**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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| In re Lululemon Securities Litigation | Case No. 13-CV-4596 (KBF) |

# MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE CONSOLIDATED CLASS ACTION COMPLAINT OR IN THE ALTERNATIVE TO STAY THE ACTION

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December 4, 2013

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Defendants lululemon athletica, inc. ("lululemon" or the "Company") and Christine Day (collectively, "Defendants")[1] respectfully submit this memorandum of law in support of their Motion to Dismiss the Consolidated Class Action Complaint (the "Complaint" or "CAC") or in the Alternative to Stay the Action under the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-5(c), and Federal Rules of Civil Procedure 9(b) and 12(b)(6) (the "Motion").

## PRELIMINARY STATEMENT

Lululemon is a yoga-inspired athletic apparel company. Lululemon sells apparel at higher prices than its competitors based on the technical attributes and high quality of its products. The Company relies entirely on third parties to provide fabric for and to produce its products according to lululemon's specifications. The Company has quality control processes to ensure that the product delivered to lululemon stores meets its specifications and provides its customers ("guests" in lululemon terminology) with a high quality product and brand experience. No quality control process, however, is fool-proof, and lululemon has never said otherwise. Product defects can occur and have a negative impact on profits and the brand. None of this is surprising. All of it was disclosed.

On March 18, 2013, lululemon announced that its black luon yoga pants that hit store shelves on March 1, 2013 suffered from sheerness when the wearer bent over—clearly a defect in yoga pants. Lululemon immediately pulled the defective product from store shelves, provided a full refund to guests who purchased the pants after March 1, and undertook remedial efforts to address the causes of the sheerness defect—all of which lululemon disclosed in real time.

[1] Defendant Dennis "Chip" Wilson, lululemon's founder—who was not an officer of the Company during the Class Period—has filed a separate 4-page brief joining in this Motion.

The federal securities laws do not provide insurance to investors when disclosed risks materialize. In this action, Plaintiff attempts to retrofit the March 2013 black luon issue into securities fraud. As Plaintiff tells it, sometime before the start of the alleged Class Period in September 2012, Defendants became aware of or recklessly disregarded serious failures in lululemon's quality control processes and/or defects in its black luon yoga pants. Rather than come clean, Defendants allegedly (i) pumped lululemon's stock price through the same general statements of belief about lululemon's commitment to quality that had appeared in the Company's disclosures for years, and then (ii) shipped hundreds of thousands of its black luon yoga pants to its stores hoping that the sheerness defect would remain undiscovered despite the product's intended use. Why Defendants would do this and how it could benefit the Company or the individual defendants is not alleged.

Apart from lacking plausibility, Plaintiff's Section 10(b) claim suffers glaring legal defects under well-developed jurisprudence in this Court.

*First*, the Complaint does not identify actionable misstatements or show why the statements at issue were false when made. Generalized statements of belief—"we believe we offer quality products and are committed to quality"—are not the stuff of securities fraud. And Plaintiff resorts to the familiar and consistently rejected tactic of trying to plead fraud by hindsight. *See* Point I, *infra*.

*Second*, Plaintiff has not alleged with particularized facts the required element of scienter under *Tellabs* or Second Circuit authority. The Complaint does not provide a cogent inference of fraud that is at least as compelling as the non-fraudulent inference that lululemon, in fact: (i) believed it offered quality products, (ii) believed it had effective quality controls, and

(iii) promptly disclosed and pulled back the defective product that did not meet its quality standards. *See* Point II, *infra*.

*Third*, Plaintiff has not adequately pleaded loss causation in connection with the March 18 black luon announcement, much less any of the additional "corrective disclosures" issued thereafter. Significantly, Plaintiff has not alleged any factual or legal connection between (i) Ms. Day's (lululemon's CEO) June 10 announcement of her intent to resign for personal reasons once a successor has been hired (and the following stock drop) and (ii) the black luon sheerness defect or any other quality issue disclosed months earlier. *See* Point III, *infra*.

In contrast to many securities class actions in this Court, this case does not involve error-laden financial statements, sudden write-downs of complex financial products, or a failed business model. Lululemon discovered a significant product defect, and, consistent with its brand integrity and core values, promptly disclosed the problem and strengthened its quality control systems to address the root causes. After successfully navigating this issue, lululemon is now stronger than ever, with sales, profits, and earnings that are significantly higher than its results a year ago, before the start of the alleged Class Period. Lululemon suffered a highly public, embarrassing, and painful misstep. But the Complaint does not convert this business misstep into an adequately pleaded claim for securities fraud.

* * *

Alternatively, this action should be stayed pending the Supreme Court's ruling this term in *Halliburton Co. v. Erica P. John Fund, Inc.* (No. 13-317), which likely will determine the continued viability and/or scope of the "fraud-on-the-market" theory, the modern day cornerstone of all securities class actions, including this action. In its CAC, Plaintiff pleads the requisite element of reliance for its Section 10(b) claim by reference to the fraud-on-the-market

presumption. *See* CAC ¶ 123. In *Halliburton*, the Supreme Court granted a petition for certiorari that raised as its first question whether the Supreme Court "should overrule or substantially modify the holding of *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), to the extent that it recognizes a presumption of class wide reliance derived from the fraud-on-the-market theory." Petition for Writ of Certiorari, *Halliburton*, 2013 WL 4855972, at *i (Sept. 9, 2013), *cert. granted*, 82 U.S.L.W. 3119 (Nov. 15, 2013). If the Supreme Court overturns or substantially modifies the *Basic* presumption, that ruling would have a significant—and potentially dispositive—impact on this Motion.

## STATEMENT OF FACTS

The purported nine-month class period from September 2012 through June 2013 encompasses three distinct periods: (1) the period before the March 18 black luon announcement, (2) the March 18 announcement of the black luon issue and related update announcements that followed, and (3) the June announcement that lululemon's CEO, Christine Day, decided to leave for personal reasons upon the appointment of her successor.[2]

**Before the Black Luon Announcement: September 7, 2012 – March 17, 2013.**

Plaintiff challenges general statements of opinion concerning the quality of lululemon's product that were set forth in its public filings, stated by Ms. Day during two investor calls, and displayed on its website. As set forth in Exhibit 1 (reflecting each of the alleged misleading statements)[3] and discussed in Point I, *infra*, the Complaint omits key words and context, fundamentally

[2] The newly-expanded Class Period (as compared to the period alleged in the initial complaint) is bookended by dates that appear tied to litigation strategy and not to any coherent version of the alleged fraud. In the initial complaint previously filed in this action, the proposed class period started on March 21, 2013. ECF Dkt # 28. Now the class begins 5 months earlier in September 2012, presumably so that Plaintiff can allege that Mr. Wilson's 10b5-1 Trading Plan was "entered into" during the Class Period.

