings (for example, attended by directors and officers who have traveled there for the occasion)."<sup>76</sup>

Understanding the perils of a legal system that most can no longer afford, the Court was motivated to foster a system that was administratively simple, whose costs were relatively low. "[A]dministrative simplicity is a major virtue in a jurisdictional statute. Complex jurisdictional tests complicate a case, eating up time and money as the parties litigate, not the merits of their claims, but which court is the right court to decide those claims."<sup>77</sup>

Litigants are not the only beneficiaries of a simpler system. "Judicial resources too are at stake. Courts have an independent obligation to determine whether subject-matter jurisdiction exists, even when no party challenges it. So courts benefit from straightforward rules under which they can readily assure themselves of their power to hear a case."<sup>78</sup> Conserving scarce judicial resources is almost always a good thing.

#### *B. Structural Support for the Nerve Center Test*

*"The United States Supreme Court has adopted the plain meaning canon as a preferred method of statutory interpretation*

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74. *Hertz*, 130 S. Ct. at 1186 (citations omitted).

75. *Id.* at 1192.

76. *Id.*

77. *Id.* at 1193 (citation omitted).

78. *Id.* (citations omitted).

*because it is a safe assumption that legislatures intended the words of the statute to convey their ordinary meaning.*"<sup>79</sup>

~ Jonathon D. Andrews

The Court's plain meaning analysis led it to conclude that the nerve center test complied with a straightforward reading of 28 U.S.C. § 1332.<sup>80</sup> The Court explained: "The statute's text deems a corporation a citizen of the 'State where it has its principal place of business.'"<sup>81</sup> From this, the Court drew three conclusions. First, the statute refers to a "State" indicating that Congress intended a single state.<sup>82</sup> Second, "principal" means the leading or main place of corporate activity.<sup>83</sup> Third, the word "place" follows the word "State" indicating that Congress intended a single place within a state and not the state itself.<sup>84</sup> Accordingly, the nerve center test best comports with the "statute's language."<sup>85</sup> Finally, the Court turned to the relevant statutory history, finding additional support for adopting the nerve center test.<sup>86</sup>

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79. Jonathon D. Andrews, *Reconciling the Split: Affording Reasonable Accommodation to Employees "Regarded As" Disabled Under the ADA—An Exercise in Statutory Interpretation*, 110 PENN ST. L. REV. 977, 995 (2006).

80. *Hertz*, 130 S. Ct. at 1184.

81. *Id.* at 1192 (quoting 28 U.S.C. § 1332(c)(1) (2005)).

82. *Hertz*, 130 S. Ct. at 1192.

83. *Id.*

84. *Id.*

85. *Id.*

86. *See id.* at 1194 ("[T]he statute's legislative history, for those who accept it, offers a simplicity-related interpretive benchmark. The Judicial Conference provided an initial version of its proposal that suggested a numerical test. A corporation would be deemed a citizen of the State that accounted for more than half of its gross income. The Conference changed its mind in light of criticism that such a test would prove too complex and impractical to apply. That history suggests that the words 'principal place of business' should be interpreted to be no more complex than the initial 'half of gross income' test. A 'nerve center' test offers such a possibility. A general business activities test does not.") (citations omitted).

## IV. PRAISE, PROBLEMS AND SOLUTIONS

*"It isn't that they can't see the solution. It's that they can't see the problem."*<sup>87</sup>

~ G.K. Chesterton

A. *Finally, A Single Test*

The academic community has long called for the adoption of a single jurisdictional test. In their seminal work, *Corporations and Diversity of Citizenship Jurisdiction: A Supreme Court Fiction Revisited*, Professors James Moore and Donald Weckstein sounded an early call for a single, simplified jurisdictional analysis.<sup>88</sup> While recognizing the significant advantages of the nerve center test,<sup>89</sup> the professors chose to support a test that focused on the state where the corporation's "greatest impact is felt."<sup>90</sup> They found that such an impact would most likely flow from the state "where the bulk of its litigation arises, where the corporation has most of its dealings with its customers and has its greatest contact with the public in general, where it derives its greatest gross income, and where it is generally considered to be 'at home.'"<sup>91</sup> A similar call was raised in the more recent *Determining a Corporation's Principal Place of Business: A Uniform Approach to Diversity Jurisdiction*, wherein the author

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87. G.K. CHESTERTON, *THE SCANDAL OF FATHER BROWN* 141 (Stratus Books 2001) (1935).

88. See James W. Moore & Donald T. Weckstein, *Corporations and Diversity of Citizenship Jurisdiction: A Supreme Court Fiction Revisited*, 77 HARV. L. REV. 1426, 1444 (1964) ("[A] corporation should be considered a citizen of the state on which the corporation most impinges, the state in which its greatest impact is felt").

89. See *id.* at 1443 ("[T]he nerve-center test has the important advantage of ease of administration. A court's jurisdiction or lack of it should be clearly delineated so that a hearing on the merits is not unduly delayed and so that expenditure of time and effort will not be wasted in a trial which may later be declared to be a nullity due to a lack of subject matter jurisdiction. The 1958 amendment [making a corporation a citizen of its state of incorporation and the state where it has its principal place of business] was designed to reduce backlogs and delay in the federal courts; this purpose will be partially defeated if too much judicial time is required to apply the new jurisdictional standard.").

90. *Id.* at 1444.

91. *Id.* at 1444-45.

rejected the nerve center and corporate activity tests, advocating for a “uniform test based upon the total activity test.”<sup>92</sup>

The call for a single test, while not ubiquitous, is prevalent. Of course, this lack of agreement is of no consequence where, as here, the Supreme Court has provided clarity on the issue, detailing not only the test to be used, but the policy and structural reasons for adopting the chosen test.

Still, a nagging doubt remains. Is *Hertz* the uniform resolution it purports to be?

### B. *A Single Test Will Never Work*

*“I didn’t fail the test, I just found 100 ways to do it wrong.”*<sup>93</sup>  
~ Benjamin Franklin

Toward the end of its opinion, the *Hertz* Court observes: “We recognize as well that, under the ‘nerve center’ test we adopt today, there will be hard cases.”<sup>94</sup> Of course there will be hard cases. There are always hard cases.<sup>95</sup> That is the natural outcome of implementing a new rule.<sup>96</sup> More importantly, reasonable people will disagree about how to apply the new rule and the standards used to determine whether such rule has been met.<sup>97</sup> It is this

92. Saunders, *supra* note 6, at 1476.

93. ADDIE JOHNSON, LIFE IS SWEET: 333 WAYS TO LOOK ON THE BRIGHT SIDE AND FIND THE HAPPINESS IN FRONT OF YOU 214 (2008).

94. *Hertz Corp. v. Friend*, 130 S. Ct. 1181, 1194 (2010).

95. See Frank J. Menetrez, *Employee Status and the Concept of Control in Federal Employment Discrimination Law*, 63 SMU L. REV. 137, 182 (2010) (“Under any reasonable standard, there will always be both easy and hard cases.”); Matthew J. Nance, Note, *The OCC’s Exclusive Visitorial Authority Over National Banks After Clearing House Ass’n v. Cuomo*, 87 TEX. L. REV. 811, 825 (2009) (“As with any rule, there will be hard cases.”).

96. See Barbara Herman, Comment, *Comment on Gavison*, 61 S. CAL. L. REV. 1663, 1665 (1988) (“Since there will always be hard cases: new circumstances under which the rules/laws do not readily apply, circumstances where the straightforward literal application of a given law will defeat its purpose, judges cannot avoid ‘activism’ . . .”).

97. See John Cirace, *A Synthesis of Law and Economics*, 44 SW. L.J. 1139, 1143 (1990) (“The problem in hard cases is that reasonable people can differ as to which of several conflicting general principles ought to control.”); Ronald C. Den Otter, *Can a Liberal Take His Own Side in an Argument? The Case for John Rawls’s Idea of Political Liberalism*, 49 ST. LOUIS U. L.J. 319, 363–64 (2005)

disagreement that makes a new rule—here, the nerve center test—problematic. Are the lower courts bound to apply the nerve center test in every case? Or do judges have some discretion in this area? The answer appears to be that there are cases in which a judge may forgo application of the nerve center test in favor of a more practical approach, as the needs of the case dictate.

The Court identifies two classes of “anomalies” for which the nerve center test will likely be inapt.<sup>98</sup> First, “some corporations may divide their command and coordinating functions among officers who work at several different locations, perhaps communicating over the internet.”<sup>99</sup> This description appears to be synonymous with what other courts have referred to as corporations that are “engaged in far-flung and varied activities which are carried on in different states . . . .”<sup>100</sup> Second, some corporations may house their directors and executives in one city, while the “bulk of a company’s business activities visible to the public take place” in a different city.<sup>101</sup>

### 1. The Large Diversified Corporation Problem

How to determine the nerve center—the principal place of business—of a large corporation with a diversified command and

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(“There will be hard cases at the margins and reasonable people will balance competing considerations differently and may reach different conclusions.”).

98. See *Hertz*, 130 S. Ct. at 1194 (“We recognize that there may be no perfect test that satisfies all administrative and purposive criteria . . . we also recognize that the use of a ‘nerve center’ test may in some cases produce results that seem to cut against the basic rationale for 28 U.S.C. § 1332.”).

99. *Id.*

100. *Scot Typewriter Co. v. Underwood Corp.*, 170 F. Supp. 862, 865 (S.D.N.Y. 1959).

101. *Hertz*, 130 S. Ct. at 1194. A third anomaly, which the Court does not address, is the problem of the inactive corporation. Where is an inactive corporation’s nerve center located? Is the answer, as the Third Circuit opinion in *Hansen* suggests, that an inactive corporation has no principal place of business because there is no nerve center? See *Midlantic Nat’l Bank v. Hansen*, 48 F.3d 693, 696 (3d Cir. 1995) (reasoning that an inactive company has no principal place of business because it conducts no business). Or, will the courts need to apply an entirely different jurisdictional rule to determine an inactive corporation’s principal place of business? See, e.g., *Levy*, *supra* note 8, at 665 (advocating that an inactive corporation’s last principal place of business is a “determinative factor” for citizenship).

control structure has long been a topic of concern.<sup>102</sup> Over four decades ago, the Third Circuit was asked to determine the principal place of business of the United States Steel Corporation—a company that had divided its command and control between New York and Pennsylvania.<sup>103</sup> The court found little to commend the nerve center test in this context, explaining:

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102. See, e.g., *Kelly v. U.S. Steel Corp.*, 284 F.2d 850, 855 (3d Cir. 1960) (listing cases that struggle with determining the nerve center of a corporation with diversified command and control).

103. The court's description of U.S. Steel's command structure in New York and Pennsylvania:

The Board of Directors regularly meets in New York. It has, however, met in Pittsburgh and as already pointed out the Board can choose its own place of meeting. The Chairman of the Board is in New York, spending one day a week in Pittsburgh. The President divides his time evenly between New York and Pittsburgh. The Executive Committee of the Board meets regularly in New York. So does the Finance Committee. The Secretary of the corporation lives and has his office in New York and the Treasurer, Comptroller and General Counsel have their office there. The company owns the building at 71 Broadway. From New York is mailed the annual report. Dividends are declared in New York. The Public Relations Department of the corporate enterprise is centered in New York. The Steel Corporation's major banking activities are there. The cash on hand and its government securities are managed and controlled in New York and the corporation's pension funds are invested in New York. To us this adds up to the conclusion that as at present conducted the final decisions through the Board of Directors, the President and top executive officers are made in New York state. If the test of 'principal place of business' is where such final decisions are made on corporate policy, including its financing, then the appellants are right in pointing to New York as the principal place of business. . . .

. . . [However,] [i]t is in Pennsylvania that the Operation Policy Committee sits and conducts its affairs. The Board of Directors has delegated to this committee the duty of conducting the business of the corporation relating to manufacturing, mining, transportation and general operation. It is composed of the Chairman of the Board, the President, the Chairman of the Finance Committee, the General Counsel and the seven Executive Vice Presidents. It makes policy decisions, of course subject to the Board of Directors. It appoints division presidents and corporate officers through the rank of Administrative Vice President. The seven Executive Vice Presidents, one at the head of each of the seven great branches of the corporation, have headquarters and staffs in Pittsburgh. All but one of the seventeen Administrative Vice Presidents and twenty-two out of the twenty-five Vice Presidents are located in Pittsburgh with their staffs. So, too, is the General Solicitor and his staff.



The appellants urge upon us that the test should be where the ‘nerve center’ of the corporation’s business is and they urge that the nerve center is New York. We do not find the figure of speech helpful. Dorland’s Medical Dictionary tells us that a nerve center is ‘any group of cells of gray nerve substance having a common function.’ We think there will be, in the case of United States Steel Corporation, a good many collections of nerve cells serving the common function of making the corporate enterprise go.<sup>104</sup>

To determine the principal place of business in the context of a diversified nerve center, the court employed the corporate activity test, balancing the weight and importance of the degree of nerve center activities in each state.<sup>105</sup>

One might reasonably argue that this analysis is what *Hertz* had in mind when it explained that the nerve center test “points courts in a single direction.”<sup>106</sup> That is, in recognizing that the nerve center test may be inappropriate where command and control functions are widely dispersed,<sup>107</sup> *Hertz* implicitly endorsed a total activity test that balances not the operational contacts, but the relative nerve center functions in the various states.

If so, we are left to wonder about the force and enduring legacy of the nerve center test. Large corporations abound.<sup>108</sup> America is the land of Microsoft, Apple, IBM, Starbucks, Ford and other large corporations with dispersed command and control functions. Does this mean that for every diversified corporation, the courts must balance the importance of the various command structures? If so, then this very balancing appears to be at cross purposes with the nerve center test’s stated advantage, that “[c]ourts

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*Id.* at 853–54.

104. *Id.* at 853.

105. *Id.* at 853–54.

106. *Hertz*, 130 S. Ct. at 1194.

107. *Id.*

108. See John C.C. Sanders, Jr., *Looking for Faith in All the Wrong Places: Rethinking Agreements to Negotiate in Good Faith*, 7 U.C. DAVIS BUS. L.J. 199, 202–03 (2006) (“Today, newspapers abound with stories of large corporations merging to become ever larger.”).

do not have to try to weigh corporate functions[.]”<sup>109</sup> If courts do have to weigh corporate functions under the nerve center test, then perhaps *Hertz’s* nerve center test, except in cases of corporations with limited activity, will become little more than a footnote in the history of jurisdictional jurisprudence, to be replaced with a modified nerve center test that explicitly calls for a balancing of nerve center functions in different locations to best determine the corporation’s principal place of business.

## 2. The Hidden Control Problem

As noted, some corporations may house their directors and executives in one city, while the “bulk of a company’s business activities visible to the public take place” in a different city.<sup>110</sup>

For example, if the bulk of a company’s business activities visible to the public take place in New Jersey, while its top officers direct those activities just across the river in New York, the “principal place of business” is New York. One could argue that members of the public in New Jersey would be *less* likely to be prejudiced against the corporation than persons in New York—yet the corporation will still be entitled to remove a New Jersey state case to federal court. And note too that the same corporation would be unable to remove a New York state case to federal court, despite the New York public’s presumed prejudice against the corporation.<sup>111</sup>

While the Court recognizes that the application of the nerve center test in the above example may lead to counterintuitive results, and may even “produce results that seem to cut against the basic rationale for 28 U.S.C. § 1332,” the Court reasons that this is the “price the legal system must pay to avoid overly complex jurisdictional administration while producing the benefits that accompany a more uniform legal system.”<sup>112</sup> Here, the Court applies a utilitarian paradigm, valuing the benefit of cost savings for the majority over the elimination of inequities for the minority. This

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109. *Hertz*, 130 S. Ct. at 1194.

110. *Id.*

111. *Id.*

112. *Id.*

utilitarian analysis hardly seems fair, and strikes at the heart of a court's obligation to do equity.<sup>113</sup>

Perhaps the Court's "points" language may be used again, this time to prevent its holding from eliminating equitable considerations.<sup>114</sup> Maybe this framework suggests that courts may look to jurisdictional considerations that go beyond the four corners of the nerve center test. If so, the lower courts may yet have the discretion to employ a nontraditional and more flexible nerve center analysis to avoid the harsh application of an overly wooden application of the nerve center test.<sup>115</sup>

### C. *And The Answer Is . . . ?*

*"It is as much the duty of Government to render prompt justice against itself, in favor of citizens, as it is to administer the same between private individuals."*<sup>116</sup>

~ Abraham Lincoln

What's next for the nerve center test? Predicting the future can be hazardous, "yet we are always obliged to anticipate what might be in store for us."<sup>117</sup> Logic dictates that one of two outcomes is likely. First, courts may take a wooden approach to the nerve center test. That is, some courts may feel constrained to identify one, and only one, nerve center. We shall refer to this approach as "Equity Be Damned." This approach is described nicely by Richard Brinsley Sheridan in his play, *The Rivals*:

Serjeant at law:

Used to the ground--I know 'tis hard to deal

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113. See *Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944) (A court's function is "to do equity and to mould each decree to the necessities of the particular case").

114. See *Hertz*, 130 S. Ct. at 1194 ("That said, our test nonetheless points courts in a single direction, towards the center of overall direction, control, and coordination.").

115. See Kate McElhone, *Inequitable Conduct: Shifting Standards for Patent Applicants, Prosecutors, and Litigators*, 17 TEX. INTELL. PROP. L.J. 385, 408 (2009) ("Courts traditionally have flexibility to tailor remedies in equitable matters, are equipped to do so, and should be allowed to do so . . .").

116. *Smith v. United States*, 507 U.S. 197, 217 (1993) (Stevens, J., dissenting) (quoting CONG. GLOBE, 37TH CONG., 2D SESS., APP. 2 (1861)).

117. George C. Christie, *Some Key Jurisprudential Issues of the Twenty-First Century*, 8 TUL. J. INT'L & COMP. L. 217, 217 (2000).

With this dread court from whence there's no appeal  
 No tricking here, to blunt the edge of law  
 Or, damned in equity, escape by flaw!<sup>118</sup>

One hopes the modern judge will reject these stark ancestral inclinations preferring instead a more enlightened standard. The *Hertz* rule “should be read with the vision of the judge, enlightened by an interest in justice, not through the opaque green eyeshade of the cloistered bookkeeper.”<sup>119</sup>

The second possible outcome would require the judge to narrowly follow the nerve center test when possible. When not possible (e.g., when nerve center functions are widely dispersed), the judge should respect the mandated test, but not slavishly so. For example, the judge could weigh the various nerve center factors at the different nerve center locations. In doing so, the judge will assess the relative importance of the different nerve center functions, identifying the ultimate nerve center based on the location where the corporation’s most important executive functions occur. This approach would do justice both to the letter of law and, as importantly, the spirit of the law. Or, in the words of Justice Blackstone: “Equity, in its true and genuine meaning, is the soul and spirit of all law: positive law is construed, and rational law is made, by it.”<sup>120</sup>

## V. CONCLUSION

There is much to commend in the Court’s adoption of the nerve center test including, for example, efficiency, reduced costs, and uniformity. At the same time, one must wonder whether these benefits will accrue to the courts and litigants when the corporate party is a large and diversified enterprise. Will the advantages

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118. RICHARD BRINSLEY SHERIDAN, *THE RIVALS: PROLOGUE* (1775), quoted in N.E.H. Hull & Peter Charles Hoffer, *Historians and the Impeachment Imbroglia: In Search of a Serviceable History*, 31 *RUTGERS L.J.* 473, 473 (2000).

119. *Smith v. United States*, 507 U.S. 197, 217 (1993) (Stevens, J., dissenting). Justice Stevens also writes that “[m]ajestic legislation like the Federal Tort Claims Act” should be read with such vision.” *Id.*

120. Sarah M. R. Cravens, *Judging Discretion: Contexts for Understanding the Role of Judgment*, 64 *U. MIAMI L. REV.* 947, 948 n.2 (2010) (quoting 3 *THE COMMENTARIES ON THE LAWS OF ENGLAND* 222 (4th ed. 1876)).

evaporate as courts struggle to apply the nerve center test in these more complex settings? And will some parties (e.g., inactive corporations) be left out altogether? And even if the test delivers the promised economic savings, are we not constrained to limit its application to prevent efficiency from trumping equity? Will the court's "points" language save the day? These are questions that only time can answer, as courts have the opportunity to struggle with and apply the *Hertz* holding in diverse contexts. Hopefully, as the lower courts are presented with the opportunity to work out the parameters of the nerve center test, they will take the time to consider their options and make choices to avoid strained or inequitable results.



# Termination of Sound Recording Copyrights & The Potential Unconscionability of Work for Hire Clauses

By: Emily Burrows

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## I. INTRODUCTION

The classic story of a young artist entering into an unfair record deal and receiving pennies on the dollar for his work after years of recording and touring resonates throughout the music

community. Although these stories are potentially exaggerated, there are certainly disparities in the compensation granted compared to the value of an artist's work. Even successful, established artists often wish to regain control of their copyrights. What if there was an opportunity for an artist to escape these arrangements?

The 1976 Copyright Act includes a provision that allows artists to recapture their copyrights thirty-five years after assigning their work to a third party, such as a publisher or record label.<sup>1</sup> Congress recognized the disparity in bargaining power between authors and assignees and provided a "practical compromise" that would recognize the interests of both sides.<sup>2</sup> In addition, the termination right acknowledges the impossibility of determining the value of a work until it has been exploited by the assignee.<sup>3</sup> Ideally, artists would have the opportunity to sign new deals after the value of their work is recognized.

