UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Appeal No. _____

IN RE: VOLKSWAGEN "CLEAN DIESEL" MARKETING, SALES PRACTICES, AND PRODUCTS LIABILITY LITIGATION

LEAD PLAINTIFF PUERTO RICO GOVERNMENT EMPLOYEES AND JUDICIARY RETIREMENT SYSTEMS ADMINISTRATION

Plaintiff-Appellee,

v.

VOLKSWAGEN AG,
VOLKSWAGEN GROUP OF AMERICA, INC.,
VOLKSWAGEN GROUP OF AMERICA FINANCE LLC,
MICHAEL HORN, and MARTIN WINTERKORN

Defendants-Appellants.

On Petition for Permission to Appeal from the U.S. District Court for the Northern District of California (No. 3:15-MDL-2672-CRB (JSC))
The Honorable Charles R. Breyer

PETITION FOR PERMISSION TO APPEAL PURSUANT TO 28 U.S.C. § 1292(b)

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure, Defendants-Petitioners Volkswagen AG ("VWAG"), Volkswagen Group of America, Inc. ("VWGoA"), and Volkswagen Group of America Finance, LLC ("VWGoAF") certify as follows: (i) VWGoA is the parent corporation of VWGoAF; (ii) VWAG is the parent corporation of VWGoA; (iii) VWAG is a publicly held German corporation that owns 10% or more of the stock of VWGoA; and (iv) Porsche Automobil Holding SE is a publicly held corporation that owns 10% or more of the stock of VWAG.

Defendants-Petitioners Michael Horn and Martin Winterkorn (together with VWAG, VWGoAF, and VWGoA, "Defendants") are natural persons.

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INTRODUCTION

This Petition for interlocutory appeal presents an important question under the federal securities laws: whether the judicially created presumption of reliance established in *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128 (1972), applies to a case based on statements alleged to be misleadingly incomplete and made by defendants owing no affirmative duty of disclosure to plaintiff.

In four opinions totaling more than 84 pages issued over two years, Judge Charles Breyer (N.D. Cal.) grappled with this question as applied to VWGoAF's newly issued bonds (the "VWGoAF notes") sold to non-fiduciary institutional investors by investment banks in a Rule 144A private placement. Puerto Rico Government Employees & Judiciary Retirement Systems ("Plaintiff") claims that the offering memorandum for those bonds contained statements about Defendants' exposure to environmental regulations and research priorities that, although truthful, allegedly were made misleading by "omitting" to disclose that certain vehicles contained software that cheated on emissions tests. Defendants learned during discovery that no evidence exists that Plaintiff's investment advisor read the offering memorandum, and moved for summary judgment on the grounds that Plaintiff could not prove reliance, "an essential element of the § 10(b) private cause of action." *Stoneridge Inv. Partners, LLC* v. *Sci.-Atlanta, Inc.*, 552 U.S. 148, 159 (2008).

After reconsidering himself twice and noting that Ninth Circuit law is "somewhat confusing," *In re Volkswagen "Clean Diesel" Mktg., Sales Practices & Prods. Liab. Litig.*, 328 F. Supp. 3d 963, 976 (N.D. Cal. 2018) ("*Bondholder III*," Ex. E hereto), Judge Breyer held that the *Affiliated Ute* presumption applied and denied Defendants' motion for summary judgment. *In re Volkswagen "Clean Diesel" Mktg., Sales Practices & Prods. Liab. Litig.*, 2019 WL 4727338, at *2-3 (N.D. Cal. Sept. 26, 2019) (the "Order," Ex. A hereto). He later certified his decision for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) and Federal Rule of Appellate Procedure 5(a), finding that the Order "involves a controlling question of law as to which there is substantial ground for difference of opinion," and "an immediate appeal from the order may materially advance the ultimate termination of the litigation." Order Granting Motion to Certify for Interlocutory Appeal, *In re Volkswagen "Clean Diesel" Mktg., Sales Practices & Prods. Liab. Litig.*, No. 15-md-02672 (N.D. Cal. Jan. 22, 2020) (ECF No. 7054) (Ex. B. hereto) (quoting *Reese* v. *BP Expl. (Alaska) Inc.*, 643 F.3d 681, 687-88 (9th Cir. 2011)). This Court should grant the Petition.

First, there are substantial grounds for difference of opinion here. A securities-fraud plaintiff must prove reliance and can do so directly by showing that the plaintiff actually read and relied upon a false or misleadingly incomplete statement. In *Affiliated Ute*, the Supreme Court created a narrow presumption of

reliance in a case where fiduciaries breached their "affirmative duty . . . to disclose [a material] fact" to their unsophisticated clients who owned illiquid stock by saying nothing about lucrative resale opportunities. 406 U.S. at 152-54. Subsequently, the Supreme Court adopted the "fraud on the market" presumption of reliance in *Basic, Inc.* v. *Levinson*, 485 U.S. 224 (1988), which governs false or misleading statements about securities actively traded in open, well-developed, efficient markets.

Where defendants owed plaintiff no affirmative duty of disclosure, courts have consistently required plaintiffs to follow *Basic*'s requirements and to prove market efficiency in cases involving mixed allegations of misstatement and omission. Although taking slightly different approaches to applying *Basic* and *Affiliated Ute*, Circuit courts have all "carefully maintained the well-established distinction, for purposes of the *Affiliated Ute* presumption, between omission claims . . . and misrepresentation and manipulation claims," warning that expansive application of *Affiliated Ute* could "'swallow the reliance requirement almost completely'" in cases where "'reliance would [not] be difficult to prove.'" *Desai* v. *Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009) (quoting *Joseph* v. *Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000)). As such, this Court and others have declined to apply the *Affiliated Ute* presumption when the purpose of

that presumption—helping a plaintiff who cannot prove direct reliance because nothing was said—is not implicated. *See* cases cited *infra* at 17-19.

In cases involving both misrepresentations and omissions, this Court (like the Second, Fifth, Tenth and Eleventh Circuits) strictly limits *Affiliated Ute* to *only* cases that "primarily" allege omissions. *Binder* v. *Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999); *see* cases cited *infra* at 17-19. But this Court has neither articulated how a case can "primarily" allege omissions, nor ever found this requirement to be satisfied in a case involving a misleadingly incomplete statement omitting material facts. *See Desai*, 573 F.3d at 941 (*Affiliated Ute* presumption "inapplicable in a case involving some omissions, but also misrepresentations and secret manipulation"); *Poulos* v. *Caesars World, Inc.*, 379 F.3d 654, 667 (9th Cir. 2004) (*Affiliated Ute* presumption did not apply to "mixed claims based on *both* affirmative misrepresentations and omissions"); *Binder*, 184 F.3d at 1063 (*Affiliated Ute* did not apply because the "complaint contains both allegations of omissions and misrepresentations").

This Court has not squarely addressed whether *Affiliated Ute* is available where, as here, defendants owed plaintiff no fiduciary duty of disclosure. At the same time, the Third, Fifth and Eleventh Circuits and many district courts nationwide have held that the *Affiliated Ute* presumption cannot apply to a case

based on misrepresentations and omissions if the defendant did not owe the plaintiff such duty. *See* cases cited *infra* at 20-22.

Nevertheless, Judge Breyer incorrectly held that *Affiliated Ute* extends to claims premised on statements that omit "a material fact necessary to make the statements made, in the light of the circumstances in which they were made, not misleading," even where a defendant owed a plaintiff no duty of disclosure arising out of a fiduciary or other special relationship. 17 C.F.R. § 240.10b-5(b); *see* Order, 2019 WL 4727338, at *1-3. He initially found that *Affiliated Ute* applied to such misleadingly incomplete statements by reasoning that the "heart" of Plaintiff's case was Defendants' failure to disclose the defeat device software in diesel vehicles, rather than the allegedly misleading statements that ostensibly created a duty to disclose the defeat device. *See In re Volkswagen "Clean Diesel" Mktg., Sales Practices & Prods. Liab. Litig.*, 2017 WL 3058563, at *14 (N.D. Cal. July 7, 2017) ("*Bondholder I*", Ex. C hereto). Judge Breyer then changed his mind, finding a new Second Circuit decision that had rejected that exact reasoning "[i]nstructive" and dismissing the Complaint because Plaintiff *could* prove direct reliance on the underlying misleading statements, and thus "the [*Affiliated Ute*] presumption's purpose—of avoiding the need to prove a speculative negative—is [not] implicated." *In re Volkswagen "Clean Diesel" Mktg., Sales Practices & Prods. Liab. Litig.*, 2018 WL 1142884, at *6 (N.D. Cal. Mar. 2, 2018)

("*Bondholder II*," Ex. D hereto).[1] In yet a third opinion, he questioned his earlier rulings, viewing Ninth Circuit law on *Affiliated Ute* as "somewhat confusing." *Bondholder III*, 328 F. Supp. 3d at 976.

Then in the Order certified for interlocutory review, Judge Breyer reverted to his original analysis in *Bondholder I*, broadening the scope of *Affiliated Ute* in conflict with courts nationwide and within this Circuit. *See* Order, 2019 WL 4727338, at *2. Without citing any authority, Judge Breyer also found that the *Affiliated Ute* presumption would not be rebutted even if Plaintiff did not read the offering memorandum for the 144A private placement, because "this is not a run-of-the-mill omissions case" due to the "substantial" and "blatant" nature of the defeat-device scheme. *Id.*; *but see, e.g.*, *Friedman* v. *Salomon Bros., Inc.*, 1994 WL 684513, at *3 (9th Cir. Dec. 7, 1994) (affirming finding that *Affiliated Ute* presumption was rebutted where plaintiffs "did not read any of the prospectuses"). The Order effectively renders the *Affiliated Ute* presumption irrebuttable for an issuer's critical omissions.

Accordingly, there are "substantial ground[s] for difference of opinion" here, because "novel legal issues are presented, on which fair-minded jurists might reach contradictory conclusions," *Reese*, 643 F.3d at 688, "the controlling law is

[1] *See Waggoner* v. *Barclays PLC*, 875 F.3d 79, 91, 95 (2d Cir. 2017) (rejecting district court's reasoning that omissions, not misleadingly incomplete statements, were "the heart of this case" and so *Affiliated Ute* applied).

unclear," and there are "conflicting and contradictory opinions" on these issues within and outside this Circuit. *Couch* v. *Telescope, Inc.*, 611 F.3d 629, 633-34 (9th Cir. 2010). By granting this Petition, this Court can clarify (i) whether *Affiliated Ute* applies in cases based on misleadingly incomplete statements, and (ii) whether *Affiliated Ute* applies if the issuer does not owe the plaintiff a fiduciary duty to affirmatively disclose the omitted information.

Second, whether *Affiliated Ute* applies to the challenged statements is a controlling question of law whose resolution will advance this case. The parties are now briefing class certification based only on *Affiliated Ute*, because Judge Breyer correctly held that Plaintiff's bond purchases in a private placement do not qualify for the *Basic* presumption. *See Bondholder III*, 328 F. Supp. 3d at 970-73. As such, this Court's ruling that *Affiliated Ute* is not available would bar class certification—effectively terminating the case. The only task remaining for Judge Breyer would be to rule on the fully submitted motion for summary judgment on the narrow issue of Plaintiff's direct reliance.

Finally, in addition to satisfying the three factors required under Section 1292, the Order represents an exceptional case warranting immediate appeal. Judge Breyer's Order opens the door to unprecedented Section 10(b) class-action liability for issuances of all new securities, which heretofore have been routinely

analyzed (and rejected) using the *Basic* fraud-on-the-market presumption.[2] But the Order applied *Affiliated Ute* to newly issued bonds sold to non-fiduciary institutional investors in a Rule 144A private placement—the antithesis of an open, well-developed, actively-traded and efficient market. This expansion of *Affiliated Ute* violates the Supreme Court's command that "the § 10(b) private right should not be extended beyond its present boundaries." *Stoneridge*, 552 U.S. at 165.

In short, this is a paradigmatic case for interlocutory appeal. The Order raises issues important to the many companies engaged in capital-raising throughout the Ninth Circuit by injecting uncertainty into the law and expanding the scope of securities-fraud class actions. Because issuers and investors would benefit from a clarification of Ninth Circuit law, this Court should exercise its discretion and accept this interlocutory appeal.

STATEMENT OF FACTS

Plaintiff alleges that Defendants violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, 15 U.S.C. § 78j and 17 C.F.R. § 240.10b-5, in connection with Plaintiff's May 15, 2014 purchases of unregistered Rule 144A VWGoAF notes that could only be sold to Qualified Institutional

[2] *See, e.g.*, *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006) (refusing to apply *Basic* to IPO stock); *Freeman* v. *Laventhol & Horwath*, 915 F.2d 193, 198-99 (6th Cir. 1990) (same, newly issued municipal bonds); *In re HealthSouth Corp. Sec. Litig.*, 261 F.R.D. 616, 640-41 (N.D. Ala. 2009) (same, newly issued corporate bonds).

Buyers with at least $100 million of discretionary investment funds. Plaintiff does not allege that any Defendant owed it a fiduciary duty, or that Plaintiff shared a relationship of trust and confidence with any Defendant.