[3] All references to Exhibits or Exs. refer to exhibits attached to the accompanying Declaration of Joseph S. Allerhand filed in support of this Motion, dated December 4, 2013.

altering the statements at issue as well as the applicable legal lens through which the statements must be viewed.

Plaintiff also ignores lululemon's repeated risk disclosures—located in the very same SEC filings alleged to contain misstatements—that the Company: (i) relies on "third-party suppliers to provide fabrics for and to produce [its] products, and [it has] limited control over them"; (ii) "[has] occasionally received, and may in the future continue to receive, shipments of products that fail to comply with our technical specifications or . . . our quality control standards" and "[i]n that event, . . . we risk the loss of net revenue resulting from the inability to sell those products"; (iii) "if defects in the manufacture of our products are not discovered until after such products are purchased by our guests, our guests could lose confidence in the technical attributes of our products and our results of operations could suffer and our business could be harmed"; and (iv) "[i]f we continue to grow at a rapid pace, we may not be able to effectively manage our growth and the increased complexity of our business and as a result our brand image and financial performance may suffer" and such growth "could result in the erosion of our brand image which could have a material adverse effect on our financial condition." Ex. 5 at 29, 30; Ex. 6 at 29, 30; Ex. 26 at 10, 11.

**The Black Luon Announcement: March 18, 2013 – April 4, 2013.** On March 18, 2013, lululemon announced a pullback of its black luon pants because it had "determined that certain shipments of product received from [its] factories and available in store from March 1, 2013" had a "a level of sheerness . . . that falls short of [lululemon's] very high standards," and advised that the black luon issue would have a "significant impact" on its financial results for Q1 2013. Ex. 9. The stock price declined modestly after this disclosure from $65.90 at the close of trading on March 18 to $64.08 per share at the close of trading the following day. Ex. 4. Shortly

thereafter, during its March 21 investor call, lululemon updated that its anticipated Q1 earnings per share ("EPS") would be $0.11 – $0.12 lower than previously projected as a result of the black luon issue. Ex. 11 at 7. Contrary to Plaintiff's allegation that Defendants sought to "minimize" the black luon issue, Ms. Day explained that lululemon was "very devastated . . . by what's happened" and stated that "[d]isappointing our guests and shareholders . . . is not something we take lightly and we deeply regret." Ex. 11 at 8, 14. Following this March 21 call, lululemon's stock price closed at $64.70 on March 21, up from $63.88 at the close of trading on March 20. Ex. 4.

Two weeks later on April 3, lululemon disclosed that "after an evaluation" of the black luon issue, it had concluded that "[w]hile the fabric involved may have met testing standards, it was on the low end of [the Company's] tolerance scale," that the Company "ha[d] found that [its] testing protocols were incomplete for some of the variables in fabric characteristics," and that, "[w]hen combined with subtle style changes in patterns, the resulting end product had an unacceptable level of sheerness." Ex. 12. This press release outlined the actions the Company was taking "to address what [it] believe[d] [we]re the contributing causes" of the sheerness issue. Ex. 1, Entry 17. Following this disclosure, lululemon's stock price increased to close at $65.66 on April 4, up from $64.24 at the close of trading on April 3. Ex. 4.

**The CEO Announcement: June 10, 2013.** On June 10, 2013, lululemon reported Q1 2013 EPS of $0.32, in line with its revised EPS projection announced on March 21. Ex. 13; Ex 11 at 7. Lululemon also announced Ms. Day's anticipated resignation, explaining that she "will continue to actively lead the organization while the Board searches for a new CEO, and will work to ensure a smooth transition." Ex. 13. During the investor call that day, Ms. Day stated that leaving lululemon "was a personal decision" and assured investors that she would continue

as CEO for "a while," focusing on "delivering a strong back half of the year." Ex. 14 at 9. After this announcement, lululemon's stock price declined sharply from $82.28 at the close of trading on June 10 to $67.85 per share at the close of trading on June 11. Ex. 4. There are no well-pleaded facts linking in any way Ms. Day's resignation to the alleged fraud involving the sheerness defect or any other disclosed quality issue.

## ARGUMENT

In deciding a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), a court must assume that well-pleaded factual allegations in the complaint are true. *See Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 555 (2007). But a court need not accept legal conclusions, naked assertions, conclusory statements unsupported by facts, or implausible inferences. *See Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009) (citing *Twombly*, 550 U.S. at 555). When addressing a Section 10(b) claim,[4] the Court applies the heightened pleading standards of Rule 9(b) and the PSLRA, which require a plaintiff to set forth particularized factual allegations sufficient to identify the challenged statements and show how they are misleading *and* that defendants acted with the required state of mind at the time they made the statements—scienter.[5]

## I. PLAINTIFF FAILS TO PLEAD ACTIONABLE MISSTATEMENTS

### A. Statements Before the March 18 Black Luon Announcement

The Complaint challenges three categories of alleged misstatements before lululemon's announcement of the black luon issue on March 18, 2013 (*see* CAC ¶¶ 80-89):

[4] To state a Section 10(b) claim, Plaintiff must adequately plead: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Levitt v. J.P. Morgan Sec., Inc.*, 710 F.3d 454, 465 (2d Cir. 2013) (citations and internal quotations omitted).

[5] *See Mori v. Saito*, 2013 WL 1736527, at *3 (S.D.N.Y. Apr. 19, 2013) (Forrest, J.) ("To state a claim under Section 10(b) or Rule 10b-5, a plaintiff . . . must satisfy the heightened pleading standards of [Rule] 9(b) and of the [PSLRA]. A plaintiff meets those standards by stating 'with particularity' the circumstances constituting the fraud, and by alleging facts that give 'rise to a strong inference' of fraudulent intent.") (citations omitted).

