No. 15-55173

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE QUALITY SYSTEMS, INC. SECURITIES LITIGATION

CITY OF MIAMI FIRE FIGHTERS' AND POLICE OFFICERS' RETIREMENT TRUST, et al.,
Plaintiffs-Appellants,

– v. –

QUALITY SYSTEMS, INC., et al.,
Defendants-Appellees-Petitioners.

On appeal from the United States District Court
For the Central District of California
No. 8:13-cv-01818-CJC-JPR
The Honorable Cormac J. Carney

BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR REHEARING EN BANC

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CORPORATE DISCLOSURE STATEMENT

Amicus curiae the Securities Industry and Financial Markets Association states that it is not a subsidiary of another corporation, and no publicly held corporation owns 10% or more of its stock.

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STATEMENT OF IDENTITY, INTEREST AND AUTHORITY[1]

The Securities Industry and Financial Markets Association ("SIFMA") is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the United States, serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("GFMA").[2] As an organization, SIFMA has an interest in the strong, accurate and timely enforcement of the federal securities laws. Moreover, many of SIFMA's members are frequent targets of class action litigation. SIFMA routinely appears as *amicus curiae* in appeals that implicate these concerns.

Whether a forward-looking statement, otherwise protected by the Private Securities Litigation Reform Act's ("PSLRA") safe harbor provision, can become

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[1] SIFMA hereby certifies that no counsel for a party authored this brief in whole or in part; that no party or counsel for a party contributed money that was intended to fund preparation or submission of this brief; and that no person other than the *amicus curiae*, its members or its counsel, contributed money that was intended to fund preparation or submission of this brief. All parties have consented to the filing of this brief.

[2] For more information, visit http://www.sifma.org.

actionable when accompanied by a materially false or misleading non-forward-looking statement raises issues important to the administration of the federal securities laws. The rule adopted by the Panel and opposed by Petitioner would undermine principles that support the effective and efficient functioning of the securities markets and chill companies from providing investors with valuable forward-looking information. This result runs contrary to the interest of American companies and investors and subverts a key purpose of the PSLRA.

PRELIMINARY STATEMENT

Congress enacted the PSLRA twenty-odd years ago to stem the tide of abusive securities litigation. One key corrosive effect of the pre-PSLRA *status quo* was that American companies could not share forward-looking projections with investors, lest any shortfall in their projections allow enterprising plaintiffs to embroil them in unfounded, but costly, litigation. Understanding the importance of such forward-looking information to the efficient functioning of the capital markets, Congress sought to unmuzzle American companies by providing them with a flexible, bifurcated safe harbor for forward-looking statements that might appear to have been misleading in hindsight. The first prong of the safe harbor provides an objective test: forward-looking statements are rendered inactionable when they are accompanied by meaningful cautionary language.

The Panel's holding that cautionary language that does not correct materially false or misleading non-forward-looking statements accompanying forward-looking statements can never satisfy the requirements of the first prong of the safe harbor, *see* Op. at 30, 33-34, has far-reaching pernicious implications. The Panel's rule has no basis in either the text of the statute or its legislative history, and if left to stand, would create a loophole that, applied literally, would swallow whole the first prong of the PSLRA's safe harbor. Under the Panel's rule, any time a company failed to meet a projection, that projection would not be protected under the objective prong of the safe harbor if plaintiffs could show that the forward-looking projection was accompanied and supported by a non-forward-looking statement that was materially false or misleading, regardless of whether the company knew that that non-forward-looking statement was misleading or of whether that non-forward-looking statement was material to the forward-looking statement. As a practical matter, the court's statement would read the objective prong of the safe harbor out of the PSLRA and could cause American companies to once again leave investors in the dark about their future prospects, thereby defeating Congress's intent in creating the safe harbor.