From 2009 to 2015, Volkswagen sold roughly 600,000 diesel cars containing defeat device software that sensed whether the car was undergoing emissions testing, and reduced the effectiveness of emissions controls for nitrogen oxides while the car was driven on the road. *See Bondholder I*, 2017 WL 3058563, at *1. In September 2015, the market prices of VWGoAF notes temporarily dipped after regulators publicly accused Volkswagen of using a defeat device in violation of the Clean Air Act. Although no VWGoAF note missed any interest or principal payments, Plaintiff sued on behalf of itself and a putative class of VWGoAF note investors.

In *Bondholder I*, Judge Breyer denied Defendants' motion to dismiss, but limited the scope of Plaintiff's claims to focus on "*two types of statements* in the May 2014 Offering Memorandum that [Plaintiff] contends were misleading because Defendants did not disclose the defeat-device scheme." *Id.* at *6 (emphasis added). These categories were (i) "statements made about Volkswagen's research and development ("R&D") priorities," namely that Volkswagen's R&D focus included reducing emissions and fuel consumption; and (ii) "statements in the Memorandum's 'Regulatory, Legal, and Tax-Related Risks'

section," namely that Volkswagen and its vehicles are subject to laws and regulations governing emissions. *Id.*

Bondholder I accepted Plaintiff's claim that those *statements* about R&D priorities and regulation created the "misleading" inference that "Volkswagen was a good investment *because of* its commitment to emissions-reducing technology," when the company "was in its fifth year of a massive fraud to cheat emissions standards." *Id.* at *7. Judge Breyer held that *Affiliated Ute* applied because the "heart" of the case was nondisclosure of the defeat device, and that the discussion of misstatements was "necessary" to "frame the omission as misleading," because absent a statement "Section 10(b) does not create an affirmative duty to disclose." *Id.* at *14 (citing *Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 44 (2011)).

In *Bondholder II*, Judge Breyer reconsidered his analysis and dismissed the Complaint in light of Ninth and Second Circuit precedent. He correctly recognized that *Affiliated Ute* does not apply to claims based on half-truths, *i.e.*, the alleged omission was only of "the truth that the statement[s] misrepresent[ed]." 2018 WL 1142884, at *4 (quoting *Waggoner*, 875 F.3d at 96). He held that the "labels 'misrepresentation' and 'omission' are of little help," and that one should look to the "rationale" of the *Affiliated Ute* presumption, namely that "where no positive statements exist . . . reliance as a practical matter is impossible to prove." *Id.* (quoting *Waggoner*, 875 F.3d at 95). He recognized that in *Desai* this Court had

"embrace[d] the purpose behind the *Affiliated Ute* presumption as the touchstone in determining when the presumption applies." *Id.* at *5 (citing *Desai*, 573 F.3d at 941). Applying this Ninth Circuit precedent, Judge Breyer reasoned that because investors could prove that they actually read and relied on allegedly misleading statements, investors who did not so rely "should not be able to overcome this shortfall by characterizing their claims as primarily alleging omissions." *Id.* at *6.

Judge Breyer began to retreat from his correct analysis of *Affiliated Ute* in *Bondholder III*. There, he denied Defendants' motion to dismiss Plaintiff's Second Amended Complaint (the current pleading), because it "plausibly alleged that [Plaintiff's investment advisor] relied directly on the *statements* at issue in the Offering Memorandum." *Bondholder III*, 328 F. Supp. 3d at 969 (emphasis added).[3] He did not rule on whether *Affiliated Ute* applied, but acknowledged the "somewhat confusing discussion of [*Blackie* v. *Barrack*, 524 F.2d 891 (9th Cir. 1975)] in *Binder*," *id.* at 976, and the lack of Ninth Circuit precedent addressing whether *Affiliated Ute* applies to violations of Rule 10b-5(b), as opposed to violations of subsections (a) and (c). *Id.* at 976-77.[4]

[3] *Bondholder III* also held that *Basic's* fraud-on-the-market presumption of reliance does not apply to Plaintiff, which "purchased the bonds at issue at a time when the bonds were not 'actively traded' on a 'well-developed' market." 328 F. Supp. 3d at 970; *see Bondholder II*, 2018 WL 1142884 at *6-*8.

[4] Rule 10b-5 (a) and (c) prohibit acts, practices, or courses of business that operate as a fraud; and devices, schemes, or artifices to defraud. 17 C.F.R. §§ 240.10b-

Judge Breyer came full circle in the Order certified for interlocutory appeal. Defendants had moved for summary judgment, arguing that the lack of evidence that Plaintiff's investment advisor read the offering memorandum defeated direct reliance and rebutted any presumption of reliance. But rather than address direct reliance, Judge Breyer "backtrack[ed] from *Bondholder II*," and reverted to *Bondholder I*'s erroneous reasoning that the "heart of the case" was the omission to disclose the defeat device, and that the "affirmative statements . . . are tethered to the omission" for the reasons explained in *Bondholder III*. Order, 2019 WL 4727338, at *1. He further held that Defendants had not rebutted the *Affiliated Ute* presumption, reasoning (without citing any authority) that although an investor's failure to read disclosure documents "could indeed be fatal" in a "run-of-the-mill omissions case," *id.* at *2, Volkswagen's alleged scheme was "so substantial and so blatant" that its hypothetical disclosure that the company's diesel vehicles contained a defeat device in an offering memorandum that Plaintiff's advisor never read still would have been noticed by the "investing public." *Id.* at *3.

On November 8, 2019, Plaintiff moved for class certification. Plaintiff's motion relies exclusively on the *Affiliated Ute* presumption of reliance to attempt to show that common issues predominate over individualized issues.

5(a) & (c). Rule 10b-5(b), by contrast, prohibits false and misleadingly incomplete statements. *Id.* § 240.10b-5(b).

STATEMENT OF ISSUES PRESENTED

1. Whether the *Affiliated Ute* presumption of reliance can apply to a case based on affirmative statements allegedly rendered misleading by Defendants' failure to disclose material facts.

2. Whether the *Affiliated Ute* presumption of reliance is available when Defendants did not owe Plaintiff an affirmative duty of disclosure arising out of a special relationship of trust and confidence.

THIS COURT SHOULD ACCEPT THIS APPEAL PURSUANT TO 28 U.S.C. § 1292(B)

A. The Order Presents Controlling Questions of Law.

A question "which, if answered differently on appeal, would terminate the case" is controlling, though a question need not be "dispositive of the [entire] lawsuit in order to be regarded as controlling." *United States* v. *Woodbury*, 263 F.2d 784, 787 (9th Cir. 1959). Whether a securities-fraud plaintiff can establish its reliance is a controlling question of law, because "[r]eliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action." *Stoneridge*, 552 U.S. at 159.

A ruling from this Court that Plaintiff cannot rely on *Affiliated Ute* would essentially terminate this litigation. It would dispose of Plaintiff's pending motion for class certification, which relies exclusively on *Affiliated Ute*. The sole issue remaining for the District Court on remand would be narrow: Resolving

Defendants' fully briefed motion for summary judgment on the issue of Plaintiff's direct reliance. As such, a controlling question of law exists here.

B. There Are Substantial Grounds for a Difference of Opinion.

Where "novel legal issues are presented, on which fair-minded jurists might reach contradictory conclusions," such as "difficult questions of first impression," substantial grounds for disagreement exist. *Reese,* 643 F.3d at 688. And, a district court's "own ruling reversing its earlier decision . . . makes clear that substantial grounds for differing opinions exist." *Deutsche Bank* v. *FDIC,* 854 F. Supp. 2d 756, 769 (C.D. Cal. 2011). Substantial grounds for difference of opinion as to both of Defendants' Questions exists here.

1. Defendants' First Question

Judge Breyer reached different conclusions in four opinions on the question of whether *Affiliated Ute* applies when a plaintiff alleges both misstatements and omissions, while acknowledging that "the Ninth Circuit has not offered detailed guidance" on the issue, *Bondholder II*, 2018 WL 1142884 at *5, and the limited precedent is "somewhat confusing." *Bondholder III*, 328 F. Supp. 3d at 976; *see* Statement of Facts, *supra.* His reversals, the "tension in Ninth Circuit precedent," and the varying approaches taken by other courts nationwide all demonstrate a substantial ground for difference of opinion. *Deutsche Bank*, 854 F. Supp. 2d at 769.

a. Ninth Circuit Precedent Is Unclear as to Whether the *Affiliated Ute* Presumption Can Apply to a Case Alleging Both Misstatements and Omissions.

In concluding that *Affiliated Ute* could be applied to a case involving both misrepresentations and omissions, Judge Breyer relied on this Court's 1975 *Blackie* decision and its 1976 description of *Blackie* as "br[inging] within the scope of *Affiliated Ute* a case in which it was alleged that certain material facts were omitted from [certain] reports, [which] contained representations rendered inaccurate by the omissions." Order, 2019 WL 4727338, at *3 & n.1 (quoting *Little* v. *First Cal. Co.*, 532 F.2d 1302, 1304 (9th Cir. 1976)). But *Little*'s dicta that *Blackie* applied *Affiliated Ute* to a mixed case is contrary to this Court's more recent statements in *Binder* that (i) this Court had *never* addressed "whether the [*Affiliated Ute*] presumption may be invoked in a case involving misrepresentations or misrepresentations and omissions," and (ii) *Blackie* "embraced the [*Affiliated Ute*] presumption because of the difficulty of proving 'a speculative negative'—that the plaintiff relied on what was not said." *Binder*, 184 F.3d at 1064. And *Little* itself recognized that this Court had not resolved the "dilemma" posed by cases involving "a general representation from which material facts are omitted and there is no independent alternative ground, such as an 'open market' situation, that justifies dispensing with a requirement that plaintiffs show individual reliance." *Little*, 532 F.2d at 1304 n.4. It is thus unsurprising that Judge

Breyer was "unsure of *Blackie*'s effect," found "somewhat confusing" *Binder*'s discussion of *Blackie*, and specifically acknowledged the tension in Ninth Circuit precedent. *Bondholder III*, 328 F. Supp. 3d at 977-78. But ultimately, Judge Breyer found himself bound by *Blackie*'s 45-year-old gloss on *Affiliated Ute*. Order, 2019 WL 4727338, at *2.

Recent decisions have universally understood *Blackie* not as an unprecedented and virtually limitless expansion of the *Affiliated Ute* presumption, but instead as an "experiment" with the fraud-on-the-market theory, which was later accepted (with modifications) by the Supreme Court in *Basic*. *Halliburton Co.* v. *Erica P. John Fund, Inc.*, 573 U.S. 258, 287 n.2 (2014) (Ginsburg, J., concurring).[5] By its terms, *Blackie* applied only to "open market purchasers." *Blackie*, 524 F.2d at 907. This Court has not yet addressed whether *Blackie*'s 45-year-old gloss on *Affiliated Ute* remains good law in the wake of *Basic*. *See Basic*, 485 U.S at 251 (White, J., concurring in part) (*Basic* "rejects" version of fraud-on-the-market theory, "adopted by some courts" including *Blackie*); *Erica P. John Fund, Inc.* v. *Halliburton Co.*, 563 U.S. 804, 811 (2011) (*Basic* applies only to

[5] *See also, e.g.*, *Basic*, 485 U.S. at 250 & n.1 (White, J., concurring in part) ("The earliest Court of Appeals case adopting [fraud on the market] theory . . . is *Blackie*."); *Conn. Ret. Plans & Tr. Funds* v. *Amgen Inc.*, 660 F.3d 1170, 1175-77 (9th Cir. 2011) (*Blackie* held, "in pre-*Basic* case, that complaint's allegation of materiality sufficed to trigger [*Affiliated Ute*]"); *In re Cirrus Logic Sec. Litig.*, 946 F. Supp. 1446, 1455 n.6 (N.D. Cal. 1996) ("'fraud on the market' theory first recognized by the Ninth Circuit in *Blackie*").

securities "traded on well-developed markets"); *Binder*, 184 F.3d at 970 (*Basic* applies only to securities "actively traded in an 'efficient market'").

The Order's conclusion—that the *Affiliated Ute* presumption applies to a case based on an affirmative statement that omits material facts—rests on a misreading of Ninth Circuit law. In *Binder*, this Court held (as have several sister Circuits) that *Affiliated Ute* does not apply to a case alleging both misrepresentations and omissions unless the case "primarily" alleges omissions—a test that this Court has never found satisfied. *Binder*, 184 F.3d at 1064 (refusing to apply presumption); *see also Desai*, 573 F.3d at 941; *Poulos*, 379 F.3d at 667.[6] Nor has this Court explained what factors should be examined to decide whether a case "primarily" alleges omissions.

b. Numerous Courts Have Declined To Extend *Affiliated Ute* to Cases Involving Misleadingly Incomplete Statements.