- General statements in lululemon's September 7 and December 6, 2012 Quarterly Reports on Form 10-Q that lululemon was a "leader" in "technical fabrics and quality construction" (CAC ¶¶ 84, 88; Ex. 1, Entries 3, 7);

- Ms. Day's statements during earnings calls held on September 7 and December 6, 2012 concerning quality (CAC ¶ 82; Ex. 1, Entries 4, 5, 6) and that the Company does not believe that "growth at any cost" is an effective business model (CAC ¶ 87; Ex. 1, Entry 8); and

- General language posted on lululemon's website, stating that "[q]uality is at the heart of everything" lululemon does; that "lululemon's assured quality level is the highest in the industry"; that it is lululemon's "job to ensure every product is made to its truest form"; that if a garment "doesn't pass [lululemon's] standards at any point in production, it's back to the drawing board"; and that the Company "get[s] a lot of help from [its] developers, product testers and QA partners overseas" (CAC ¶ 80; Ex. 1, Entries 1, 2).[6]

*First*, Plaintiff has omitted language that changes the legal framework and exposes the Complaint's failure to identify actionable statements. With respect to the challenged statements in the Form 10-Qs, Plaintiff omits the lead-in language, "*We believe that our brand is recognized as*," which precedes the challenged statements as to being a "leader." CAC ¶¶ 84, 88; Ex 1, Entries 3, 7 (emphasis added). This is no small omission. Under Second Circuit law, Plaintiff has not and cannot allege that Defendants did not hold such a belief. *See Fait v. Regions Fin. Corp.*, 655 F.3d 105, 110 (2d Cir. 2011) (when a "plaintiff asserts a claim . . . based upon a belief or opinion . . . liability lies only to the extent that the statement was both objectively false *and* disbelieved by the defendant at the time it was expressed") (emphasis added); *see also City of Omaha, Neb. Civilian Emps.' Ret. Sys. v. CBS Corp.*, 679 F.3d 64, 67-68 (2d Cir. 2012) (*Fait*'s "reasoning applies under Sections 10(b) and 20(a) of the 1934 Act").

[6] These statements appeared in the "careers" (Ex. 15) and "education" (Ex. 7) pages of lululemon's website and were not made "in connection with" the sale or purchase of a security, as required under Section 10(b), 15 U.S.C. § 78j(b). The statements were clearly directed at potential jobseekers or customers, not investors. *See Hemming v. Alfin Fragrances, Inc.*, 690 F. Supp. 239, 244-45 (S.D.N.Y. 1988) (statements directed toward the "consumers of a product" and not "investors in a corporation" are not actionable under Rule 10b-5).

In any event, these statements and others like them are not actionable.[7] The Second Circuit and the district courts therein consistently have rejected statements regarding a company's commitment to and/or leadership in integrity, controls, and discipline as non-actionable "puffery" that is "too general to cause a reasonable investor to rely on them." *See ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 205-06 (2d Cir. 2009) (company's statements as to its "standard-setting reputation for integrity," its "highly disciplined . . . risk management process," and its "focus on financial discipline" "did not, and could not, amount to a guarantee that its choices would prevent failures in its risk management practices" and were "precisely the type of 'puffery' that [the Second] and other circuits have consistently held to be inactionable") (citation omitted).[8]

*Second*, as to Ms. Day's statements during the September 7 and December 6 earnings calls, Plaintiff has taken the statements out of context and again omitted important language. With respect to the Q2 earnings call on September 7, which began with Ms. Day's addressing in prepared remarks a specific (and previously disclosed) quality issue involving color bleeding,[9] Plaintiff omits Ms. Day's explanation that the product is "*made by humans and therefore not always perfect*." Ex. 1, Entry 4. When viewed in context of the *disclosed* color bleeding issue, the challenged statements that "quality is our key differentiating factor" and is what the

[7] *See* CAC ¶¶ 80, 82, 84, 87, 88; Ex. 1, Entries 1-4, 7-8.

[8] *See also In re SAIC, Inc. Sec. Litig.*, 2013 WL 5462289, at *12-13 (S.D.N.Y. Sept. 30, 2013) (statements concerning "core value[s]," "culture of high ethical standards, integrity, operational excellence, and customer satisfaction" "amount[ed] to inactionable puffery"); *In re Austl. & N. Z. Banking Grp. Ltd. Sec. Litig.*, 2009 WL 4823923, at *11 (S.D.N.Y. Dec. 14, 2009) ("general statements about [the company's] risk management practices and controls," including statements that it was "committed to best practice" and "maintain[ed] the strong control and financial governance frameworks," all "constitute[d] 'puffery.'").

[9] Over a month before the start of the Class Period, on July 24, 2012, lululemon informed investors that it had experienced "color bleeding" in certain of its colored products. Ex. 16. The Company also disclosed that it had "brought in the leading fabric and dye expert, along with additional, on site quality inspection at every stage to identify potential causes" for the color bleeding and that it was "testing more variables . . . [to] solve the problem." Ex. 16. In this same July 24 disclosure, lululemon further warned, "when a product does not make the grade we will take action, and when needed, pull product from our stores and make it right." Ex. 16; CAC ¶ 44.

Company "stand[s] for" and "behind" simply reflect Ms. Day's good faith belief that the color issue had been adequately addressed, and that "we feel very comfortable now with the product and being able to do our strategic intent, which is to push color and maintain quality." CAC ¶ 82; Ex. 1, Entries 4, 6. There is not a single allegation to suggest that Ms. Day's belief that the color issue had been adequately resolved was either subjectively or objectively false when made.

With respect to the Q3 earnings call on December 6, Ms. Day's allegedly misleading statements concerning "a healthy business model" and forswearing "growth at any cost" have also been taken out of context and also reflect her non-actionable good faith beliefs. Ms. Day was asked to address the company's plans for *international* expansion. Her answer, which has nothing to do with luon pants or the sheerness defect at issue here, merely stated her view based on her prior stint at Starbucks that it is not advisable to build a "loss leading market" and then "clean[ ] it up afterwards," and that in pursuing international expansion, lululemon was not employing a "growth at any cost" model. Plaintiffs have taken the "growth at any cost" statement out of its context—international expansion—and instead grossly mischaracterized Ms. Day's statement as an "assurance" that lululemon was "not sacrificing quality in pursuit of growth" and was "putting into place processes to prevent serious problems from occurring." CAC ¶ 87; Ex. 1, Entry 8.

*Third*, all of the pre-March 18 statements suffer from the pleading defect Judge Friendly identified years ago as "fraud by hindsight." *See Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978). Just because lululemon sold defective yoga pants in March 2013 does not mean that its executives knew and failed to disclose the problem at an earlier time. In *Sinay v. CNOOC Limited*, this Court dismissed securities fraud claims after the defendant suffered a disastrous oil spill. Plaintiff challenged prior statements to the effect that the defendant company was

committed to safety and the environment, and had put in place plans to deal with oil spills. 2013 WL 1890291, at *10 n.15 (S.D.N.Y. May 6, 2013) (Forrest, J.). Here, lululemon's several statements of belief in its product quality are not rendered misleading simply because a defect occurred, just as the defendant company's statements of commitment to safety in *Sinay* were not rendered misleading by the subsequent oil spill. *See also In re Agnico-Eagle Mines Ltd. Sec. Litig.*, 2013 WL 144041, at *19-20 (S.D.N.Y. Jan. 14, 2013) (problems leading to a mine closure not sufficient to show falsity of prior statements) (citations omitted), *aff'd sub nom. Forsta AP-Fonden v. Agnico-Eagle Mines Ltd.*, 2013 WL 5486152 (2d Cir. Oct. 3, 2013).