Significantly, works for hire are not subject to the right of termination.<sup>4</sup> As an obvious result, record companies prefer to own a copyright as a work for hire, rather than as an assignment.<sup>5</sup> If a sound recording is considered a work for hire, then the record company retains full copyrights for the entire duration of the copyright—up to ninety-five years.<sup>6</sup> If sound recordings are considered a work for hire, artists completely lose the right to recapture the copyrights in their master recordings.<sup>7</sup> Often, young or

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1. 17 U.S.C. § 203(a)(3) (2006).

2. H.R. REP. NO. 94-1476, at 124 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5740.

3. *Id.*

4. 17 U.S.C. § 203(a).

5. Ryan Ashley Rafoth, *Limitations of the 1999 Work-For-Hire Amendment: Courts Should Not Consider Sound Recordings to be Works-For-Hire When Artists' Termination Rights Begin Vesting in Year 2013*, 53 VAND. L. REV. 1021, 1028 (2000).

6. *See* 17 U.S.C. § 203 (listing conditions for termination for works other than works made for hire).

7. This paper focuses on the termination of copyrights for sound recordings, rather than copyrights for musical compositions. To clarify, musical works are the music, as well as any accompanying words. U.S. COPYRIGHT OFFICE, CIRCULAR 56A, COPYRIGHT REGISTRATION OF MUSICAL COMPOSITIONS AND SOUND RECORDINGS 1 (2009), *available at* <http://www.copyright.gov/circs/circ56a.pdf>. The author is generally the songwriter or composer. *Id.* A sound recording is the *fixation* of music in a tangible medium, and the author is the performer of the work. *Id.* Musicians who write their own songs typically own the copyright in the musical composition (or assign the rights to a publisher), but assign their copyright



inexperienced artists are forced into a contract that does not fully compensate them for the value of their work.

Termination rights for works transferred on or after January 1, 1978, will begin in 2013.<sup>8</sup> However, notice of termination may be served between two and ten years *before* the thirty-five year mark.<sup>9</sup> Therefore, notices of termination for pre-1978 works could have been served as early as 2003.<sup>10</sup> There is little clarity as to whether recording agreements will be construed as creating works for hire. It will likely take a high court decision or legislative action to determine if sound recordings are works for hire and therefore ineligible for copyright termination.

This paper will examine the work for hire doctrine and the potential impact of the termination of sound recordings. Part II provides an overview of the pertinent history of copyright law in the United States. Part III describes Sections 203 and 304(c) of the Copyright Act and the problems that these termination rights bring forth. Part IV outlines the factors of the work for hire doctrine as applied to artist contracts. Part V describes legislative changes to the right of termination. Finally, Part VI considers defenses available to artists if the work for hire doctrine is found to apply to recording contracts.

## II. COPYRIGHT HISTORY

### A. *The Copyright Act of 1790*

The Constitution empowers Congress to promote the “useful Arts, by securing for limited Times to Authors . . . the exclusive Right to their respective Writings . . . .”<sup>11</sup>

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in the sound recordings to the record label. PASSMAN, *infra* note 26, at 206–07, 308–09.

8. See 17 U.S.C. § 203(a)(3) (“Termination of the grant may be effected at any time during a period of five years beginning at the end of thirty-five years from the date of execution of the grant.”).

9. *Id.* at § 203(a)(4)(A).

10. Lee Phillips, a name partner at Manatt, Phelps & Phillips, vowed to begin issuing termination notices for huge acts, such as The Eagles, Journey, and Barbra Streisand. Eriq Gardner, *Copyright Battle Comes Home*, IP LAW & BUS., Oct. 8, 2009, available at <http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202434372952&pos=ataglance>.

11. U.S. CONST. art. I, § 8, cl. 8.

The first federal Copyright Act was passed in 1790.<sup>12</sup> This act was based upon the system of formalities and restrictions of the English Statute of Anne.<sup>13</sup> The Statute of Anne was enacted in 1710 and was a considerable shift in law because it recognized the rights of authors, rather than just the rights of printers and booksellers.<sup>14</sup> The statute provided the author with the exclusive right to print his works for fourteen years and included an additional renewal term of fourteen years for a living author.<sup>15</sup> These structural provisions combined with the recognition of a creator's rights formed the basis for future copyright legislation.<sup>16</sup>

### B. *The Copyright Act of 1909*

The Copyright Act of 1909 extended the duration of copyright from fourteen years to twenty-eight years from the date of publication.<sup>17</sup> The Act also included a renewal term of twenty-eight years that could be exploited by the author *and* his heirs.<sup>18</sup> This maximum copyright term of fifty-six years applies to many older copyrighted works today. Additionally, the second renewal term is now automatic. Thus, the author does not forfeit the additional twenty-eight years if he or his heirs fail to renew.<sup>19</sup> For works created before 1978, the copyright was secured on the earlier of the publication or registration dates.<sup>20</sup>

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12. Act of May 31, 1790, 1 ch. 15, 1 Stat. 124.

13. ROBERT A. GORMAN & JANE C. GINSBURG, COPYRIGHT: CASES AND MATERIALS 4-5 (Robert C. Clark et al. eds., 7th ed. 2006).

14. *Id.* at 2-3.

15. *Id.* at 2.

16. *E.g.*, Copyright Act of 1909, 17 U.S.C. § § 1-216 (2006); Copyright Act of 1790, 17 U.S.C. 101-810 (2006).

17. 3 MELLVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 9.03[B] (1997).

18. *Id.* § 9.08.

19. Copyright Renewal Act of 1992, 17 U.S.C. § 304(a)(1)(C)(iv) (2010) (detailing conditions for renewal of the copyright).

20. Copyright Act of 1909, 17 U.S.C. § § 10, 12 (1909). *But see* 17 U.S.C. § 302(a) ("Copyright in a work created on or *after* January 1, 1978, subsists from its *creation* . . .") (emphasis added). In essence, copyright registration is now less important for the purpose of proof of ownership, but it nevertheless provides for certain rights, such as statutorily-defined damages in the event of infringement. *Id.*

### C. *The Copyright Act of 1976*

The Copyright Act of 1976 was created in response to the technological changes associated with the development of the motion picture, phonograph, radio, and television.<sup>21</sup> Compounding this development were mounting pressures to conform to international copyright treaties and standards.<sup>22</sup> Although there have been numerous amendments over the past several decades, the Copyright Act of 1976 serves as the basis for modern American copyright law.

The Copyright Act of 1976 “marked a significant philosophical departure from the centuries-old traditions” of the Statute of Anne and previous United States Copyright Acts.<sup>23</sup> One of the more fundamental changes was the shift from static terms of protection to a system extending copyright protection to the life of the author plus fifty years.<sup>24</sup> This extension conformed to the duration requirements of the Berne Copyright Convention, an international standard originally adopted in 1886 by Belgium, France, Germany, Italy, Luxemburg, Spain, Switzerland, Tunisia, and the United Kingdom.<sup>25</sup> It also extended the protection of the works covered by the 1909 Act—works created before January 1, 1978—by nineteen years, granting those works a total of seventy-five years of protection.<sup>26</sup>

The Sonny Bono Copyright Term Extension Act of 1998 further extended copyright protection. For works created after January 1, 1978, the term was extended to the life of the author plus seventy years.<sup>27</sup> Additionally, twenty-five years of further protection

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21. GORMAN & GINSBURG, *supra* note 13, at 7.

22. *Id.*

23. *Id.* at 8.

24. 17 U.S.C. § 203(a) (2006).

25. J.A.L. STERLING, *WORLD COPYRIGHT LAW*, 765–66, 792 (3d ed., 2008). The Berne Convention created common rules to adjust to the increased globalization of copyright. *Id.* The Convention requires that copyright protection be automatic (i.e., protection is granted without a registration requirement). *Id.* The minimum life of copyright protection is the life of the author plus fifty years. *Id.* at 765, 792–93.

26. DONALD S. PASSMAN, *ALL YOU NEED TO KNOW ABOUT THE MUSIC BUSINESS* 291 (6th ed., 2006).

27. (Sonny Bono) Copyright Term Extension Act § 102(b)(1), Pub. L. No. 105-298, 112 Stat. 2827. On the other hand, the duration of copyright in the United Kingdom for sound recordings is the life of the author plus fifty years, while other types of works are protected for seventy years after the death of the

was granted to pre-1978 works, for a total of ninety-five years.<sup>28</sup> The constitutionality of the Sonny Bono Copyright Term Extension Act was sustained by the United States Supreme Court in *Eldred v. Ashcroft*.<sup>29</sup> Various individuals and corporations, which used works that were in the public domain before the extension, challenged the constitutionality of the amendment on the basis of the “Limited Times” clause of the Constitution.<sup>30</sup> The Court found that the extension was a rational exercise of legislative authority, especially considering it brought United States copyright law in line with the Berne Convention standards.<sup>31</sup>

The constitutionality of increased copyright duration leaves open the possibility of future extensions. The continuous extension of copyright duration benefits the holder of a copyright by prolonging the amount of time he can exclusively exploit the work. This begs the following question: should a record label retain the copyright for the entire term of protection or should the copyright revert to the artist who created the work before the end of the term of protection?

### III. STATUTORY TERMINATION RIGHTS

#### A. Section 304(c) – Pre-1978 Works

One of the most artist-friendly provisions of the Copyright Act of 1976 is the right to recapture assigned copyrights.<sup>32</sup> Under the 1909 Act, the main purpose of the original and renewal terms was to allow the author and his heirs to enjoy ownership of the work

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author. KENNETH D. CREWS & JACQUE RAMOS, COMPARATIVE ANALYSIS OF WORLD COPYRIGHT LAW: ISSUES FOR UNIVERSITY SCHOLARSHIP 21–22 (2006), available at [http://copyright.surf.nl/copyright/files/International\\_Comparative\\_Chart\\_Zwolle\\_III\\_rev071306.pdf](http://copyright.surf.nl/copyright/files/International_Comparative_Chart_Zwolle_III_rev071306.pdf).

28. § 102(b)(3).

29. 537 U.S. 186 (2003).

30. *Id.* at 186; see U.S. CONST. art. I, § 8, cl. 8. (“[B]y securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries . . .”).

31. *Eldred*, 537 U.S. at 205–08.

32. See 17 U.S.C. §§ 203(a)(3), 304(c) (2006) (detailing rights and conditions of copyright termination).

after the initial term.<sup>33</sup> Section 304(c) grants authors an inalienable right to terminate a grant in a copyright fifty-six years after the original grant.<sup>34</sup>

Termination of pre-1978 copyrights is less of a looming issue for the music industry than is termination for post-1978 works.<sup>35</sup> Federal law did not recognize copyrights in the transference of sound recordings until February 15, 1972, and thus the earliest termination could not occur until fifty-six years after that date—February 2028.<sup>36</sup> Sound recordings created before February 15, 1972, are generally protected under state law.<sup>37</sup>

An author seeking to terminate a grant in copyright must serve advance notice in writing to the grantee.<sup>38</sup> Notice of termination may be served at any time during a five-year period beginning at the later of either fifty-six years from the date of copyright, or January 1, 1978.<sup>39</sup> The notice must also be given between two and ten years before the effective date of termination.<sup>40</sup> The time window was created “so that the only rights to the copyright affected thereby were those to the 19-year extension in the renewal term created by the 1976 Act, leaving undisturbed the grantee's vested interest to the original 28-year renewal term . . . .”<sup>41</sup>

This interpretation recognizes the importance of allowing a grantee to exploit the copyright for the length of time for which he

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33. GORMAN & GINSBURG, *supra* note 13, at 447.

34. See 17 U.S.C. § 304(c) (detailing the rights and conditions of an author's copyright termination).

35. See Randy S. Frisch & Matthew J. Fortnow, *Termination of Copyrights in Sound Recordings: Is There a Leak in the Company Vaults?*, 17 COLUM.-VLA J.L. & ARTS, 211, 214 (1993) (reasoning that termination of pre-1978 transfers is not important for sound recordings because federal law did not recognize copyrights in sound recordings until 1972, and thus there is no immediate threat of termination of recordings made fifty-six years ago).

36. See Sound Recording Act of 1971, Pub L. No. 92-140, 85 Stat. 391 (1971) (marking the legislation that led to the recognition in the transference of sound recordings); see also Frisch & Fortnow, *supra* note 35, at 214.

37. Frisch & Fortnow, *supra* note 35, at 214 (indicating state law claims were based on common law principles such as unfair competition, misappropriation, and anti-piracy).

38. 17 U.S.C. § 304(c)(4) (2006).

39. *Id.* at § 304(c)(3).

40. *Id.* at § 304(c)(4)(A). The termination notice provisions for works created after January 1, 1978, are virtually identical. 17 U.S.C. § 203(a)(4).

41. *Siegel v. Warner Bros. Entm't Inc.*, 542 F. Supp. 2d 1098, 1117 (C.D. Cal. 2008).

bargained. However, it also values the reversionary interest of an author and allows him to take advantage of the copyright extensions. This is of great importance to the music industry because the 1976 Act benefits record companies that failed to provide adequate consideration at the initial bargaining stage, but which may enjoy the subsequent extensions.

*B. Section 203 – Post 1978 Works*

Section 203 of the United States Code operates as a substitute for the § 304(c) renewal term reversion; it serves as “a provision safeguarding authors against unremunerative transfers.”<sup>42</sup> Congress recognized the disparity in bargaining power between recording labels and artists, as well as the difficulties in determining a work’s value before commercial exploitation.<sup>43</sup> The statute provides for an inalienable right of termination at the end of thirty-five years from the date of publication.<sup>44</sup>

The termination is not automatic, and notice of termination must be provided in writing within the specified time limits.<sup>45</sup> The termination right for pre-1978 works is automatic, but the post-1978 provision necessitates affirmative action on the part of the author or his heirs.<sup>46</sup>

A major exception of the right of termination is that works made for hire may not be terminated.<sup>47</sup> In a work for hire, the employer who orders the work is considered the author and owns all of the rights in the copyright, unless the parties have agreed

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42. H.R. REP. NO. 94-1476, at 124 (1976).

43. *See id.* (noting the need for a provision like Section 203 because of the unequal bargaining position of authors caused by the impossibility of determining a work’s value until after it has been exploited).

44. 17 U.S.C. § 203(a)(3), (4) (2006). Copyright grants in the music industry almost always cover publication, but the statute also provides for termination forty years after the grant if the work is never published. *Id.*; PASSMAN, *supra* note 26, at 302.

45. 17 U.S.C. § 203(a)(3). The notice timing requirements are identical to the provisions for pre-1978 works. Termination notice may begin at any time during a five-year period beginning at the end of thirty-five years, but must take place two to ten years before the effective date of termination. *See supra* notes 38–41 and accompanying text.

46. H.R. REP. NO. 94-1476, at 125 (1976).

47. *See* 17 U.S.C. § 203(a) (detailing conditions for termination for works other than works made for hire).

otherwise.<sup>48</sup> This concept will be explored more thoroughly, as it is extremely important with regards to the music industry's relationship with the right of termination.<sup>49</sup> If it is determined that a sound recording is a work for hire, artists lose their right to terminate any grants of copyright assignment in that work.

Section 203(b)(1) provides a further limitation: a derivative work prepared before the termination may "continue to be utilized . . . but this privilege does not extend to the preparation" of other derivative works based on the original, terminated work.<sup>50</sup> Essentially, this provision enables the grantee to use in perpetuity any new works the grantee created from the original granted work during the period before termination.

### C. *Problems With the Statutes*

The two-headed termination statute is necessary due to changes in copyright law. However, the 1978 bifurcation has created confusion over which statute to apply to a given agreement. A typical scenario is as follows: an artist signs a recording deal in 1975 and creates sound recordings through 1985.<sup>51</sup> Are songs written after January 1, 1978, subject to § 203 (thirty-five years until termination), or are they included under § 304 (fifty-six years until termination) because the agreement took place before the new Copyright Act?

Section 304(c) of the Copyright Act applies where work "subsists" in its first or renewal term.<sup>52</sup> It is unclear how a work can subsist before it has been created, or how a work could be exempt from termination by falling in between the two statutes. In fact, Charlie Daniels has sent a termination notice for his song "The Devil Went Down to Georgia," which he wrote in 1979 under an

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48. 17 U.S.C. § 201(b).

49. *See infra* Part IV.

50. 17 U.S.C. § 203(b)(1).

51. *See generally*, Ben Sheffner, *Songwriters v. Publishers*, BILLBOARD, Apr. 17, 2010, at 4 (setting forth a scenario "ripe for conflict," where an exclusive songwriting agreement overlaps the 1909 Copyright Act and the 1975 Copyright Act).

52. 17 U.S.C. § 304(c). The first term is twenty-eight years while the renewal term is an additional sixty-seven years. 17 U.S.C. § 304(a)(1)(A) & (a)(2)(A). *See also* Bank One v. Mr. Dean MV, 293 F.3d 830, 837 (5th Cir. 2002) ("The word 'subsists' becomes essential here, because it does not mean 'springs into being' but rather 'exists' in the sense of 'persists' or 'continues.'").

agreement he signed in 1976.<sup>53</sup> Daniels sent his termination notice on the theory that his song falls under § 203's thirty-five year termination provision, because, as his attorney points out, there is no reason why Congress would "obviate a whole group of works from a termination provision."<sup>54</sup>

Despite Daniels's eagerness, the termination right has barely been used in practice. In *Siegel v. Warner Bros. Entertainment*, the United States District Court for the Central District of California addressed the lack of termination notices while attempting to clarify the notice requirements for termination.<sup>55</sup> The court noted that authors are forced to jump through hoops because termination is no longer automatic, as it was under the Copyright Act of 1909.<sup>56</sup> As a result, only "approximately 0.72% of [termination] transfers have been recorded, as required, with the Copyright Office."<sup>57</sup> Although Congress has attempted to clarify the notice requirements,<sup>58</sup> it is still easy for an author or his heir to miss the termination window or not include sufficient information to make the termination effective.

Other countries' copyright laws do not have a termination right similar to the United States. However, some civil law countries, such as Germany and France, recognize a right of retraction as one of the moral rights of an author.<sup>59</sup> An author may choose to retract his work from publication because of changed opinion.<sup>60</sup> However, the author must indemnify the publisher and the publisher usually has the first option to re-sign the author.<sup>61</sup> The United States does not recognize such "moral rights,"<sup>62</sup> but perhaps

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53. Sheffner, *supra* note 51, at 4.

54. *Id.*

55. 690 F. Supp. 2d 1048, 1057–58 (C.D. Cal. 2009).

56. *Id.* at 1050 (citing William F. Patry, *The Failure of the American Copyright System: Protecting the Idle Rich*, 72 NOTRE DAME L. REV. 907, 922 (1997)).

57. *Id.*

58. See 37 C.F.R. § 201.10 (2009) (listing the requirements for notices of termination of transfers and licenses).

59. STERLING, *supra* note 25, at 398. Moral rights, as opposed to economic rights, relate to the protection of the integrity of the author's work and personality. *Id.* at 392. Other moral rights include divulgence, paternity, integrity, and destruction rights. *Id.* at 395–98.

60. *Id.* at 398.

61. *Id.*

62. *Id.* at 408–10.



the concept of indemnifying the grantee for lost profits could be implemented in future legislation.

#### IV.      WORKS MADE FOR HIRE

The Copyright Act of 1976 states that if a copyrightable work is a work made for hire, the employer or person for whom the work is prepared owns the copyright, unless the parties have agreed otherwise.<sup>63</sup> Accordingly, any agreement under which the employee is to own the rights must be in writing and signed by the parties.<sup>64</sup> The work for hire doctrine is important for musicians because artists lose their termination right if their assigned work is determined to be a work for hire.<sup>65</sup>

The stated rationale behind the doctrine recognizes the idea that if an employer pays an employee for the purpose of creating a work, the employer should reap the benefits of the payment.<sup>66</sup> In *Community for Creative Non-Violence v. Reid*, the United States Supreme Court addressed the doctrine's profound impact on freelance artists and the music industry.<sup>67</sup> Classifying a work as a "work for hire" determines the initial ownership of the copyright, the duration of copyright protection, the owner's renewal rights, and of course, the termination rights enjoyed by the author.<sup>68</sup> The test for determining whether a work is a work for hire is two-pronged and stringent: the first prong requires that specific conditions constituting an employer-employee relationship are met; the second prong requires that the work fit into one of nine narrow categories.<sup>69</sup>

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63. 17 U.S.C. § 201(b) (2006).

64. H.R. REP. NO. 94-1476, at 124 (1976).

65. 17 U.S.C. § 203(a).

66. Scott K. Zesch, Annotation, *Application of "Works for Hire" Doctrine Under Copyright Act of 1976*, 132 A.L.R. FED. 301, 311 (1996).

67. 490 U.S. 730, 737 (1989).