The Order conflicts with myriad circuit and district court decisions, including within this Circuit, refusing to extend the *Affiliated Ute* presumption to cases alleging misleadingly incomplete statements. "Most courts" will "enforce clear-cut limitations on the *Ute* presumption of reliance," applying this

[6] *Accord, e.g.*, *Waggoner*, 875 F.3d at 93; *Joseph*, 223 F.3d at 1162-63; *Finkel* v. *Docutel/Olivetti Corp.*, 817 F.2d 356, 359 (5th Cir. 1987); *Cavalier Carpets, Inc.* v. *Caylor*, 746 F.2d 749, 756 (11th Cir. 1984). The Fourth Circuit is more strict, refusing to consider applying *Affiliated Ute* to any case that involves both misrepresentations and omissions. *See Cox* v. *Collins*, 7 F.3d 394, 396 (4th Cir. 1993).

presumption "*only where there is no affirmative statement* alleged to have been misleading." *Roman* v. *UBS Fin. Servs. of P.R.*, 2017 WL 3608238, at *5 (D. PR. Aug. 21, 2017) (emphasis added). Courts both inside and outside this Circuit have so limited *Affiliated Ute*. *See*, *e.g.*, *Loritz* v. *Exide Techs., Inc.*, 2015 WL 6790247, at *21 (C.D. Cal. July 21, 2015) (refusing to apply *Affiliated Ute* to claims premised on "affirmative statements relating to . . . [regulatory] risk" that omitted to "disclose certain changes regarding . . . [regulatory] compliance"); *George* v. *Cal. Infrastructure & Econ. Dev. Bank*, 2010 WL 2383520, at *6 (E.D. Cal. June 10, 2010) (*Affiliated Ute* does not apply to misleadingly incomplete statements in prospectus).[7] Indeed, the Second and D.C. Circuits have rejected Judge Breyer's exact reasoning. *Compare Strougo* v. *Barclays PLC*, 312 F.R.D. 307, 319 (S.D.N.Y. 2016) (applying *Affiliated Ute* where "a case could be made that it is the material omissions, not the affirmative statements, that are at the heart of this

[7] *See also*, *e.g.*, *Johnston* v. *HBO Film Mgmt., Inc.*, 265 F.3d 178, 193 (3d Cir. 2001) (*Affiliated Ute* unavailable where "a misrepresentation is necessary to create the specific expectation that the omission does not negate"); *Gross* v. *GFI Group*, 310 F. Supp. 3d 384, 397 (S.D.N.Y. 2018) (*Affiliated Ute* unavailable where claims "involve omissions only to the extent that omitted statements were necessary to make [defendant's statement] not misleading"); *Jensen* v. *Thompson*, 2018 WL 1440329, at *14-15 (D.S.D. Mar. 22, 2018) (*Affiliated Ute* unavailable where defendants "omitted . . . material information necessary to make disclosed information not misleading"); *In re Credit-Suisse-AOL Sec. Litig.*, 253 F.R.D. 17, 26 (D. Mass. 2008) ("*Affiliated Ute* applies to 'omissions cases' only where there is a special affirmative 'obligation to disclose' material information rather than merely a duty to speak truthfully.").

case"), *rev'd in relevant part by Waggoner*, 875 F.3d 79; *with Bondholder I*, 2017 WL 3058563, at *14 ("heart of the case" was omission, not statements that "frame the omission as misleading"); *see also In re InterBank Funding Corp. Sec. Litig.*, 629 F.3d 213, 221 (D.C. Cir. 2010) (refusing to apply *Affiliated Ute* and rejecting plaintiffs' argument that "non-disclosure of [a] Ponzi scheme was of 'primary importance'," because "the fact that a fraud is significant is irrelevant to whether the fraud stems from misrepresentations or omissions").

Moreover, the Order conflicts with cases, including in this Circuit, holding that "it would be contrary to *Affiliated Ute* and basic tort principles to award a presumption of reliance in a case where plaintiffs could . . . allege actual reliance." *In re Interbank Funding Corp. Sec. Litig.*, 668 F. Supp. 2d 44, 50-51 (D.D.C. 2009); *see, e.g., In re Silver Wheaton Corp. Sec. Litig.*, 2017 WL 2039171, at *11-12 (C.D. Cal. May 11, 2017) (finding *Interbank* "persuasive"). As the Ninth Circuit and its sister circuits have emphasized, the purpose of *Affiliated Ute* is to relieve plaintiffs from the impossible hurdle of proving direct reliance where nothing was said. *See, e.g., Desai*, 573 F.3d at 941; *Waggoner*, 875 F.3d at 96; *Joseph*, 223 F.3d at 1163.

Here, no such hurdle to proving reliance exists. In *Bondholder III*, Plaintiff's case survived a motion to dismiss by *pleading* direct reliance on allegedly misleading statements in the offering memorandum, but the Order

applied *Affiliated Ute* at summary judgment without holding Plaintiff to its burden of proof. That was error. *See, e.g.*, *Huddleston* v. *Herman & MacLean*, 640 F.2d 534, 548 (5th Cir. 1981), *rev'd in part on other grounds*, 459 U.S. 375 (1983) (*Affiliated Ute* did not apply where prospectus contained misstatements and omitted "facts necessary to make the statements . . . not misleading," because there were no "difficulties of proof of reliance").

Finally, Plaintiff alleges a violation of Rule 10b-5(b) premised only on misleadingly incomplete statements, not a subsection (a) and (c) "scheme" claim. "[T]he Ninth Circuit has not expressly held that *Affiliated Ute* applies only in claims under Rule 10b-5 subsections (a) and (c)," although *Binder* and *Blackie* are "somewhat confusing" in this regard. *Bondholder III*, 328 F. Supp. 3d at 977. Contrary to the Order, the Fifth Circuit has held that the *Affiliated Ute* presumption does not apply to Rule 10b-5(b) claims, which "always rest[] upon an affirmative statement," while subsection (a) and (c) claims "could be based primarily on an omission." *Smith* v. *Ayers*, 845 F.2d 1360, 1363 (5th Cir. 1988).

2. Defendants' Second Question

The Court should also address whether the *Affiliated Ute* presumption can apply absent an "affirmative duty . . . to disclose [a] fact to [the plaintiff]." 406 U.S. at 153. Such a "duty to disclose arises when one party has information that the other party is entitled to know *because of a fiduciary* or other similar relation of

trust and confidence between them." *Chiarella* v. *United States*, 445 U.S. 222, 228 (1980) (emphasis added). This requirement of an affirmative duty to disclose was imposed by the *Affiliated Ute* court itself. *Id.* at 229. In *Bondholder III*, Judge Breyer correctly held that no fiduciary relationship existed between Defendants and Plaintiff. 328 F. Supp. 3d at 984.

Rule 10b-5(b)'s duty not to speak half-truths is distinct from a fiduciary's Rule 10b-5(a) and (c) duty of affirmative disclosure. *United States* v. *Laurienti*, 611 F.3d 530, 541 (9th Cir. 2010). "The parties to an impersonal market transaction," such as a bond issuer and investors, "owe no duty of disclosure to one another absent a fiduciary or agency relationship, prior dealings, or circumstances such that one party has placed trust and confidence in the other." *Paracor Fin., Inc.*, v. *Gen. Elec. Capital Corp.*, 96 F.3d 1151,1157 (9th Cir. 1996) (quoting *Jett* v. *Sunderman*, 840 F.2d 1487, 1493 (9th Cir. 1988)). As such, "[d]isclosure is not a rite of confession, and companies do not have a duty to disclose uncharged, unadjudicated wrongdoing." *City of Pontiac Policemen's & Firemen's Ret. Sys.* v. *UBS AG*, 752 F.3d 173, 184 (2d Cir. 2014); *see, e.g.*, *Retail Wholesale & Dep't Store Union Local 338 Ret. Fund* v. *Hewlett-Packard Co.*, 52 F. Supp. 3d 961, 971 (N.D. Cal. 2014), *aff'd*, 845 F.3d 1268 (9th Cir. 2017) (corporation is not "liable [for securities fraud] whenever [it is] involved in misconduct . . . unless the conduct is disclosed" and "materiality alone is not enough to place a duty to

disclose") (quoting *Zaluski* v. *United Am. Healthcare Corp.*, 527 F.3d 564, 572 (6th Cir. 2008)).

Under Plaintiff's theory, Defendants' duty to disclose that Volkswagen diesel vehicles contained a defeat device arose solely because of "*statements* . . . which were misleading in light of the *context surrounding the statements*." *Retail Wholesale & Dep't Store Union Local 338 Ret. Fund* v. *Hewlett-Packard Co.*, 845 F.3d 1268, 1278 (9th Cir. 2017) (emphasis added); *see Bondholder I*, 2017 WL 3058563, at *6. Judge Breyer's application of *Affiliated Ute* absent a fiduciary or other special relationship conflicts with the decisions of other courts within and outside this Circuit. *See, e.g.*, *Rabin* v. *NASDAQ OMX PHLX LLC*, 712 F. App'x 188, 194 (3d Cir. 2017) (declining to apply *Affiliated Ute*, which is "premised on a defendant-fiduciary's failure to disclose material facts he had an affirmative duty to disclose"); *Regents of Univ. of Cal.* v. *Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 384 (5th Cir. 2007) (*Affiliated Ute* not available where defendants "were not fiduciaries and were not otherwise obligated to the plaintiffs"); *Cavalier Carpets*, 746 F.2d at 756 (*Affiliated Ute* "is triggered only when a relationship of trust and confidence exists between victim and deceiver creating a duty to disclose."); *Wilco Fin. Servs. Corp.* v. *Halberd Corp*, 2013 WL 12136599, at *3 (C.D. Cal. Nov. 12, 2013) (*Affiliated Ute* unavailable because even if "case did primarily involve omissions, plaintiffs would need to allege that defendants had a

duty to disclose" arising from "fiduciary or agency relationship" (quoting *Paracor*, 96 F.3d at 1157)).

C. An Immediate Appeal Will Materially Advance the Ultimate Termination of the Litigation.

Resolution of a question "materially advances" the termination of a litigation when, as here, it "shorten[s] the time" or reduces the "effort or expense of conducting the lawsuit," *In re Cement Antitrust*, 673 F.2d 1020, 1027 (9th Cir. 1981), or "conserve[s] judicial resources," *Lakeland Vill. Homeowners Ass'n* v. *Great Am. Ins. Grp.*, 727 F. Supp. 2d 887, 897 (E.D. Cal. 2010). This Court may also consider the precedential impact of an appeal on other cases. *See, e.g.*, *Hawaii ex rel. Louie* v. *JP Morgan Chase & Co.*, 921 F. Supp. 2d 1059, 1067 (D. Haw. 2013) (collecting cases).

Resolution of Defendants' Questions "sooner, rather than later" will avoid protracted, costly litigation in the District Court and "save the courts and the litigants unnecessary trouble and expense." *United States* v. *Adam Bros. Farming, Inc.*, 369 F. Supp. 2d 1180, 1182 (C.D. Cal. 2004) (quoting *John* v. *United States*, 247 F.3d 1032, 1051 (9th Cir. 2001)). Plaintiff has moved for class certification solely based on *Affiliated Ute*, and Judge Breyer has rejected Plaintiff's attempts to invoke other presumptions of reliance. *See Bondholder III*, 328 F. Supp. 3d 969-73. If Plaintiff cannot invoke *Affiliated Ute*, the only remaining issue to be decided is whether Defendants are entitled to summary judgment on Plaintiff's direct

reliance. Although Defendants' motion has been fully briefed and submitted to the District Court, the Order declined to reach the issue of direct reliance given its expansive application of *Affiliated Ute*. Judge Breyer should be able to easily resolve the issue of Plaintiff's direct reliance, which Defendants believe should terminate this case.

CONCLUSION

Defendants respectfully request that the Court exercise its discretion to address the important legal issues presented by the Order by granting the petition.

Dated: February 3, 2020

Respectfully submitted,

/s/ *Robert J. Giuffra, Jr.*

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FILER'S ATTESTATION

I, William H. Wagener, certify that that all other signatories listed, and on whose behalf this filing is submitted, concur in the filing's content and have authorized the filing.

/s/ William H. Wagener
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STATEMENT OF RELATED CASES

Defendants-Appellants are aware of nine related cases pending in this Court within the meaning of Ninth Circuit Rule 28-2.6. This case is part of a consolidated multi-district litigation pending before Judge Breyer in the Northern District of California, *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prods. Liab. Litig.*, and nine other cases in that multi-district litigation are pending before this Court, namely: *Jason Hill, et al*. v. *Volkswagen AG, et al.* (No. 16-17168); *Jason Hill, et al*. v. *Volkswagen Group of America, I, et al*. (No. 17-16065); *The Environmental Protection Comm., et al.* v. *Volkswagen Group of America, Inc., et al*. (No. 18-15937); *James Feinman* v. *Volkswagen Group of America* (No. 19-16074); *Farchione Motors, Inc*. v. *Volkswagen Group of America, et al.* (No. 19-16361); *Autovid, LLC* v. *Volkswagen Group of America, et al.* (No. 19-16362); *Kennedy's Autos, LLC* v. *Volkswagen Group of America, et al.* (No. 19-16363); *Haddad Claimants* v. *Volkswagen Group of America* (No. 19-16376); and *J. Bertolet, Inc., et al*. v. *Robert Bosch, LLC, et al*. (No. 20-15034).

CERTIFICATION OF COMPLIANCE

Pursuant to Ninth Circuit Rule 32-2(b), counsel for Defendants-Petitioners hereby certifies that this brief complies with the type-volume limitation of Ninth Circuit Rule 32-2 because this brief contains 5,591 words, excluding the parts of the brief exempted by Rule 32(a) of the Federal Rules of Appellate Procedure. Counsel's approximation is based on the "Word Count" function of the word processing program used to draft the enclosed brief.

Counsel for Defendants-Appellees further certifies that this brief complies with the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point Times New Roman font.

/s/ Robert J. Giuffra, Jr.
Robert J. Giuffra, Jr.

