No. 20-1364

In the Supreme Court of the United States

BOFI HOLDING, INC., ET AL.,
Petitioners,
v.
HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICI CURIAE* SECURITIES AND FINANCIAL MARKETS ASSOCIATION AND CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*[1]

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association representing the interests of hundreds of securities firms, banks, and asset managers. Its mission is to support a strong financial industry, while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA is the United States regional member of the Global Financial Markets Association.

The Chamber of Commerce of the United States of America (the "Chamber") is the Nation's largest business federation. It directly represents 300,000 members and indirectly represents the interests of approximately 3 million businesses, trade, and professional organizations of every size, in every sector, and from every region of the United States. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the Nation's business community. Many of the Chamber's members are

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[1] Pursuant to Rule 37.6, Counsel of *amici* represent that they authored this brief in its entirety and that none of the parties nor their counsel, nor any other person or entity other than *amici*, their members or their counsel have made a monetary contribution intended to fund the preparation of submission of this brief. Counsel of record provided timely notice of the intent to file this *amici* brief pursuant to Rule 37.2 and both parties have consented to the filing.

companies subject to the U.S. securities laws who would be adversely affected if the decision below is not corrected.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Ninth Circuit in *Houston Municipal Employees Pension System v. BofI Holding, Inc. (In re BofI Holding, Inc. Securities Litigation)*, No. 18-55415, 977 F.3d 781 (9th Cir. 2020) further cements a circuit split as to whether uncorroborated allegations are a "corrective disclosure" sufficient to reveal the "truth" and satisfy the requirements of loss causation under *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005). The Ninth Circuit held that the filing of a wrongful termination lawsuit by a former employee of the Defendant, containing uncorroborated accusations of financial wrongdoing, could constitute a corrective disclosure that exposed the "truth" about the Defendant's business to the market. *Amici* strongly support the contrary rule in the Eleventh Circuit that allegations of wrongdoing against an issuer cannot, without any subsequent corroboration of wrongdoing, establish loss causation. The Supreme Court should accept this case to resolve the circuit split.

In splitting with the Eleventh Circuit, the Ninth Circuit ruled that the relevant question for pleading loss causation is whether the complaint indicates that shareholders reasonably *perceived* the allegations as true by acting on the information. In other words, did the stock price drop? The Ninth Circuit thus confused the element of economic "loss" with that of "loss causation." That an *allegation* caused the stock price to

drop does not mean that disclosure of *the truth* caused the stock price to drop. Simply the fact that an allegation is made against a company often causes a stock price to drop. As emphasized by Judge Lee in dissent, a stock price drop following allegations of misconduct does not indicate truth has been revealed but rather that the market perceives "an added *risk* of future corrective action."

By permitting securities fraud cases to move forward without any actual truth emerging, the Ninth Circuit incentivizes baseless litigation where there is no real indication that fraud has occurred. Plaintiffs' attorneys are even further incentivized to file securities fraud suits after every allegation about a company that is followed by a stock drop. Even though defendants may ultimately prevail in dismissing such suits at summary judgment (or trial), companies face hydraulic pressure to settle securities class actions. Companies, and shareholders, may therefore pay significant settlements to resolve securities fraud suits premised on underlying allegations of wrongdoing that are never substantiated or even shown to be related to false or misleading statements.

ARGUMENT

I. THE NINTH CIRCUIT'S DECISION IS SQUARELY AT ODDS WITH ELEVENTH CIRCUIT PRECEDENT, FURTHER DEEPENING A CIRCUIT SPLIT

A. THE CIRCUITS ARE SPLIT ON WHETHER UNCORROBORATED ALLEGATIONS CAN SERVE AS CORRECTIVE DISCLOSURES

Supreme Court review of the decision below is critical because the circuits are divided on what suffices to show a corrective disclosure for purposes of pleading loss causation in securities fraud suits.

The Eleventh Circuit has recognized that mere allegations without subsequent corroboration cannot serve as a corrective disclosure. In *Meyer v. Greene*, 710 F.3d 1189, 1201 n. 13 (11th Cir. 2013), the Eleventh Circuit held that the announcement of an SEC investigation did not constitute a corrective disclosure because, "standing alone and without any subsequent disclosure of actual wrongdoing," the fact of an investigation does not reveal to the market the "truth." The Court recognized that the disclosure of a government investigation could qualify as a partial corrective disclosure if followed by another disclosure corroborating the alleged wrongdoing, but standing alone, an investigation concerning potential wrongdoing is insufficient. *Id*. As stated by the Eleventh Circuit: "[i]t is, after all, impossible to say that an SEC investigation was the moment when the

'relevant truth beg[an] to leak out' if the truth never actually leaked out." *Id*. (citing *Dura*, 544 U.S. at 342.)