ARGUMENT

I. The PSLRA Safe Harbor Is Critical In Promoting The Flow Of Crucial Forward-Looking Information From Companies To Investors

A. Before The PSLRA, The Specter Of Abusive Securities Litigation Prevented Companies From Providing Valuable Forward-Looking Information To Investors

While believing that proper private securities lawsuits "promote public and global confidence in our capital markets and help to deter wrongdoing," Congress was "prompted by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and maintain confidence in our capital markets." H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730. The House and Senate Committees heard evidence that abusive practices committed in private securities litigation included "the routine filing of lawsuits against issuers of securities and others whenever there [was] a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action," and "the abuse of the discovery process to impose costs so burdensome that it [was] often economical for the victimized party to settle." *Id.*

Beyond merely imposing a deadweight litigation cost on American businesses, however, the abusive litigation practices prevalent in the early 1990s also had a pernicious "muzzling effect" on American companies. *Id.* at 42.

Although forward-looking information was "often considered a critical component of investment recommendations made by broker-dealers, investment advisers and other securities professionals," Safe Harbor for Forward-Looking Statements, Securities Act Release No. 33-7101, 57 SEC Docket 1999 (Oct. 13, 1994), and "[u]nderstanding a company's own assessment of its future potential would be among the most valuable information shareholders and potential investors could have about a firm," H.R. Rep. No. 104-369, at 43 (quoting testimony of Hon. Richard C. Breeden, former Chairman, SEC, before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs, April 6, 1995), American companies that made forward-looking statements prior to the enactment of the PSLRA did so at tremendous peril of litigation. As Congress recognized, "If a company fail[ed] to satisfy its announced earnings projections—perhaps because of changes in the economy or the timing of an order or new product—the company [was] likely to face a lawsuit." *Id.* A significant number of firms "were reluctant to discuss their performance with analysts or the public because of the threat of litigation," *id.*, and as former SEC Commissioner J. Carter Beese testified, this corporate silence was enforced by "legions of lawyers scrub[bing] required filings to ensure that disclosures [were] as milquetoast as possible, so as to provide no grist for the litigation mill." *Id.* Ending this silence was a key objective of the PSLRA.

B. Congress Created A Flexible, Two-Pronged Safe Harbor To Enable American Companies To Share Valuable Forward-Looking Information With Investors

To unmuzzle corporate leadership and thereby "enhance market efficiency," Congress created a statutory safe harbor. *Id*. Building on SEC Rule 175 and the judicially-created "bespeaks caution" doctrine, Congress designed the statutory protection of forward-looking statements as a "bifurcated safe harbor that permits greater flexibility to those who may avail themselves of safe harbor protection." *Id.*

Under the first prong of the safe harbor, a forward-looking statement is not actionable so long as the statement is "identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or immaterial." 15 U.S.C. § 78u-5(c)(1)(A). This first prong sets forth an objective test to determine whether a forward-looking statement was accompanied by cautionary language that was meaningful. A court can easily administer this objective test at the motion-to-dismiss stage. Crucially, and reflecting the understanding that hindsight is 20/20, the statute does *not* require that a forward looking statement be accompanied by "all" meaningful cautionary statements. *See id*. To the contrary, Congress specifically indicated that "Failure to include the particular factor that ultimately causes the forward-looking statement

not to come true will not mean that the statement is not protected by the safe harbor." H.R. Rep. No. 104-369, at 44. Moreover, the first prong neither requires nor permits an inquiry into the defendant's *mens rea*. *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1112 (9th Cir. 2010) ("[T]he state of mind of the individual making the statement is irrelevant . . . . "). *See also* H.R. Rep. No. 104-369, at 44 ("Courts should not examine the state of mind of the person making the statement.").

By design, the "second prong of the safe harbor provides an alternative analysis," H.R. Rep. No. 104-369, at 44, focusing on the "actual knowledge" of the speaker. *See* 15 U.S.C. § 78u-5(c)(1)(B).

For over twenty years, these two prongs of the statutory safe harbor have enhanced market efficiency by giving American companies the freedom to share valuable forward-looking information with investors.