Attorney for Defendants-Appellants Volkswagen AG, Volkswagen Group of America, Inc. and Volkswagen Group of America Finance, LLC

Dated: February 3, 2020

Exhibit A

2019 WL 4727338
Only the Westlaw citation is currently available.
United States District Court, N.D. California.

IN RE: VOLKSWAGEN "CLEAN DIESEL" MARKETING, SALES PRACTICES, AND PRODUCTS LIABILITY LITIGATION
This Order Relates to: Dkt. No. 6423
Bondholder Action

MDL No. 2672 CRB (JSC)
|
Signed 09/26/2019

ORDER DENYING MOTION FOR SUMMARY JUDGMENT

CHARLES R. BREYER, United States District Judge

***1** Plaintiff, a public pension fund, purchased Volkswagen bonds in 2014. In October 2015, one month after Volkswagen's diesel scandal became front-page news, Plaintiff sold those bonds for a loss. Plaintiff then filed a proposed class action against Volkswagen for violations of the federal securities laws. In that action, Plaintiff maintains that Volkswagen was required (but failed) to disclose in its 2014 bond offering memorandum that the company was using defeat devices in millions of diesel cars worldwide to cheat on emissions tests and was at risk of losing billions of dollars as a result. Without that information, Plaintiff asserts that the offering memorandum was misleading and led investors to purchase the company's bonds at artificially inflated prices.

Volkswagen has moved for summary judgment. The company argues that summary judgment is warranted because Plaintiff lacks the evidence needed to prove reliance, which is one of the elements of its claims. Specifically, Volkswagen urges that the evidence is insufficient to support that Plaintiff's investment manager, who bought the bonds on Plaintiff's behalf and had complete discretion to do so, read the offering memorandum before executing the trade. And without such proof, Volkswagen insists that Plaintiff cannot prove that its investment manager would have acted differently and foregone purchasing the bonds if additional disclosures had been made in the offering memorandum.

Having reviewed the record and—once more—the relevant caselaw, the Court concludes that this case is best characterized as "primarily a nondisclosure case," as opposed to a "positive misrepresentation case." *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999). As a result, Plaintiff is entitled to a presumption of reliance under *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153–54 (1972), and need not prove that it or its investment manager actually relied on the statements made in the bond offering memorandum. *See Binder*, 184 F.3d at 1063–64.

The case is best characterized as a nondisclosure case because, as the Court noted in *Bondholders I*, the "heart of the case" is an omission. *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prod. Liab. Litig. (Bondholders I)*, No. MDL 2672 CRB (JSC), 2017 WL 3058563, at *14 (N.D. Cal. July 19, 2017). Volkswagen failed to disclose that, for years, it had been secretly installing defeat devices in its "clean diesel" line of cars to mask unlawfully high emissions, and that it was at risk of losing billions of dollars in fines and penalties if it was caught. Volkswagen's failure to disclose this information is ultimately what drives Plaintiff's claims.

To be sure, Plaintiff does also base its claims on certain affirmative statements in the bond offering memorandum. (*See* Dkt. No. 4956, SAC ¶ 227 (detailing disclosures about Volkswagen's focus on emission-reducing technologies and its need to comply with increasingly stringent emission laws).) As the Court noted in *Bondholders I*, though, "none of these statements were necessarily false," and the reason they are relevant is that they may have been rendered misleading by Volkswagen's failure to disclose its emissions fraud. *See* 2017 WL 3058563, at *6–7. Even these affirmative statements, in other words, are tethered to the omission that is at the heart of the case.

***2** In reaching this holding, the Court backtracks from *Bondholders II*, where it relied on *Waggoner v. Barclays PLC*, 875 F.3d 79 (2d Cir. 2017), in reasoning that *Affiliated Ute*'s presumption of reliance did *not* apply. *See In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prod. Liab. Litig. (Bondholders II)*, No. MDL 2672 CRB (JSC), 2018 WL 1142884, at *1–6 (N.D. Cal. Mar. 2, 2018). For the reasons brought to the Court's attention by Plaintiff and discussed in *Bondholders III*, the Court concludes that its interpretation of *Affiliated Ute* in *Bondholders II* was inconsistent with *Binder*, 184 F.3d at 1063–64 and with *Blackie v. Barrack*, 524 F.2d 891, 905–06 (9th Cir. 1975). *See In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prod. Liab. Litig. (Bondholders III)*, 328 F. Supp. 3d 963, 973–78 (N.D. Cal. 2018) (considering but not ruling on Plaintiff's request for

reconsideration of *Bondholders II*). *Binder* and *Blackie* are binding on this Court; *Waggoner* is not. Under *Binder* and *Blackie*, the Court concludes that *Affiliated Ute*'s presumption of reliance applies. [1]

Having determined that a presumption of reliance applies, the Court turns to whether Volkswagen has sufficiently rebutted that presumption. To do so on summary judgment, Volkswagen must offer evidence that establishes "beyond controversy" that Plaintiff's investment manager "would not have attached significance to the omitted facts, and therefore would have acted as he did if he had known the truth." *S. Cal. Gas Co. v. City of Santa Ana*, 336 F.3d 885, 888 (9th Cir. 2003); *Keirnan v. Homeland, Inc.*, 611 F.2d 785, 789 (9th Cir. 1980).

Pointing to the deposition of Plaintiff's investment manager, Volkswagen contends that the evidence in the record would not permit a jury to reasonably conclude that the investment manager read the bond offering memorandum before purchasing the bonds. Based on that interpretation of the record, Volkswagen insists that it has rebutted the presumption of reliance; for if Plaintiff's investment manager did not read the offering memorandum, then, the theory goes, Plaintiff cannot prove that its investment manager would have attached significance to the emissions fraud (and foregone the investment in Volkswagen bonds) if Volkswagen had disclosed the fraud in the offering memorandum.

In the run-of-the-mill omissions case, an investor's failure to read the relevant disclosure documents could indeed be fatal. Having not read those documents, any additional disclosures in them would have been unlikely to come to the investor's attention. As a result, it would be difficult for the investor to prove that he would have acted differently—and avoided the investment—if additional disclosures were made in those documents.

This is not a run-of-the-mill omissions case, however. The omitted facts detailed Volkswagen's large-scale and long-running defeat-device scheme. When that scheme was disclosed to the public, in September 2015, it was front-page news and prompted congressional hearings, video apologies by Volkswagen executives, and hundreds of lawsuits. The disclosure also prompted Plaintiff's investment manager to reevaluate Plaintiff's investment in Volkswagen bonds and to sell those bonds for a loss within a month's time. (*See* Dkt. No. 6580–1, Berg. Decl., Exs. 8–12.)

***3** If Volkswagen had disclosed its defeat-device scheme in its 2014 bond offering memorandum, instead of waiting until September 2015, the same publicity, and the same response by Plaintiff's investment manager, would likely have followed. The scheme was so substantial and blatant that it is hard to fathom that its disclosure would have gone unnoticed by the investing public, and that Plaintiff's investment manager would not have been made aware of it.

Assuming, then, that Volkswagen's evidence demonstrates that Plaintiff's investment manager did not read the offering memorandum prior to purchasing the bonds, that evidence alone is insufficient to establish beyond controversy that Plaintiff's investment manager would not have attached significance to the omitted facts about Volkswagen's emissions fraud if those facts had been disclosed in the offering memorandum. As a result, Volkswagen has not rebutted *Affiliated Ute*'s presumption of reliance.

Volkswagen moved for summary judgment exclusively on the element of reliance. Because it has failed to rebut *Affiliated Ute*'s presumption of reliance, summary judgment is not warranted and the Court DENIES Volkswagen's motion.

IT IS SO ORDERED.

All Citations

Slip Copy, 2019 WL 4727338

Footnotes

1 Volkswagen's contention that *Blackie* was only a fraud-on-the-market case is inaccurate. As the Ninth Circuit explained in a subsequent decision, *Blackie* "brought within the scope of *Affiliated Ute* a case in which it was alleged that certain material facts were omitted from [certain] reports," and the reports "contained representations rendered inaccurate by the omissions." *Little v. First Cal. Co.*, 532 F.2d 1302, 1304 (9th Cir. 1976). *Blackie*'s reasoning that reliance could also be proven on the facts of the case based on the fraud-on-the-market theory was only "an alternative rationale for its holding." *Id.* at 1304 n.3.

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Exhibit B

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

IN RE: VOLKSWAGEN "CLEAN DIESEL" MARKETING, SALES PRACTICES, AND PRODUCTS LIABILITY LITIGATION
_____/

MDL No. 2672 CRB (JSC)

ORDER GRANTING MOTION TO CERTIFY FOR INTERLOCUTORY APPEAL

This Order Relates To:
MDL Dkt. No. 6845

BONDHOLDER ACTION
_____/

The Court finds that its September 26, 2019 order denying Volkswagen's motion for summary judgment "involves a controlling question of law as to which there is substantial ground for difference of opinion" and that "an immediate appeal from the order may materially advance the ultimate termination of the litigation." *Reese v. BP Exploration (Ala.) Inc.*, 643 F.3d 681, 687–88 (9th Cir. 2011) (quoting 28 U.S.C. § 1292(b)). Volkswagen's motion for leave to appeal pursuant to 28 U.S.C. § 1292(b) is therefore GRANTED. Volkswagen has not requested that this action be stayed pending interlocutory appeal, and the Court confirms that the action will not be stayed.

IT IS SO ORDERED.

Dated: January 22, 2020

CHARLES R. BREYER
United States District Judge

Exhibit C

2017 WL 3058563
United States District Court, N.D. California.

IN RE: VOLKSWAGEN "CLEAN DIESEL" MARKETING, SALES PRACTICES, AND PRODUCTS LIABILITY LITIGATION
This Order Relates to: MDL Dkt. Nos. 2893, 2895, 2897
BRS v. Volkswagen AG, et al., Case No. 16-cv-3435 ("Bondholders Securities Action")

MDL No. 2672 CRB (JSC)
|
Signed 07/19/2017

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTIONS TO DISMISS THE BONDHOLDERS' CLASS ACTION COMPLAINT

CHARLES R. BREYER, United States District Judge

***1** This order addresses the second of two consolidated securities actions in this MDL. Both actions are against Volkswagen and members of management, and arise from the Company's use of a "defeat device" in nearly 600,000 TDI diesel engine vehicles sold in the United States from 2009 through 2015. The first action is by Volkswagen shareholders (the "ADR action"). (*See* Dkt. Nos. 2636, 2862, 3392.) This action is by Volkswagen bondholders —specifically, institutional investors who purchased bonds offered by Volkswagen Group of America Finance, LLC ("VWGoAF") between May 23, 2014 and September 22, 2015. (Dkt. No. 2507 (Compl.).) The bondholders allege that during the class period Volkswagen failed to disclose its emissions fraud, which rendered statements to prospective bondholders misleading and caused VWGoAF's bonds to sell at inflated prices. The bondholders contend that Defendants' conduct violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act").

Defendants have filed motions to dismiss the bondholders' Complaint. Central to the motions is the contention that Defendants did not make any material misrepresentations or omissions in the Bond Offering Memorandum on which Lead Plaintiff relied; and, to the extent Defendants did so, the allegations do not support that Defendants made those misrepresentations or omissions with scienter. For the reasons that follow, the Court concludes that Lead Plaintiff has plausibly alleged that the relevant Offering Memorandum was misleading, and that at least some (but not all) Defendants made statements and omissions therein with scienter. The Court accordingly GRANTS in part and DENIES in part the motions.

BACKGROUND

I. The Defeat Device Scheme

Between 2009 and 2015, Volkswagen sold nearly 600,000 Volkswagen-, Audi-, and Porsche-branded TDI "clean diesel" vehicles in the United States, which it marketed as being environmentally friendly, fuel efficient, and high performing. (Compl. ¶¶ 148–49.) Unbeknownst to consumers and regulatory authorities, Volkswagen installed a software defeat device in these cars that allows the vehicles to evade EPA and California Air Resources Board ("CARB") emissions test procedures. The defeat device senses whether the vehicle is undergoing emissions testing or being operated on the road. During emissions testing, the defeat device produces regulation-compliant results. When the vehicle is on the road, the defeat device reduces the effectiveness of the vehicles' emissions control systems. Only by installing the defeat device in its vehicles was Volkswagen able to obtain Certificates of Conformity from EPA and Executive Orders from CARB for its 2.0– and 3.0–liter TDI diesel engine vehicles; in fact, these vehicles release nitrogen oxides (NOx) at a factor of up to 40 times permitted limits. (*Id.* ¶ 54.)

In the fall of 2015, the public learned about Volkswagen's emissions scheme, when EPA issued two Notices of Violation of the Clear Air Act to Volkswagen Aktiengesellschaf ("VW AG"), Volkswagen Group of America, Inc. ("VWGoA") and related entities, announcing that Volkswagen had admitted to deliberately cheating on emissions tests. (*Id.* ¶¶ 232–33, 270–71.) Martin Winterkorn, the CEO and Chairman of the Management Board of VW AG from 2007 to September 23, 2015, acknowledged that Volkswagen broke the public's trust by manipulating environmental standards. (*Id.* ¶ 237.) Michael Horn, the President and CEO of VWGoA from January 2014 to March 2016, also admitted that "our company was dishonest with the EPA, and [ ] CARB and with all of you.... We've totally screwed up." (*Id.* ¶ 241.)