The Eleventh Circuit reinforced this rule in *Sapssov v. Health Mgmt. Assocs., Inc.*, 608 F. App'x 855, 863 (11th Cir. 2015). There, plaintiffs alleged that an analyst report that summarized a whistleblower suit by a former employee of a company, coupled with the announcement of subpoenas from a regulator, revealed to the market that the company had been engaged in fraud. *Id*. The Eleventh Circuit affirmed the dismissal of the suit, holding that whether "[t]aken independently or combined," the subpoenas, whistleblower suit, and the analyst report do not suffice as corrective disclosures. *Id* at 864. The Court emphasized that "[a]n adverse market reaction . . . does not establish the disclosure of an investigation constitutes a corrective disclosure; further allegations are required to establish that previous statements were 'false or fraudulent.'" *Id.* at 863 (citation omitted). Finally, the Court held that "[t]he market may react negatively to the disclosure of an investigation, because it 'can be seen to portend an added *risk* of future corrective action.'" *Id*. (quoting *Meyer*, 710 F.3d 1189 at 1201.)

In the decision below, the Ninth Circuit reached a wholly contrary conclusion. Although it had previously agreed with the Eleventh Circuit that the mere announcement of an internal investigation, standing alone, could "not reveal to the market any *facts* that could call into question the veracity of the company's prior statements," App. 18a (discussing *Loos v. Immersion Corp.*, 762 F.3d 880 (9th Cir. 2014), it held

that mere *allegations* in a lawsuit could do so. App. 17a. In particular, the court considered allegations made in a wrongful termination lawsuit filed against BofI Holding, Inc. ("BofI") by a former employee (Erhart) alleging financial wrongdoing at the company. *See* App. 14a-17a. According to the Ninth Circuit, "the relevant question for loss causation purposes is whether the market reasonably *perceived* [the] allegations as true and acted upon them accordingly." App. 16a. The Ninth Circuit elaborated that "[t]he fact that BofI's stock price plunged by more than 30% on extremely high trading volume immediately after the market learned of Erhart's allegations bolsters the inference that the market regarded his allegations as credible" and that "[a] price drop of that magnitude would not be expected in response to whistleblower allegations perceived as unworthy of belief." App. 17a.

This variance from the conclusion reached by the Eleventh Circuit is significant. The decision below provides that an adverse market reaction and market *perception*—regardless of evidence—is a sufficient basis to treat mere allegations as a corrective disclosure of the truth. No further corroborating disclosures are necessary to establish a corrective disclosure. And that ruling significantly undermines the force of the Ninth Circuit's ruling in *Loos* that a mere investigation cannot establish loss causation, as such a rule can be evaded merely by announcing the allegations that an investigation might consider.

The Ninth Circuit joined the Sixth Circuit in this view. The Sixth Circuit in *Norfolk Cty. Ret. Sys. v. Cmty. Health Sys.* held that mere allegations can serve

as corrective disclosures revealing the truth. *Norfolk Cty. Ret. Sys. v. Cmty. Health Sys., Inc.*, 877 F.3d 687, 696 (6th Cir. 2017). In that decision, the Sixth Circuit said that a court "must evaluate each putative disclosure individually (and in the context of any other disclosures) to determine whether the market could have *perceived* it as true." *Id.* (emphasis added). By focusing on market perception, the Sixth Circuit departed from the Eleventh Circuit's reasoning that adverse market reactions do not by themselves establish corrective disclosures.

By joining the Sixth Circuit in holding that market perception of a disclosure is what counts to render that disclosure as "true" for purposes of determining loss causation in securities litigation, the Ninth Circuit has deepened an existing Circuit Split and made the need for this Court's clarity all the more critical.