Plaintiff attempts to cure this fraud-by-hindsight nature of its pleading through reference to an unidentified expert and eleven confidential witnesses ("CWs"). With respect to its expert, Plaintiff simply proffers this individual's conclusion that lululemon's quality controls fell short of "standard industry practice" by failing to do a live model test in certain circumstances (CAC ¶¶ 49, 108) and contends, *ipse dixit*, that Defendants should therefore have known their statements were false. Notably, Plaintiff pleads no facts supporting this conclusion and "conclusions[] are not entitled to the assumption of truth" on this Motion. *Iqbal*, 556 U.S. at 679. Plaintiff's reliance on CW allegations fares no better. Putting aside the many defects of the CW allegations (*see* Ex. 2),[10] only three of the CWs purport to have any information with respect to alleged knowledge of a luon "sheerness issue" before March 18. But those CWs (CW1, CW5, and CW11) do not provide particularized facts concerning (i) the source or scale of the alleged "sheerness issue" (*i.e.,* alleging whether these were *ad hoc* customer complaints routine to any retailer vs. discovery of a significant manufacturing or design flaw); or (ii) why and how this

[10] "[W]here plaintiffs rely on confidential personal sources," they must "provide an adequate basis for believing that the defendants' statements were false" and "describe[] [the confidential sources] in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000).

information should have alerted Defendants that there would be a pullback of defective luon product months later.[11]

**B. Statements Concerning the Black Luon Issue On or After March 18**

Plaintiff also fails to plead the falsity of lululemon's statements on or after March 18 concerning (i) its investigation into the sheerness issue and (ii) its commitment to quality. *See* CAC ¶¶ 80, 81, 90-103.

Again, statements are plucked from context and inaccurately characterized. Plaintiff alleges that the March 18 press release attempted to "minimize[e]" the black luon issue as a "mere 'inconvenience'" but omits the actual origin of this quotation, the CEO's direct apology to consumers: "We regret any inconvenience this has caused to our guests." *See* CAC ¶¶ 53, 93; Ex. 1, Entry 10. Plaintiff also accuses lululemon of falsely stating on March 18 that "it only learned of the black Luon sheerness problem on March 11" (CAC ¶ 93), when lululemon actually explained that it "began to understand *the extent of the [black luon] issue* on Monday, March 11th" (*see* Ex. 1, Entry 11).

Plaintiff also challenges Defendants' March 18 and 21 statements that lululemon was "working closely with [its manufacturer, Eclat] to understand what happened during the period this fabric was made" (CAC ¶¶ 53, 61, 94, 113), that the sheer luon pants "did not 'meet [its] technical specifications'" (CAC ¶¶ 94, 113), that it had "used the same manufacturing partner since 2004" and thus the defect "was not the result of changing manufacturers or quality of ingredient" (CAC ¶ 53), and that "it had a dedicated team" working to identify and resolve the problem (CAC ¶ 97). *See* Ex. 1, Entries 10, 17. But the Complaint is devoid of any facts

[11] *See Local No. 38 Int'l Bhd. of Elec. Workers Pension Fund v. Am. Express Co.*, 724 F. Supp. 2d 447, 461 (S.D.N.Y. 2010) (confidential witness allegations insufficient where they "do not establish what specific contradictory information the Individual Defendants received or when they received it"), *aff'd*, 430 F. App'x 63 (2d Cir. 2011).

demonstrating that lululemon: (i) was not in fact working closely with its manufacturers to understand what happened, (ii) knew the sheer luon pants met its technical specifications, (iii) had used a different manufacturing partner, or (iv) did not have a dedicated team working to investigate the sheerness issue.[12]

Plaintiff claims it was further misled by lululemon's April 3 update concerning its luon investigation because the Company purportedly disclosed that it "was taking significant actions to ensure that no such product failures occur in the future" but failed to disclose that "the Company's quality control problems continued, were not limited to black luon bottoms, and were not fully corrected by the Company's purported remedial measures." CAC ¶ 99. But what lululemon actually stated on April 3 was that it had "initiated three work streams to address what we believe are the contributing causes" of the sheerness issue and provided further detail concerning each work stream. Ex. 12; *see also* Ex. 1, Entry 19. Lululemon did not say that *all* quality issues were behind the Company. Ex. 1, Entry 19. The Complaint does not allege that the "3-work stream" statement was false, nor does it plead any particularized facts showing what additional "quality control problems" existed and should have been disclosed on April 3. Plaintiff thus fails to plead with particularity "why and how" the alleged misstatements concerning the black luon investigation were misleading. *See Rombach v. Chang*, 355 F.3d 164, 174 (2d Cir. 2004).[13]

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[12] Plaintiff's challenge to the statements cited in CAC ¶¶ 24, 62, 95, 96 (regarding "battery of tests" conducted by independent inspection company) fails for the same reason. Ex. 1, Entry 13. Plaintiff does not allege what tests, with respect to which products, for which seasons, and what potential defects, were not performed consistently with lululemon's public statements. Separately, the statement alleged in CAC ¶ 24 fails to sustain a claim because the statement was made more than a year before the beginning of the Class Period (*see* Ex. 17 at 14) and the statement alleged in CAC ¶¶ 1, 23, 109 ("maniacal about protecting" luon quality) fails for the same reason, as it was also made more than a year before the start of the Class Period on June 10, 2011. CAC ¶ 23.

[13] Plaintiff cannot rely on its CWs to support the falsity of the challenged statements concerning the black luon investigation. Only four of the eleven CWs even worked at lululemon at the time of the black luon announcement on March 18, and none of those CWs claims to have been involved in or have any knowledge concerning the pullback of black luon pants, the investigation, or the actions lululemon took to address the problem. *See* Ex. 2; *Novak*, 216

Finally, many of the challenged statements made on or after March 18 are merely general statements concerning lululemon's commitment to quality (*see* CAC ¶¶ 93, 95, 99; Ex. 1, Entries 9, 11-14, 18; *supra* at p. 9) and as such are not actionable, and, even if they were, Plaintiff does not adequately plead that these expressions of belief and opinion were objectively false or not honestly held when made. *See supra* at p. 8.[14]

## II. PLAINTIFF FAILS TO PLEAD SCIENTER

Separately, Plaintiff's claims should be dismissed for failure to plead scienter—"a mental state embracing intent to deceive, manipulate, or defraud." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007) (citation omitted). In determining if Plaintiff has met its burden of pleading "an inference of scienter *at least as likely as any plausible opposing inference*," the Court

> must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff . . . but also competing inferences rationally drawn from the facts alleged. An inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for the defendant's conduct.