***2** After public disclosure, consumers, dealers, investors, and government entities filed suit against Volkswagen, and hundreds of lawsuits were consolidated before this Court as part of this MDL. Volkswagen has since settled claims related to the defeat device scheme brought by classes of U.S.

consumers, franchise dealers, and reseller dealerships, as well as claims brought by EPA, CARB, and the FTC. On March 10, 2017, VW AG also pled guilty to three criminal felony counts, including conspiracy to defraud the United States and the Company's U.S. customers, and to violate the Clean Air Act, by lying about whether its "clean diesel" vehicles complied with U.S. emissions standards. (*See United States v. Volkswagen AG*, No. 16–CR–20394, Dkt. 68 (E.D. Mich. Jan. 11, 2017).) Together, civil and criminal penalties and civil settlements are expected to cost Volkswagen approximately $20 billion.

II. The Bond Offerings

On three occasions in 2014 and 2015—prior to public disclosure of the emissions fraud—Volkswagen issued U.S.-dollar denominated bonds, through VWGoAF, for a total of $8.3 billion in par value. (Compl. ¶ 3.) VWGoAF is a wholly-owned subsidiary of VWGoA, and the bonds were guaranteed by VW AG, the ultimate parent company of VWGoA and VWGoAF. (*Id.* ¶¶ 20–22.) VWGoAF issued the bonds in private placements led primarily by U.S.-based investment banks. (*Id.* ¶ 15.) The bonds were exempt from registration with the SEC under Rule 144A, and accordingly could be purchased only by qualified institutional buyers ("QIBs")—institutional investors with at least $100 million in securities under management. *See* 17 C.F.R. § 230.144A(a)(1)(i). The bonds traded during the Class Period. (Compl. ¶ 3.)

Each VWGoAF bond offering was made pursuant to an Offering Memorandum. The Offering Memoranda are dated May 15, 2014 (for a May 23, 2014 offering), November 12, 2014 (for a November 20, 2014 offering), and May 19, 2015 (for a May 22, 2015 offering). (*Id.* ¶ 4.) Each Memorandum includes legal and financial disclosures, the terms of the offering, and various business and regulatory risk factors for investors to consider. (*See, e.g.*, Stanley Decl., Dkt. No. 2896–6 (May 15, 2014 Mem.).) Appended to each Memorandum are certain audited and unaudited financial statements of VW AG. (*See id.*; *see also* Giuffra Decl., Dkt. No. 2898–1 (excerpts of the May 15, 2014 Mem.).)

III. The Bondholders' Lawsuit

After learning about Volkswagen's emissions fraud, VWGoAF bondholders filed securities fraud claims against the Company and members of management. On October 11, 2016, the Court appointed the Puerto Rico Government Employees and Judiciary Retirement Systems Administration as Lead Plaintiff ("Lead Plaintiff," "Plaintiff," or "PRGERS"), and Abraham, Fruchter & Twersky, LLP as Lead Counsel. (Dkt. No. 2023.) Lead Plaintiff purchased 4,210 bonds (CUSIP: 928668AA0) issued as part of the May 23, 2014 offering and pursuant to the May 15, 2014 Offering Memorandum. (Compl. ¶ 16.)

In its Class Action Complaint, Plaintiff names as defendants VW AG, VWGoA, and VWGoAF (collectively, the "Corporate Defendants"), and Martin Winterkorn and Michael Horn (collectively, the "Individual Defendants," and all together, "Defendants" or "Volkswagen"). (*Id.* ¶¶ 20–25.) Plaintiff alleges that each Defendant is responsible for false and misleading statements and omissions in the Bond Offering Memoranda with respect to the emissions fraud. (*Id.* ¶¶ 199–202.) Plaintiff also alleges that VW AG and Winterkorn made false and misleading statements in the financial statements appended to the Offering Memoranda, by failing to recognize probable liabilities related to the fraud. (*Id.* ¶¶ 215–17.) Finally, Plaintiff contends that Defendants made false and misleading statements and omissions in materials outside the Offering Memoranda, including in interim and annual reports (*id.* ¶¶ 203–14), press releases (*id.* ¶¶ 218–26), and Corporate Social Responsibility and Sustainability Reports (*id.* ¶¶ 227–30) issued during the class period. As a result of Defendants' conduct, Plaintiff asserts that each Defendant violated Section 10(b) the Exchange Act, and that VW AG, VWGoA, Winterkorn, and Horn are also liable as "controlling persons" under Section 20(a) of the Exchange Act.

***3** Horn, Winterkorn, and the Corporate Defendants have each filed a motion to dismiss the Complaint. (*See* Dkt. Nos. 2893, 2895, 2897.) Horn and Winterkorn have also joined the Corporate Defendants' motion. Together, Defendants argue that the Court should dismiss the Complaint because Plaintiff (1) lacks standing; (2) fails to allege any actionable misstatements or omissions; (3) does not adequately plead that Defendants possessed scienter at the time Plaintiff purchased VWGoAF bonds; and (4) does not adequately plead reliance. (Dkt. No. 2897 at 3–4.) Winterkorn and Horn also challenge the control-person claims against them (Dkt. Nos. 2893 at 20–21; 2895 at 15–16), and Winterkorn additionally argues that Plaintiff's claims against him should be dismissed for lack of personal jurisdiction (Dkt. No. 2895 at 16–23). The Court held a hearing on the motions on July 7, 2014.

IV. The ADR Lawsuit

The shareholders in the ADR action are persons who purchased Volkswagen-sponsored Level 1 American Depositary Receipts in an over-the-counter market in the United States from November 19, 2010 through January 4, 2016. (*See* Dkt. No. 2862 ¶¶ 6, 35–36.) The Court addressed motions to dismiss the ADR action on two prior occasions, granting in part and denying in part the motions both times. (*See* Jan. 4, 2017 Order, Dkt. No. 2636; June 28, 2017 Order, Dkt. No. 3392.) The causes of action and many of the allegations in the ADR action and the bondholders' action are the same, and in a number of instances the parties here rely on the Court's ADR orders.

LEGAL STANDARD

Pursuant to the authority granted to the SEC under Section 10(b) of the Exchange Act, the SEC adopted Rule 10b–5, which makes it unlawful for any person, in connection with the purchase or sale of a security, "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b–5(b). The elements of a securities fraud claim under Section 10(b) and Rule 10b–5 are (1) that the defendant made a material misrepresentation or omission, (2) that the defendant did so with 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. *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 37–38 (2011); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005). At the pleading stage, plaintiff "must satisfy the dual pleading requirements of Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act ('PSLRA')." *Reese v. Malone*, 747 F.3d 557, 568 (9th Cir. 2014) (citing *In re VeriFone Holdings, Inc. Sec. Litig.*, 704 F.3d 694, 701 (9th Cir. 2012)). Rule 9(b) requires that plaintiff "state with particularity the circumstances constituting fraud or mistake," while the PSLRA requires plaintiff to plead both falsity and scienter with particularity. Fed. R. Civ. P. 9(b); 15 U.S.C. § 78u–4(b); *Tellabs v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314, 321–22 (2007).

Section 20(a) of the Exchange Act makes certain "controlling persons" liable for violations of Section 10(b). *See* 15 U.S.C. § 78t(a). "[A] defendant employee of a corporation who has violated the securities laws will be jointly and severally liable to the plaintiff, as long as the plaintiff demonstrates 'a primary violation of federal securities law' and that 'the defendant exercised actual power or control over the primary violator.' " *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 990 (9th Cir. 2009) (quoting *No. 84 Emp'r–Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 945 (9th Cir. 2003)).

In considering a motion to dismiss a securities fraud action, "courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true." *Tellabs*, 551 U.S. at 322. Presuming all factual allegations to be true, the Court must then determine if the complaint pleads "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A claim is plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). "Courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." *Tellabs*, 551 U.S. at 322. If the Court grants a motion to dismiss, it will give leave to amend "when justice so requires." Fed. R. Civ. P. 15(a)(2).

DISCUSSION

I. Standing

***4** Initially, Defendants argue that Lead Plaintiff lacks standing to bring claims on behalf of persons or entities who purchased different classes of bonds, or who purchased bonds in offerings other than the May 2014 offering in which Lead Plaintiff participated. (Dkt. No. 2897 at 45–46.) Defendants' argument is based on two related decisions by Judge Pfaelzer, holding that "the named plaintiff must have standing to sue for each of the asserted claims by purchasing in the offerings that are putatively part of the class action." *FDIC v. Countrywide Fin. Corp.*, No. 2:12–CV–4354 MRP, 2012 WL 5900973, at *10 (C.D. Cal. Nov. 21, 2012); *see also In re Countrywide Fin. Corp. Mort.–Backed Sec. Litig.*, 934 F. Supp. 2d 1219, 1229–30 (C.D. Cal. 2013) (citing favorably to decisions where "courts extend standing only to the offerings or tranches purchased by the named plaintiff").

Judge Pfaelzer's decisions predate *Melendres v. Arpaio*, 784 F.3d 1254 (9th Cir. 2015), *cert. denied*, 136 S. Ct. 799 (2016), which clearly controls and supports Plaintiff's standing. In *Melendres*, the Ninth Circuit noted that there are two rubrics for determining whether a lead plaintiff may pursue claims on

behalf of unnamed class members: the "standing approach" and the "class certification approach."

> The "standing approach" treats dissimilarities between the claims of named and unnamed plaintiffs as affecting the "standing" of the named plaintiff to represent the class. In other words, if there is a disjuncture between the injuries suffered by named and unnamed plaintiffs, courts applying the standing approach would say the disjuncture deprived the named plaintiff of standing to obtain relief for the unnamed class members. *See, e.g.*, *Blum v. Yaretsky*, 457 U.S. 991, 999–1002 (1982). The "class certification approach," on the other hand, "holds that once the named plaintiff demonstrates her individual standing to bring a claim, the standing inquiry is concluded, and the court proceeds to consider whether the Rule 23(a) prerequisites for class certification have been met." NEWBERG ON CLASS ACTIONS § 2:6.

Melendres, 784 F.3d at 1261–62. After discussing these two approaches, the court in *Melendres* held that, "We adopt the class certification approach." *Id.* at 1262. As a result, "representative parties who have a direct and substantial interest have standing," and "the question whether they may be allowed to present claims on behalf of others who have similar, but not identical, interests depends not on standing, but on an assessment of typicality and adequacy of representation." *Id.* (quoting 7AA Charles Alan Wright et al., *Federal Practice & Procedure* § 1785.1 (3d ed.)).

Defendants do not attempt to distinguish *Melendres*, but instead assert that *Melendres* does not help Lead Plaintiff, who has failed to state a claim on its own behalf. (*See* Dkt. No. 3124 at 11 n.2.) If Lead Plaintiff does not plead facts sufficient to state its own claim, Defendants are correct that Lead Plaintiff cannot represent others who may have a claim. *See Lierboe v. State Farm Mut. Auto. Ins. Co.*, 350 F.3d 1018, 1022 (9th Cir. 2003) ("[I]f Lierboe has no stacking claim, she cannot represent others who may have such a claim...."). But if Lead Plaintiff is able to state its own claim (and it is able to do so as discussed below), *Melendres* clearly forecloses Defendants' argument that Plaintiff lacks standing to represent other putative class members who purchased VWGoAF bonds in different tranches or offerings.

II. Section 10(b) Claims

A. The Universe of Statements

In considering Plaintiff's Section 10(b) claims, it is first necessary to address whether Plaintiff may rely on statements outside the May 15, 2014 Offering Memorandum, which is the Memorandum that governed Plaintiff's bond purchase. The Complaint relies on statements and omissions within the body of the May 2014 Offering Memorandum, in financial statements appended to the Memorandum, and in materials outside the Offering Memorandum, including in various interim and annual reports (Compl. ¶¶ 203–14), press releases (*id.* ¶¶ 218–26), and Corporate Social Responsibility and Sustainability Reports (*id.* ¶¶ 227–30) issued by Volkswagen during the class period. Plaintiff contends that at least certain of these materials were incorporated by reference into the Offering Memorandum and accordingly should be considered. (*Id.* ¶ 203; *see also* Dkt. No. 3021 at 31.)

***5** The Court agrees with Defendants that Plaintiff can base its securities fraud claims only on the May 2014 Offering Memorandum and the financial statements appended thereto. Near the front of May 2014 Offering Memorandum, at the top of the page and in bold-faced type, is the statement that "**You should rely only on the information contained in this Offering Memorandum**" when considering this investment. (Dkt. No. 2898–1 at 4.) In accepting the Memorandum, "Investors also acknowledge[d] that ... they ha[d] relied only on the information contained in this document" in making an investment decision. (*Id.*)

Based on this instruction and acknowledgment, Plaintiff, as an institutional investor with more than $100 million in securities under management, could not reasonably have relied on statements outside the May 2014 Offering Memorandum and the appended financial statements in making its investment decision. *See Harsco Corp. v. Segui*, 91 F.3d 337, 342–44 (2d Cir. 1996) (affirming dismissal where sophisticated plaintiff disclaimed reliance on matters outside of agreement but brought Section 10(b) claim "principally alleging conduct that falls outside [the] boundaries [of the agreement]").

Nor does Plaintiff explain how the May 2014 Offering Memorandum incorporated by reference any of Volkswagen's interim and annual reports, let alone the cited press releases and Corporate Social Responsibility and Sustainability Reports. The only section of the Memorandum that appears to address the interim and annual reports is a section stating that:

> Information presented in this Offering Memorandum is qualified in its entirety by the description of recent developments related to the Volkswagen Group set forth

> in '*Developments since January 1, 2014 and Outlook*' which reflects among other things information disclosed in the unaudited interim ***report*** of Volkswagen AG and its consolidated subsidiaries for the period from January 2014 to March 2014.