B. IN JOINING THE SIXTH CIRCUIT, THE NINTH CIRCUIT JOINED THE WRONG SIDE OF THE SPLIT WITH THE ELEVENTH CIRCUIT

In holding that allegations alone can serve as a corrective disclosure, the Ninth Circuit erred in multiple respects. First, the court held that the relevant question is whether plaintiff has alleged facts showing "the market reasonably *perceived* [the] allegations as true." App. 16a, 18a. ("If the market treats allegations in a lawsuit as sufficiently credible to be acted upon as truth. . . then the allegations can serve as a corrective disclosure."). But as this Court explained in *Dura*, the relevant question for loss causation is whether there was a loss after "*the truth*

became known" (not whether the market "perceived" that a truth became known). *See Dura*, 544 U.S. at 342-345, 347 (emphasis added). Allowing a plaintiff to plead loss causation based on showing the market treated allegations as "sufficiently credible to be acted upon" allows the loss causation element to be satisfied by a pleading of a loss. That is, a plaintiff would need to plead only that the stock price dropped following allegations, and therefore the market perceived them as truthful. Allowing such a claim to proceed confuses the element of economic "loss" with that of "loss causation." *See id.* at 342.

What is more, a decline in stock price amounting to such a "loss" may be only temporally related to an allegation of wrongdoing. The fact that a stock price drop occurred at or near the same time as a disclosure is not a proper basis to assume the price drop was a result of the market perceiving the alleged disclosure as "true." Even where the price drop did relate in whole or part to the disclosure, most investors value security and abhor unpredictability and thus may have decided it was commercially responsible to sell stock quickly in order to avoid any impending volatility, regardless of their perception of the truth or falsity of the disclosure.

The Ninth Circuit compounded its error by relying on the magnitude of the drop following Erhart's allegations to find that allegations alone could satisfy loss causation. *See* App. 17a ("The fact that BofI's stock price plunged by more than 30% on extremely high trading volume immediately after the market learned of Erhart's allegations bolsters the inference that the market regarded his allegations as credible."). As

explained by Judge Lee in dissent, a drop—even a large drop—in a stock price does not indicate a misrepresentation has been revealed, but rather "market speculation about whether fraud has occurred." App. 34a. Indeed, that BofI's shares dropped by 30% after Erhart accused BofI of wrongdoing "does not necessarily mean [that] Erhart's allegations revealed the 'truth' and acted as a corrective disclosure" but rather "is better construed as a disclosure of 'an added *risk* of future corrective action.'" App. 33a-34a.

Further, the magnitude of a drop may also be influenced by the seriousness of the accusations. Serious accusations that the market does not regard as particularly credible could cause a similar price drop as accusations of less serious wrongdoing that the market regards as very credible. The magnitude of a stock price drop following public allegations about a company should not be used as a proxy for whether the allegations have actually revealed truth.

The rule adopted by the Sixth and Ninth Circuits creates an unworkable standard. With only a bare complaint as reference, the decision below suggests a court must sort and weigh myriad factors in order to determine whether a particular percentage drop is sufficient to support an inference that the whistleblower's allegations revealed the truth, such as the nature of a purported whistleblower's allegations, the severity of the alleged wrongdoing, and other unrelated market factors. Courts could be forced to decide whether a 20% drop, or a 10% drop, or a 15% drop, is sufficient to "bolster" the inference that the

truth has been revealed. The Sixth and Ninth Circuits have not given clarity on where this line may lie.

The rule adopted in the Sixth and Ninth Circuits is additionally flawed because, if uncorroborated allegations in lawsuits are deemed to reveal truth, where is the line drawn on what form of uncorroborated information reveals truth? While the Ninth Circuit found in this case that stock price drops following anonymous blog posts authored by short-sellers were insufficient for revelation of truth, the court explicitly left open the possibility that blog posts (or other bare allegations) could qualify as corrective disclosures. Thus, it is unclear where the line is drawn. What if the blog posts were not anonymized but authored by a well-known investor? Would a Tweet with allegations be sufficient to show truth was revealed if followed by a significant stock price drop? This issue was rightfully noted by Judge Lee, who stated that permitting securities fraud suits to move forward without any additional corroboration risks subjecting public companies to significant liability over "wisps of innuendo and speculation." App. 30a.

Nor have the Sixth and Ninth Circuits addressed how litigation over a whistleblower's allegations should affect an ongoing securities case in which those allegations have been used to establish "loss causation" or vice versa. What effect if any would the subsequent dismissal of the whistleblower suit have on the securities suit? Relatedly, what effect if any should treating a whistleblower's allegations as effectively "true" for purposes of a securities suit have on the whistleblower suit in a different court?