68. *Id.*

69. 17 U.S.C.A. § 101 (2010). A work is a work for hire if it is a work prepared by an employee within the scope of his or her employment, or a work created by an independent contractor that is, (1) a contribution to a collective work, (2) a part of a motion picture or other audiovisual work, (3) a translation, (4) a supplementary work, (5) a compilation, (6) an instructional text, (7) a test, (8) answer material for a test, or (9) an atlas that is specially ordered or commissioned and there is a written agreement between the parties specifying that the work is a work made for hire. *Id.*

The “employment prong” and the “independent contractor prong” are mutually exclusive, so courts must determine whether the work was prepared by an employee or by an independent contractor using common law agency principles.<sup>70</sup> The Supreme Court used the Restatement (Second) of Agency to determine the hiring party’s right to control the “manner and means” by which the final product is accomplished.<sup>71</sup>

In determining whether a hired party is an employee under the law of agency, the Supreme Court considered several factors (the *CCNV* test): the skill required to produce the work; the source of instrumentalities and tools used to produce the work; the location of the work; the duration of the relationship between the parties; whether the hiring party had the right to assign additional projects; the hired party’s discretion on when and where to work; the method of payment; the hired party’s role in hiring and paying assistants; whether the work was part of the regular business of the hiring party; the provision of employee benefits; and the tax treatment of the hired party.<sup>72</sup> Later decisions have added “actual control” as a factor.<sup>73</sup> No single factor is determinative of whether there is an employer-employee relationship in a particular case.<sup>74</sup>

At least one court has cautioned that the *CCNV* test may be misapplied when determining whether a work is a work for hire because some factors will have little or no significance in a given case.<sup>75</sup> In *Aymes v. Bonelli*, the Second Circuit stated that the *CCNV* factors should not be tallied, but rather weighed according to their significance under the particular circumstances.<sup>76</sup> The court went on to hold that the following five factors are most probative of the “true nature of the employment relationship” and are therefore entitled to more weight in an agency analysis:

- 1) The hiring party’s right to control the manner and means of creation;

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70. *Reid*, 490 U.S. at 750–51.

71. *Id.*

72. *Id.* at 751–52. See RESTATEMENT (SECOND) OF AGENCY § 220(2) (1958) (setting forth a non-exhaustive list of factors relevant to determining whether a hired party is an employee).

73. *Marco v. Accent Publ’g. Co.*, 969 F.2d 1547, 1550 (3d Cir. 1992).

74. *Reid*, 490 U.S. at 751–52.

75. *Aymes v. Bonelli*, 980 F.2d 857, 861 (2d Cir. 1992).

76. *Id.*

- 2) The skill required;
- 3) The provision of employee benefits;
- 4) The tax treatment of the hired party; and
- 5) Whether the hiring party has the right to assign additional products to the hired party.<sup>77</sup>

How a court analyzes the question of whether a work is a work for hire will depend on the determination of whether the work was created within the employment relationship or by an independent contractor. If the court finds that the work was created through an employer-employee relationship, it must then determine if the work was done in the scope of employment. If the work was created in an employer-employee relationship but not in the scope of employment, it is likely not a work for hire. If the work was created by an independent contractor, the court must then determine if (a) the work falls into one of nine limited categories, (b) the work was specially ordered or commissioned, and (c) there was a written agreement between the parties stating that the work is a work for hire.<sup>78</sup>

#### A. *Employment Prong*

If a court finds that an employee, rather than an independent contractor has done the work, the court must determine if the work was done within the scope of employment.<sup>79</sup> Although the Copyright Act of 1976 does not define “employee” or “scope of employment,” the *Reid* Court articulated that “[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.”<sup>80</sup> The Court further explained that, though Congress had not defined the term “employee” in the past, the legislation “intended to

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77. *Id.*

78. 17 U.S.C.A § 101 (2006).

79. *Id.*

80. *Cnty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989) (quoting *NLRB v. Amax Coal Co.*, 453 U.S. 322, 329 (1981)).

describe the conventional master-servant relationship as understood by common-law agency doctrine.”<sup>81</sup>

The Court adopted Congress’s use of the term “scope of employment” to further support its determination that agency law was the appropriate guide for this prong.<sup>82</sup> The Court cited § 228 of the Restatement (Second) of Agency for the common law definition of “scope of employment.”<sup>83</sup> The Restatement’s three-part test asks whether the conduct in question (1) was of the kind the employee is employed to perform, (2) occurred substantially within the authorized time and space limits of the employment, and (3) was actuated, at least in part, to serve the employer.<sup>84</sup>

The employer must prove each element of the Restatement test in order to show that the employee’s work was created within the scope of employment, and should thus be considered a work for hire.<sup>85</sup> Although a recording artist is not a traditional employee of a record label, such as an executive, secretary, or janitor, the artist’s conduct may nevertheless be analyzed under these agency principles.

While the first and third factors of the Restatement Test are satisfied fairly easily, the second factor is a closer question. Recording music is typically the main task musicians are employed to perform. Although they may have other responsibilities, such as touring, promotional appearances, and product endorsement, these activities derive their value from the recorded work. Thus, the first factor of the Restatement Test, that the conduct in question be of the sort the employee is employed to perform, is likely satisfied in the case of an artist creating a sound recording. The third Restatement factor—that the conduct is actuated, at least in part, to serve the employer—is related to the first. A label enters into a recording agreement with the expectation that an artist will provide sound recordings that the company may then commercially exploit. Thus, the third requirement under the Restatement is arguably met.

Less clear is the second factor, which pertains to the authorized temporal and spatial limits of the conduct. Recording

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81. *Id.* at 739–40 (citing *Kelley v. S. Pac. Co.*, 419 U.S. 318, 322–23 (1974); *Baker v. Texas & Pac. Ry. Co.*, 359 U.S. 227, 228 (1959); and *Robinson v. Baltimore & Ohio R.R. Co.*, 237 U.S. 84, 94 (1915)).

82. *Id.* at 740.

83. *Id.*

84. RESTATEMENT (SECOND) OF AGENCY § 228 (1958).

85. *City of Newark v. Beasley*, 883 F. Supp 3d, 8 (D.N.J. 1995) (citing *Avtec Sys., Inc. v. Peiffer*, 21 F.3d 568 (4th Cir. 1994)).

artists are not generally given “working hours” like a traditional employee. In addition, artists are usually free to record their work at any given studio, as long as the expense is within the recording budget. The term “substantially” thus leans in the artist’s favor, even though recording contracts generally include a required delivery date for the work. Ultimately, a court could find that the nature of the music industry requires a less strict interpretation of the authorized time and space provision.

After weighing the various arguments and circumstances, a court is likely to find that a recording artist is an independent contractor rather than the employee of a record label. The agency factors described in the previous section support a finding that artists are independent contractors. Therefore, the employment prong of the work for hire test likely does not apply to recording artists.

### B. *Independent Contractor Prong*

As described above, courts consider several agency factors to determine if a work is the product of an employee or an independent contractor.<sup>86</sup> No single factor is dispositive, and the factors should be weighed relative to their significance in the case.<sup>87</sup> This section will analyze several applicable factors to show why courts will likely find that artists are independent contractors, rather than employees.

#### 1. Hiring Party’s Right to Control the Manner and Means By Which the Product is Accomplished

The hiring party’s control over the manner and means of production cuts against viewing the hired party (i.e., the artist) as an employee.<sup>88</sup> This factor is one of the most heavily weighed, but the absence of a hiring party’s exercise of control does not mean that the artist is not an employee.<sup>89</sup> The Restatement (Second) of Agency commentary points to many occupations where, given the nature of a

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86. *See supra* Section IV.A.

87. *Aymes v. Bonelli*, 980 F.2d 857, 861 (2d Cir. 1992).

88. *Cnty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 737 (1989).

89. *Martha Graham Sch. & Dance Found., Inc. v. Martha Graham Ctr. of Contemporary Dance*, 380 F.3d 624, 642 (2d Cir. 2004).

profession, the employer would not normally control the employee's work.<sup>90</sup> For example, "the full-time cook is regarded as a servant although it is understood that the employer will exercise no control over the cooking."<sup>91</sup> It remains to be seen if an artist will be considered in the same manner.

The experience and creative control of an artist will likely be determinative for this factor.<sup>92</sup> A new artist tends to retain less creative control, but may still select the songs to be recorded and participate in other creative decisions, subject to the approval of the record label.<sup>93</sup> On the other hand, a more established artist will only be limited by certain contractual parameters.<sup>94</sup> Record companies often do not exercise the full gamut of their control rights over artists in an effort to retain "relational goodwill" between the artist and the label.<sup>95</sup>

Additionally, artists generally select the producer of the work.<sup>96</sup> The producer is responsible for "maximizing the creative process" and bringing the product into tangible, marketable form.<sup>97</sup> This fact also favors the artist with regard to the hired party's role in hiring and paying assistants. Labels retain the right to approve the final product, but courts give more weight to detailed decisions rather than general objectives.<sup>98</sup> Therefore, courts will likely find that artists control the manner and means of creation.

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90. RESTATEMENT (SECOND) OF AGENCY § 220(1) cmt. a (1958) (discussing the relationship and control between an employer and employee).

91. *Id.*

92. Rafoth, *supra* note 5, at 1033.

93. *See id.* (comparing the likelihood of artists with great creative control to be classified as independent contractors, as opposed to artists with little creative control).

94. *See id.* (indicating that parameters include a delivery date, minimum song requirements, and recording budgets).

95. *Id.*

96. PASSMAN, *supra* note 26, at 120.

97. *Id.* at 114.

98. *See* Rafoth, *supra* note 5, at 1034 n.46 ("The hiring party in Hi-Tech had control over 'artistic objectives,' but the court found that the importance of this fact was diminished by the '[high level] of . . . skill required of the [hired party], as well as the [hired party's] artistic contributions to the product.'" (citing *Hi-Tech Video Prods., Inc. v. Capital Cities/ABC, Inc.*, 58 F.3d 1093, 1097 (6th Cir. 1995))).

## 2. The Skill Required

An artist is more likely to be found an independent contractor if a high level of skill is required to complete the work.<sup>99</sup> This factor also favors the artist because artists are hired solely for their musical talent. In contrast, the ordinary staff at a record company presumably lacks the musical skill necessary to produce a commercially successful sound recording.

## 3. The Source of Instrumentalities and Discretion on When and Where to Work

If an artist provides the instrumentalities and tools used to produce the sound recording, that artist is more likely to be considered an independent contractor.<sup>100</sup> A typical rock band generally owns its own instruments, although additional instruments may be rented for the recording project. Artists typically choose the recording studio (within the limits of the recording budget) because record companies generally do not own studios for artists to use.<sup>101</sup>

The funding for recording comes from an "advance," which is negotiated when a record deal is signed.<sup>102</sup> The artist spends the advance on the album and keeps any amount that is left over.<sup>103</sup> However, the record label is able to recuperate the amount of the advance by withholding money owed to the artist in the form of royalties.<sup>104</sup> Although the label pays for the recording initially, the artist eventually pays the label back. The fact that recording and production are partially self-funded endeavors likewise suggests that artists are independent contractors.

Artists generally have discretion over when and where to work, which also favors the finding that an artist is an independent contractor. As described above, the artist generally chooses where to

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99. See *Cnty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 737 (1989) (holding a sculptor was an independent contractor based on various factors, including the fact that sculpting is a skilled occupation).

100. *Id.* at 751.

101. Frisch & Fortnow, *supra* note 35, at 220.

102. PASSMAN, *supra* note 26, at 88–91.

103. *Id.*

104. *Id.* at 78.

record the work. The only limitation is a deadline for delivery of recordings, which most independent contractors would also face.<sup>105</sup>

#### 4. Method of Payment & Tax Treatment

If an artist is paid and taxed like a conventional employee, this factor indicates that an artist is an employee. In *Reid*, the Supreme Court stated that “Congress meant to refer to a hired party in a conventional employment relationship.”<sup>106</sup> As described above, artists are generally paid through advances, rather than regular wages or hourly rates, as a conventional employee would be. An artist must pay income tax on the advance.<sup>107</sup> However, artists are generally taxed as “self-employed.”<sup>108</sup> They receive 1099 tax forms from the label and other sources of income, and often must pay self-employment and federal income taxes on any income.<sup>109</sup> Occasionally there will be a provision added to the agreement by the record company which (a) confirms that the label will not be withholding, (b) obligates the artist to be responsible for his own taxes on such payments, and (c) requires the artist to indemnify the label if the label suffers any penalties or other payment obligations as a result of not withholding.<sup>110</sup>

Record labels generally do not deduct payroll or social security taxes from their artists. As the Second Circuit Court of Appeals noted in *Aymes v. Bonelli*, the failure to treat hired parties as employees for payroll (and employee benefit) purposes is given significant weight and is a “virtual admission” by the employer that they do not consider the hired party to be an employee.<sup>111</sup>

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105. *Reid*, 490 U.S. at 753 (“Apart from the deadline for completing the [work, the artist] had absolute freedom to decide when and how long to work.”); Frisch & Fortnow, *supra* note 35, at 220; *see also*, *Marco v. Accent Publ’g. Co. Inc.*, 969 F.2d 1547, 1550 (3d Cir. 1992) (finding that the imposition of deadlines is not considered to affect an independent contractor’s discretion over personal work hours).

106. *Reid*, 490 U.S. at 743.

107. PASSMAN, *supra* note 26, at 80.

108. GEOFFREY P. HULL, *THE RECORDING INDUSTRY* 149 (2d ed. 2004).

109. Peter J. Riley, *Musicians and Singers*, RILEY ASSOCIATES P.C., available at <http://www.artstaxinfo.com/musicians.shtml> (last visited Apr. 22, 2010).

110. E-mail from Edward Z. Fair, entertainment attorney, to author (Apr 25, 2010, 11:29 CST) (on file with author).

111. 980 F.2d 857, 862–63 (2d Cir. 1992).



## 5. Provision of Employee Benefits

This factor is important to the independent contractor analysis because, as the Second Circuit pointed out, “every case since *Reid* that has applied the [Supreme Court’s multi-factor] test has found the hired party to be an independent contractor where the hiring party failed to extend benefits or pay social security taxes.”<sup>112</sup>

Record labels typically do not provide artists with standard employee benefits.<sup>113</sup> On the other hand, record labels do provide conventional employee benefits to their permanent staff, which illustrates how unconventional the relationship between record labels and musicians is in practice.<sup>114</sup> Some labels have agreements with musicians’ unions that require the record company to contribute to the union’s health insurance and retirement funds.<sup>115</sup> However, these benefits are “minimal” compared to companies’ benefit plans for their regular employees.<sup>116</sup>

## 6. Work As Part of the Regular Business of the Hiring Party.

This is the factor most likely to favor the record label. If a court finds that the recording was created as part of the regular business of the record label, this factor will probably favor the finding that an artist is an employee.<sup>117</sup> It is undeniable that record labels are in the business of distributing sound recordings. Their staffs are focused on finding, developing and utilizing artists and their works. Although this factor tends to favor the record label, no one factor is indicative of how a court should rule.<sup>118</sup>

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112. *Id.* at 863 (citations omitted).

113. Frisch & Fortnow, *supra* note 35, at 219.

114. *Id.*

115. *Id.* (citing AFTRA, NATIONAL CODE OF FAIR PRACTICE FOR PHONOGRAPH RECORDINGS, § 34 (1977)).

116. *Id.*

117. *See* Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 752 (1989) (listing factors that are relevant to determining whether a hired party is an employee).

118. *Id.* at 751–52.

## 7. Work for Hire Clauses.

Recording contracts often include clauses stating that the artist's work is commissioned as a work for hire or that the artist is a record company employee.<sup>119</sup> A typical work for hire clause states:

Artist acknowledges that all of the Masters recorded and produced hereunder, all of the Records manufactured therefrom, together with the performances embodied thereon, and all artwork created by or for [Record Company] for use in connection therewith, shall be considered works "made for hire" for [Record Company] within the meaning of the United States Copyright Act. If it is determined that a particular Master does not so qualify, then such Master, together with all rights therein (including the sound recording copyright), shall be deemed transferred and assigned to [Record Company] by this Agreement.<sup>120</sup>

Nevertheless, courts often look to the actual relationship between the parties, rather than the language of the contract.<sup>121</sup> The strength of the independent contractor argument suggests that a court overturn potentially unconscionable work for hire agreements. This concept will be explored more thoroughly as a potential defense for

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119. See Joseph B. Anderson, *The Work Made for Hire Doctrine and California Recording Contracts: A Recipe for Disaster*, 17 HASTINGS COMM. & ENT. L.J. 587, 592 (1995) (discussing the relevance of "work made for hire" clauses in recording and publishing contracts).

120. 25B WEST'S LEGAL FORMS, INTELLECTUAL PROPERTY § 23:74.

121. See Robert A. Kreiss, *Scope of Employment and Being an Employee Under the Work-Made-for-Hire Provision of the Copyright Law: Applying the Common-Law Agency Tests*, 40 U. KAN. L. REV. 119, 145-46 (1991) (noting that contractual attempts to designate a party as an employee are ineffective because the "Copyright Act, not the contract" determines if the creator is an employee). Cf. *Bartels v. Birmingham*, 332 U.S. 126 (1947) (holding that musicians performing at a hotel were under the control of their band leader and were not employees of the hotel for purposes of the Social Security Act in spite of a contractual provision purporting to give the hotel control over musicians); Rev. Rul. 68-303, 1968-1 C.B. 165 ("[A] contractual arrangement will not be determinative of the employer-employee relationship where the realities of the situation contradict the terms of the contract.").

artists that wish to dispute an unconscionable recording agreement.<sup>122</sup>

Interestingly, record contracts often define artists as independent contractors for liability purposes.<sup>123</sup> A standard clause includes: "In entering into this agreement and in providing services pursuant hereto, you . . . have and shall have the status of *independent contractors* and *nothing herein* contained shall contemplate or constitute you . . . as Company's agents or employees."<sup>124</sup> This admission could be a strong factor in favor of finding artists to be independent contractors, rather than employees retained to create works for hire.

## V. LEGISLATIVE HISTORY

A court will likely determine that an artist is an independent contractor, rather than a record label's employee. In order for an independent contractor to create a work for hire, the work must fit into one of nine specific categories, be specially ordered or commissioned, and the agreement commissioning the work must be in writing.<sup>125</sup> Musical works are not one of the specified categories of works.<sup>126</sup>

However, in 1999, the Intellectual Property and Communications Omnibus Reform Act added "sound recordings" to the enumerated categories of §101.<sup>127</sup> The provision was added as a "technical amendment" and passed without hearings or debate.<sup>128</sup> Artists and supporters "went ballistic"<sup>129</sup> because of the impact the

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122. *See infra* Part VI.B.

123. Frisch & Fortnow, *supra* note 35, at 221.

124. ALAN H. KRESS & SAMUEL J. FOX, ENTERTAINMENT INDUSTRY CONTRACTS: NEGOTIATING & DRAFTING GUIDE 159-112, Form 159-1 (Donald C. Farber & Peter A. Cross eds., 1986) (emphasis added).

125. 17 U.S.C. § 101 (2006).

126. *Id.*

127. H.R. CONF. REP. NO. 106-464, at 105-106 (1999).

128. Rafoth, *supra* note 5, at 1023-24 ("Discussion of the work-for-hire amendment in the Congressional Record went no further than to adopt the Conference report." (citing 145 CONG. REC. S14,836 (daily ed. Nov. 18, 1999), 145 CONG. REC. S14,712 (daily ed. Nov. 17, 1999), and 145 CONG. REC. H11,769, H11,811-18 (daily ed. Nov. 9, 1999))).

129. PASSMAN, *supra* note 26, at 289.

provision would have on the music industry.<sup>130</sup> If sound recordings remained as an enumerated work for hire category, an artist would be deemed to be employed by his record label and likely unable to terminate his grant of rights in sound recordings. In response to the backlash, Congress quickly reversed the action and removed sound recordings from the Act.<sup>131</sup>

The Code's definition of "work made for hire" now states:

In determining whether any work is eligible to be considered a work made for hire under paragraph (2), neither the amendment contained in section 1011(d) of the Intellectual Property and Communications Omnibus Reform Act of 1999 . . . nor the deletion of the words added by that amendment (A) shall be considered or otherwise given any legal significance, or (B) shall be interpreted to indicate congressional approval or disapproval of, or acquiescence in, any judicial determination . . . .<sup>132</sup>

Congress determined that these amendments should be considered as if they were "never enacted."<sup>133</sup> If Congress had conducted hearings, it would have been forced to consider the scope of negotiations behind the Copyright Act of 1976 and common law precedent.<sup>134</sup> Legislative history reveals that Congress weighed the interests of book publishers and authors in creating the original enumerated classes of commissioned works.<sup>135</sup> Book publishers argued that they exert a great deal of effort compiling freelance

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130. See 146 CONG. REC. H7772 (daily ed. Sept. 19, 2000) (statement of Rep. Conyers) ("Without the benefit of committee hearings or other debate, the change terminated any future interest that artists might have in their sound recordings and turned them over permanently to the record companies. We have since learned that we should never do business this way.").

131. Work Made for Hire and Copyright Corrections Act of 2000, Pub. L. No. 106-379 § 2(a)(1), 114 Stat. 1444, 1444 (2000).

132. 17 U.S.C.A. § 101 (2006).

133. *Id.*

134. See generally Rafoth, *supra* note 5, at 1023–35 (indicating that Congress did not thoroughly investigate the implication of the work-for-hire amendment).

135. *Id.* at 1048–49 (detailing different issues advocated by publishers and authors).

authors to create textbooks and encyclopedias.<sup>136</sup> Authors countered by demanding a narrower scope of defined commissioned works, in recognition of the fact that freelance authors rarely have the bargaining power to negotiate around work for hire clauses.<sup>137</sup>

The resulting list of works reflects categories that require intensive diligence on the part of publishers to coordinate and compile, often requiring the efforts of many people.<sup>138</sup> Recording contracts are different from encyclopedia contracts; there are fewer parties to negotiate with and the compilation process is less labor intensive.<sup>139</sup>

Case law also supports the proposition that sound recordings are not a work for hire and should not be included on the list of enumerated categories.<sup>140</sup> In *Ballas v. Tedesco*, the United States District Court for the District of New Jersey analyzed an infringement claim by an artist and found that the sound recordings a producer created were not a work for hire.<sup>141</sup> One of the main points the court made was that sound recordings “do not fit within any of the nine enumerated categories,”<sup>142</sup> which reflects the fundamental difference between sound recordings and the works that producers must work harder to compile.