(Dkt. No. 2898–1 at 9 (second emphasis added).) This statement does not incorporate Volkswagen's interim reports into the Memorandum. Rather, it provides that, under the heading *Developments since January 1, 2014 and Outlook*, which is a particular section in the Memorandum, certain information from the interim report is disclosed. Plaintiff does not assert that the representations in the interim report on which it relies were included in that disclosure.

Given that Plaintiff is a large institutional investor and the May 2014 Offering Memorandum expressly instructed it to rely only on information contained within it, Plaintiff cannot base its securities fraud claims on statements in documents or sources other than the Offering Memorandum and the appended financial statements.

B. The Body of the May 2014 Offering Memorandum

Plaintiff makes different arguments for why the body of the May 2014 Offering Memorandum was false and misleading, and why the appended financial statements were false and misleading. The Court first addresses the statements and omissions within the body of the Memorandum and in Section C discusses the financial statements.

1. Whether the Statements and Omissions Were False and/or Misleading

Plaintiff contends that the "heart of this action" is Defendants' failure to disclose their massive defeat-device scheme. (Dkt. No. 3021 at 31.) Neither side disputes that Volkswagen's use of the defeat device was material information—that is, a reasonable investor would have viewed it "as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988). Defendants contend, however, that they did not have a duty to disclose the use of the defeat device in the May 2014 Offering Memorandum.

***6** Section 10(b) and Rule 10b–5 "do not create an affirmative duty to disclose any and all material information." *Matrixx*, 563 U.S. at 44. Instead, a duty to disclose arises only when disclosure is "necessary ... to make the statements made, in light of the circumstances under which they are made, not misleading." 17 C.F.R. § 240.10b–5(b); *see also Schueneman v. Arena Pharm., Inc.*, 840 F.3d 698, 706 (9th Cir. 2016) ("[O]nce defendants choose to tout positive information to the market, they are bound to do so in a manner that wouldn't mislead investors, including disclosing adverse information...." (internal quotation marks omitted)).

Plaintiff highlights two types of statements in the May 2014 Offering Memorandum that it contends were misleading because Defendants did not disclose the defeat-device scheme. The first category includes statements made about Volkswagen's research and development ("R & D") priorities. Specifically, the May 2014 Offering Memorandum explained that:

- Volkswagen's top priority for research and development in 2011, 2012 and 2013 was to develop engines and drivetrain concepts to reduce emissions, and to develop and expand the modular longitudinal toolkit platforms and the modular transverse toolkit platforms. (Dkt. No. 2896–6 at 141; *see also* Compl. ¶ 201(a).)

- A focal point of Volkswagen's current and future development activities is and will be innovative mobility concepts and the reduction of fuel consumption and emissions of the fleet.... With a broad range of development activities in the drivetrain sector, Volkswagen will continue to reduce the emissions of our vehicles in the coming years. (Compl. ¶ 201(b).)

- Our future business success depends on our ability to develop new, attractive and energy-efficient products that are tailored to our customers' needs and to offer these products on competitive terms and conditions. In their purchasing decisions, customers are increasingly emphasizing lower fuel consumption and exhaust emissions. (*Id.* ¶ 201(h).)

The second category includes statements in the Memorandum's "Regulatory, Legal, and Tax-Related Risks" section. Specifically:

- Volkswagen is subject to laws and regulations that require it to control automotive emissions, including exhaust emission standards, vehicle evaporation standards and onboard diagnostic system requirements. (*Id.* ¶ 201(c).)

- Volkswagen's vehicles must comply with increasingly stringent requirements concerning emissions. (*Id.* ¶ 201(d).)

- U.S. federal and state governments and agencies ... have created a suite of vehicle emission regulations aimed at improving local air quality and minimizing the potential effects of global climate change. Automobile manufacturers must ensure that their individual vehicles, and in some cases, fleets of vehicles, must comply with various pollutant, carbon dioxide, fuel economy, and zero-emission technology requirements.... Volkswagen is responsible under these regulations for the performance of vehicle emission control systems, as well as the emission performance of its sold cars and light duty trucks over certain time and mileage periods. (*Id.* ¶ 201(e).)

As an initial matter, none of these statements were necessarily false. Plaintiff does allege that the R & D statements were false "because Defendants did not intend to, or effectively, reduce emissions." (Compl. ¶ 202(c).) But the Complaint does not include any allegations supporting that Volkswagen did not wish to reduce emissions, or that it had stopped researching or developing emissions-reducing technologies. Nor do the allegations support that the "risk factors" were false—Volkswagen *is* subject to U.S. federal and state emissions regulations and Volkswagen must comply with those requirements or face penalties.

***7** Rather than pursuing a falsity argument, Plaintiff instead asserts that the R & D statements and "risk factors" were generally misleading without disclosure of the massive defeat-device scheme. (Dkt. No. 3021 at 34.) The Court agrees. The statements that Volkswagen's "top priority" and "focal point" for R & D was to develop engines that reduced emissions could have led a reasonable investor to conclude that Volkswagen was committed to emissions-reducing technology. A reasonable investor also could have concluded from the Memorandum that Volkswagen's commitment to emissions-reducing technology was important for the Company's future success given the "increasingly stringent [regulatory] requirements concerning emissions" and that "customers [were] increasingly emphasizing lower fuel consumption and exhaust emissions" when shopping for a vehicle. (Compl. ¶ 201(d), (h).) Together, the inference that arises from these statements is that Volkswagen was a good investment *because* of its commitment to emissions-reducing technology. That inference was misleading because Volkswagen was in its fifth year of a massive fraud to cheat emissions standards.

In arguing that the statements in the Offering Memorandum are not actionable, Defendants cite to a number of decisions holding that "risk factors," i.e, a company's statements about laws and regulations it is subject to, are not actionable. *See, e.g., In re LeapFrog Enters., Inc. Sec. Litig.*, 527 F. Supp. 2d 1033, 1048 (N.D. Cal. 2007) (a company's "cautionary statements ... are not actionable to the extent plaintiffs contend defendants should have stated that the adverse factors 'are' affecting financial results rather than 'may' affect financial results"); *In re Foundry Networks, Inc.*, No. C00–4823 MMC, 2002 WL 32354617, at *7 (N.D. Cal. June 6, 2002) ("Plaintiffs ... cannot state a claim based on the disclosure of risk factors."); *Zeid v. Kimberley*, 930 F. Supp. 431, 437 (N.D. Cal. 1996) ("[W]arnings regarding potential adverse factors are not actionable as a matter of law."). [1] The courts reaching these holdings, however, did so while evaluating risk factors in isolation. Here, it is the combination of Volkswagen's warnings regarding tighter emissions requirements (the "risk factors") and Volkswagen's R & D statements that creates the plausible deceit. That U.S. regulators were tightening restrictions on emissions made Volkswagen's focus on emissions-reducing technology more important. Given increased regulatory scrutiny, Volkswagen even acknowledged that, "Our future business success depends on our ability to develop new, attractive and energy-efficient products." (Compl. ¶ 201(h).) Yet Volkswagen was intentionally cheating emissions requirements in hundreds of thousands of "clean diesel" vehicles. (*See generally* Compl. ¶¶ 50–179.) Reading the risk factors in conjunction with the R & D factors is necessary and appropriate. *See Bodri v. GoPro, Inc.*, —— F. Supp. 3d ——, 2017 WL 1732022, at *7 (N.D. Cal. May 1, 2017) ("A statement is misleading only if a reasonable investor, reading the statement fairly *and in context*, would be misled." (emphasis added)).

Defendants also argue that Volkswagen's statements about its "top priority" and "focal point" for R & D constituted corporate puffery, which multiple courts have held is not actionable. *See, e.g.*, *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1111 (9th Cir. 2010) (defendants' statement that "we believe our employee relations are good" was not actionable, even though many employees were leaving the company, because "[w]hen valuing corporations ... investors do not rely on vague statements of optimism like 'good,' 'well-regarded,' or other feel good monikers"); *In re Ford Motor Co. Sec. Litig.*, 381 F.3d 563, 570 (6th Cir. 2004) (statements such as "[a]t Ford quality comes first," and "Ford is a worldwide leader in automotive safety," were not actionable, even though Ford omitted information regarding the dangerousness of

Ford Explorer vehicles, because "[s]uch statements are either corporate puffery or hyperbole that a reasonable investor would not view as significantly changing the general gist of available information").

***8** These puffery decisions are distinguishable. In *Ford*, the Sixth Circuit acknowledged that statements such as "quality comes first" were possibly misleading. But even if misleading, the court concluded that the statements were not *material.* 381 F.3d at 570–71. Underlying this conclusion was that the claimed dangers with the Ford Explorer were not as significant as the plaintiffs claimed. *See id.* at 569 (describing complaints and limited recalls in the Middle East and in Venezuela and a series of lawsuits Ford had settled with injured passengers in the U.S.). Similarly in *Cutera*, the Ninth Circuit held that the statement "our employee relations are good" was not *material* given its subjectiveness, and the fact that the company made other disclosures about reductions to its sales force. 610 F.3d at 1110–11. Here, in contrast, it is undisputed that Volkswagen's use of a defeat device was material. At the time of the May 2014 bond offering, Volkswagen was in the middle of a years-long fraud that affected a significant number of vehicles in the United States and involved intentional deception of regulators and consumers.

Volkswagen's R & D statements were also more specific than the "quality comes first" and "employee relations are good" statements in *Ford* and *Cutera*. Volkswagen identified its top R & D priority in concrete terms: "to develop engines and drivetrain concepts to reduce emissions, and to develop and expand the modular longitudinal toolkit platforms and the modular transverse toolkit platforms." (Dkt. No. 2896–6 at 141; see also Compl. ¶ 201(a).) Even if Volkswagen was pursuing this R & D goal, the statement in context was misleading given the ongoing defeat device scheme.

Ultimately, "[w]hether a public statement is misleading, or whether adverse facts were adequately disclosed is a mixed question to be decided by the trier of fact." *Fecht v. Price Co.*, 70 F.3d 1078 (9th Cir. 1995), *superseded by statute on other grounds as stated in Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1309 (C.D. Cal. 1996); *see also Durning v. First Boston Corp.*, 815 F.2d 1265, 1268 (9th Cir. 1987) ("Like materiality, adequacy of disclosure is normally a jury question."). Here, a fact finder could reasonably conclude that the statements in the May 2014 Offering Memorandum were misleading when viewed in context and when considered along with the defeat-device omission.

2. Whether Defendants Made the Statements in the Body of the May 2014 Offering Memorandum with Scienter

Defendants argue that, even if the statements in the May 2014 Offering Memorandum were misleading, they did not make those statements with scienter. Neither Winterkorn nor Horn were responsible for the Offering Memorandum, Defendants argue, so neither of them could have "made" the statements with scienter. And even if Winterkorn and/or Horn were responsible for the Memorandum, Volkswagen argues that the Individual Defendants made the statements therein without knowledge of the defeat device scheme. If the Individual Defendants lacked scienter, Volkswagen argues the Corporate Defendants also lacked scienter.

a. Whether Winterkorn and Horn "Made" the Statements

"For purposes of Rule 10b–5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Janus Capital Gp., Inc. v. First Deriv. Traders*, 564 U.S. 135, 142 (2011). For example, "a corporate official ... who, acting with scienter, signs [an] SEC filing containing misrepresentations, 'makes' a statement so as to be liable as a primary violator under § 10(b)." *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1061 (9th Cir. 2000). And even without a signature, a corporate official makes a statement if the official "actually participated in and had authority over the [corporation's] filing process." *Reese v. BP Expl. (Alaska) Inc.*, 643 F.3d 681, 693 n.8 (9th Cir. 2011).

Here, neither Winterkorn nor Horn signed the May 2014 Offering Memorandum. Although Winterkorn signed the financial statements appended to the Memorandum, those historical statements predated the Memorandum, so his signatures on those statements, without more, do not support that he had control over the Memorandum. Other allegations, however, support that both Winterkorn and Horn "actually participated in and had authority over" VWGoAF's Offering Memorandum. *Id.* At the time of the May 2014 bond offering, Winterkorn was the CEO of VW AG, which was the ultimate parent company of VWGoAF and the guarantor of the bonds. (Compl. ¶¶ 22–23.) In fact, VWGoAF was incorporated in February 2014 specifically to serve as a debt issuing vehicle for VW AG. (*Id.* ¶ 22.) At the same time, Horn was the CEO of VWGoA, a wholly-owned subsidiary of VW AG doing business in the United States, and the direct parent company

of VWGoAF. (*Id.* ¶¶ 21–22.) In these roles, Plaintiff alleges that both Winterkorn and Horn were "involved in the day-to-day operations of, and exercised power and control over" VWGoAF. (*Id.* ¶¶ 23, 25.) Additionally, Plaintiff alleges that both Winterkorn and Horn "were able to and did control the content of the various offering memoranda," and were "provided with copies of documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected." (*Id.* ¶ 27.)