None of the answers to these questions is clear from the Sixth and Ninth Circuit decisions. What is clear is that the case-by-case standard set out below, should it stand, will generate unpredictable and inconsistent decisions, unlike the bright-line approach taken by the Eleventh Circuit.

Under the Eleventh Circuit approach, an allegation of wrongdoing must be supported by *some* corroboration before being treated as the disclosure of "the truth" under *Dura*. In *Meyer*, the defendant company's stock price fell 7% on the date an informal SEC investigation was announced and 9% on the date a related "private order of investigation" was disclosed by the company, but afterwards "the SEC never issued any finding of wrongdoing or in any way indicated that the Company had violated the federal securities laws." *Meyer*, 710 F.3d at 1201. Thus, the Eleventh Circuit ruled that the announcement of an investigation, without more, revealed only the investigation, not that the company's previous statements were false or fraudulent. *Id.* This outcome would likely have differed had the announcements been followed by government fines or enforcement actions, as such actions would have corroborated the allegation of wrongdoing that one might read into the announcement of an SEC investigation. Similarly, this case would be different had BofI released a revenue restatement or had there been some disclosure or information alleged by plaintiffs to corroborate the mere allegations in the Erhart complaint. As noted by Judge Lee, "a surprise restatement of earnings" or "an unexplained announcement about an increase in reserves" could

confirm allegations and act as a corrective disclosure. App. 35a. There is none here.

The Eleventh Circuit rule reflects an appropriate balance of the interests underlying the securities laws. As the Supreme Court made clear in *Dura*, the purpose of the securities laws is "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause." *Dura*, 544 U.S. at 345. The Eleventh Circuit's rule serves this purpose well.

II. THE NINTH CIRCUIT'S DECISION COULD IMPOSE SIGNIFICANT COSTS ON PUBLIC COMPANIES IN THE UNITED STATES

The Ninth Circuit's ruling that securities fraud cases may move forward based on a "corrective disclosure" that may not actually be true further incentivizes the filing of fraud complaints that have no basis in fact. Every allegation or rumor about a company that precedes a drop in share price will be even more likely to precipitate the filing of a securities fraud lawsuit. Lawsuits by former employees or business counterparties accusing a company of misconduct will, coupled with a stock drop, be similarly likely to lead to a securities fraud suit. This dynamic risks "transform[ing] a private securities action into a partial downside insurance policy" for marketplace loss. *Dura,* 544 U.S. at 347-348.

Here, for instance, Plaintiffs challenged broad and generic statements in BofI public filings. *See, e.g.*, App. 6a. ("We have made significant investments in our

overall compliance infrastructure . . . ."); ("We continue to have an unwavering focus on credit quality of the bank . . . ."). Nearly any allegation or investigation regarding financial and accounting matters could be alleged to "reveal" the earlier statements were fraudulent and therefore, under the Ninth Circuit's precedent, serve as fodder for a securities fraud suit.

Critically, securities lawsuits will increasingly be filed without any actual corrective disclosure revealing the "truth" to the market—such as a financial restatement by the company. As emphasized by Judge Lee, "[w]e may end up with a scenario in which [the whistleblower] loses his [] trial, and the government agencies end their investigations without any action and yet BofI may end up settling a securities fraud case for millions of dollars to avoid litigation costs." App. 32a.

The Ninth Circuit's holding will thus further increase the already rising number of securities lawsuits. Within the last decade, the number of class action filings has dramatically increased from 164 in 2009 and 174 in 2010 to 427 in 2019 and 334 in 2020. Cornerstone Research, Securities Class Action Filings 2020 Year in Review, 38 (2021), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2020-Year-in-Review. Overall, these recent securities class action cases are "larger than before and therefore threaten much higher litigation and settlement costs than cases filed in prior years—nearly three times larger than the average for 1997 to 2017." U.S. Chamber Institute for Legal Reform, *Containing the Contagion: Proposals to Reform*

the Broken Securities Class Action System, 2 (Feb. 2019). Such claims also are being brought by an extremely small subset of the plaintiffs' bar with individual plaintiffs increasingly appointed as lead plaintiffs instead of institutional investors, indicating an increase in the sort of lawyer-driven, meritless litigation Congress long sought to eliminate. *Id.* at 14. And this rule promises many more such filings.