*Id.* at 314 (emphasis added).[15]

The Complaint suggests the following theory of fraud: sometime before the start of the Class Period, Defendants allegedly became (or recklessly failed to become) aware of a major sheerness defect in their black luon yoga pants or of serious quality control deficiencies. Instead of disclosing this defect, as the Company ultimately did in March 2013, Defendants continued to tout lululemon's commitment to quality and the belief that lululemon offered high quality

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F.3d at 314 ("[W]here plaintiffs rely on confidential personal sources" they must "provide an adequate basis for believing that the defendants' statements were false").

[14] Plaintiff's challenge to the statements alleged in CAC ¶ 97 (Ex. 1, Entries 15, 16) fails because Plaintiff fails to plead any facts, much less particularized facts, demonstrating the falsity of the challenged statements concerning the complexity of testing protocols for sheerness.

[15] *See also Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 197 (2d Cir. 2008) (inference of scienter must be "at least as compelling" as any competing inferences) (citation omitted).

technical products that allowed it to charge higher prices than its competitors. Defendants purportedly did so despite knowing that lululemon was on a path toward shipping sheer yoga pants to its stores, hoping that they would get away with this "fraud" because no one would notice.

There is, of course, an alternative theory: lululemon sells athletic wear at higher prices because consumers recognize it as a quality brand. Lululemon knows this and discloses in its SEC filings that quality is mission critical and that lululemon has processes in place to ensure that quality. Lululemon is also a relatively young company that is not immune to growing pains. When it experienced problems with respect to certain colors bleeding, the Company apologized and addressed it publicly. *See* Ex. 16. In March 2013, lululemon experienced a serious problem when black luon yoga pants made their way into customers' hands despite a sheerness defect. The Company immediately pulled back the affected product, offered a refund to affected customers, and quickly moved to rectify the root causes it identified. This theory offers something that Plaintiff's version lacks: plausibility.

Even setting aside the implausibility of the story alleged in the CAC, Plaintiff's specific scienter allegations (CAC ¶¶ 107-116) do not satisfy the Second Circuit's standard for pleading (i) motive and opportunity or (ii) conscious misbehavior and recklessness.[16]

**A. Motive and Opportunity**

"In order to raise a strong inference of scienter through 'motive and opportunity' to defraud, Plaintiffs must allege that [the defendants] 'benefitted in some concrete and personal way from the purported fraud.'" *ECA*, 553 F.3d at 198 (quoting *Novak*, 216 F.3d at 307-08).

[16] Plaintiff may establish a strong inference of scienter only by pleading particularized facts that "(1) show[] that the defendants had both motive and opportunity to commit the fraud or (2) constitute strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007). Where a "plaintiff has failed to demonstrate that defendants had a motive to defraud . . . he must produce a stronger inference of recklessness." *Kalnit v. Eichler*, 264 F.3d 131, 143 (2d Cir. 2001) (emphasis added).

Here, the only 'motive' allegation provided by Plaintiff relates to stock sales by Mr. Wilson and Ms. Day. However, "no inference of scienter should be drawn from insider trading activity unless that activity is unusual." *George v. China Auto. Sys., Inc.*, 2012 WL 3205062, at *9 (S.D.N.Y. Aug. 8, 2012) (Forrest, J.) (citing *Acito v. IMCERA Grp., Inc.*, 47 F.3d 47, 54 (2d Cir. 1995)). There was nothing "unusual" about either Mr. Wilson's or Ms. Day's Class Period trading activity.

*1. Mr. Wilson's Stock Sales*

Mr. Wilson's Class Period stock sales occurred pursuant to a 10b5-1 plan (the "Trading Plan") (*see* CAC ¶¶ 74, 77; Ex. 18), and it is undisputed that the total sales at issue constituted a small percentage of Mr. Wilson's lululemon holdings.[17] Mr. Wilson started the Class Period with 42,737,495 shares and ended the Class Period with 40,423,995 shares, thus retaining over 94% of his pre-Class Period holdings. Ex. 19. Further, there is nothing remotely "suspicious" about the amount or timing of the sales transactions executed by Merrill Lynch pursuant to the Trading Plan. Merrill Lynch sold only 2.3 million of Mr. Wilson's shares during the Class Period—*i.e.*, 5.4% of his total shares owned. CAC ¶ 77.[18] The Second Circuit and this Court consistently have found much larger sales not suspicious. *See, e.g.*, *Rothman v. Gregor*, 220 F.3d 81, 94 (2d Cir. 2000) (9%); *Kwalbrun v. Glenayre Techs., Inc.*, 1999 WL 1212491, at *2

[17] Knowing that "trades under [a] 10b–5–1 plan do not raise a strong inference of scienter," *Glaser v. THE9, Ltd.*, 772 F. Supp. 2d 573, 592 (S.D.N.Y. 2011), Plaintiff appears to have strategically started the Class Period 5 months earlier than in the initial complaint so that Mr. Wilson's 10(b)5-1 plan was "entered into" during the Class Period and thus would not automatically protect against a finding of scienter. *See supra* at p. 4, n.2. Plaintiff's unsupported assertion that Mr. Wilson entered into the 10(b)5-1 plan during the Class Period "in order to capitalize on the increase in Lululemon's stock price" and then "moved extremely quickly to unload a substantial portion of the shares he had allotted in the 2012 Trading Plan" (CAC ¶ 74) is flatly contradicted by the terms of the Trading Plan (which limit the amount of sales every month) and the small number of shares sold. *See* Exs. 18-21; Allerhand Decl. ¶ 3.

[18] Plaintiff understates Mr. Wilson's holdings by failing to include10,328,858 shares held by Mr. Wilson through LIPO Investments (USA) Inc ("LIPO"). Specifically, Mr. Wilson held 5,164,429 shares through LIPO at the start of 2010 that doubled on July 11, 2011 as a result of a two-for-one stock split. Ex. 20, ll. a, 52-53. Thus, he sold approximately 5.41% of his stock during the Class Period, not 7% as alleged in the CAC. Ex. 21.

(2d Cir. Dec. 16, 1999) (11%); *Acito*, 47 F.3d at 54 (11%); *In re Gildan Activewear, Inc. Sec. Litig.*, 636 F. Supp. 2d 261, 271 n.5 (S.D.N.Y. 2009) (22.5%). Moreover, Mr. Wilson's sale of 5.41% of his total holdings was in line with his historical trading practice: Mr. Wilson sold 4.88% of his shares in 2010, 4.05% in 2011, and 3.91% in 2012. Ex. 21.[19] *See Gildan*, 636 F. Supp. 2d at 270 ("[i]nsider stock sales are unusual where the trading was in amounts dramatically out of line with prior trading practices") (internal citations omitted).