***9** In the ADR case, the Court held that allegations similar to these were sufficient to satisfy *Janus*. (*See* Jan. 4, 2017 Order, Dkt. No. 2636 at 31–32.) The Court reaches the same conclusion here. Plaintiff's allegations plausibly support that both Winterkorn and Horn had "ultimate authority" over the May 2014 Offering Memorandum, because they were both able to and did control the content of the Memorandum. The statements in the Memorandum can therefore be attributed to them. *See In re Rocket Fuel, Inc. Sec. Litig.*, No. 14–CV–3998–PJH, 2015 WL 9311921, at *10 (N.D. Cal. Dec. 23, 2015) (finding allegations that individual defendants "possessed the power and authority to control the contents of the Company's press releases [and] investor and media presentations" sufficient to satisfy *Janus* and withstand motion to dismiss). The Court therefore continues by analyzing whether Winterkorn and/or Horn "made" the statements in the Offering Memorandum with scienter.

b. Scienter

i. Legal Standard

"In a § 10(b) action, scienter refers to a mental state embracing intent to deceive, manipulate, or defraud." *Merck & Co., Inc. v. Reynolds*, 559 U.S. 633, 648 (2010) (internal quotation marks omitted). "To adequately demonstrate that the defendant acted with the required state of mind, a complaint must allege that the defendants made false or misleading statements either intentionally or with deliberate recklessness." *Zucco*, 552 F.3d at 991 (internal quotations marks and citations omitted). To establish deliberate recklessness "the plaintiff must plead a highly unreasonable omission [of information] ... that is either known to the defendant or is so obvious that the actor must have been aware of it." *Id.* (internal quotation marks and citation omitted).

To find that a corporate defendant acted with scienter, it is usually necessary to reach "a concurrent finding that a defendant director or officer also had the requisite intent." *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1436 (9th Cir. 1995); *see also In re ChinaCast Educ. Corp. Sec. Litig.*, 809 F.3d 471, 476 (9th Cir. 2015) ("In the context of Rule 10b–5, we have adopted the general rule of imputation and held that a corporation is responsible for a corporate officer's fraud committed within the scope of his employment[.]" (internal quotation marks omitted)). But even without facts to support that a particular corporate officer acted with scienter, under certain circumstances plaintiff may be able to plead collective scienter for a corporation. As the Ninth Circuit noted in *Glazer Capital Management, LP v. Magistri*, 549 F.3d 736 (9th Cir. 2008):

> [I]n certain circumstances, some form of collective scienter pleading might be appropriate. For instance, as outlined in the hypothetical posed in *Makor*, there could be circumstances in which a company's public statements were so important and so dramatically false that they would create a strong inference that at least some corporate officials knew of the falsity upon publication.

Id. at 744 (emphasis in original) (citing *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 710 (7th Cir. 2008)). The *Makor* hypothetical referenced in *Glazer* is that "[s]uppose General Motors announced that it had sold one million SUVs in 2006, and the actual number was zero." 513 F.3d at 710. In such a circumstance, the *Makor* court concluded that "[t]here would be a strong inference of corporate scienter, since so dramatic an announcement would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false." *Id.*

The PSLRA requires a plaintiff to state with particularity facts giving rise to a strong inference of a defendant's scienter. *See* 15 U.S.C. § 78u–4(b)(2). "[A]n inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Tellabs*, 551 U.S. at 314. "Where pleadings are not sufficiently particularized or where, taken as a whole, they do not raise a 'strong inference' that misleading statements were knowingly or ... reckless[ly]

made to investors, a private securities fraud complaint is properly dismissed under Rule 12(b)(6)." *Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001).

ii. Winterkorn

***10** The allegations support that, by the time Winterkorn made the statements in the May 15, 2014 Offering Memorandum, he knew Volkswagen was using an illegal defeat device. Plaintiff alleges that in 2007 Bosch—the alleged co-developer of the defeat device—"sent a letter to VW AG's 'top circles' informing the Company that using the software for the planned application of reducing emissions during testing would be illegal." (Compl. ¶ 127.) "In 2011, an internal whistleblower [also] warned the Company, including Winterkorn's confidant and Volkswagen's then-head of development Neuβer, that the Company was illegally manipulating reported emissions data." (*Id.*) When Winterkorn became CEO of VW AG in 2007, he also installed two of his "top aids during his tenure at Audi," Ulrich Hackenberg and Wolfgang Hatz, both of whom had "daily responsibility for developing Volkswagen's clean-diesel strategy." (*Id.* ¶ 84.) It was later reported that these two Winterkorn aids were "at the center of [Volkswagen's] probe into the installation of engine software designed to fool regulators." (*Id.*) Plaintiff also alleges that Winterkorn had a "detail-oriented nature" and had "knowledge of everything his two close[s]t lieutenants were doing." (*Id.* ¶ 312.) "Clean diesel" vehicles were also an important component of Winterkorn's " 'Strategy 2018,' to make VWAG the largest and most profitable car maker in the world by 2018." (*Id.* ¶ 35.)

Together, these allegations give rise to a strong inference that, by May 2014, and likely much earlier, Winterkorn knew that Volkswagen was using an illegal defeat device in its "clean diesel" vehicles. While not of the smoking-gun variety, it is highly plausible that Winterkorn knew about the scheme given his attention to detail, his close relationships with aids that were directly involved with the scheme, and the importance of the "clean diesel" vehicles for Volkswagen's growth strategy. As a result, when Winterkorn made the misleading statements in the May 15, 2014 Offering Memorandum, the allegations support that he knew the statements were misleading or was deliberately reckless to their effect.

In challenging the sufficiency of the scienter allegations, Defendants note that it was not until at least May 23, 2014 that Winterkorn is alleged to have received an important memo about the emissions scandal from Bernd Gottweis, VW AG's top quality-assurance executive. It was in that memo that Gottweis alerted Winterkorn to a study conducted at West Virginia University and commissioned by the International Council on Clean Transportation ("ICCT"), which indicated that during road tests Volkswagen's "clean diesel" vehicles emitted NOx at levels up to 40 times the legal limits. (Compl. ¶ 151.) In his memo, Gottweis also explained that CARB would conduct a follow-up investigation, and that "it can be assumed that the authorities will then investigate the VW systems to determine whether Volkswagen implemented a ... so-called defeat device[ ]." (Dkt. No. 2898–8 at 7; *see also* Compl. ¶¶ 170–71.)[2] Defendants argue that because the Gottweis memo postdated the May 15, 2014 Offering Memorandum, Winterkorn did not learn about the emissions fraud until after Gottweis sent his memo. (Dkt. No. 28971 at 41.)

While important, the Gottweis memo is not the only allegation supporting that Winterkorn knew about Volkswagen's use of a defeat device. Rather, the other allegations discussed above plausibly support that Winterkorn knew about Volkswagen's use of a defeat device by May 2014, and perhaps as early as 2007. Moreover, although the Gottweis memo plausibly put Winterkorn on notice that regulators were investigating Volkswagen's "clean diesel" vehicles, knowledge of an investigation is not necessary to prove scienter as to the statements and omissions in the body of the May 2014 Offering Memorandum. It was Winterkorn's failure to disclose Volkswagen's use of a defeat device that made the statements in the Memorandum misleading. And the allegations support that Winterkorn knew about the Company's use of a defeat device by the time he made those statements.

iii. Horn

***11** The allegations of scienter as to Horn are not as strong. Horn did not join VWGoA until January 2014, and the earliest allegation supporting that he was aware of the defeat device is that, on the same date VWGoAF issued the May 2014 Offering Memorandum, May 15, he received an email from the then-head of Volkswagen's U.S. Regulatory Compliance Office, Oliver Schmidt, which indicated "that 500,000 [to] 600,000 vehicles in the United States from model years 2009 to 2014 could be affected by the diesel scandal[,]" that potential fines included " 'EPA: $37,500 and CARB: $5,500' per violation," and that, given the potential penalties, " '[t]he

contents of this [ICCT] study cannot be ignored!' " (Compl. ¶ 290 (third and fourth alterations in complaint).)

Even if Plaintiff did not finalize its bond purchase until May 23, 2014, and Horn accordingly had time to read the Schmidt email before the transaction was complete, managers are permitted a reasonable amount of time to consider, digest, and investigate negative information before they disclose that information to the public. *See, e.g.*, *Slayton v. Am. Express Co.*, 604 F.3d 758, 763–64, 774, 777 (2d Cir. 2010) (affirming dismissal; taking two months to "ascertain and disclose future losses" is "both proper and lawful" (citation omitted)); *Higginbotham v. Baxter Intern., Inc.*, 495 F.3d 753, 760–61 (7th Cir. 2007) (affirming dismissal; holding that disclosing accounting errors at subsidiary two months after discovery was a "reasonable time" because "[p]rudent managers conduct inquiries rather than jump the gun with half-formed stories as soon as a problem comes to their attention"); *In re Yahoo! Inc. Sec. Litig.*, No. C 11–02732 CRB, 2012 WL 3282819, at *22 (N.D. Cal. Aug. 10, 2012) (granting dismissal; relying on *Slayton* and *Higginbotham* and concluding that the defendants' disclosure of a corporate restructuring five weeks after receiving notice was reasonable). Here, it would have been reasonable for Horn to have obtained the Schmidt email and to have considered and investigated the issue for more than a week before disclosing the information to potential bondholders or the public. The Schmidt email therefore does not support a strong inference that Horn made statements in the May 15, 2014 Offering Memorandum with scienter, or that his failure to correct the Offering Memorandum by May 23, 2014 was done with scienter. [3]

Putting aside the May 15, 2014 Schmidt email, Plaintiff argues that other allegations in the Complaint support scienter as to Horn. Specifically, Plaintiff highlights allegations that Horn was "centrally involved in the process for acquiring all necessary approvals and certifications so that [Volkswagen's] vehicles could legally be sold and driven in the United States." (Compl. ¶ 319.) Plaintiff also notes that in the wake of the scandal Horn resigned. (*Id.* ¶ 289.) In the January 4 ADR Order, the Court gave weight to these allegations in concluding that scienter was well pled as to Horn. (*See* Dkt. No. 2636 at 25–26.) In reaching this conclusion, though, the Court also relied on the Schmidt email. If the Schmidt email is not considered, the other allegations are not sufficient to support a strong inference that, as of either May 15 or May 23, 2014, Horn knew about the defeat device scheme and intentionally or recklessly omitted information about the scheme in the May 2014 Offering Memorandum.

***12** In a letter brief submitted after oral argument, Plaintiff also argues that scienter may be established under the "core operations" doctrine. (Dkt. No. 3422–1.) Under that doctrine, scienter may be inferred if the fraud is based on facts "critical to a business's core operations," such that the company's key officers would know of those facts. *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 783–84 (9th Cir. 2008) (internal quotation marks omitted). Courts applying the core operations doctrine, however, have required plaintiffs to plead "details about the defendants' access to information within the company" related to the fraud. *Id.* at 785. For example, in *In re Daou Systems, Inc.*, 411 F.3d 1006 (9th Cir. 2005), plaintiffs successfully relied on the core operations doctrine where the complaint included specific allegations that defendants monitored the data that was the subject of the allegedly false statements. *Id.* at 1022–23. Similarly, in *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226 (9th Cir. 2004), plaintiffs relied on the core operations doctrine to demonstrate a CEO's scienter as to false statements regarding the company's sales, where the CEO stated that: "All of our information is on one database. We know exactly how much we have sold in the last hour around the world." *Id.* at 1231.

The situation here is different. Volkswagen's "clean diesel" campaign was undoubtedly important to the Company's strategy to become the largest and most profitable car maker. (Compl. ¶¶ 35, 128.) However, unlike the data in *Daou* and the sales database in *Nursing Home*, the Complaint does not included allegations supporting that information about the *defeat device*—a software program—was readily available to Horn. (*Id.* ¶ 25.) The core operations doctrine therefore does not apply and the allegations do not support that Horn intentionally or recklessly made the misleading statements and omissions in the May 2014 Offering Memorandum.

iv. Corporate Defendants

The allegations supporting Winterkorn's scienter are also sufficient to raise a strong inference of scienter as to VW AG, because "a corporation is responsible for a corporate officer's fraud committed within the scope of his employment[.]" *In re ChinaCast*, 809 F.3d at 476. Additionally, because Winterkorn plausibly participated in, and had authority over, the May 2014 Offering Memorandum, his scienter may be imputed to VWGoAF. *See Valentini v. Citigroup, Inc.*, 837 F. Supp. 2d 304, 317 (S.D.N.Y. 2011) (scienter may be imputed from one entity to another if plaintiff demonstrates "that the

parent or affiliate possessed some degree of control over, or awareness about, the fraud"). Conversely, because Plaintiff's allegations do not support a strong inference of scienter as to Horn, and "corporate scienter relies heavily on the awareness of the directors and officers," *Nordstrom*, 54 F.3d at 1436, the allegations also do not support scienter as to VWGoA.

Plaintiff contends that the Court should apply the doctrine of collective scienter as to VWGoA. (Dkt. No. 3021 at 27.) As noted above, collective scienter may be appropriate in the limited circumstances "in which a company's public statements were so important and so dramatically false that they would create a strong inference that at least some corporate officials knew of the falsity upon publication." *Glazer*, 549 F.3d at 744. But the statements in the May 2014 Offering Memorandum, while misleading, were not false, let alone "so dramatically false that they would create a strong inference that at least some corporate officials knew of the falsity upon publication." *Id.*

As a comparison, in the ADR action the Court applied collective scienter as to certain statements by Volkswagen in annual reports and press releases. (*See* Jan. 4, 2017 Order, Dkt. No. 2636, at 24.) The statements there were clearly false, as Volkswagen expressly represented that its "clean diesel" vehicles complied with emissions standards. (*See id.* at 28 ("The Golf TDI Clean Diesel also fulfils the most stringent emissions standards in the world: the LEV3/TIER 3 standards in the USA." (quoting ADR Compl. ¶ 412)); *id.* ("Lower raw emissions and its SCR (selective catalytic reduction) emissions control system enable the powertrain to meet the strict requirements of the US BIN5/ULEV emissions laws." (quoting ADR Compl. ¶ 379)).) In contrast, the statements in the May 2014 Offering Memorandum about Volkswagen's "top" R & D priorities and tightening emissions regulations were not false, but were misleading given that Volkswagen omitted to disclose in the Offering Memorandum that it was in the middle of a years-long effort to cheat emissions regulations. Because these statements were not false, the doctrine of collective scienter does not apply.