The expansion of securities class actions is particularly pronounced with respect to "event-driven" litigation like this case. When some circumstance or bad press causes a corporation's stock price to fall, plaintiffs immediately bring securities litigation alleging that the company should have previously disclosed the risks or misconduct that ultimately precipitated this price drop. *Id.* at 9.

While a company faced with such securities fraud suits can win on the merits (such as at summary judgment or trial), securities fraud putative class actions generally do not proceed that far. Particularly once a class is certified, defendants often face "hydraulic pressure" to settle and "avoid[] the risk, however small, of potentially ruinous liability." *Hevesi v. Citigroup Inc.*, 366 F.3d 70, 80 (2d Cir. 2004) (citation omitted); *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 746 (5th Cir. 1996) ("The risk of facing an all or nothing verdict presents too high a risk, even when the probability of an adverse judgment is low."). It is "well known that [class actions] can unfairly 'plac[e] pressure on the defendant to settle even unmeritorious claims.'" *Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612, 1632 (2018) (citing *Shady Grove Orthopedic Associates, P.A.*

v. Allstate Ins. Co., 559 U.S. 393, 445, n. 3 (2010) (Ginsburg, J., dissenting)). *See also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 149 (2008) (reviewing "practical consequences" and declining to interpret law in a way that would "allow plaintiffs with weak claims to extort settlements from innocent companies."). In recent years, the median securities class action settlement amount after ruling on a motion to dismiss (and before class certification) was $5.4 million. Cornerstone Research, Securities Class Action Settlements 2019 Review and Analysis, 14 (2020), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2019-Review-and-Analysis.

The benefits of event-driven securities litigation, if any, are slight. The primary result of class-securities settlements is to transfer wealth from one group of innocent shareholders to another, after subtracting a sizable share for attorneys' fees. U.S. Chamber Institute for Legal Reform, *Risk and Reward: The Securities-Fraud Class Action Lottery* 4 & n. 16 (Feb. 2019).

Yet the costs on American businesses, investors, and employees are significant. One recent study showed that, due in part to the rise in event-driven litigation, as many as one in eleven S&P 500 companies will be sued annually in a securities suit (excluding M&A cases). U.S. Chamber Institute for Legal Reform, *Containing the Contagion* 11. The costs of such litigation are spread to all U.S. public companies, which must pay more for insurance and to access capital, all while competing with overseas counterparts

not subject to the same constant litigation threat. *See* C. Metzger & B. Mukherjee, *Challenging Times: The Hardening D&O Insurance Market*, Harvard Law School Forum on Corporate Governance (Jan. 29, 2020). Many companies may instead choose to remain private, depriving the public of investment opportunities previously open to them. *See* M. Wusterhorn & G. Zuckerman*, Fewer Listed Companies: Is that Good or Bad for Stock Markets?*, Wall St. J. (Jan. 4, 2018) (noting that the number of public companies dropped by more than half since 1996).

Moreover, beyond the prospect of increased securities litigation, the Ninth Circuit's ruling incentivizes mischief in the market. Because the court held that uncorroborated allegations can be sufficient to support loss causation, short-sellers, competitors, or others looking to hurt a company will be incentivized to publish unsubstantiated or speculative allegations of wrongdoing in order to draw a securities fraud suit. Short seller "research reports" are prepared precisely with the intent of triggering stock drops and potentially subsequent litigation, to the financial gain of the author. *See* Margaret Dale and Mark Harris, *Establishing Loss Causation in Securities Fraud Class Actions*, Law.com (Dec. 14, 2020), https://www.law.com/newyorklawjournal/2020/12/14/establishing-loss-causation-in-securities-fraud-class-actions/. With the Ninth Circuit's ruling, the force and detrimental effects of unsubstantiated allegations are multiplied, as a company will have to respond to the allegations themselves and also the almost-inevitable securities fraud follow-on suit. In the end, shareholders will suffer.

This Court should grant BofI's petition for *certiorari* and make clear that unsubstantiated allegations alone are insufficient for pleading that "the truth became known" and satisfying the loss causation requirement for a securities fraud claim. *Dura*, 544 U.S. at 342-345, 347.

CONCLUSION

WHEREFORE, this Court should grant the Petitioners' request for review.

Respectfully submitted,

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