A district court in California addressed sound recordings in the Napster copyright litigation.<sup>143</sup> The court pointed to the “glaring omission in the statutory requirements” and suggested that the works of the artists claiming infringement are not works for hire.<sup>144</sup> The court also commented on the music industry’s recent failed attempt to add sound recordings to the list of works covered by the independent contractor prong of the work for hire doctrine.<sup>145</sup>

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136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.* at 1049.

140. *See In re Napster, Inc.*, 191 F. Supp. 2d 1087, 1097–98 (N.D. Cal. 2002) (explaining sound recordings are not among the nine listed works); *Ballas v. Tedesco*, 41 F. Supp. 2d 531, 541 (D.N.J. 1999) (“[P]laintiff’s argument that the sound recordings were a work for hire is without merit.”).

141. *Ballas*, 41 F. Supp. 2d at 541.

142. *Id.*

143. *Napster*, 191 F. Supp. 2d at 1092.

144. *Id.* at 1097.

145. *Id.* at 1097–98.

By contrast, in *Moran v. London Records*, the Seventh Circuit found that the announcer whose voice was featured in a television commercial was not the owner of the commercial.<sup>146</sup> The announcer's employment contract explicitly provided that he had no "right, title, or interest of any kind or nature whatsoever in or to the commercial."<sup>147</sup> The court held that the plaintiff could have secured an interest in the copyright by expressly negotiating that he would have an ownership interest in the commercial.<sup>148</sup>

However, this decision took place before *Reid*, in which the United States Supreme Court spelled out the work for hire two-prong test.<sup>149</sup> Commentators have surmised that, given the facts of the *Moran* case, it appears unlikely that the announcer would be considered an employee in light of the Court's distinction between employees and independent contractors.<sup>150</sup> This idea is striking in light of the lack of creative control that many announcers exercise as compared to the high level of creative control applied by many artists. Presumably, artists would have a stronger case under *Reid*. Moreover, the court's view that the plaintiff could have contracted around the employment provision is not realistic given the minimal bargaining power that artists have in contract negotiations.

## VI. POTENTIAL DEFENSES OF THE WORK FOR HIRE DETERMINATION

As explained above, the work for hire agency analysis tips in favor of artists who wish to terminate their assignments of copyright to record labels. However, the analysis may not end there, as record companies have several defenses available to rebut the independent contractor determination. Despite these defenses, the argument favoring artist termination rights remains strong.

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146. *Moran v. London Records*, 827 F.2d 180, 183 (7th Cir. 1987).

147. *Id.*

148. *Id.*

149. *Cmtty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 737 (1989).

150. Scott K. Zesch, Annotation, *Application of "Works for Hire" Doctrine Under Copyright Act of 1976*, 132 A.L.R. FED. 301, § 18[a] (1996).

A. *Enforceability of Work for Hire Clauses*

As previously described,<sup>151</sup> recording contracts typically include language similar to “[the copyrighted works] shall be considered works ‘made for hire’ for [the record company] within the meaning of the United States Copyright Act.”<sup>152</sup> Courts are reluctant to find a term unenforceable when parties bargain for the term and a lack of enforcement will frustrate a party’s legitimate expectations and reliance upon that term.<sup>153</sup> However, courts will intervene if “there is a corresponding benefit to be gained in . . . avoiding an inappropriate use of the judicial process.”<sup>154</sup>

Section 178 of the Restatement (Second) of Contracts describes when and how a term will be found unenforceable on public policy grounds:

(1) A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is *clearly outweighed* in the circumstances by a public policy against the enforcement of such terms.

(2) In weighing the interest in the *enforcement* of a term, account is taken of:

- (a) the parties' justified expectations,
- (b) any forfeiture that would result if enforcement were denied, and
- (c) any special public interest in the enforcement of the particular term.

(3) In weighing a public policy *against enforcement* of a term, account is taken of:

- (a) the strength of that policy as manifested by legislation or judicial decisions,

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151. See *supra* Part IV.B.

152. 25B WEST'S LEGAL FORMS, INTELLECTUAL PROPERTY § 23:74.

153. RESTATEMENT (SECOND) OF CONTRACTS § 178 cmt. b (1981).

154. *Id.* at cmt. e.

- (b) the likelihood that a refusal to enforce the term will further that policy,
- (c) the seriousness of any misconduct involved and the extent to which it was deliberate, and
- (d) the directness of the connection between that misconduct and the term.<sup>155</sup>

The Section reflects the conflict between the law's traditional interest in enforcement and the need to protect the interests of the parties against the "abhorrence" of unjust enrichment.<sup>156</sup> As a result, the Restatement includes several considerations that must be considered independently of each other. First, "legislation" is used broadly and may include statutes, administrative regulations, and, importantly, foreign laws (to the extent they do not conflict with United States law).<sup>157</sup>

The comments for the section indicate that legislation rarely expressly provides that a term is unenforceable based on public policy.<sup>158</sup> Congress has been unwilling to take a stance on the enforceability of work for hire clauses with regard to sound recordings.<sup>159</sup> This is evidenced by the current definition of "work for hire" in the Copyright Act.<sup>160</sup>

Courts are in a position to conclude that a term is unenforceable when it is necessary to protect some aspect of the public welfare.<sup>161</sup> The provision has been applied in cases ranging from serious criminal charges to constitutional rights violations.<sup>162</sup> It is unclear if courts will consider a non-beneficial recording contract clause as contrary to public policy. The decision will require a careful balancing of the general interest in enforceability against the

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155. RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981) (emphasis added).

156. *Id.* at cmt. b.

157. *Id.* at cmt. a. (citing RESTATEMENT (SECOND) CONFLICT OF LAWS § § 203, 203 (1971)).

158. *Id.* at cmt. b.

159. *See* 17 U.S.C. § 201 (2006) (declining to specifically reference sound recordings).

160. *Id.* § 101.

161. *Id.* § 201.

162. *See, e.g.,* *Town of Newton v. Rumery*, 480 U.S. 386 (1987) ("The threshold question is whether compelling [a party to waive constitutional rights] impairs to an appreciable extent any of the policies behind the rights involved." (quoting *Crampton v. Ohio*, 402 U.S. 183 (1971))).



public policy underlying the term of the contract. Additionally, courts must consider the effect unenforceability of the term will have on the remainder of the agreement.<sup>163</sup>

Courts should consider the parties' justified expectations, any forfeiture that would result if enforcement were denied, and any special public interest in enforcement of the particular term.<sup>164</sup> Record labels will likely fare well in these considerations. First, labels justifiably expect to exploit the works for the duration of copyright. Whether or not the terms seem fair to an outsider, the industry has allowed this type of deal to continue for decades. Second, record companies will lose an immeasurable amount of expected profits if copyright terminations are able to proceed. In response to the loss of future earnings, labels will likely make the front end of contracts even less favorable to artists in order to make up for the lost revenue. Finally, there may be a public interest in preventing the undoubtedly vast amount of litigation that will ensue if work for hire clauses are deemed unenforceable and copyright grant terminations become actionable.

On the other hand, artists may argue that allowing artists and labels to contract around an inalienable termination right with work for hire language violates public policy and the language of the Copyright Act.<sup>165</sup> If judicial proceedings or legislation determine that a work for hire clause should be unenforceable due to the unfair bargaining position of artists, the Copyright Act strongly supports that policy.<sup>166</sup> The inconclusiveness of this section underscores the necessity for a clear decision from either courts or Congress on whether sound recordings are considered a work for hire.

### *B. Unconscionability of Work for Hire Clauses*

Artists may counter a determination that work for hire clauses are enforceable by raising the defense of unconscionability. The Uniform Commercial Code provides:

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163. RESTATEMENT (SECOND) OF CONTRACTS § 178 cmt. f (1981) (“[T]he question of the effect of such a determination on the rest of the agreement is sometimes a complex one.”).

164. RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981).

165. Rafoth, *supra* note 5, at 1030; *see* 17 U.S.C. § 203(a)(5) (2006) (stating that termination of a grant may be effected notwithstanding any agreement).

166. 17 U.S.C. § 203(a)(5)(2006).

- (1) If the court as a matter of law finds the contract or any term of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable term, or it may so limit the application of any unconscionable term as to avoid any unconscionable result.
- (2) If it is claimed or appears to the court that the contract or any term thereof may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.<sup>167</sup>

The commentary indicates that the court may remove terms it finds unconscionable rather than attempt to achieve its result by manipulating the language of the statute or by finding the term contrary to public policy.<sup>168</sup>

If an artist can successfully argue unconscionability, future artists could more easily use this argument (rather than the Restatement's enforceability standard) to find a work for hire clause unenforceable, or at least limit the clause's applicability. The UCC's basic test is whether "in the light of the general commercial background and the commercial needs of the particular trade or case, the term or contract involved is so one-sided as to be unconscionable under the circumstances existing at the time. . . ."<sup>169</sup> This standard is easier to prove than the "clearly outweigh[ing]" standard articulated by the Restatement.<sup>170</sup> Record labels presumably have not engaged in the serious misconduct necessary to outweigh the interest in enforcing parties' expectations in contract negotiations.

However, it is not clear if courts will consider work for hire

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167. U.C.C. § 2-302 (2004).

168. *Id.* at cmt. 1.

169. *Id.*

170. See RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981) (stating that a contract should not be enforced when public policy concerns "clearly outweigh" the benefits of enforcement).

clauses to be unconscionable in light of music industry trade practices. In negligence considerations, courts look to whether the defendant acted in accordance with the uniform customs of the business.<sup>171</sup> If the defendant acted in accordance with uniform customs, he will not be found negligent unless the court finds that the particular industry custom is negligent.<sup>172</sup>

As in negligence cases, courts must examine the industry standard to determine whether work for hire clauses are unconscionable. A record label undeniably acts in accordance with the uniform customs of the music industry by including a work for hire clause in recording contracts. Less clear is whether a court would find that the entire industry is behaving unconscionably by using these clauses. Industry negligence cases often involve abandoning safety in order to save money,<sup>173</sup> but it is nevertheless possible to draw a comparison to that of artists with low bargaining power who are forced into inflexible recording agreements so that labels may make more money. This harsh position that many artists face is unconscionable when compared to the value created by their work.

### C. *Other Considerations*

#### 1. Derivative Work Loophole

Section 203(b)(1) of the Copyright Act of 1976 provides a potential loophole for record labels. A derivative work prepared before termination may “continue to be utilized . . . [as the] privilege does not extend to the preparation” of other derivative works based on the original, terminated work.<sup>174</sup> A “derivative work” is a work based on one or more preexisting works, “such as a . . . sound recording . . . or any other form in which a work may be recast, transformed, or adapted. A work consisting of editorial revisions,

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171. 57A AM. JUR. 2D *Negligence* § 164 (2004).

172. *Id.*

173. *See* *Tug Ocean Prince, Inc. v. United States*, 584 F.2d 1151, 1155 (2d Cir. 1978) (discussing liability in a boating accident pertaining to the vessel’s seaworthiness); *Frank Mastoloni & Sons, Inc. v. U.S. Postal Service*, 546 F. Supp. 415, 421–22 (S.D.N.Y. 1982) (granting post office’s motion for summary judgment even though defendant did not check the signature when delivering a package).

174. 17 U.S.C. § 203(b)(1) (2006).

annotations, elaborations, or other modifications which, as a whole, represent an original work of authorship, is a 'derivative work.'"<sup>175</sup> In *Mills Music Inc. v. Snyder*, the Supreme Court held that the "critical point" in determining if a derivative work survives the termination of a transfer of copyright is whether the derivative work was "prepared" before termination.<sup>176</sup>

Record labels could potentially argue that any post-delivery remastering or mixing of a sound recording could be considered a derivative work, thereby allowing free reign over the commercially-released work. Labels may look to *Mills Music* for support, where the potential derivative work was created before termination of the grant of copyright.<sup>177</sup> However, record labels will likely lose this argument given that any addition to the preexisting work must be able to stand alone as an original work, and minimal changes to a sound recording will not suffice.<sup>178</sup> In addition, the derivative work must be more than a "stylized version" of a copyrighted sound recording; in essence, a derivative work requires the addition of new material.<sup>179</sup>

## 2. Equitable Considerations

Both the artist community and the recording industry have strong arguments for retaining the copyright in sound recordings.

As explained,<sup>180</sup> some civil law countries allow indemnification of publishers when authors choose to retract their publication rights. Perhaps this right could create a compromise between the interests of record labels and artists. However, a potential drawback is the expense and subjectivity in determining the future earnings of an artist. Indeed, the lack of consideration of an artist's worth is one of the main reasons artists wish to terminate their original copyright grants.

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175. *Id.* § 101.

176. 469 U.S. 153, 173 (1985).

177. *Id.*

178. See *Anderson v. Stallone*, No. 87-0592 WDKGX, 1989 WL 206431, \*23-25 (C.D. Cal. Apr. 25, 1989) (analyzing use of the Rocky character in a new work); *PASSMAN supra* note 26 at 66-67 (describing the technical process of mastering).

179. *Woods v. Bourne Co.*, 841 F.Supp.118, 121 (S.D.N.Y. 1994).

180. See *supra* Part III.C.

## VII. CONCLUSION

The right to terminate an assignment of copyright under the bifurcated Copyright Act is a confusing concept for artists, their heirs, their record labels, and even their attorneys. Despite the confusion, it is important to recognize the value of the right. Congress recognized the disparity in bargaining power between artists and grantees when it created the termination right.

Adding to the confusion is the fact that works for hire are not eligible for termination. The work for hire doctrine requires an in-depth analysis of the relationship between the contracting parties. Nevertheless, the structure of the typical artist-record label relationship suggests that an artist is an independent contractor, and, therefore, his work is ineligible as a work for hire because sound recordings are not included in the list of enumerated works in § 101 of the Copyright Act.<sup>181</sup>

Despite this analysis, record companies include clauses in recording contracts that explicitly refer to artists' works as works made for hire, which are therefore owned by the label. Courts may be willing to overturn this type of clause if they find that the interest in enforcing the clause is outweighed by public policy considerations, or if the court finds the clause to be unconscionable.

These crucial issues will not be clarified without a judicial or legislative determination as to whether sound recordings are works for hire. Hopefully, the increased visibility of the termination right and notice requirements will bring more cases to the fold and force either Congress or the courts to make a final decision on these open factors.

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181. 17 U.S.C. § 101 (2006).



# “Non-Media” Jury Prejudice and Rule 21(a): Lessons from Enron

By: Andrew Mayo\*

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## I. INTRODUCTION

The initial decision by the U.S. Department of Justice to try Khalid Sheik Mohammed in the Southern District of New York<sup>1</sup> made a powerful statement about the institution of the American jury. The Obama administration first announced that they would bring Khalid Sheik Mohammed—the alleged mastermind behind the September 11th attacks<sup>2</sup>—to trial in lower Manhattan, blocks away from Ground Zero.<sup>3</sup> The government is reconsidering this plan,<sup>4</sup> but their initial decision raises an important question: is it possible to empanel an impartial jury for the trial of an alleged September 11th conspirator in New York City? Is it possible anywhere in the United States?

Potential jurors may become biased when exposed to intense levels of pretrial media coverage. This traditional Due Process concern is compounded when a particular crime negatively and exclusively impacts one community. The Enron scandal and the ongoing prosecution of the company's executives highlight this less frequently encountered problem. The collapse of the Houston-based company produced negative financial and emotional repercussions for the entire city. The case's unique impact on a single jury pool is a source of jury prejudice separate from, yet related to, pretrial publicity.

Section II of this note addresses two competing models of the jury and their significance with regards to pretrial publicity. Section III covers the prevailing Supreme Court cases on presumed jury prejudice and outlines the traditional procedural mechanism used to address this problem in litigation—Federal Rule of Criminal Procedure 21(a). Section IV describes the categories and concerns surrounding pretrial publicity in traditional presumed prejudice analysis. Section V discusses the prosecution of Enron CEO Jeffrey

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1. Benjamin Weiser, *Deciding Terror Trial's Location Becomes a Complex Case Itself*, N.Y. TIMES, Dec. 26, 2009, at A1.

2. Terry McDermott, *The Mastermind: Khalid Sheikh Mohammed and the making of 9/11*, THE NEW YORKER, September 13, 2010, at 38.

3. Weiser, *supra* note 1.

4. See McDermott, *supra* note 2 (explaining that the location of the trial is now undetermined).



Skilling and several problems with the traditional jury prejudice framework. Section VI suggests recognizing "community crime" as a new and separate category of jury prejudice. Section VII argues that this new community crime category presents a stronger case for an irrebuttable presumption of jury prejudice than does pretrial publicity. Finally, Section VIII addresses the practical and theoretical challenges to this approach.

## II. PRETRIAL PUBLICITY—IMPARTIAL VS. LOCAL JUSTICE

The Sixth Amendment embodies two competing models of the jury.<sup>5</sup> A criminal defendant is entitled to a jury that is both "impartial" and composed "of [jurors from] the State and district wherein the crime shall have been committed."<sup>6</sup> A truly "impartial" juror is completely free of prejudice or bias that would affect his or her verdict—a blank slate, in other words.<sup>7</sup> Pure impartiality requires the potential juror to be unfamiliar with the facts at hand, so as to focus solely on the facts presented at trial to render a fair and impartial verdict.<sup>8</sup> The second model represented in the Sixth Amendment guarantees "local justice," rendered by a jury of the defendant's peers.<sup>9</sup> This model emphasizes the importance of trial by a defendant's peers in his or her community.<sup>10</sup>

The tension between these two competing jury models finds particular relevance in the phenomenon of pretrial publicity. Pretrial publicity can give a community familiarity with the facts of a case, allow for discussion on a case's merits outside of a courtroom, and lead to prejudice. Adhering blindly to the ideal of a local jury in such a case increases the potential for sacrificing impartiality. Where no possibility exists for a jury that is both impartial and local, impartiality ought to take precedence. The right to an impartial jury

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5. U.S. CONST. amend. VI.

6. *Id.*

7. JEFFREY ABRAMSON, WE, THE JURY 17 (2001).

8. *Id.*

9. *Id.* at 17–18.

10. *Id.* at 18.

is grounded in Due Process,<sup>11</sup> judges must transfer cases from districts where a fair trial is impossible, and may transfer cases merely for convenience.<sup>12</sup>

Generally, however, a criminal defendant should go to trial in the community in which the alleged crime was committed.<sup>13</sup> This default will usually be the most practical and efficient choice. Witnesses and evidence are more likely close to the crime, serving the convenience of all parties. Furthermore, the ability of a local jury to render impartial verdicts, even with a limited amount of pretrial publicity, is central to its role in the criminal justice system. In a time when information can spread instantaneously, we must accept that juries may encounter pretrial publicity for many serious crimes and still retain their impartiality. Indeed, some scholars argue that screening out potential jurors with any knowledge of the case or parties fosters ignorance, rather than impartiality.<sup>14</sup> Some exposure to pretrial publicity may be a sign of a juror's ability to deal with multiple sources of information on a topic, a potentially valuable trait in a juror.<sup>15</sup> A balance must be struck between filtering bias and inviting ignorance into the jury room, and in most situations the ideal juror is both local and well-informed. Cases with extreme pretrial publicity exacerbate this central tension between impartial and local justice. This tension frames the entire issue of presumed prejudice, to which we now turn.

### III. PRESUMED PREJUDICE AND CHANGE OF VENUE

A criminal defendant may assert a violation of his right to an impartial jury based on two types of alleged prejudice: (1) actual and (2) presumed. Showing "actual prejudice" contaminated the seated

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11. See *In re Murchison*, 349 U.S. 133, 136 (1955) ("A fair trial in a fair tribunal is a basic requirement of due process.").

12. See FED. R. CRIM. P. 21 (mandating a change of venue when any of a number of conditions is met).

13. U.S. CONST. amend. VI.

14. ABRAMSON, *supra* note 7, at 53.

15. See *id.* (observing that cases where pretrial publicity forecasted conviction, such as the Marion Barry and Rodney King cases, the pretrial publicity did not result in convictions by the juries).

jury is a difficult burden for the defendant.<sup>16</sup> The standard for "presumed prejudice," on the other hand, speaks to whether it is possible to empanel an impartial jury in light of pretrial publicity.<sup>17</sup>

A. *Early Supreme Court Precedent on Presumed Prejudice*

In *Rideau v. Louisiana*,<sup>18</sup> the Supreme Court reversed a conviction based upon the trial court's refusal to grant a request for a change of venue, which was held to violate Due Process.<sup>19</sup> Hours after a bank robbery, kidnapping, and murder, local authorities in a small Louisiana town arrested the defendant.<sup>20</sup> While the defendant was in custody, the Sheriff of Calcasieu Parish questioned him.<sup>21</sup> During this questioning, the defendant eventually confessed to the crimes.<sup>22</sup> The entire interview occurred in the jail the night of the defendant's arrest,<sup>23</sup> before he had access to an attorney.<sup>24</sup> A local TV station aired the interview between the Sheriff and defendant each of the following three days, reaching an audience of up to 53,000 of Calcasieu Parish's 150,000 residents.<sup>25</sup> Defendant's counsel moved for a change of venue on the grounds that airing the video would unduly prejudice the jury.<sup>26</sup>

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16. See *United States v. McVeigh*, 153 F.3d 1166, 1179 (10th Cir. 1998) ("A claim of actual prejudice is subjected to a more deferential standard of review . . . . The determination of whether the seated jury could remain impartial in the face of negative pretrial publicity, and the measures that may be taken to ensure such impartiality, lay squarely within the domain of the trial court.") (internal citations omitted).

17. See *United States v. Skilling*, 554 F.3d 529, 558 (5th Cir. 2009), *vacated on other grounds*, 130 S. Ct. 393 (2010) (explaining the difference between presumed and actual prejudice).