Indeed, according to Plaintiff, the first alleged corrective disclosure of the black luon issue on March 18, 2013 had "a devastating impact on Lululemon" that caused the stock price to "decline[] sharply." CAC ¶¶ 63, 91. But Merrill Lynch sold only 300,000 of Mr. Wilson's shares before the March 18 announcement. In contrast, Merrill Lynch sold 2 million shares (or 87.0% of Wilson's alleged Class Period sales) *after* the black luon issue was announced and *after* the stock price had declined that day. CAC ¶ 77; Ex. 20, Entries 127-37. Such facts do not logically support an inference of scienter. *See City of Taylor Gen. Emps. Ret. Sys. v. Magna Int'l Inc.*, 2013 WL 4505256, at *24 (S.D.N.Y. Aug. 23, 2013) (stock sales are unusual only "at times calculated to maximize the personal benefit from undisclosed inside information") (citation omitted).[20]

*2. Ms. Day's Stock Sales*

To start, the fact that Ms. Day "increased [her] . . . holdings during the Class Period," from 35,232 shares to 60,567 shares (Ex. 22), is "wholly inconsistent with fraudulent intent."[21]

[19] "When a complaint alleges only 'incomplete information' concerning insider sales, the court is 'free to consider' defendants' SEC filings to fill gaps on motion to dismiss." *Glaser*, 772 F. Supp. 2d at 587 (citations omitted).

[20] Mr. Wilson's high trading volume from mid-May to early June 2013—including his sale on June 7 (CAC ¶ 75)—is explained by the express terms of the Trading Plan itself, rather than any fraudulent purpose. *See* Allerhand Decl. ¶ 3; Ex. 18.

[21] Notably, Plaintiff omits Ms. Day's March 29, 2013 trade—which resulted in a net increase in her holdings during the Class Period—from its Complaint. *See* CAC ¶ 79; Ex. 22, Entry 8.

*In re Bristol-Myers Squibb Sec. Litig.*, 312 F. Supp. 2d 549, 561 (S.D.N.Y. 2004). Further, Ms. Day's Class Period trading activity, set forth in Exhibit 22, is entirely consistent with her practice of exercising recently vested stock options and immediately selling an identical number of shares on a quarterly basis in March, June, September, and December, as shown in Ex. 23. Ms. Day's Class Period sales were also consistent with her trading activity in prior years. *See* Ex. 24 (showing sales of 74.25% of the shares she held or acquired during the 9-month Class Period, sales of 90.67% of such shares in 2012, sales of 93.48% of such shares in 2011, and sales of 81.89% of such shares in 2010). And the timing of the alleged trades further undermines any fraudulent intent as Ms. Day sold no stock for months leading up to the March 18 announcement of the black luon issue. Ex. 23. *See Glaser*, 772 F. Supp. 2d at 587 ("Whether trading was unusual or suspicious turns on factors including . . . whether sales occurred *shortly before corrective disclosures*.") (emphasis added).

**B. Conscious Misbehavior or Recklessness**

Unable to plead motive, Plaintiff must demonstrate that Defendants acted with conscious misbehavior or recklessness. To plead conscious misbehavior, Plaintiff must allege with particularity that Defendants engaged in "deliberate illegal behavior." *Novak*, 216 F.3d at 308. The bar for pleading recklessness is equally high: Plaintiff must allege that Defendants "knew facts or had access to information suggesting that their public statements were not accurate," or "failed to review or check information that they had a duty to monitor." *Dynex*, 531 F.3d at 196. To meet this standard, a plaintiff "'must *specifically identify* the reports or statements that are contradictory to the statements made, or must provide specific instances in which [d]efendants received information that was contrary to their public declarations,' and that 'was available to the defendants [ ] *at the same time* they made their misleading statements.'" *Sinay*, 2013 WL 1890291 (citations omitted, emphasis added).

In support of its claim that Ms. Day recklessly misled investors regarding lululemon's product quality, Plaintiff merely states the obvious: Ms. Day was "involved" in and "regularly received reports on the severity and breadth of product quality issues." CAC ¶ 114. Only four CWs purport to ascribe knowledge to Ms. Day, but none of these credibly sets forth the requisite particularized allegations of specific, contradictory information available to Ms. Day at the time of the alleged misstatements. For example, CW2 alleges only that Ms. Day was "'notified' about 'pretty much everything that happened'" and received "regular reports" on "product quality issues"—all of which presumably could have been entirely consistent with Ms. Day's statements about lululemon's commitment to quality and its product quality. CAC ¶ 43. Similarly, CW10 alleges that "when a product quality issue was 'bad', it would be elevated to Defendant Day." CAC ¶ 43.[22] These generalized allegations fail to set forth the requisite particulars concerning (i) what issues existed; (ii) with respect to what products; (iii) of what scale (*i.e.*, customer complaints vs. discovery of a manufacturing or design flaw); (iv) at what moment in time—much less (v) how and when Ms. Day was notified of these specifics.[23]

Plaintiff also attempts to plead scienter based on Ms. Day's resignation. But the CAC alleges only that Ms. Day's resignation was "abrupt[]," "sudden," "suspicious[]," and "follow[ed] the Company's worst product quality disaster in its history." CAC ¶ 114. In fact, the resignation occurred months after the March 18 announcement and the allegations do nothing

[22] As discussed *supra* at p. 11, CW1 fails to provide any of the requisite details concerning the source or scale of the purported "sheerness issue" such that Ms. Day's opinions and statements were knowingly or recklessly false when made. And CW6 merely alleges that in the "winter of 2012-2013," Ms. Day purportedly stated that "quality was sacrificed" due to growth (CAC ¶ 32)—an inherently backward-looking assessment. This does not suggest, much less plead with particularity, that Ms. Day was contemporaneously aware of an undisclosed quality issue that rendered the September and December 2012 statements knowingly or recklessly false when made.