II. The Panel's Rule Functionally Eviscerates The Statutory Safe Harbor To The Detriment Of Investors And Public Markets

In reversing the district court's decision and allowing claims based on forward-looking statements to proceed, the Panel adopted a novel rule that opens the door to "the practice of 'pleading fraud by hindsight'" that the PSLRA—and the safe harbor provision specifically—was enacted to prevent. *See In re Daou Sys., Inc.*, 411 F.3d 1006, 1021 (9th Cir. 2005) (internal citation omitted); *see also In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1415 (9th Cir. 1994) (discussing the "bespeaks caution" doctrine). That rule could return companies in this Circuit

to the pre-PSLRA state of affairs and incentivize them to withhold forward-looking information of the kind that Congress deemed valuable to investors and market efficiency.

A. The Panel's Rule Will Allow Plaintiffs To Strip Forward-Looking Statements Of Safe Harbor Protection By Alleging That They Accompanied A False Non-Forward-Looking Statement

As crafted by Congress, the first prong of the safe harbor allows companies to "opt in" to safe harbor protection by bundling forward-looking statements with meaningful cautionary language. However, the Panel considered another bundling—when forward-looking statements are "accompanied by a non-forward-looking statement that supports the forward-looking statement," Op. at 30—and held that where "the non-forward-looking statement is materially false or misleading, it is likely that no cautionary language—short of an outright admission of the false or misleading nature of the non-forward-looking statement—would be 'sufficiently meaningful' to qualify the statement for the safe harbor," *id.* This rule finds no support in either the text of the statute or in its legislative history.[3] To the contrary, as explained above, Congress specifically envisioned that the important factors that companies identified in their cautionary language would be illustrative

[3] Unsurprisingly, given the clear conflict between the Panel's rule and the text and legislative history of the PSLRA, the Panel's rule is also unsupported by case law. Tellingly, in their appeal papers, Plaintiffs cite no case where a non-forward-looking statement was used to rob a forward-looking statement of safe harbor protection under the PSLRA.

rather than exhaustive.[4] Moreover, the Panel's invented rule would reach far beyond the specific (and perhaps exceptional) facts of the case at hand to rob American corporations of the objective protection Congress gave them through the first prong of the safe harbor.

An example illustrates the problem created by the Panel's rule. Consider a multinational plastics recycling company with plants around the world. Informed by the SEC guidance that encourages companies to make forward-looking statements, the company makes an earnings projection at an investor presentation and accompanies that projection with extensive cautionary language. At the same conference, however, the company provides current information about the recently-increased capacity of its plants, including its plant in Germany. Because of a communications mistake, the presentation claims that the German plant can now process 100 million kilograms of plastic a year, but the correct figure is 100 million *pounds* (45.4 million kilograms). (The figures regarding the capacity of the other plants are accurate.) The company later discloses that it failed to meet

[4] The legislative history does reveal that Congress intended that "A cautionary statement that *misstates* historical facts is not covered by the Safe [sic] harbor" but that in order to defeat the safe harbor based on an allegation that the cautionary language misstated historical facts, a plaintiff "must plead with particularity all facts giving rise to a strong inference of a material misstatement in the cautionary statement." H.R. Rep. No. 104-369, at 44 (emphasis added). The decision to limit this exception to encompass only cautionary statements with "misstatements" but not those with "omissions" illustrates how far the Panel's holding strays from congressional intent.

projections due to a variety of negative events, including the bankruptcy of its primary customer and a protracted strike at its main facility.

A purchaser of the company's securities who can allege that they were misled by the reckless statement regarding the German plant and suffered loss as a result can recover for the loss caused by the falsity of the historic statement under conventional securities law and without the aid of the Panel's ruling. However, the Panel's rule will now invite an enterprising plaintiff who suffered loss from an entirely different cause (*i.e.*, the shortfall in earnings against the projection) to sift through the company's non-forward-looking statements that accompanied the projection and ground a lawsuit about the shortfall on the alleged overstatement of the capacity of the company's plants. Instead of defending the objective quality of its cautionary language and being protected by the quality of that cautionary language, the company will now have to defend both against a claim that there was an overstatement of the German plant capacity and that such overstatement was material[5] (when no investor claims to have suffered loss from that statement and the error was not known to the company) and against the claim that the company made the projection "with actual knowledge" that it was materially false or