18. 373 U.S. 723 (1963).

19. *Id.* at 726.

20. *Id.* at 723–24.

21. *Id.* at 724.

22. *Id.*

23. *Id.*

24. *Id.* at 727.

25. *Id.* at 724.

26. *Id.*

The Supreme Court agreed, analogizing the interview to a trial outside of the courtroom.<sup>27</sup> Indeed, it viewed the extrajudicial proceedings as the only meaningful trial, referring to the subsequent proceedings as a “kangaroo court.”<sup>28</sup> The Court emphasized the prejudicial effect of the pretrial publicity, stating that “[a]ny subsequent court proceedings in a community so pervasively exposed to such a spectacle could be but a hollow formality.”<sup>29</sup>

In *Rideau*, the pretrial publicity included evidence inadmissible in court, yet seen and heard by the prospective jury pool. The dissent noted that only three members of the seated jury actually admitted to seeing the confession, all of whom testified to their ability to render an impartial verdict.<sup>30</sup> However, the Court held that the trial judge’s denial of the defendant’s motion to change venue, despite the results of voir dire, violated due process. The Court’s finding that the jury could not have rendered an impartial verdict, or at least should not have been trusted to do so, is now known as “presumed prejudice.”<sup>31</sup>

The Court further developed and expanded the presumed prejudice framework in two subsequent cases. In *Sheppard v. Maxwell*,<sup>32</sup> the Court held that pretrial publicity required a reversal of a conviction for murder.<sup>33</sup> The local media interwove its coverage of the investigation of Dr. Sheppard with editorial criticisms of the prosecution and assertions of Sheppard’s guilt.

<sup>34</sup> The Court noted the “‘editorial artillery’ [that] opened fire” on the defendant,<sup>35</sup> citing numerous newspaper pieces implying or assuming his guilt,<sup>36</sup> and the overall frenzy surrounding the case.<sup>37</sup>

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27. *Id.* at 726 (“For anyone who has ever watched television the conclusion cannot be avoided that this spectacle, to the tens of thousands of people who saw and heard it, in a very real sense was Rideau’s trial—at which he pleaded guilty to murder.”).

28. *Id.* at 726.

29. *Id.* at 725.

30. *Rideau v. Louisiana*, 373 U.S. 723, 733 (1963) (Clark, J., dissenting).

31. *See, e.g., Goss v. Nelson*, 439 F.3d 621, 628 (10th Cir. 2006) (describing *Rideau* as the first Supreme Court case to find “presumed prejudice”); *see also* ABRAMSON, *supra* note 7, at 47 (observing that presumed prejudice “came into the law” with *Rideau*).

32. 384 U.S. 333 (1966).

33. *Id.* at 363.

34. *Id.* at 339–40.

35. *Id.* at 339.

The defendant in *Sheppard* drew legal support from another pretrial publicity case the Court decided a term before, *Estes v. Texas*.<sup>36</sup> The Court in *Sheppard* reiterated that while it often demands "identifiable prejudice" to prove a Due Process violation, "at times a procedure employed by the State involves such a probability that prejudice will result that it is deemed inherently lacking in due process."<sup>39</sup>

*Sheppard* extended the logic of *Rideau*, stating "where there is a reasonable likelihood that prejudicial news prior to trial will prevent a fair trial, the judge should continue the case . . . or transfer it to another county not so permeated with publicity."<sup>40</sup> Regardless of whether state and lower federal courts have adhered to the literal ramifications of the "reasonable likelihood" standard, this portion of *Sheppard* poses a challenge for judges. Compounding this challenge, the Court also reiterated that the trial judge is primarily responsible for remedying instances of presumed prejudice.<sup>41</sup>

#### B. Refining Presumed Prejudice

While recognizing the continuing validity of the presumed prejudice concept, the Supreme Court has retreated from the implications of the broad holdings in the above three cases.<sup>42</sup>

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36. *See id.* at 339–41 (listing article titles including: "Why No Inquest? Do It Now, Dr. Gerber.", "Kerr (Captain of the Cleveland Police) Urges Sheppard's Arrest.", and "Why Isn't Sam Sheppard in Jail?").

37. *Id.* at 342 (describing five volumes filled with similar clippings from each of the three Cleveland newspapers covering the period from the murder until Sheppard's conviction in December 1954).

38. 381 U.S. 532 (1965).

39. *Sheppard*, 384 U.S. at 352 (quoting *Estes*, 381 U.S. at 542–43) (internal quotation marks omitted).

40. *Sheppard*, 384 U.S. at 363.

41. *See id.* ("[T]he state trial judge did not fulfill his duty to protect Sheppard from the inherently prejudicial publicity which saturated the community and to control disruptive influences in the courtroom . . .") (emphasis added). For a particularly helpful explanation of the case and its importance for jury prejudice jurisprudence, see generally Gary A. Hengstler, *Sheppard v. Maxwell Revisited—Do the Traditional Rules Work for Nontraditional Media?*, 71 LAW & CONTEMP. PROBS., Autumn 2008, at 171.

42. *See* ABRAMSON, *supra* note 7, at 48–49 (describing the Supreme Court's departure from preferring jurors with empty minds).

*Murphy v. Florida* held that a defendant with a well-publicized criminal history did not establish presumed prejudice.<sup>43</sup> Most importantly, the Court stated that prior Supreme Court precedent "cannot be made to stand for the proposition that juror exposure to information about a state defendant's prior convictions or to news accounts of the crime with which he is charged alone presumptively deprives the defendant of due process."<sup>44</sup>

The Court continued this trend in *Patton v. Yount*, finding any presumption of jury prejudice rebutted.<sup>45</sup> Local media extensively covered the defendant's confession and first conviction.<sup>46</sup> The central inquiry was not jury exposure to pretrial publicity, "but whether the jurors . . . had such fixed opinions that they could not impartially judge the guilt of the defendant."<sup>47</sup> Without specifically holding there was a presumption of prejudice, the Court held any such presumption was rebutted by the time between the highly publicized event (the first trial) and the relative lack of publicity leading up to the second trial.<sup>48</sup>

The Court again found against a presumption of prejudice in *Mu'Min v. Virginia*,<sup>49</sup> despite media coverage of the defendant's confession of killing a woman.<sup>50</sup> The absence of intense and focused pretrial publicity distinguished this case from *Irvin v. Dowd*, which found such a presumption.<sup>51</sup> Once again, the Court focused on how the media coverage affected the public primarily by analyzing the extent of such publicity.<sup>52</sup> During voir dire, all jurors were questioned about their consumption of pretrial publicity and whether they had formed an opinion, leading to several jurors being

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43. 421 U.S. 794, 803 (1975).

44. *Id.* at 799.

45. 467 U.S. 1025, 1035 (1984).

46. *Id.* at 1032.

47. *Id.* at 1035.

48. *Id.*

49. 500 U.S. 415, 429-30 (1991).

50. *Id.* at 418, 429-30.

51. *Id.* at 429-30 (citing *Irvin v. Dowd*, 366 U.S. 717, 725-27 (1961)).

52. *Mu'Min*, 500 U.S. at 429 (reasoning that media coverage attending capital murder charges is fairly common).

excused.<sup>53</sup> The majority thus held that voir dire sufficiently rooted out jury prejudice.<sup>54</sup>

C. *Presumed Prejudice in Federal Practice: Rule 21(a)*

As seen throughout these cases, one way for a defendant to challenge jury bias at the trial stage is by moving for a change of venue.<sup>55</sup> Federal Rule of Criminal Procedure 21(a) requires a district court to transfer a case when faced with sufficient bias in the community.<sup>56</sup> The rule provides that "[u]pon the defendant's motion, the court must transfer the proceeding against that defendant to another district if the court is satisfied that so great a prejudice against the defendant exists in the transferring district that the defendant cannot obtain a fair and impartial trial there."<sup>57</sup>

When a defendant moves for a change of venue, a trial judge has three options. He or she may (1) deny the motion;<sup>58</sup> (2) grant the motion, finding a presumption of prejudice in the jury pool;<sup>59</sup> or (3) hold the motion pending until voir dire is complete. Courts most frequently employ this third option.<sup>60</sup>

Granting motions to transfer venue is highly disfavored and seen as appropriate only in extreme circumstances.<sup>61</sup> Courts most

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53. *Id.* at 431.

54. *Id.* at 431–32.

55. *See, e.g.,* United States v. Skilling, 554 F.3d 529 (5th Cir. 2009) *vacated on other grounds*, 130 S. Ct. 393 (2010) (involving motion for change of venue due to community bitterness against the defendant); United States v. Rodriguez, 581 F.3d 775 (8th Cir. 2009) (involving motion for change of venue due to pretrial publicity). This paper focuses on the options lawyers and judges have at the trial level. It is beyond the scope of this paper to delve into all the procedural postures in which jury prejudice may appear in criminal litigation.

56. FED. R. CRIM. P. 21(a).

57. *Id.*

58. *See, e.g.,* Skilling, 554 F.3d at 558 (upholding the trial judge's denial of defendant's Rule 21(a) motion).

59. *See supra* Part III.A. (discussing three cases in which the Supreme Court found the trial judge should have granted motions for change of venue).

60. *See, e.g.,* Skilling, 554 F.3d at 559 n.40 (stating that this third option is the "most usual"); WAYNE R. LAFAVE, ET AL., CRIMINAL PROCEDURE § 23.2(a), at 1122 (5th ed. 2009) (describing holding the motion pending until the completion of voir dire as the most common practice).

61. *See, e.g.,* ABRAMSON, *supra* note 7, at 46 (explaining that trial judges' reluctance to grant transfer motions does not come from a commitment to "local

often stay the motion until at least the completion of voir dire.<sup>62</sup> Under this third option, judges will grant or deny the motion based on whether voir dire has succeeded in impaneling an impartial jury.<sup>63</sup>

#### IV. PRESUMED PREJUDICE JURISPRUDENCE: TRADITIONAL CATEGORIES AND CONCERNS

As demonstrated above, the leading Supreme Court cases on presumed prejudice deal with pretrial publicity. Jury prejudice problems created by pretrial publicity may take several forms. Local media outlets may broadcast or publish evidence otherwise inadmissible by a court. A separate but related issue arises when coverage includes admissible, yet otherwise prejudicial, evidence. A final challenge is posed by negative press against the defendant, including editorials and other media asserting the defendant's guilt. Of course, these three types of pretrial publicity are overlapping and perhaps only theoretically distinct. Nonetheless, these categories provide useful insight into understanding why presumed prejudice cases naturally focus on pretrial publicity.

##### A. *Evidentiary breaches*

Many pretrial publicity cases involve the exposure of the jury pool to pretrial media coverage. This coverage may include exposure to material that could theoretically be used as evidence against the defendant, regardless of whether or not it is admitted at trial. For example, *Rideau v. Louisiana* involved the broadcast of a confession not admitted as evidence in court.<sup>64</sup> Potential jurors' pretrial exposure to inadmissible evidence (e.g., the *Rideau* confession) carries some of the same dangers as would juror exposure to any

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justice"); WAYNE R. LAFAVE, et al., CRIMINAL PROCEDURE § 23.2(a), at 1121 (5th ed. 2009) (stating that motions to transfer are rarely used and the defendant has a high burden to overcome).

62. See *supra* note 60 and accompanying text.

63. See *Skilling*, 554 F.3d at 559 n.40 ("A district court should usually hold a transfer motion in abeyance while conducting voir dire instead of dismissing it at the outset.").

64. 373 U.S. 723, 730 (1963) (Clark, J., dissenting).



other prejudicial material (e.g., an editorial proclaiming Rideau's guilt). One danger unique to pre-trial exposure to an inadmissible piece of evidence is that the juror is confronted by, and therefore processes, the information before the court has instructed the jury to draw conclusions based only on admitted evidence. Defense counsel cannot respond to inadmissible evidence, even if the juror perceives that inadmissible evidence as fact. If the juror treats the inadmissible evidence as fact, it may improperly affect the juror's weighing of the evidence that is admitted at trial.

The short-lived prosecution of Jack Ruby demonstrates a similar evidentiary concern. Ruby shot and killed Lee Harvey Oswald in front of a live national television audience on November 24, 1963—two days after the assassination of President John F. Kennedy.<sup>65</sup> Any potential juror who witnessed the shooting either live or replayed might have been prejudiced against Ruby.<sup>66</sup> Even if video of the shooting was admissible in court, the risks of pretrial publicity still exist with admissible evidence. The repeated viewing of the shooting, coupled with extensive media coverage in the days following the Presidential assassination, leads to the same concern: jurors will have already been exposed to evidence outside the controlled courtroom environment. Indeed, Ruby's conviction was overturned by the Texas Court of Criminal Appeals partially on the basis of the trial court's failure to grant Ruby's change of venue motion.<sup>67</sup>

While the Ruby case presents the problem of evidentiary pretrial publicity, the case also raises two additional concerns with changing venue. Because media coverage was so widespread, transferring venue would not necessarily cure the problem associated with prejudice. Equal exposure to pretrial publicity across the nation made one jury pool no less prejudiced than another. Furthermore, attempting to find any juror in the country who had not witnessed the footage would merely invite those ignorant of "the major events of

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65. ABRAMSON, *supra* note 7, at 54.

66. *Id.*

67. *Id.*

the day.”<sup>68</sup> As discussed above, a search for impartiality may find ignorance,<sup>69</sup> or at least a lack of engagement with society.

B. *Negative Press*

In addition to the danger of jurors processing evidence in the absence of instruction from the court, other problems regarding pretrial publicity arise from general negative treatment in the media. If a defendant is the subject of articles and editorials that proclaim or assume his or her guilt, courts may fear that jurors have already made up their mind.

The pretrial publicity in *Sheppard* demonstrates this problem and exemplifies how these issues overlap in criminal trials.<sup>70</sup> Although other factors influenced the *Sheppard* Court’s analysis, saturation of negative press before trial weighed heavily. Indeed, the “reasonable likelihood” standard announced in the case relates to such pretrial publicity.<sup>71</sup> The defining feature of *Sheppard* was the extent to which negative pretrial publicity saturated the local jury pool.

Pretrial publicity of this kind also indirectly implicates the tension between the impartial and the local juror, as illustrated by the ignorant juror. While a juror should not base his verdict off an editorial, a danger exists in removing the type of juror who reads editorials. As with evidentiary breaches, some value must be placed on having an attentive juror. In addition, automatically disqualifying a juror who has read any *opinions* on the case might remove citizens most accustomed to hearing and evaluating conflicting arguments. This may be precisely the juror most prepared to listen to and evaluate both sides of a case.<sup>72</sup>

Beyond the scientific support for this conclusion lies a more common sense rationale. The respective activities of a juror and an active consumer of media are in some respects analogous. Both

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68. *Id.* at 55.

69. *See supra* Part II (discussing the possibility that weeding out all knowledgeable jurors will result in an ignorant jury).

70. *See supra* Part III.A (discussing the *Sheppard* case).

71. *Sheppard v. Maxwell*, 384 U.S. 333, 363 (1963).

72. *See* ABRAMSON, *supra* note 7, at 53 (noting the modern trend toward deselecting well-informed potential jurors).

involve holding two competing ideas in mind and making judgments. Negative press is more likely to affect active, rather than passive, consumers of media, and thus raises more juror-quality concerns than do pretrial evidentiary breaches.

## V. ENRON ON TRIAL: U.S. V. SKILLING

The Enron prosecutions highlight a source of jury prejudice separate from that of pretrial publicity. In these limited cases, the alleged crime disproportionately impacts a single community, creating challenges to finding a jury both local and impartial.

### A. *The Fall of Enron*

Enron was a Houston-based company that filed for bankruptcy in early 2002. Investigators quickly discovered an "elaborate conspiracy to deceive investors about the state of Enron's fiscal health."<sup>73</sup> The conspiracy allegedly involved numerous mechanisms, which effectively increased reported earnings and decreased losses, supporting a high, yet fragile, stock price.<sup>74</sup> Upon the company's collapse, then-President George W. Bush appointed the "Enron Task Force" to begin investigating these reports of corporate malfeasance.<sup>75</sup> These and subsequent investigations led to the prosecution of several top Enron executives, including Kenneth Lay and Jeffrey Skilling.<sup>76</sup> Both men served as Enron's Chief Executive Officer during different periods in the years prior to the company's collapse.<sup>77</sup>

Local and national media coverage regarding Enron's collapse quickly reached a fever pitch. Thousands of articles and television pieces in Houston discussed the fall of Enron and the role

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73. *United States v. Skilling*, 554 F.3d 529, 534 (5th Cir. 2009).

74. *Id.*; see Russell Powell, *The Enron Trial Drama: A New Case for Stakeholder Theory*, 38 U. TOL. L. REV. 1087, 1092–93 (2007) (explaining some of these accounting "schemes").

75. *Skilling*, 554 F.3d at 534.

76. *Id.*

77. *Id.*

of top executives such as Skilling and Lay.<sup>78</sup> Enron stirred national publicity, making it one of the country's top stories for months.<sup>79</sup> It was as a result of this widespread publicity that Congress held hearings on the scandal and former President Bush appointed the Enron Task Force.<sup>80</sup>

*B. Jury Bias: Skilling's Motion to Transfer*

Skilling and Lay became the focus of the government's prosecution efforts, leading to their trial in 2006.<sup>81</sup> Several top Enron executives testified against Skilling and Lay as part of plea bargains.<sup>82</sup>

Before voir dire, Skilling moved for a change of venue under Rule 21(a).<sup>83</sup> District Judge Sim Lake denied the motion, based largely on the lack of sensationalism in the facts themselves and the perceived fairness of pretrial publicity.<sup>84</sup> Judge Lake then went on to conduct voir dire in two parts: a fourteen-page questionnaire sent to members and further questioning in court.<sup>85</sup>

Skilling brought several challenges on appeal, including presumed and actual jury bias.<sup>86</sup> The Fifth Circuit, with Judge Edward Prado writing for the court, analyzed the contention of jury bias in two parts. The Fifth Circuit first questioned the district judge's Rule 21(a) denial and his corresponding finding of no presumed prejudice.<sup>87</sup> Second, the court analyzed whether voir dire had succeeded in empanelling an impartial jury.<sup>88</sup>

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78. *Id.* at 559 n.41.

79. *See, e.g.,* Kathleen F. Brickey, *From Boardroom to Courtroom to Newsroom: The Media and the Corporate Governance Scandals*, 33 J. CORP. L. 625, 625–28 (2008) (describing the extent of national media coverage of the Enron scandal).

80. *See Skilling*, 554 F.3d at 534 (describing events leading up to the trial of Skilling and Lay).

81. Powell, *supra* note 74, at 1095.

82. *Id.* at 1094–95.

83. *Skilling*, 554 F.3d at 559 & n.39.

84. *Id.* at 559.

85. *Id.* at 562.

86. *Id.* at 534.

87. *Id.* at 558.

88. *Id.* at 561.

The Fifth Circuit disagreed with the denial of Skilling's Rule 21(a) motion on several grounds. The court noted that the most common practice of a trial judge in response to a motion for a change of venue is to hold the motion in abeyance during voir dire.<sup>89</sup> As discussed previously, this allows a judge to determine the success of voir dire in producing an impartial jury. As to the merits of Skilling's claim, the court found enough "inflammatory" pretrial publicity to "require" finding a presumption of jury prejudice.<sup>90</sup>

More importantly, the Fifth Circuit's opinion recognized that something besides pretrial publicity warranted a finding of presumed prejudice.<sup>91</sup> The court rejected the trial court's sole focus on pretrial publicity, stating that the "wider context" is whether there could be an impartial jury.<sup>92</sup> The court's opinion stated:

[T]he district court seemed to overlook that the prejudice came from more than just pretrial media publicity, but also from the sheer number of victims. Thousands of Enron employees in Houston lost their jobs, and many saw their 401(k) accounts wiped out. As happens, moreover, in an interconnected economy, Enron's demise spilled over into other industries. Accounting firms that serviced Enron's books had less work, hotels had more open rooms, restaurants sold fewer meals, and so on. The collapse of Enron affected countless people in the Houston area, and the district court failed to account for any of this *non-media prejudice*.<sup>93</sup>

This separate source of presumed prejudice weighed heavily on the court's analysis. Apart from the local or national coverage, the effect of the crime on the community itself is a separate source of

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89. *Id.* at 559 n.40.

90. *Id.* at 559.

91. *Id.* at 560.

92. *Id.* at 560 ("The evaluation of the volume and nature of reporting is merely a proxy for the real inquiry: whether there could be a 'fair trial by an impartial jury' that was not 'influenced by outside, irrelevant sources.'" (quoting *United States v. Chagra*, 669 F.2d 241, 249 (5th Cir. 1982))).

93. *Id.* at 560 (emphasis added).

potential jury prejudice. Ultimately, however, the court affirmed the district court's Rule 21(a) denial, finding the presumption of prejudice was sufficiently rebutted by the results of voir dire.<sup>94</sup>

The Supreme Court affirmed the Fifth Circuit's holding that no presumed prejudice existed.<sup>95</sup> Writing for the majority, Justice Ginsburg reached this conclusion based primarily on the distinction between *Skilling* and the traditional application of presumed prejudice jurisprudence.<sup>96</sup> The majority dismissed the Fifth Circuit's focus on community impact, determining voir dire adequately prevented community impact bias from tainting the jury.<sup>97</sup>

In contrast, Justice Sotomayor's dissent focused on the dual "backdrop of widespread *community impact* and pervasive pretrial publicity."<sup>98</sup> Enron's collapse "wounded Houston deeply," leaving many victims in the city.<sup>99</sup> Justice Sotomayor recognized that the impact on this specific community, coupled with pretrial publicity, raised a danger of jury bias unique to this case.<sup>100</sup>

## VI. ONE TYPE OF "NON-MEDIA PREJUDICE": UNIQUE IMPACT ON A COMMUNITY

The Fifth Circuit's opinion finds a different source of presumed prejudice, outside the traditional forms of pretrial publicity. Enron is the paradigmatic case of a crime with strong and particular effects on a distinct community. The impact of the alleged crimes, mostly isolated to this community, is itself a potential source of jury prejudice. This impact creates jury bias independent of pretrial publicity, yet the two become intertwined and mutually reinforcing. Pretrial publicity in presumed prejudice jurisprudence is

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94. *Id.* at 564–65.