[23] *See supra* at p. 11 nn. 11, 12; *Landesbank Baden-Wurttemberg v. Goldman, Sachs & Co.*, 821 F. Supp. 2d 616, 621 (S.D.N.Y. 2011) ("To move past the pleading stage, plaintiff must specify the internal reports, who prepared them and when, how firm the numbers were or which company officers reviewed them.") (internal quotation marks and citation omitted), *aff'd*, 478 F. App'x 679 (2d Cir. 2012).

to link Ms. Day's resignation with any purported fraud. *See In re PXRE Grp. Ltd., Sec. Litig.*, 600 F. Supp. 2d 510, 545 (S.D.N.Y. 2009) (absent "additional factual allegations linking [the executives'] resignation . . . to the alleged fraud," such allegations are "insufficient to raise a strong inference of scienter" and collecting cases), *aff'd sub nom. Condra v. PXRE Grp. Ltd.*, 357 F. App'x 393 (2d Cir. 2009).[24]

Grasping at straws, Plaintiff argues that a handful of prior issues dating back to 2007 that had nothing to do with luon "put Defendants on notice" that their statements concerning the quality of lululemon's products were false and misleading. CAC ¶ 111. Plaintiff does not (because it cannot) explain how seaweed clothing (CAC ¶ 34), shopping bags (CAC ¶ 37), color bleeding (CAC ¶ 38), swimwear (CAC ¶ 41), or men's waistbands (CAC ¶ 42) (none of which relate to the design or manufacture of luon) have any relationship to the sheerness defect. And in any event, far from showing fraudulent intent, Plaintiff's allegations primarily rely on lululemon's prior *public* disclosures—disclosures demonstrating that, far from engaging in a fraud to conceal 'risks' and 'bad news,' lululemon promptly disclosed product problems when they arose.[25]

In sum, instead of pleading particularized facts as to specific information or reports internally available to Defendants that contradicted their public statements, Plaintiff takes lululemon's disclosures issued *after* its investigation of the sheerness issue and, without support,

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[24] As set forth in Mr. Wilson's memorandum of law in support of his motion to dismiss, the CAC does not contain a single particularized allegation concerning what information was available to Mr. Wilson, how it contradicted lululemon's public statements, or whether it was available to him at the time of any of the challenged statements.

[25] *See, e.g.*, *Rombach*, 355 F.3d at 176 ("[T]he allegation that defendants behaved recklessly is weakened by their disclosure of certain financial problems prior to the deadline to file [the company's] financial statements."); *Local No. 38 Int'l Bhd. of Elec. Workers Pension Fund v. Am. Exp. Co.*, 724 F. Supp. 2d 447, 463 (S.D.N.Y. 2010) (allegations that individual defendant misled investors concerning loan loss reserves were belied by the company's "disclos[ure of] the method by which it calculated loss reserves in its public filings"), *aff'd*, 430 F. App'x 63 (2d Cir. 2011).

ascribes this knowledge to the Defendants at the beginning of the Class Period.[26] This pleading tactic has been repeatedly rejected by this Court and others in the Second Circuit. *Sinay*, 2013 WL 1890291, at *8 (allegations regarding after-the-fact disclosures are "classically insufficient to support a strong inference of scienter absent well-pleaded and plausible factual allegations about what specific information contradicting [defendant's] public statements was available to [defendant] at the time those statements were made"); *Foley v. Transocean Ltd.*, 861 F. Supp. 2d 197, 121 (S.D.N.Y. 2012) (dismissing complaint where the alleged facts that defendants concealed were "almost entirely derived from sources" related to the company's investigation after the alleged corrective disclosure).

**C. Corporate Scienter**

Where, as here, plaintiffs cannot raise any inference of scienter as to any individual defendant, they can nevertheless attempt to demonstrate "corporate" scienter by pleading an alleged misstatement "so dramatic" that it "would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false." *Dynex*, 531 F.3d at 195-96. As an example of such a radical misstatement, the Second Circuit described a scenario where "General Motors announced that it had sold one million SUVs in 2006, and the actual number was zero." *Id.* (quoting *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 710 (7th Cir. 2008)). The purportedly radical misstatement alleged by Plaintiff here—a statement displayed on the "careers" section of lululemon's website that "lululemon's

[26] *Compare, e.g.*, CAC ¶¶ 81(c), 83(c) (Defendants allegedly knew "testing protocols were incomplete" at the start of the Class Period), *with* Ex. 12 (disclosing that "after an evaluation" of the black luon issue announced on March 18, lululemon had found that certain "testing protocols were incomplete"); *compare also* CAC ¶¶ 81(d), 83(d), *with* Ex. 1, Entries 17, 19. CW5's assertions—that the black luon pants "never would have even left lululemon's manufacturing plants" had SGS tested them properly (CAC ¶ 62) and that Eclat was purportedly "sending it test reports . . . that weren't actually accurate" (CAC ¶ 61)—does not cure the CAC's fatal lack of particularity. CW5 does not identify what testing protocols were employed by SGS or Eclat, how SGS and Eclat deviated from these testing protocols, or when and how any executive officer was specifically made aware of these deviations, much less plead any facts demonstrating a connection between these purported deviations from unidentified protocols and the sheer luon issue.

assured quality level is the highest in the industry" (CAC ¶¶ 80, 108) (quoting Ex. 15)—does not remotely resemble the Second Circuit's "General Motors" scenario where a key corporate fact (not belief) was misrepresented, or other examples where courts in this Circuit have found corporate scienter based on misstatements of similar significance.[27]

## III. PLAINTIFF FAILS TO PLEAD LOSS CAUSATION

The Second Circuit's standards for pleading loss causation are clear cut and familiar. The Complaint "must allege . . . that the *subject* of the fraudulent statement or omission was the cause of the actual loss suffered, *i.e.*, that the misstatement or omission concealed something from the market that, *when disclosed*, negatively affected the value of the security." *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 173 (2d Cir. 2005) (second emphasis added) (internal citation and quotation marks omitted). Failure to make this basic showing requires dismissal. *See, e.g.*, *Cent. States, S.E. & S.W. Areas Pension Fund v. Fed. Home Loan Mortg. Corp.*, 2013 WL 5911476, at *7 (2d Cir. Nov. 5, 2013) (affirming dismissal for failure to adequately plead loss causation).[28] Here, Plaintiff seeks to recover losses allegedly resulting from (i) the black luon announcement on March 18 and (ii) five supplemental "corrective disclosures" issued thereafter. For the Court's convenience, we have attached as Exhibit 3 a chart detailing the alleged corrective disclosures and lululemon's stock price movements following the disclosures.

To start, Plaintiff fails to plead loss causation based on the March 18 black luon announcement because the Complaint does not plead that the March 18 announcement revealed "some then-undisclosed fact with regard to the specific misrepresentations alleged in the

[27] *See, e.g.*, *Sgalambo v. McKenzie*, 739 F. Supp. 2d 453 (S.D.N.Y. 2010), (finding corporate scienter where company's exposure in key joint venture understated by 35%); *In re MBIA, Inc., Sec. Litig.*, 700 F. Supp. 2d 566, 574, 590-93 (S.D.N.Y. 2010) (finding corporate scienter where company misstated its CDO exposure by $8.1 billion); *In re NovaGold Res. Inc. Sec. Litig.*, 629 F. Supp. 2d 272, 299 (S.D.N.Y. 2009) (finding corporate scienter where company restated capital costs by $2.6 billion one year after project began).