[5] Courts in this Circuit generally do not dismiss lawsuits for lack of materiality. *See, e.g.*, *Siracusano v. Matrixx Initiatives, Inc.*, 585 F.3d 1167, 1178 (9th Cir. 2009) ("[d]etermining materiality in securities fraud cases 'should ordinarily be left to the trier of fact.'") (alterations in original, internal citations omitted), *aff'd*, 563 U.S. 27 (2011).

misleading. Moreover, the company could be exposed to extensive and costly discovery, not just in connection with the misleading non-forward-looking statement about plant capacity, but on the significantly more expansive topic of its projections. This is precisely what Congress sought to curb when it enacted the PSLRA.

These defects are inherent in the rule that the Panel drafted. It leaves open the question of what it means for a forward-looking statement to be "accompanied" by a non-forward-looking statement that "supports" the forward-looking statement.[6] The Panel's rule provides that if any "accompanying" statements of current or historical fact are materially false, then the cautionary language must say so, or else it is not meaningful. Notably, on its face the Panel's rule appears also to apply to situations where the misstatement of a non-forward-looking fact is not material to the forward-looking statement. The Panel's language also extends to situations where the underlying statements were not made with *knowledge* of their falsity;[7] since companies cannot caution against mistakes of which they are

[6] Forward-looking statements, such as financial projections, are frequently accompanied by statements about the current or historic state of affairs which underlie those projections. *See* Op. at 18 (describing "mixed statements").

[7] To the extent the Panel's rule can be read otherwise—*i.e.*, to apply only where the accompanying materially false or misleading non-forward-looking statements were made with scienter—the rule is in conflict with the statute. *See In re Cutera Sec. Litig.*, 610 F.3d 1103, 1112 (9th Cir. 2010) ("[T]he state of mind of the individual making the statement is irrelevant . . . ."); *see also* H.R. Rep. No. 104-369, at 44 ("Courts should not examine the state of mind of the person making the

unaware, that rule would effectively destroy companies' ability to opt in to safe harbor protection through the use of cautionary statements with any degree of certainty. Together, these deficiencies open a back door to the safe harbor and incentivize creative plaintiffs' lawyers, whose zeal necessitated the PSLRA in the first place, to trawl through disclosures for a materially false or misleading non-forward-looking statement that can infect forward-looking statements.

B. The Effect Of The Panel's Rule Will Be To Restore The "Muzzling Effect" That The Safe Harbor Was Enacted To Overcome

The magnitude of the Panel's decision cannot be underestimated. Companies' forward-looking projections are often accompanied by numerous and varied statements of present and historical fact. Now, if a company in this Circuit fails to meet its projections and a plaintiff can allege that any one of the accompanying non-forward-looking statements was materially false—for whatever reason—the company will be faced with the risk of a burdensome and expensive inquiry into both the non-forward-looking statement and its state of mind as to the forward-looking statement. Companies will be incented to respond to this state of affairs as they did before the PSLRA—by "muzzling" themselves and declining to

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statement."); *id.* at 47 ("The applicability of the safe harbor provisions under [the first prong] . . . does not depend on the state of mind of the defendant."). Moreover, the Panel's rule is unnecessary in such circumstances, because a materially false non-forward-looking statement that causes loss and is made with scienter affords its own basis for a securities fraud claim.

share forward-looking information with the market. *See* H.R. Rep. No. 104-369, at 42-43 (explaining that "corporate counsel advise clients to say as little as possible"). The risk of abusive litigation could once again be too great to do otherwise.

CONCLUSION

For the foregoing reasons, SIFMA respectfully requests that this Court grant the Petitioners' Petition for Rehearing.

Dated: September 14, 2017
New York, New York

Respectfully submitted,

By: /s/ Lewis J. Liman

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