95. *Skilling v. United States*, 130 S. Ct. 2896, 2925 (2010).

96. *Id.* at 2915–16.

97. *Id.* at 2917 (Sotomayor, J., dissenting).

98. *Id.* at 2946 (emphasis added).

99. *Id.* at 2942.

100. *Id.* at 2953 ("The devastating impact of Enron's collapse and the relentless media coverage demanded exceptional care on the part of the District Court to ensure the seating of an impartial jury . . . . [Voir dire] did not suffice in the extraordinary circumstances of this case to safeguard *Skilling's* constitutional right to a fair trial before an impartial jury.").

understandably focused on a one-way interaction—the effect of media coverage on the jury pool. Fully recognizing this new category, however, entails a slightly more nuanced understanding of the relationship between jurors and the media. While members of a community may develop an understanding of the impact on the community in part from media coverage, pretrial publicity is symbiotic in its relationship to extreme community sentiment against the defendant. These two separate, yet interrelated, processes strengthen and reflect each other. As demonstrated in traditional presumed prejudice analysis, pretrial publicity can reflect and strengthen local hostility towards a defendant in many ways. But when potential jurors perceive that a crime impacts their specific community alone, this perception creates local hostility reflected in and reinforced by pretrial publicity. The perceived impact upon a community itself must be examined as a separate potential source of jury prejudice.

*A. Enron: Paradigm of a Community Crime*

As discussed above, not all participants in the ongoing Enron prosecution recognize this source of presumed prejudice as separate from pretrial publicity. Indeed, the Fifth Circuit disagreed with the trial court’s ruling primarily because of the latter’s failure to recognize this separate source of bias. The Supreme Court majority ignored this non-media prejudice, while Justice Sotomayor explicitly referenced it in her dissent.

The Fifth Circuit found the circumstances surrounding the Skilling prosecution very persuasive for finding a presumption of prejudice. Indeed, the nature of this crime and this defendant caused devastating and widespread effects on a specific community. The sudden bankruptcy of the largest company in Houston inevitably led to adverse financial consequences across the city. The court enlists much of the same support Skilling brought forth in his motion. For example, the court found it relevant that one-third of all Houstonians “‘personally kn[e]w’ someone harmed by what happened at Enron.”<sup>101</sup>

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101. United States v. Skilling, 554 F.3d 529, 560 n.47 (5th Cir. 2009).

Beyond the Fifth Circuit's analysis of the presumption of prejudice issue, data supports that the jury was, in fact, influenced by the effects of the crime on the community.<sup>102</sup> Comments made by jurors after the Enron trial support the theory that effects on the community played at least some part in juror deliberations.<sup>103</sup> Several comments demonstrated the jury's sensitivity to the Enron scandal and the effect it had on employees and the community at large.<sup>104</sup> While such comments are not conclusive of actual bias impacting deliberations, they support the argument that this trial was inevitably influenced by the surrounding context. One possible explanation for these comments is that, despite the traditional legal authority of the jury, jurors sometimes cannot "ignore the scope of alleged harm" in their decisions.<sup>105</sup>

*B. Community Crime in a Different Context: Terrorism*

While the Enron prosecutions demonstrate some of the better cases for finding a non-media source for a presumption of prejudice, this concept is not without precedent in presumed prejudice jurisprudence in federal and state courts. Terrorist prosecutions also demonstrate the importance of recognizing Enron as a paradigmatic case and applying a separate source for a presumption of prejudice.

On June 2, 1997, Timothy McVeigh was convicted for his role in the notorious 1995 Oklahoma City Bombing.<sup>106</sup> After being brought to trial in an Oklahoma district court, McVeigh and his co-

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102. The ultimate verdict, of course, cannot by itself speak to jury prejudice; a multitude of factors enter into a verdict. Unquestioning reliance on even these findings may not fully capture the realities of the deliberation. However, insofar as post-trial interviews and comments made by the jury allow us to gain some insight into the jury's decision-making process, we may in a limited sense peer into the "black box."

103. See Powell, *supra* note 74, at 1090 (summarizing the jury findings as suggesting "the degree of harm to employees and the community influenced [the jury's] decision to convict.").

104. See *id.* at 1090 n.12 (providing quotations made by jurors to the media after Skilling's trial indicating that, among other things, jurors wanted their verdict to "send a message").

105. *Id.* at 1102-03 (citing Andrew J. Wistrich et al., *Can Judges Ignore Inadmissible Information? The Difficulty of Deliberately Disregarding*, 153 U. PA. L. REV. 1251, 1270-76 (2005)).

106. *United States v. McVeigh*, 153 F.3d 1166, 1179 (10th Cir. 1998).



defendant at the time, Terry Nichols, moved for a change of venue under Rule 21(a).<sup>107</sup> The District Court granted the change of venue request, moving it to Denver.<sup>108</sup> The motion was granted primarily due to the particularly inflammatory coverage in Oklahoma as compared to the rest of the country,<sup>109</sup> in addition to separate considerations in death penalty cases.<sup>110</sup>

While the court did not explicitly separate pretrial publicity from local hostility in the case, it is clear from the context of the case that the Oklahoma City Bombing also represents a community crime. Not all Oklahomans experienced the bombing first-hand. Most viewed or read media coverage of the event and subsequent investigation. In that sense, it is helpful to focus on pretrial publicity. However, the effects of the crime itself on the jury pool go beyond local media coverage to the memory of the hundreds lost and the inevitable shock in the state of Oklahoma. Indeed, the parties stipulated that holding trial in Oklahoma City would not be an option. The court further concluded that the same reasoning applied to the entire state.<sup>111</sup>

This is a potential response to this type of case—to grant a change of venue rather than await the results of voir dire. Voir dire will not, or at least is not guaranteed to, filter out the prejudice of the jury in such an extreme case. Unless such direct effects exist in the community of the transferee district comparable to the original community, then there is no need for a second transfer. Indeed, to grant a second transfer would be to tacitly admit that no jury in the country could give a fair trial. By allowing the trial to proceed in Denver, District Court Judge Richard Matsch avoided the non-media bias in Oklahoma and reaffirmed his faith in the ability of an American jury to render an impartial verdict.

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107. *United States v. McVeigh*, 918 F. Supp. 1467, 1469 (W.D. Okla. 1996).

108. *Id.* at 1474–75.

109. *Id.* at 1471.

110. *Id.* at 1474.

111. *Id.* at 1470.

## VII. LEGAL SIGNIFICANCE OF COMMUNITY CRIMES: AN IRREBUTTABLE PRESUMPTION

As outlined above, finding a presumption of prejudice based on pretrial publicity can solve one problem, but also creates many more. These problems are persuasive reasons for providing a rebuttable presumption, at least to a degree, based on the results of voir dire. On the contrary, transferring venue in cases of non-media prejudice (e.g., community crimes) does not implicate all of the same concerns. The reasons for this divergence demonstrate why the argument for an irrebuttable presumption is much stronger in cases of non-media prejudice.

### A. *A Two-Way Street*

The categories of pretrial publicity outlined above presuppose a one-way process of jury bias. Under this model, pretrial publicity conveys information to the community, either fact or opinion-based, which taints the community's understanding about the merits of the case. Such informational prejudice can at least theoretically be eliminated through voir dire. Many features of a jury trial system reflect at least a functional trust of jurors to tell the truth. We ask jurors to disregard evidence through motions in limine, and in this context jurors must answer whether they can put aside information learned from pretrial publicity. A judge's finding of an irrebuttable presumption of prejudice in pretrial publicity cases would reflect a mistrust of jurors that is seldom warranted.

Irrebuttability in community crimes, however, does not reflect a similar mistrust of the jury. In order for the jury to function, some trust must be given to jurors' answers about their ability to neutrally evaluate the case. Of course, prosecutors may ask a juror if he or she can apply the law to the facts. One way to understand this difference is to look at these cases as an extension of dismissing jurors with a relationship to the victim. In these cases, the entire community may have a "relationship" with the victim, or even feel like a victim himself (even without pecuniary loss). This mistrust of jurors who have a relationship with the victim is hardly unique in the criminal justice system.

### *B. Juror Competence*

As discussed above, traditional presumed prejudice cases involve a concern for juror competence. Every grant of a motion to transfer venue based off Rule 21(a) inherently creates a danger of removing able and attentive jurors. More importantly, jurors aware of negative press may be the very type of jurors fit to serve. Finding an irrebuttable presumption of prejudice and transferring venue in these cases necessarily encroaches on juror competence.

However, with community crimes, the danger of sacrificing juror competence is not directly implicated. In this limited set of cases where the crime itself affects a whole community, transferring venue is not based on juror knowledge. Finding a presumption here does not rest solely on whether the judge determines jurors have been exposed to too much media coverage. Instead, the judge asks whether the alleged crime has such an impact on the community that it creates a prejudice within the community. This prejudice arises from how the community is impacted by the crime. For example, the one-third of Houstonians reporting they personally knew someone directly or indirectly affected by the Enron collapse did not merely learn of the case through media coverage. They learned from their experiences and physical residence within the community. The presumption thus rests on a basis inapposite to the concern of creating ignorant juries.

### *C. National vs. Local Publicity*

The uniformity of media coverage is a concern present in Rule 21(a) motions in the traditional pretrial publicity cases. With the expansion of media technology, publicity of an event can reach beyond the community where the crime occurred. As noted before, the Enron scandal itself received national media attention. When media coverage reaches a national level, transferring venue to any other district in the state, or even country, may not solve the underlying problem.<sup>112</sup> If presumed prejudice is a one-way

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112. Donna A. Balaguer, *Venue*, 30 AM. CRIM. L. REV. 1259, 1272 & n.114 (1993) (explaining why national media coverage can make transfer moot); see, e.g., *United States v. Haldeman*, 559 F.2d 31, 64 n.43 (D.C. Cir. 1976) (“[W]e note that a change of venue would have been of only doubtful value. Many of the

phenomenon, with pretrial publicity infringing upon the impartiality of potential jurors, potential jurors in Los Angeles would be just as potentially biased as those in Nashua, New Hampshire, regardless of the location of the crime. For a judge to grant a motion to transfer venue in these cases would defy logic and unnecessarily strain judicial resources.

As soon as one admits an alternative source of "non-media" bias, however, this concern decreases. Even in light of uniform media coverage throughout the country, a case with distinctly local effects must be treated differently. If it shares some similarities with the community crime cases, a distinct source of potential bias exists unique to that community. The case falls within this category because the impact of the crime is most powerful in this specific community. In a case where transfer would most likely ameliorate jury prejudice, rather than have no effect, the argument for finding a strong, or even irrebuttable, presumption exists.

#### *D. Not Just Another Crime*

Intense pretrial publicity on major crimes is hardly an anomaly. As the Supreme Court stated in *Mu'Min* concerning one moderately sized jurisdiction, "unfortunately, hundreds of murders are committed each year."<sup>113</sup> The routine nature of even violent crimes dampens the desirability of an irrebuttable presumption in most pretrial publicity cases. An irrebuttable presumption in any case featuring intense pretrial publicity would result in far too many changes of venue. The prevalence of crime coverage in local media further supports the reluctance to transfer venue simply because of intense media coverage.

This danger of extreme judicial inefficiency is not implicated nearly as much in community crime cases. These cases are simply

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articles appellants submitted . . . were taken from nationally circulated news magazines [and other media]. Scandal at the highest levels of the federal government is simply not a local crime of peculiar interest to the residents of the District of Columbia."); *United States v. Poindexter*, 725 F. Supp. 13, 38 n.54 (D.D.C. 1989) ("It is not apparent, in any event, what a change of venue would accomplish. The publicity regarding the Iran-contra affair, like that accompanying many 'governmental,' white collar criminal cases, and unlike those involving common law offenses, has been national rather than local.").

113. *Mu'Min v. Virginia*, 500 U.S. 415, 429 (1991).

rarer and only a subset of the larger cases garnering intense media scrutiny. The crimes involved are inherently atypical, causing a substantial and distinct impact on a local community. The fear that irrebuttability will lead to a flood of venue transfers is thus unfounded in this new category.

#### VIII. EVALUATION OF A NEW APPROACH

Several arguments make the recognition of community crimes potentially problematic. First, the boundaries of this new category must be defined. Second, the extent to which irrebuttability is central to this category must be addressed. Third, and perhaps most fundamentally, one could accept the validity of the distinction, yet doubt the importance of formally recognizing it as a separate category from pretrial publicity.

##### *A. Boundaries of Community Crimes*

One potential challenge to this category attacks the definition of the category itself. Certainly crimes always have some impact on the community. In fact, when crime becomes routine, the impact on the community becomes greater; high crime rates can lead to more fear and arguably create cycles of poverty in the community. The psychological and financial impact in the category of community crimes, therefore, must be much more extreme than for crime in general. The Oklahoma City Bombings and Enron prosecutions provide an idea of the scale necessary to qualify as a community crime. The psychological impact on a city when a prominent building is bombed producing hundreds of local victims is an impact of a different nature and extent than most heinous crimes involving multiple victims. Likewise, the psychological and financial impact of the collapse of a major company in a community goes beyond even infamous corporate malfeasance.

While these examples provide the clearest examples of community crimes, there is certainly no obvious threshold for qualification. The point of recognizing this alternative source of jury prejudice is for lawyers and judges to creatively formulate its precise boundaries. Future cases will share some, but not all, characteristics

with the aforementioned cases. The natural process of litigation will flesh out the scope of the category by adjudicating slightly differing cases. Understanding the category conceptually and as applied to the paradigmatic cases will produce creative future criminal litigation on this issue, in an admittedly small but important class of cases.

### *B. Irrebuttability*

Applying a standard of irrebuttability to the presumption in this category of cases may seem unnecessary at first glance. If the trial judge feels that voir dire demonstrates the empanelling of an impartial jury, then why should we second-guess that determination? The answer to this question is that the reason we can sometimes trust the jury's answers during voir dire is not applicable to this new category. Mistrusting the jury to render an impartial verdict in community crime cases entails less of a foundational attack on the institutional concept of the jury than juror mistrust in pretrial publicity cases does.

Recognition of this category does not demand a uniform presumption that cannot be overcome by voir dire, and irrebuttability need not be mechanically applied to every case in this new category. As with the exact boundaries of the category itself, the arguments for irrebuttability will be more or less persuasive in individual cases. This paper simply argues that this category of cases inherently invites more jury prejudice than pretrial publicity alone.

### *C. Why a Different Category?*

Finally, the most potent criticism of this new category is based not on the logic of whether or not to recognize community crime bias at all, but rather on the fact that courts have already recognized such bias absent a distinct category. In many of the cases, including the McVeigh and Skilling prosecutions, judges either formally or implicitly recognize community crime prejudice. If judges already recognize this source of prejudice and its rare applicability, then the need for formal recognition of a separate category is less apparent.

Nevertheless, while some judges recognize this category, others do not. Chief Judge Matsch, the trial judge in *McVeigh*,

implicitly recognized both sources of prejudice as reasons for transferring venue from Oklahoma City.<sup>114</sup> However, Judge Lake did not account for this source of prejudice in the Enron prosecutions: Judge Prado explicitly criticized Judge Lake's failure to recognize that this particular Rule 21(a) motion involved more than mere pretrial publicity.<sup>115</sup> In dissent, Justice Sotomayor also acknowledged the particular impact of this crime on the Houston community.<sup>116</sup>

Even if judges are aware of this source of prejudice, separating it from pretrial publicity is important. Recognizing this source as a separate category allows lawyers and judges to see the connections between seemingly inapposite cases. Traditional presumed prejudice jurisprudence is replete with judges and lawyers comparing and contrasting different instances of pretrial publicity in order to evaluate its impact in the specific case. Gathering these cases from different factual circumstances and demonstrating their limited similarities in this context will allow for creative and useful advocacy in deciding Rule 21(a) motions. Lastly, important parallels exist between the community-specific impacts of both the Enron scandal and the Oklahoma City Bombing, as well as that of the September 11th attacks.

## IX. CONCLUSION

Judges and lawyers need not approach "non-media prejudice" as an entirely distinct and separate legal category from pretrial publicity. One can better understand *Skilling* as part of a line of cases involving non-media prejudice. The exact parameters of this category and the argument for irrebuttability will be explicitly tested by the decision of the DOJ to bring the alleged mastermind behind the September 11th attacks to trial in the United States, if not in New

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114. See *United States v. McVeigh*, 918 F. Supp. 1467, 1470 (W.D. Okla. 1996) ("The effects of the explosion on that community are so profound and pervasive that no detailed discussion of the evidence is necessary.").

115. See *United States v. Skilling*, 554 F.3d 529, 560 (5th Cir. 2009) (explaining that Judge Lake "failed to account for any of this non-media prejudice").

116. *Skilling v. United States*, 130 S. Ct. 2896, 2954 (2010).

York City.<sup>117</sup> Comparing and contrasting *Skilling* and *McVeigh* with future War on Terror prosecutions may help evaluate the inevitable motions to transfer venue that will be filed in War on Terror cases. Any ruling on these motions will reflect our trust in the role of the American jury in the criminal justice system.

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117. See *supra* notes 1–4 and accompanying text (discussing the forthcoming trial of Khalid Sheik Mohammed).



# The Legacy of *United States v. Thomas*: Second Circuit’s Swing and a Miss Puts Defendants’ Rights at Risk

Brian Osimiri\*

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## I. INTRODUCTION

After the conclusion of summations in *United States v. Thomas*, a seemingly ordinary narcotics case, the court charged the jury and deliberations began.<sup>1</sup> During deliberations, the judge investigated allegations that a juror was purposefully disregarding the court’s instructions on the law.<sup>2</sup> After interviewing the juror, the judge dismissed him, ruling that the juror’s attempt at nullification of the law was “just cause” for dismissal under Rule 23(b)<sup>3</sup> of the Federal Rules of Criminal Procedure.<sup>4</sup> The reconstituted jury returned guilty verdicts for the defendants.<sup>5</sup> Unbeknownst to the parties involved, this case established precedent.

In May 1997, the Second Circuit vacated the defendants’ convictions in *Thomas*, holding that the district court erred in

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\* J.D. expected, May 2011, The University of Texas School of Law; A.B., 2006, Dartmouth College. I would like to express my appreciation to Jeffrey B. Abramson, Professor of Law and Government of the University of Texas, for his help in developing this piece, and all the members of the Review of Litigation who took part in the editorial process of this Note. Special thanks to Sarah R. Frazier for all her help with this Note.

1. 116 F.3d 606, 611 (2d Cir. 1997).

2. *Id.*

3. FED. R. CRIM. P. 23(b)(3) (“After the jury has retired to deliberate, the court may permit a jury of 11 persons to return a verdict, even without a stipulation by the parties, if the court finds good cause to excuse a juror.”).

4. *Thomas*, 116 F.3d at 612.

5. *Id.*

dismissing the juror.<sup>6</sup> The case produced two distinct consequences: (1) the Second Circuit held that a “deliberating juror’s intent to nullify constitutes ‘just cause’ for dismissal,”<sup>7</sup> and (2) the court adopted the evidentiary standard, first set forth in *United States v. Brown*,<sup>8</sup> to determine whether a deliberating juror has exhibited “just cause” under Rule 23(b).<sup>9</sup> This evidentiary standard provides that, when considering a request for a Rule 23(b) dismissal, “if the record evidence discloses any possibility that’ a complaint about a juror’s conduct ‘stems from the juror’s view of the sufficiency of the government’s evidence, the court must deny the request.’”<sup>10</sup>

Jury nullification is

[a] jury’s knowing and deliberate rejection of the evidence or refusal to apply the law either because the jury wants to send a message about some social issue that is larger than the case itself or because the result dictated by law is contrary to the jury’s sense of justice, morality, or fairness.<sup>11</sup>

By holding that intent to nullify constitutes just cause for juror dismissal, the Second Circuit clarified a previously unsettled area of law. Prior to *Thomas*, courts had used Rule 23(b) mostly in instances of juror illness or unavailability.<sup>12</sup> However, after the Second Circuit’s ruling, judges can use Rule 23(b) to dismiss a juror who intends nullification or is unwilling to deliberate in earnest.<sup>13</sup>

By adopting the evidentiary standard in *Brown*, the Second Circuit set three goals for *Thomas*: (1) removal of juror impropriety,<sup>14</sup> (2) protection of the defendant’s right to a verdict from a unanimous jury,<sup>15</sup> and (3) protection of the secrecy of jury

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6. *Id.* at 608–09.

7. *Id.* at 612.

8. 823 F.2d 591, 596 (D.C. Cir. 1987)

9. *Thomas*, 116 F.3d at 622.

10. *Id.* at 621–22 (quoting *Brown*, 823 F.2d at 596).

11. BLACK’S LAW DICTIONARY 936 (9th ed. 2009).

12. *Thomas*, 116 F.3d at 613.

13. *Id.* at 612.

14. *See id.* (holding that “a presiding judge has a duty to dismiss a juror who purposefully disregards the court’s instructions”).