[28] *See also Solow v. Citigroup Inc.*, 507 F. App'x 81, 82 (2d Cir. 2013) (affirming dismissal for failure to adequately plead loss causation); *GE Investors v. Gen. Elec. Co.*, 447 F. App'x 229, 231-32 (2d Cir. 2011) (same).

complaint." *Cent. States*, 2013 WL 5911476, at *2 (quoting *In re Omnicom Grp., Inc. Sec. Litig.*, 597 F.3d 501, 511 (2d Cir. 2010)*; see* Point I, *supra.* Further, the risk of a product defect was expressly stated in the very same disclosures that contain the allegedly misleading statements. *See supra* at p. 5; Ex. 1, Entries 1, 2, 4; Ex. 5 at 30; Ex. 6 at 30; Ex. 26 at 10, 11. It is a bedrock principle of the securities laws that the materialization of a *disclosed* risk does not demonstrate loss causation. *See Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147, 158 (2d Cir. 2007) (affirming dismissal when defendant "provided substantial indicia of the risk that [the company] would file for bankruptcy," so the risk was not concealed) (citation and internal quotations omitted).[29]

Plaintiff's attempt to establish loss causation in connection with any post-March 18 disclosures fares no better: several are media or analyst commentary (not lululemon disclosures), others were followed by stock price increases (not declines), and the sole remaining corrective disclosure on June 10 is wholly unrelated to the alleged fraud. *First*, the purportedly "corrective disclosure" issued on April 18 is no such thing. CAC ¶ 101; Exs. 3, 25. This is a news article that regurgitated previously disclosed information, not a lululemon disclosure that revealed new, previously concealed information. *See Cent. States*, 2013 WL 5911476, at *2 (affirming dismissal of the complaint where plaintiff did not "identify how the alleged corrective disclosures even purported to reveal some then-undisclosed fact with regard to the specific misrepresentations alleged in the complaint").[30]

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[29] *See also Lentell*, 396 F.3d at 177 (same, when "substantial indicia of the risk that materialized are unambiguously apparent on the face of the disclosures alleged to conceal the very same risk").

[30] Plaintiff's reliance on analyst reports to plead loss causation (*see* CAC ¶¶ 92, 98) is misplaced. "[T]hird-party articles and reports" that merely "express[] negative opinions . . . based on information that [is] already publicly available . . . . are not 'corrective' for the purpose of pleading loss causation." *Cent. States*, 2013 WL 5911476, at *2 (citing *Omnicom*, 597 F.3d at 512); *see also Janbay v. Canadian Solar, Inc.*, 2012 WL 1080306, at *16 (S.D.N.Y. Mar. 30, 2012) (the "raising of questions and speculation by analysts and commentators does not reveal any 'truth' about an alleged fraud as required by *Dura*").

*Second*, Plaintiff does not plead that lululemon's stock price declined following the release of the March 19 news articles (CAC ¶ 94), the April 3 luon update (CAC ¶ 99), or the April 12 Facebook post (CAC ¶ 101). And, in fact, lululemon's stock price increased, not declined, following each of these disclosures. *See* Exs. 3, 4. Plaintiff thus runs afoul of the most basic requirement of loss causation pleading set forth in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005)—a stock price drop. *See Masters v. GlaxoSmithKline*, 271 F. App'x 46, 51 (2d Cir. 2008) (complaint fails to plead loss causation when it does not link a corrective disclosure with a drop in share price).

*Third*, and most important in terms of Plaintiff's strategic but unsupported effort to expand the Class Period and potential damages, Plaintiff fails to plead any facts connecting (i) Ms. Day's June 10 resignation announcement and the following stock price decline to (ii) the alleged fraud involving the black luon issue disclosed months earlier on March 18. Rather than address the actual disclosure of Ms. Day's decision to leave lululemon for "personal" reasons when a successor was appointed (Ex. 28), Plaintiff speculates that she was a casualty of the black luon issue. CAC ¶¶ 70-71. This does not come close to the Second Circuit's standard for pleading loss causation, which requires that a corrective disclosure provide new information that reveals the falsity of a defendant's prior alleged misstatements. *See Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 175 n.4 (2d Cir. 2005).

Indeed, the Second Circuit rejected similarly deficient allegations at the summary judgment stage in *In re Omnicom Grp., Inc. Sec. Litig.*, where the "essence" of plaintiffs' claim was that a director's resignation was allegedly related to the company's accounting practices, and that "the resultant negative publicity suggesting possible accounting malfeasance may lead to recovery for a temporary drop in share price." 597 F.3d at 510-13. However, like the announced

departure of Ms. Day, the director's resignation in *Omnicom* did not establish loss causation because the resignation was not "even purported to reveal some then-undisclosed fact with regard to the specific misrepresentations alleged in the complaint." *Id. See Cent. States*, 2013 WL 5911476, at *2 (applying this *Omnicom* standard at the pleading stage).

Similarly, in *Police & Fire Retirement System of the City of Detroit v. SafeNet, Inc*., 645 F. Supp. 2d 210, 229 (S.D.N.Y. 2009), plaintiffs alleged that the defendant CFO's resignation served as a corrective disclosure of the defendant company's accounting practices. The Court dismissed the complaint for a failure to plead exactly "how the [resignation] disclosure is related to the fraud claims" and held that "[s]tanding alone, the announcement of the departure of an officer, without explanation, would not alert investors to any improprieties so as to allege loss causation." *Id.* Rather, the CFO's resignation "was just another item of news [] which had to be disclosed but is wholly unrelated to the fraud that Plaintiffs plead in the Complaint." *Id.*

Just like in *Omnicom* and *Safenet*, there are no allegations here that connect the announcement of an officer's departure (and subsequent stock price drop) to the fraud claims. There is no previously undisclosed risk or misstated fact that was in any way "corrected" or materialized by Ms. Day's decision to leave lululemon for personal reasons, and the claim that the following stock drop was caused by the alleged fraud involving earlier statements concerning the Company's "quality" must be dismissed.[31]

## CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court dismiss the Complaint with prejudice, or alternatively stay the action pending the Supreme Court's ruling in *Halliburton*.

[31] Because Plaintiff fails to state a claim for a primary violation under Section 10(b) and Rule 10b-5, its control person claim under Section 20(a) also fails. *See Rombach*, 355 F.3d at 178.

Dated: December 4, 2013
New York, New York

Respectfully submitted,

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