15. *See id.* at 622 (“The evidentiary standard that we endorse . . . serves to protect these holdouts from fellow jurors who have come to the conclusion that the

deliberations from intrusive preverdict judicial inquiries.<sup>16</sup>

This Note argues that the holding in *Thomas* is unworkable as a vehicle for accomplishing these goals. Part II provides a brief history of Rule 23(b) and an account of the facts and holding *Thomas*. Part III offers three reasons why the holding in *Thomas* is unworkable as a means of accomplishing the Second Circuit's three goals. First, the Second Circuit's failure to provide instruction regarding *Thomas*'s evidentiary standard has resulted in inconsistent application and, consequently, inconsistency in the strength of the right to a unanimous verdict. Second, the court in *Thomas* substantially reduced judges' ability to identify a nondeliberating or nullifying juror by restricting judicial inquiry, thereby increasing the likelihood of wrongfully removing a holdout juror. Third, the use of judicial discretion in determining the length and thoroughness of judicial inquiries—enabled by the Second Circuit in *Thomas*—has resulted in uneven protection of the right to a unanimous verdict. Part IV proposes that the goals of the Second Circuit in *Thomas* can be achieved by relaxing the restrictions placed on judicial inquiry of deliberating jurors.

## II. THE HISTORY OF RULE 23(B) AND JUROR DISMISSAL IN *THOMAS*

In 1983, language was added to Rule 23(b) of the Federal Rules of Criminal Procedure that allows courts to unilaterally remove jurors for good cause after deliberations have begun.<sup>17</sup> Prior to this amendment to Rule 23(b), dismissal of a juror and allowance of a verdict from the resulting eleven-person jury could only occur through the consent of both parties.<sup>18</sup> Rule 23(b) was amended to address the situation where, “after the jury has retired to consider its verdict . . . one of the jurors is seriously incapacitated or otherwise

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holdouts are acting lawlessly.”); *see also* *Andres v. United States*, 333 U.S. 740, 748 (U.S. 1948) (“Unanimity in jury verdicts is required where the Sixth and Seventh Amendments apply. In criminal cases this requirement of unanimity extends to all issues—character or degree of the crime, guilt and punishment—which are left to the jury.”) (citation omitted).

16. *Thomas*, 116 F.3d at 622.

17. FED. R. CRIM. P. 23(b)(3).

18. *Thomas*, 116 F.3d at 613.

found to be unable to continue service upon the jury.”<sup>19</sup> Since the amendment of Rule 23(b), courts have dismissed jurors for “good cause”<sup>20</sup> in instances of juror illness or unavailability.<sup>21</sup> However, the Second Circuit in *Thomas* established that a juror’s purposeful disregard of the court’s instructions on the law also constitutes good cause for dismissal.<sup>22</sup>

In *Thomas*, the defendants were charged with both conspiracy to possess and distribute cocaine and crack cocaine and actual possession of narcotics.<sup>23</sup> The government tried to use a peremptory challenge against Juror Number Five (Number Five),<sup>24</sup> but the defense responded by objecting to the challenge as racially motivated under *Batson v. Kentucky*.<sup>25</sup> The government claimed that the challenge was made because the juror failed to make eye contact during voir dire.<sup>26</sup> Although the court found that the challenge was not racially motivated, the court denied the challenge because the government’s reason for dismissal was insufficient.<sup>27</sup>

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19. FED. R. CRIM. P. 23(b) advisory committee’s note.

20. FED. R. CRIM. P. 23(b). The term “just cause” in Rule 23(b) was changed to “good cause” as part of the “general restyling of the Criminal Rules to make them more easily understood and to make style and terminology consistent throughout the rules.” FED. R. CRIM. P. 23(b) advisory committee’s note.

21. See *United States v. Reese*, 33 F.3d 166, 172–73 (2d Cir. 1994) (excusing a juror because of the juror’s upcoming business trip); *United States v. Wilson*, 894 F.2d 1245, 1249–51 (11th Cir. 1990) (excusing a juror because the juror became ill); *United States v. Stratton*, 779 F.2d 820, 830–31 (2d Cir. 1985) (excusing a juror because the juror could not deliberate on a religious holiday).

22. *Thomas*, 116 F.3d at 625.

23. *Id.* at 609.

24. *Id.*

25. 476 U.S. 79, 79–80 (1986). Although a prosecutor ordinarily is entitled to exercise peremptory challenges:

for any reason at all, as long as that reason is related to his view concerning the outcome of the case to be tried, the Equal Protection Clause forbids the prosecutor to challenge potential jurors solely on account of their race or on the assumption that black jurors as a group will be unable impartially to consider the State’s case against a black defendant.

*Id.* (citations omitted).

26. *Thomas*, 116 F.3d at 609.

27. *Id.* (noting that the government met its burden under *Batson* by providing a race neutral explanation for the challenge, the Second Circuit concluded that the district court should have granted the challenge). Interestingly, if the district court

Shortly after deliberations had begun, the jury informed the court that it could not reach a verdict due to Number Five's "predisposed disposition" that the defendants were not guilty.<sup>28</sup> The court decided to conduct in camera, on-the-record interviews with each of the jurors.<sup>29</sup> During the interviews, several jurors complained about Number Five's conduct during deliberations.<sup>30</sup> Moreover, the jurors confirmed Number Five's steadfast disposition towards acquittal of the defendants.<sup>31</sup> However, the jurors had conflicting beliefs about the basis of Number Five's disposition.<sup>32</sup> One claimed that Number Five favored acquittal because the defendants were "his people."<sup>33</sup> Another juror felt that Number Five believed that the defendants were good people.<sup>34</sup> Others felt that Number Five thought drug dealing was "commonplace" or that the crime occurred out of "economic necessity."<sup>35</sup> Nevertheless, several jurors stated that Number Five based his beliefs on the insufficiency of the evidence.<sup>36</sup> In addition, when interviewed, Number Five stated that he "needed 'substantive evidence' establishing guilt 'beyond a reasonable doubt' in order to convict."<sup>37</sup>

After completing the interviews, the court decided to remove Number Five pursuant to a Rule 23(b) finding that he was ignoring the court's instructions in favor of his own predisposed opinion as to the defendants' culpability.<sup>38</sup> The court told the remaining jurors to

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had dismissed Number Five during voir dire, the Second Circuit's unprecedented holding on "good cause" under Rule 23(b) would never have occurred.

28. *Id.* at 611.

29. *Id.*

30. *See id.* ("One juror described [Number Five] 'hollering' at fellow jurors, another said [Number Five] had called his fellow jurors racists, and two jurors told the court that [Number Five] had come close to striking a fellow juror.").

31. *Id.*

32. *Id.* at 611.

33. *Id.*

34. *Id.*

35. *Id.*

36. *See id.* ("[O]ne juror indicated specifically that [Number Five] was discussing the evidence, and four recalled him saying that the evidence, including the testimony of the prosecution's witnesses, was insufficient or unreliable.").

37. *Id.*

38. *See id.* at 612 ("I believe after hearing everything that [Number Five's] motives are immoral, that he believes that these folks have a right to deal drugs, because they don't have any money, they are in a disadvantaged situation and probably that's the thing to do. And I don't think he would convict them no matter what the evidence was.").

restart their deliberations.<sup>39</sup> Shortly thereafter, the jury returned with verdicts convicting all of the defendants.<sup>40</sup>

On appeal, the Second Circuit held that a deliberating juror's intent to disregard the court's instructions on the law constitutes good cause for dismissal under Rule 23(b).<sup>41</sup> Because nullification is "a violation of the juror's oath to apply the law as instructed by the court," the circuit court reasoned that trial courts should not "permit it to occur when it is within their authority to prevent."<sup>42</sup> Accordingly, a presiding judge has a duty to dismiss a nullifying juror,<sup>43</sup> and thus a corresponding duty to investigate allegations of a deliberating juror's intent to disregard the law.<sup>44</sup>

However, because of the need to safeguard the secrecy of jury deliberations, the extent of investigations into juror impropriety must be limited once deliberations begin.<sup>45</sup> The secrecy of jury deliberations is essential for enabling juries to function properly.<sup>46</sup> Thus, there should be "strict limitations on intrusions from those that participate in the trial process itself, including counsel and the presiding judge."<sup>47</sup> Specifically, courts are limited "in the extent to which [they] may investigate the reasons underlying a juror's position on the merits of a case."<sup>48</sup>

The court in *Thomas* realized that the strict limitations placed on investigations would likely leave judges with little evidence to help them distinguish between a juror who is purposely disregarding the law and one who is simply unpersuaded by the government's case.<sup>49</sup> In order to prevent the wrongful dismissal of a juror who is simply unpersuaded, the court adopted the high evidentiary standard

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at 614.

43. *Id.* at 612.

44. *See id.* at 616 ("A federal judge, whose own oath of office requires the judge to 'faithfully and impartially discharge and perform all the duties incumbent upon [the judge] . . . under the Constitution and laws of the United States . . . and may not ignore colorable claims' that a juror is acting on the basis of such improper considerations.") (citations omitted).

45. *Id.* at 618.

46. *Id.*

47. *Id.* at 618–20.

48. *Id.* at 620 (noting that allowance of such inquiries would "seriously breach the principle of the secrecy of jury deliberations").

49. *Id.* at 621.

established in *United States v. Brown*<sup>50</sup> as a limitation on the use of Rule 23(b) in any case where a juror allegedly disregards the law.<sup>51</sup> The standard provides that a judge shall not dismiss a juror under Rule 23(b) “if the record evidence discloses *any possibility* that a complaint about a juror’s conduct ‘stems from the juror’s view of the sufficiency of the government’s evidence.’”<sup>52</sup>

The Second Circuit vacated the judgments of the district court, holding that the judge erred in dismissing the juror.<sup>53</sup> The court found that the jurors’ statements evinced a possibility that Number Five’s conduct during deliberations stemmed from his views on the merits of the case.<sup>54</sup> Accordingly, the convictions could not stand.<sup>55</sup>

### III. THE UNWORKABLE NATURE OF *THOMAS*

#### A. *Inconsistent Evidentiary Standards*

The Second Circuit’s failure to provide clarification for the “any possibility” evidentiary standard has resulted in inconsistent

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50. 823 F.2d 591 (D.C. Cir. 1987). In *Brown*, a juror sent a note to the court stating that he felt that he could no longer discharge his duties as a member of the jury. *Id.* at 594. Through his interview with the juror, the judge learned that the juror did not agree with the Racketeer Influenced and Corrupt Organizations Act. *Id.* The juror also indicated that he had issues with the way the evidence had been presented by the government. *Id.* The judge dismissed the juror under Rule 23(b). *Id.* at 595. The Court of Appeals for the District of Columbia Circuit reversed the dismissal holding that a Rule 23(b) dismissal is barred “if the record evidence discloses any possibility that the request to discharge stems from the juror’s view of the sufficiency of the government’s evidence.” *Id.* at 596. Because the record disclosed “a substantial possibility that [the] juror . . . requested to be discharged because he believed that the evidence offered at trial was inadequate to support a conviction,” his dismissal was improper. *Id.*

51. *Thomas*, 116 F.3d at 622.

52. *Id.* (emphasis added) (quoting *Brown*, 823 F.2d at 596).

53. *Id.* at 625.

54. *See id.* at 623–24 (“[Number Five] said nothing to the court to indicate that he was unwilling to follow the court’s instructions. . . . [And s]everal of the jurors indicated in their interviews with the court that [Number Five] justified his position during deliberations in terms of the evidence—that he found the Government’s evidence, including its witness testimony, insufficient or unreliable.”).

55. *Id.* at 625.

application of the standard and thus inconsistent protection of the right to a unanimous verdict. *Thomas* held that the dismissal of a deliberating juror under Rule 23(b) was improper if the record evinced *any possibility* that the juror's misconduct stemmed from the juror's views on the merits of the case.<sup>56</sup> However, the court did not state that the "any possibility" evidentiary standard should be applied literally,<sup>57</sup> which left interpretation of the standard within trial courts' discretion. As a result, the strength of the standard has varied from case to case. Because the strength of the safeguard protecting the right to a unanimous verdict is dependent on the strength of the evidentiary standard as applied,<sup>58</sup> the level of protection for this right is subject to variance as well.

For example, in *United States v. Symington*,<sup>59</sup> the judge, upon receiving notification of Juror Cotey's unwillingness or inability to deliberate, questioned each juror individually about the allegations.<sup>60</sup> All of the jurors, except Cotey, verified the allegations and felt Cotey should be removed.<sup>61</sup> During the course of the interviews, two jurors, Witter and Bamond, displayed frustration with Cotey.<sup>62</sup> Witter expressed that continued deliberations with Cotey would likely result in a "hung jury."<sup>63</sup> Bamond stated that Cotey was blocking the jury from delivering a verdict and that he did not "want to be blocked any more."<sup>64</sup> The district judge dismissed Cotey "for being either unwilling or unable to participate in the deliberative process in accordance with the instructions of the court."<sup>65</sup>

On appeal, the Ninth Circuit interpreted the evidentiary standard in *Thomas* as providing that "if the record evidence

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56. *Id.* at 622.

57. Interestingly, the court implied that the "any possibility" standard should be applied literally. *See id.* at 625 ("A court must not, however, remove a juror for an alleged refusal to follow the law as instructed unless the record leaves *no doubt* that the juror was in fact engaged in deliberate misconduct . . .") (emphasis added).

58. *See id.* at 622 (noting that the use of a lower evidentiary standard than "any possibility" could lead to the "wrongful removal" of a holdout juror or a juror who is simply not persuaded by the government's evidence).

59. 195 F.3d 1080 (9th Cir. 1999).

60. *Id.* at 1083.

61. *Id.*

62. *Id.* at 1088.

63. *Id.*

64. *Id.*

65. *Id.* at 1084.



discloses any *reasonable possibility* that the impetus for a juror's dismissal stems from the juror's views on the merits of the case, the court must not dismiss the juror."<sup>66</sup> According to the Ninth Circuit, a literal interpretation of the "any possibility" standard could prohibit dismissal of a deliberating juror in all cases.<sup>67</sup> The court concluded that the "reasonable possibility" standard was "appropriately high and conceivably attainable."<sup>68</sup>

In reversing the district court's conviction, the court noted that the statements of Bamond and Witter demonstrated a "reasonable possibility" that their frustration with Cotey stemmed from Cotey's opinion on the sufficiency of the government's evidence.<sup>69</sup> Despite its belief that the difficulties with Cotey did not stem from her position on the merits of the case, the court concluded that there was a *reasonable possibility* that "such difficulties [could] certainly manifest themselves in concerns about a juror's reasonableness or general capacity as a juror."<sup>70</sup> Thus, the judge erred in dismissing Cotey under Rule 23(b).<sup>71</sup>

Despite the Ninth Circuit's statement in *Symington* that it was endorsing the "reasonable possibility" standard, the standard actually applied by the court more closely resembled a literal interpretation of the "any possibility" standard in *Thomas*. The *Symington* court found that the statements of Jurors Witter and Bamond evinced a reasonable possibility that the allegations of misconduct stemmed from Juror Cotey's views on the merits of the case.<sup>72</sup> However, when looking at the statements within the context of the interviews, the statements satisfy only the "any possibility" standard. When asked by the judge if there was anything the court could do to help deliberations, Witter responded:

Well, I said there's probably the only things we can do and that would be completely go through the process like you instructed us to, but I do know what the outcome is going to be, other than a few items that

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66. *Id.* at 1087 (emphasis added).

67. *Id.* at n.5.

68. *Id.*

69. *Id.* at 1088.

70. *Id.*

71. *Id.*

72. *Id.*

we—we do mutually agree upon. And that would be an undecided vote, a hung jury or I don't know—if there was a replacement person that can come in, I don't know the process of how that works.<sup>73</sup>

The “hung jury” comment was in response to the judge’s question. Witter was predicting the outcome of deliberations if Cotey continued on the jury.

When interviewed, Bamond testified that Cotey struggled to remember topics discussed during deliberation, which forced the jury to rehash past discussions.<sup>74</sup> The Ninth Circuit chose to focus on Bamond’s statement that the jury was “blocked” and that he did not want to be blocked anymore.<sup>75</sup> Looking at this comment within the context of his entire interview, there was a possibility that Bamond’s frustrations stemmed from a disagreement with Cotey’s views on the merits of the case. However, Bamond’s testimony demonstrates that he felt Cotey’s inability to retain information from previous deliberations was the cause of the blockage. Thus, Bamond’s statements evinced a possibility, but not a “reasonable possibility,” that his frustrations with Cotey stemmed from Cotey’s views on the merits of the case.

By barring dismissal in *Symington*, the court applied an evidentiary standard similar to a literal interpretation of the “any possibility” standard. Thus, contrary to the court’s opinion, the safeguard protecting the defendant’s right to a unanimous verdict was set at the higher evidentiary standard of “any possibility” rather than the lower “reasonable possibility.” However, because *Thomas* left open both the interpretation and application of the “any possibility” standard, a defendant could just as easily receive a lower level of protection for his constitutional right.

For instance, in *United States v. Wilkerson*, the court came to the same conclusion as the Ninth Circuit.<sup>76</sup> However, it interpreted the evidentiary standard set forth in *Thomas* as requiring a

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73. *Id.* at 1094.

74. *Id.* at 1095–96.

75. *Id.* at 1088.

76. 656 F. Supp. 2d 1, 7 (D.D.C. 2009) (declaring that the applicable standard is “substantial possibility”). Although the Ninth Circuit and the *Wilkerson* court used different terms for the evidentiary standard, the *Wilkerson* court concluded that the terms “any possibility” and “substantial possibility” are interchangeable. *Id.*

“substantial possibility”<sup>77</sup> that the juror’s views on the merits were the impetus for dismissal. In contrast to the *Symington* court’s use of the “reasonable possibility” standard, the *Wilkerson* court adhered to the literal meaning of substantial possibility. The nullifying juror stated that her distress stemmed from the “whole case.”<sup>78</sup> The juror did not provide any further clarification, which left open the possibility that deliberations, and thus her views on the merits, caused her distress. However, because the court did not find this possibility to be substantial, the dismissal of the juror was proper.<sup>79</sup>

Unlike *Symington*, where, despite the court’s indication to the contrary, *any possibility*, not just a *reasonable possibility*, barred a Rule 23(b) dismissal, the existence of any possibility in *Wilkerson* was not sufficient for preventing a juror’s removal. Furthermore, the right to a unanimous verdict did not receive the same level of protection as it did in *Symington*. Because the court in *Wilkerson* adopted and applied the lower evidentiary standard—“substantial possibility”—the safeguards protecting the right were lower.

Despite claims in *Wilkerson* and *Symington* that those cases used the same evidentiary standard, the two courts applied the *Thomas* standard in substantively different ways. As a result, the defendants in these cases failed to receive equal protection of their right to a unanimous verdict. The Second Circuit’s failure to provide sufficient guidance on the use of the “any possibility” standard has produced unavoidable inconsistency and wavering protection of a constitutional right.

### B. *Limiting Evidence on the Record*

Recognizing the defendant’s right to a unanimous verdict and the need for jury secrecy,<sup>80</sup> *Thomas* placed strict limits on judicial inquiry of a deliberating juror. Such restrictions severely limit the evidence a judge has on hand when determining whether good cause for dismissal exists. As a result, judges are often forced to make this

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77. *Id.* at 8 (“The Court used ‘substantial possibility’ in its oral opinion because that language appeared in *Brown*. Several other qualifiers—*reasonable*, *appreciable*, *realistic*, *genuine*, *credible*, *tangible*—could be employed.”) (emphasis added).

78. *Id.* at 3.

79. *Id.* at 10.

80. *See supra* note 15–16 and accompanying text (describing defendant’s constitutional right to a unanimous verdict and the need for jury secrecy).

determination about a juror's intent based on minimal evidence. It is therefore difficult for a judge to distinguish between a juror who is disregarding the instructions of the court and a juror who is simply unpersuaded by the evidence presented at trial.

Despite *Thomas's* attempt to protect the right to a unanimous verdict through its adoption of the "any possibility" standard, the court put this right at substantial risk by limiting judicial inquiry. The *Thomas* court assumed that in instances where little evidence was available, judges would err on the side of caution by declining to dismiss.<sup>81</sup> In doing so, judges would be guarding against the wrongful removal of a juror and thus ensuring the right to unanimity. However, recent cases have shown that the Second Circuit's assumption does not accord with reality.

In *Wilkerson*, the judge dismissed a juror under Rule 23(b) after only one interview with the juror.<sup>82</sup> Moreover, the interview largely served as a restatement of the dismissed juror's note in which she requested dismissal.<sup>83</sup> Nevertheless, the judge concluded from the limited evidence that the possibility the juror was simply unpersuaded by the evidence was not substantial.<sup>84</sup>

Likewise, in *Duke v. County of Nassau*,<sup>85</sup> the judge dismissed a juror after conducting only one interview.<sup>86</sup> On the first and third day of deliberations, jurors sent a note to the court stating they were hopelessly deadlocked.<sup>87</sup> On the fourth day, the court received a note from one of the jurors stating he could no longer deliberate.<sup>88</sup> The juror stated he had been subjected to verbal abuse from the other jurors, and that the abuse had caused him great stress and stomach problems.<sup>89</sup> The judge conducted a short interview questioning the juror about the verbal abuse.<sup>90</sup> After the interview, the judge dismissed the juror under Rule 23(b) because the juror's "stated

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81. *United States v. Thomas*, 116 F.3d 606, 621 (2d Cir. 1997).

82. *Wilkerson*, 656 F. Supp. 2d at 3.

83. *See id.* at 10–11 (confirming juror's disagreement with the law and that she suffered from emotional and mental distress).

84. *See id.* at 11 (holding that use of Rule 23(b), which cannot be used when a juror is not persuaded by the evidence, was proper).

85. 63 F. App'x 558 (2d Cir. 2003).

86. *Id.* at 560.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

maladies” left him unable to deliberate.<sup>91</sup> The judge did not conduct any further interviews prior to the dismissal.<sup>92</sup> On appeal, the Second Circuit upheld the dismissal because the record did not show the juror was unpersuaded by the evidence.<sup>93</sup> The dismissed juror’s testimony reiterated his prior message to the judge and failed to add anything substantial to the record.<sup>94</sup> Based on the available evidence, the court held that dismissal pursuant to Rule 23(b) was proper.<sup>95</sup>

The record in both *Wilkerson* and *Duke* contained some evidence that the dismissed jurors’ conduct stemmed from their views on the sufficiency of the government’s evidence. In *Wilkerson*, the nullifying juror sent a note to the judge requesting her dismissal because she disagreed with the court’s instructions on the law and could not follow them.<sup>96</sup> Further, she stated she was experiencing emotional and mental distress, and felt that her stress alone supported dismissal.<sup>97</sup> In response to the note, the judge interviewed the juror.<sup>98</sup> During the interview, the judge asked the juror if she agreed with the court’s instructions on the law and whether her distress stemmed from deliberations.<sup>99</sup> The juror stated that she disagreed with the instructions and that her distress stemmed from the “whole case.”<sup>100</sup> Because of the limitations imposed by *Thomas*, the judge refused to ask her whether she had any evidentiary concerns.<sup>101</sup> However, because her stress stemmed from the “whole case,” her testimony evinced a possibility that her views on the evidence were partially responsible for her stress.

In *Duke*, the dismissed juror testified that his stress was caused by verbal abuse from his fellow jurors.<sup>102</sup> Prior to his

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91. *Id.*

92. *Id.*

93. *See id.* at 561 (noting that there was “no evidence . . . that Juror No. 7 . . . was a holdout”).

94. *See id.* at 560 (confirming in his interview that “he had been subjected to ‘verbal abuse,’ which caused him ‘great stress’ and ‘stomach problems, diarrhea, loss of appetite, [and an] inability to sleep’”).

95. *Id.* at 561–62.

96. *United States v. Wilkerson*, 656 F. Supp. 2d 1, 2 (D.D.C. 2009).

97. *Id.*

98. *Id.*

99. *Id.* at 3.

100. *Id.*

101. *Id.* at 5.

102. *Duke v. County of Nassau*, 63 F. App’x 558, 560 (2d Cir. 2003).

interview, the jury sent notice to the court on two separate occasions stating they were deadlocked.<sup>103</sup> Viewed in conjunction, those notifications raised a possibility that the verbal abuse stemmed from the dismissed juror's views on the merits of the case.

In both *Wilkerson* and *Duke*, the judges concluded from the little available evidence that the record clearly showed the jurors were unable to perform their duties as jurors. The Second Circuit hoped that in cases such as these—where the evidence of a juror's intent to nullify was far from “unambiguous”—that the judge would refrain from using Rule 23(b).<sup>104</sup> However, *Wilkerson* and *Duke* indicate that courts are willing to use Rule 23(b) based on minimal evidence of a juror's intent to nullify.

### C. Use of Judicial Discretion for Judicial Inquiries

*Thomas* failed to instruct courts on how to conduct an inquiry of deliberating jurors. Absent these express instructions, judges have used their own discretion when interviewing deliberating jurors. As a result, the length and thoroughness of inquires varies from case to case. Accordingly, the quality of evidence garnered through these interviews also varies, leaving some judges better prepared than others to make the distinction between a nullifying juror and a juror who is simply unpersuaded by the prosecution's evidence. The ability to make accurate determinations as to nondeliberating or nullifying jurors provides defendants with better protection of their constitutional right. Thus, because of the inconsistent nature of judicial inquiries, protection of the right to a unanimous verdict varies.

In some cases, the trial judge makes a concerted effort to create a substantial record of juror intent to nullify. For example, in *United States v. Kemp*,<sup>105</sup> the judge interviewed jurors on three separate occasions.<sup>106</sup> Furthermore, the judge interviewed every juror on the jury.<sup>107</sup> Ultimately, the judge chose to dismiss a juror under Rule 23(b) because the record showed that the juror refused to consider evidence, refused to follow the court's instructions, and was

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103. *Id.*

104. *United States v. Thomas*, 116 F.3d 606, 622 (2d Cir. 1997).

105. 379 F. Supp. 2d 690 (E.D. Pa. 2005).

106. *Id.* at 707.

107. *Id.*

biased.<sup>108</sup> On defendant's motion for acquittal or new trial, the district court upheld the dismissal because the extensive evidence regarding nullification supported the dismissal.<sup>109</sup>

Similarly, in *United States v. Samet*,<sup>110</sup> the judge interviewed the allegedly nondeliberating juror on three separate occasions.<sup>111</sup> At the end of the third interview, the judge denied the government's motion for dismissal and declared a mistrial.<sup>112</sup> Initially, the judge intended to dismiss the juror under Rule 23(b) because it was evident the juror was unable to continue deliberations with the jury.<sup>113</sup> However, the judge learned through interviews that the juror's inability to deliberate resulted from a difference of opinion with her fellow jurors on the merits of the case.<sup>114</sup> Accordingly, in order to protect the defendant's right to a unanimous verdict, the judge could not remove the juror from the jury.<sup>115</sup>

In both *Kemp* and *Samet*, the judges conducted lengthy and thorough investigations following allegations of juror impropriety. In both instances, the investigations produced substantial evidence pertaining to the allegations. In *Kemp*, the evidence garnered through interviews showed that the juror's dismissal should not be overturned on appeal.<sup>116</sup> In *Samet*, the interviews helped the judge realize that the juror was simply unpersuaded by the government's case.<sup>117</sup> Thus, instead of dismissing the juror—which would have denied the defendant his right to a unanimous verdict—the judge was able to protect the right to unanimity by declaring a mistrial.<sup>118</sup> In both cases, thorough investigations resulted in thorough protection of the right.

The Second Circuit's failure to expressly approve the use of judicial discretion when conducting judicial inquiries has also

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108. *Id.*

109. *Id.*

110. 207 F. Supp. 2d 269 (S.D.N.Y. 2002).

111. *Id.* at 276.

112. *Id.*

113. *Id.* at 277.

114. *Id.*

115. *See id.* at 281–82 (noting that Rule 23(b) cannot be used to remove a holdout juror).

116. *See United States v. Kemp*, 379 F. Supp. 2d 690, 707 (E.D. Pa. 2005) (noting that “the facts showed . . . several independent reasons to excuse her”).

117. *Samet*, 207 F. Supp. 2d at 277, 279.

118. *Id.* at 281–82.

resulted in significantly less thorough investigations. In *United States v. Luisi*,<sup>119</sup> the judge initially intended to interview every member of the jury.<sup>120</sup> But after interviewing only the foreperson and the allegedly nullifying or nondeliberating juror, the judge stopped the investigation and dismissed the juror.<sup>121</sup> The one interview with the nullifying juror convinced the judge that the juror could not apply the law as instructed by the court, and thus a Rule 23(b) dismissal was proper.<sup>122</sup> Likewise, in *Duke*, the judge conducted a truncated investigation after deliberations commenced.<sup>123</sup> The trial judge dismissed a juror under Rule 23(b) after only one short interview with the juror.<sup>124</sup>

In both *Luisi* and *Duke*, the judges conducted short investigations into allegations of a nondeliberating juror. In both instances, the investigations failed to produce substantial information. In *Luisi*, the interview of the nullifying juror established that he did not agree with the court's interpretation of the law.<sup>125</sup> But the interview did not establish that the juror would or could not follow the court's instructions on the law. In fact, the juror stated that he did not believe that a juror should purposefully disregard the court's interpretation of the law.<sup>126</sup> Conducting interviews of the other jurors may have provided more information regarding the alleged nullification. At the very least, additional interviews would have been prudent, further ensuring that the judge did not violate the defendant's right to a unanimous verdict.

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119. 568 F. Supp. 2d 106 (D. Mass. 2008).

120. *Id.* at 108–09.

121. *Id.* at 109–10.

122. *Id.*

123. See *Duke v. County of Nassau*, 63 F. App'x. 558, 560 (2d Cir. 2003) (asking the allegedly nondeliberating juror only two questions before dismissing him from the jury).

124. *Id.* at 560.

125. See *Luisi*, 568 F. Supp. 2d at 109 (“When asked if he could accept that interpretation and apply the law . . . Juror No. 2 stated that he could ‘only accept the words that have been given to [him], and [he could] only accept the fact that [the Commerce Clause] is written as it is written.’”).

126. *Id.* at 109–10 (“[T]he Court asked Juror No. 2 whether he believed he had the authority to ‘decide whether the law is valid.’ He responded: ‘No, I don’t decide. . . . I am familiar with the philosophy known as a fully informed juror, but I disagree with it.’”). The “fully informed juror” philosophy proposes “jurors possess an ‘unalienable right’ to set aside the court’s instructions and to apply the law as they see fit.” *Id.* at 119.



In *Duke*, the jury twice indicated it was deadlocked.<sup>127</sup> Frustration stemming from the eventually-dismissed juror's views on the merits of the case may have caused the verbal abuse. Still, unlike the judge in *Samet*, the judge in *Duke* chose to interview the dismissed juror only once.<sup>128</sup> The three interviews in *Samet* provided the judge with evidence regarding the true reason for what appeared to be a juror's non-deliberation.<sup>129</sup> Thus, the judge was able to prevent a violation of the right to unanimity.<sup>130</sup> Multiple interviews in *Duke* may have produced the same result leading to greater protection of the defendant's right.

#### IV. EXTENSION OF JUDICIAL INQUIRY

The Second Circuit's holding in *Thomas*, as applied by lower courts, fails to accomplish all of the court's purported goals: (1) removal of nondeliberating or nullifying jurors from the jury,<sup>131</sup> (2) protection of the guaranteed right to a unanimous verdict,<sup>132</sup> and (3) preservation of preverdict jury secrecy.<sup>133</sup> By only slightly adjusting the holding in *Thomas* to allow judges to conduct more extensive inquiries—thereby enabling them to delve into the substance of deliberations—all three of the court's goals can be better achieved.

Relaxing the restrictions placed on judicial inquiry would make interviews more productive by revealing evidence as to whether good cause for dismissal exists. Judges could inquire into the beliefs of the nondeliberating or nullifying juror in order to determine if the juror's alleged misconduct stems from insufficiency

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127. *Duke*, 63 F. App'x at 560.

128. *Id.*

129. See *United States v. Samet*, 207 F. Supp. 2d 269, 277 (S.D.N.Y. 2002) (“There is no question in my mind that Juror # 2 could not continue to deliberate . . . [a]nd I would have discharged her under that rule, but for the fact that she told us enough to reveal that the source of her distress was some difference of opinion between her and the other jurors.”).

130. *Id.*

131. See *United States v. Thomas*, 116 F.3d 606, 612 (2d. Cir. 1997) (holding that “a presiding judge has a duty to dismiss a juror who purposefully disregards the court's instructions”).

132. See *id.* at 622 (“The evidentiary standard that we endorse . . . serves to protect these holdouts from fellow jurors who have come to the conclusion that the holdouts are acting lawlessly.”).

133. *Id.*

of evidence. Thus, courts would no longer need to depend on jurors volunteering information regarding the substance of deliberations.<sup>134</sup> Judges no longer handcuffed by the strict limitations of *Thomas* could conduct thorough investigations into allegations of juror impropriety.<sup>135</sup> Importantly, because judicial inquiries would become substantially more effective, judges would be able to determine whether someone is a nondeliberating juror with a higher degree of certainty.

Furthermore, relaxing the limitations on judicial inquiry would help rectify inconsistent interpretation of the evidentiary standard announced in *Thomas*. The Second Circuit endorsed the high “any possibility” standard in order to safeguard the right to a unanimous verdict by making dismissal of a juror difficult.<sup>136</sup> Because courts after *Thomas* have interpreted “any possibility” to mean a “reasonable” or “substantial possibility”—a lower evidentiary standard—*Thomas*’s protection of the right has been weakened. Given the limited evidence that judges are able to gather during their inquiries, the possibility that the evidence satisfies the standard is reduced. The possibility of dismissing jurors who are merely unpersuaded by the evidence rather than intentionally nullifying the jury thus increases. Extended judicial inquiries would return the protection of this constitutional right to its original strength. Judicial inquiries would produce more evidence as to juror intent, thus enabling judges to better determine whether dismissal is proper. Better decisions equate to better protection of the right. Therefore, while *Thomas* and its progeny have created contrasting interpretations as to the meaning of “any possibility,” the varying standards all lead to the same erosion of a defendant’s right to a unanimous verdict.

The *Thomas* court adopted strict limitations on judicial inquiries to preserve the secrecy of jury deliberations. However, the court’s explanation for protecting preverdict jury secrecy and jury

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134. See *United States v. Wilkerson*, 656 F. Supp. 2d 1, 5 (D.D.C. 2009) (concluding that a juror must volunteer information regarding any difficulty with the sufficiency of the evidence because *Thomas* provides that this question may not be asked by the court).

135. See *id.* at 2, 5 (denying defendant’s counsel’s request to ask a juror “whether she has some difficulty with whether the evidence is sufficient” because *Thomas* provides that courts have a duty “not to intrude upon the process of jury deliberations”).

136. *Thomas*, 116 F.3d at 621–22.

secrecy during the course of deliberations is unpersuasive. In supporting its argument for the protection of preverdict jury secrecy, the Second Circuit relied almost exclusively on authorities discussing the protection of *postverdict* jury secrecy.<sup>137</sup> For example, the court cited an article by Professor Abraham Goldstein entitled *Jury Secrecy and the Media: The Problem of Postverdict Interviews*.<sup>138</sup> Similarly, the court cited Rule 606(b) of the Federal Rules of Evidence, which prohibits the use of juror testimony to impeach a final verdict.<sup>139</sup>

The preservation of the finality of a verdict is the most important policy justification for jury secrecy. Many courts, including the Second Circuit in *Thomas*, have evinced their concern with the finality of jury verdicts.<sup>140</sup> For example, in *Tanner v. United States*, the Supreme Court expressed that:

“[t]here is little doubt that postverdict investigation into juror misconduct would in some instances lead to the invalidation of verdicts reached after irresponsible or improper juror behavior. . . . [Thus a]llegations of juror misconduct, incompetency, or inattentiveness, raised for the first time days, weeks, or months, after the verdict, seriously disrupt the finality of the process.”<sup>141</sup>

However, preverdict inquiries differ from postverdict inquiries because preverdict inquiries do not affect finality—by definition, no verdict has been rendered by the jury. Thus, the policy consideration of finality in *Thomas* applies only to postverdict inquiries, which can lead to reversals through inquiries by the media or other litigants. This same rationale does not apply to preverdict inquiries, which do

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137. In fact, the only citation to an authority discussing preverdict jury secrecy is a reference to the secrecy discussed in *United States v. Brown*, which provides no evidence for its stance. *Id.* at 620. See also *United States v. Brown*, 823 F.2d 591, 596 (“[A] court may not delve deeply into a juror’s motivations because it may not intrude on the secrecy of the jury’s deliberations.”).

138. *Thomas*, 116 F.3d at 619.

139. FED. R. EVID. 606(b) (“Upon an inquiry into the validity of a verdict or indictment, a juror may not testify as to any matter or statement occurring during the course of the jury’s deliberations . . .”).

140. *Thomas*, 116 F.3d at 618.

141. *Tanner v. United States*, 483 U.S. 107, 120 (1987).

not threaten the finality of a nonexistent verdict.

Another justification for the preservation of preverdict jury secrecy offered by *Thomas* is the potential endangerment of the deliberative process by unrestricted judicial inquiry.<sup>142</sup> In support of this claim, the Court quoted Justice Cardozo in *Clark v. United States* who stated, “[f]reedom of debate might be stifled and independence of thought checked if jurors were made to feel that their arguments and ballots were to be freely published to the world.”<sup>143</sup> Other courts have endorsed this position as well, such as the First Circuit in *In re Globe Newspaper Co.*<sup>144</sup> The First Circuit stated that the “secrecy of jury deliberations fosters free, open and candid debate in reaching a decision.”<sup>145</sup> Thus, the *Thomas* court reasoned that extended judicial inquiries would “foment discord among jurors,” “invite trial judges to second-guess and influence the work of the jury,” and “permit judicial interference with, if not usurpation of, the fact-finding role of the jury.”<sup>146</sup>

While concern about endangering the deliberative process may apply in some ways to preverdict inquiries, the Second Circuit failed to note how judicial discretion and the structure of preverdict judicial inquiry address this concern. Preverdict inquiries are narrowly tailored to focus on the allegation of juror impropriety. Judges are limited to seeking information pertaining to good cause and prohibited from second-guessing the jury. Accordingly, concerns regarding judicial usurpation of the role of the jury are overstated. As an additional safeguard, judges can seal the court record and thus conceal the results of judicial inquiry from the public. Jurors are free to deliberate because judges are able to ensure confidentiality and that jurors’ thoughts will not be “freely published to the world.”<sup>147</sup>

Lastly, the Second Circuit justified preverdict jury secrecy by stating that secrecy is needed to maintain public confidence in the jury system.<sup>148</sup> In endorsing this same policy, the Supreme Court in *Tanner* asserted that the “community’s trust in a system that relies on

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142. *Thomas*, 116 F.3d at 618.

143. *Id.* at 619 (quoting *Clark v. United States*, 289 U.S. 1, 13 (1933)).

144. 920 F.2d 88, 94 (1st Cir. 1990).

145. *Id.*

146. *Thomas*, 116 F.3d at 620, 622.

147. *Clark*, 289 U.S. at 13.

148. *Thomas*, 116 F.3d at 618.

the decisions of laypeople would. . . . [B]e undermined by a barrage of postverdict scrutiny of juror conduct.”<sup>149</sup> Endorsing the views of both the Second Circuit and Supreme Court, one commentator noted that:

[An] exposure of jury deliberations brings to light not only differences of opinion among jurors, but also decisional premises with which various members of the public are bound to disagree. The revelation of these inevitable yet disquieting divergences may unnecessarily undermine public acceptance of jury verdict.<sup>150</sup>

As with the concern of endangering the deliberative process, public confidence in the jury system can be addressed by the structure of judicial inquiry and the use of judicial discretion. Postverdict inquiries are typically conducted by the media or other litigants, thus the court cannot prevent the interviews from becoming public knowledge. However, preverdict inquiries are conducted by judges and the inquiries can be sealed. Judges can prevent the public from learning of the substance of jury deliberations. Furthermore, preverdict judicial inquiries are narrowly tailored to the allegations of juror impropriety. The narrow tailoring of judicial inquiry ensures that even if the public learns of the inquiry, it would receive only a very limited view of jury deliberations. Such decisional premises upon which the jury based its verdict would not be disclosed.

The *Thomas* court’s analogy between pre and postverdict jury secrecy is not justified. The types of protections necessary for postverdict jury secrecy are not needed in the preverdict context. Thus, a relaxation of the limits on judicial inquiry can be allowed under the holding in *Thomas* as, for the most part, the policies supporting strict limitation on judicial inquiry apply only to postverdict jury secrecy.

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149. *Tanner v. United States*, 483 U.S. 107, 120–21 (1987).

150. Note, *Public Disclosures of Jury Deliberations*, 96 HARV. L. REV. 886, 891 (1983).

## V. CONCLUSION

The Second Circuit's holding in *Thomas*, while intended to simultaneously help identify nullifying jurors, protect defendants' right to a unanimous verdict, and maintain the secrecy of jury deliberations, resulted in an improper balance between these concerns. The vaguely defined evidentiary standard advanced by *Thomas* has been interpreted in a variety of ways. Many of these interpretations raise the bar that must be met in order to show that a juror is unpersuaded by the merits of a case. As a result, potentially unpersuaded jurors may be dismissed more easily, placing a defendant's right to a verdict from a unanimous jury at risk.

Compounding this problem is *Thomas*'s requirement for limited judicial inquiry with regard to jury deliberations. Courts, confined in their questioning by these limitations, are unlikely to develop a record of evidence sufficient to meet a "reasonable" or "substantial" showing that a juror is unpersuaded by the merits. Furthermore, the allowance of judicial discretion in conducting judicial inquiries has resulted in varying levels of thoroughness in judicial investigations. As a consequence, the right to a unanimous verdict has received varied levels of protection.

Movement away from the unnecessary emphasis on the protection of preverdict jury secrecy will better enable courts to effectuate the intent of *Thomas*. The Second Circuit's concerns regarding preverdict inquiry are misplaced. Preverdict judicial inquiry, by itself, does not threaten the sanctity of jury deliberations. Allowing more extensive preverdict judicial inquiries will still maintain the finality of verdicts. The structure of preverdict judicial inquiry, along with judicial authority to seal the court record, can protect both the public's confidence in the verdict and the deliberative process.

Extended preverdict judicial inquiry would enable courts to accomplish the three main goals of *Thomas*. First, inquiries would produce more evidence for use in identifying a nullifying or nondeliberating juror. Second, relaxation of the limitations on inquiry would accomplish the intent of *Thomas*'s high evidentiary standard, even when a court chooses to use the lower "reasonable" or "substantial" standard. Finally, extended judicial inquiry would better enable a judge to make the distinction between a holdout juror and a nullifying or nondeliberating juror. As a result, judges would

be better equipped to avoid the wrongful removal of a juror and the resulting violation of a defendant's right to a unanimous verdict.