3. Conclusion as to Statements in the Body of the May 2014 Offering Memorandum

***13** Plaintiff's allegations are sufficient to support that the May 2014 Offering Memorandum was materially misleading. The allegations also support that Winterkorn, VW AG, and VWGoAF made these misleading statements with scienter. The allegations do not support scienter as to Horn or VWGoA.

C. The Financial Statements Appended to the May 2014 Offering Memorandum

Defendants appended certain historical VW AG financial statements to the May 15, 2014 Offering Memorandum; specifically, VW AG's Q1 2014 interim and 2012 and 2013 audited consolidated financial statements. (*See* Dkt. No. 2898–1.) Plaintiff alleges these financial statements were false and misleading because VW AG and Winterkorn did not recognize a "provision" in the statements for probable liabilities stemming from the emissions fraud. (Compl. ¶¶ 193–94, 215.)

As discussed in the Court's June 28 ADR Order, International Accounting Standards do not require VW AG to recognize a "provision" until the probability of a *loss* related to an event is probable. (Dkt. No. 3392 at 5–9.) And a loss is not probable simply because a company knowingly decides to engage in fraudulent activity. Rather, "[a]t most, the disclosure obligation would arise when an investigation into the conduct began." *Gusinsky v. Barclays PLC*, 944 F. Supp. 2d 279, 290–91 (S.D.N.Y. 2013), *vacated in part on other grounds sub nom. by Carpenters Pension Trust Fund of St. Louis v. Barclays PLC*, 750 F.3d 227 (2d Cir. 2014).

As in the ADR action, the allegations here plausibly support that, by the end of May 2014, Winterkorn and VW AG knew or should have known that losses related to the emissions fraud were probable. It was during that month that U.S. regulators learned of the ICCT study results, which indicated that Volkswagen's "clean diesel" vehicles emitted excess emissions during road tests. (Compl. ¶ 67.) The ICCT study in turn resulted internal communications at Volkswagen about the results, including the May 23, 2014 Gottweis memo, which explained that CARB would conduct a follow-up investigation and would likely investigate whether Volkswagen's vehicles utilized a defeat device. (Dkt. No. 2898–8 at 7; *see also* Compl. ¶¶ 170–71.)

All of this activity, however, postdated the financial statements appended to the May 15, 2014 Offering Memorandum. VW AG's Q1 2014 financials were the closest in time of the three appended statements, reflecting results for the three-month period ending March 31, 2014, prepared as of April 29, 2014. (Dkt. No. 2898–1 at 56.) Plaintiff argues that, "although VWAG may not have known that it was understating its liabilities when [the] financial statements were initially issued, it certainly knew that it was understating its liabilities as of the date those statements were incorporated in the Offering Memoranda and issued to the

Bond investors." (Dkt. No. 3021 at 37.) The allegations do not support this inference.

Plaintiff alleges that Winterkorn received the Gottweis memo in his "extensive weekend mail" or "weekend suitcase" on Friday, May 23, 2014. (Compl. ¶¶ 171, 173.) The most reasonable inference accordingly is that, at the earliest, he read the memo on Saturday, May 24, 2014. By this time the Offering Memorandum had been out the door for a week and the bond offering was finalized. And although there were other communications at VW AG about the ICCT study results earlier than May 24, only the Gottweis memo is tied directly to Winterkorn. Thus, the allegations support that Winterkorn learned that losses related to the emissions fraud were probable only after Plaintiff finalized its bond purchase. And because "conduct actionable under Rule 10b–5 must occur *before* investors purchase the securities," *Binder v. Gillespie*, 184 F.3d 1059, 1066 (9th Cir. 1999) (emphasis added), Plaintiff cannot base its Section 10(b) claim on what Winterkorn learned after the bond purchase. Lacking a strong inference of scienter, Plaintiff accordingly cannot base its Section 10(b) claim on the financial statements appended to the May 2014 Offering Memorandum.

D. Reliance

***14** Defendants also challenge the reliance element of Plaintiff's Section 10(b) claims. "The traditional (and most direct) way a plaintiff can demonstrate reliance is by showing that he was aware of a company's statement and engaged in a relevant transaction—*e.g.*, purchasing common stock—based on that specific misrepresentation." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2407 (2014) (citation omitted). In two scenarios, however, a plaintiff may establish a rebuttable presumption of reliance without individualized proof. Plaintiff contends that this case implicates both of those scenarios. (*See* Compl. ¶¶ 331–33.) Defendants argue that neither scenario applies.

1. The Two Presumption Scenarios

In "omission cases," the Supreme Court's decision in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153–54 (1972) allows the court to presume reliance when the information withheld is material. *Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 939 (9th Cir. 2009) (per curiam). The theory behind *Affiliated Ute* is that proof of reliance in omission cases requires "proof of a speculative negative"—that, "I would not have bought had I known." *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975). Because "[d]irect proof" of a negative "would ... impose a difficult evidentiary burden.... the same casual nexus can be adequately established indirectly, by proof of materiality coupled with the common sense that a stock purchaser does not ordinarily seek to purchase a loss in the form of artificially inflated stock." *Id.*

A claim based in part on misrepresentations may also warrant the *Affiliated Ute* presumption if "the case can be characterized as one that primarily alleges omissions." *Binder*, 184 F.3d at 1064. In a "mixed case," the district court must " 'analytically characterize [the] action as either primarily a nondisclosure case (which would make the presumption applicable), or a positive misrepresentation case.' " *Id.* (quoting *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 359 (5th Cir. 1987)).

Alternatively, a plaintiff may establish a rebuttable presumption of reliance under *Basic*, 485 U.S. 224, based on the "fraud-on-the-market" theory. To demonstrate that the *Basic* presumption applies, plaintiff must prove: "(1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that the plaintiff traded the stock between the time the misrepresentations were made and when the truth was revealed." *Halliburton*, 134 S. Ct. at 2408.

2. Application

The *Affiliated Ute* presumption applies here because Plaintiff's case can be characterized as one that primarily alleges omissions. (*See* Dkt. No. 3021 at 18; *see also* Compl. ¶ 331.) The heart of the case, as Plaintiff notes, is that Volkswagen misled bond purchasers by failing to disclose its use of a defeat device in its "clean diesel" vehicles. (*See* Compl. ¶ 4 (noting that Defendants "made numerous materially false and misleading statements and omissions" during the class period, but that "[s]pecifically, Volkswagen failed to disclose that it installed and utilized a 'defeat device' in a substantial amount of vehicles ...").) Although the Complaint also alleges misrepresentations, it does so primarily to frame the omission as misleading, which is necessary given that Section 10(b) does not create an affirmative duty to disclose all material information. *Matrixx*, 563 U.S. at 44.

Defendants contend that "the Complaint contains no less than 18 pages of supposedly 'false and misleading statements' regarding 'the Company's operations, its business and financial condition, and its outlook.' " (Dkt. No. 2897

at 24 (citations omitted).) Almost all of those statements, however, are *outside* the Offering Memorandum, in interim and annual reports (Compl. ¶¶ 203–14), press releases (*id.* ¶¶ 218–26), and Corporate Social Responsibility and Sustainability Reports (*id.* ¶¶ 227–30). These are the same materials that Defendants argue cannot be considered given that the Offering Memorandum expressly limited the universe of materials that investors could consider. Defendants cannot have it both ways—arguing that, on the one hand, these statements should not be considered, but that, on the other hand, these statements make Plaintiff's claims "overwhelmingly based on alleged affirmative misstatements." (Dkt. No. 2897 at 25.)

***15** Defendants also rely on *Desai*, 573 F.3d 931 in challenging *Affiliated Ute*'s application. (Dkt. No. 3124 at 12.) *Desai*, however, is materially distinguishable, as the Ninth Circuit there held that a stock market manipulation scheme could not be characterized as an omissions claim. *Id.* at 941. Here, Plaintiff has not alleged a market manipulation scheme. The distinction between actionable omissions and market manipulation discussed in *Desai* is therefore not relevant.

Although this is a "mixed case" of affirmative misrepresentations and omissions, the action can be "analytically characterize[ed] ... as ... primarily a nondisclosure case." *Binder*, 184 F.3d at 1064 (quoting *Finkel*, 817 F.2d at 359). Plaintiff therefore has properly invoked *Affiliated Ute* to plead reliance. Having concluded that *Affiliated Ute* applies, the Court does not need to determine whether the *Basic* presumption of reliance also applies.

III. Section 20(a) Control-Person Claims

To prove a prima facie case under § 20(a), plaintiff must prove: (1) a primary violation of federal securities laws, and (2) that the defendant "exercised actual power or control over the primary violator." *Howard*, 228 F.3d at 1065. There is no concrete test for establishing whether a defendant is a control person. The decision "is an intensely factual question" and "involves scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions." *Id.* (quoting *Kaplan v. Rose*, 49 F.3d 1363, 1382 (9th Cir. 1994)). "[A] plaintiff must plead the circumstances of the control relationship with sufficient particularity to satisfy rule 9(b)." *Howard v. Hui*, No. C 92–3742–CRB, 2001 WL 1159780, at *4 (N.D. Cal. Sept. 24, 2001).

Plaintiff brings control-person claims against VW AG, VWGoA, Winterkorn, and Horn. (Compl. ¶ 352.) Plaintiff contends that VW AG and VWGoA were control persons of VWGoAF (*id.* ¶¶ 353–54), that Winterkorn was a control person of VW AG, VWGoA, and VWGoAF (*id.* ¶¶ 355–56), and that Horn was a control person of VWGoA and VWGoAF (*id.* ¶¶ 355, 357). The Corporate Defendants do not challenge the control-person claims against them, other than on the basis that the claims fail because Plaintiff has not alleged a primary securities violation. Winterkorn and Horn, however, challenge certain of the control-person claims against them under the second Section 20(a) element.

Because Plaintiff has not adequately alleged a primary violation as to Horn, Plaintiff's control-person claims against him are DISMISSED. The Court addresses the control-person claims challenged by Winterkorn below.

A. Winterkorn's Control over VWGoA

Plaintiff offers the following allegations in support of Winterkorn's power and control over VWGoA. First, Winterkorn was CEO of VW AG, which is the parent corporation and sole owner of VWGoA. (Compl. ¶¶ 23, 356.) Second, he was an infamous micromanager (*id.* ¶¶ 73–76), who "frequently travelled to the United States to attend and make presentations at various car shows across the country in order to promote the sales of Volkswagen cars with the purported clean diesel technology" (*id.* ¶ 24). Third, "[s]ales of 'clean diesel' cars in the United States were a central part of Volkswagen's [and Winterkorn's] growth strategy." (*Id.* ¶¶ 35, 38.) Fourth, he "was involved in the day-to-day operations of, and exercised power and control over VWAG and its subsidiaries, including by, among other things, directing their public statements, and regulatory actions." (*Id.* ¶ 23.)

***16** Winterkorn argues that these allegations are not particular enough to support that he had power or control over VWGoA. (Dkt. No. 2895 at 15.) As to the general allegation that Winterkorn "was involved in the day-to-day operations" of VW AG subsidiaries, the Court held in its January 4 ADR Order that a similar general allegation of control, without more, was not sufficient. (*See* Dkt. No. 2636 at 33 (dismissing control-person claims against Horn and Jonathan Browning where "Plaintiffs do no plead the specific circumstances of [their] alleged control," "[a]side from asserting that each of them was 'involved in the day-to-day operations of, and exercised power and control over, VWGoA and VWoA ...' ").) Plaintiff, though, offers more

than that Winterkorn was simply involved in the day-to-day operations of VWGoA. Winterkorn's detailed management style and focus on increasing sales in the United States, along with his position as CEO of VWGoA's parent corporation, are particularized allegations that support his active involvement in the "day-to-day affairs" of VWGoA and his "power to control [the] corporate actions" of VWGoA. *Howard*, 228 F.3d at 1065 (citation omitted). Plaintiff's claim that Winterkorn is a "controlling person" of VWGoA is therefore well pled.

B. Winterkorn's Control over VWGoAF

Plaintiff alleges that the following allegations support Winterkorn's control over VWGoAF. First, he was the CEO of VW AG, which was the ultimate parent company of VWGoAF and the guarantor of VWGoAF's bonds. (Compl. ¶¶ 20, 23.) Second, he was able to and did "control the content of the various offering memoranda," and "was provided with copies of documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected." (*Id.* ¶ 27.) Third, he was an infamous micromanager. (*Id.* ¶¶ 73–76.) Fourth, he was involved in VW AG's financial reporting and accounting, and his signature was on the Offering Memoranda certifications. (*Id.* ¶ 356.)

The signature allegations are of limited help to Plaintiff. As Winterkorn notes, his signature was on only the financial statements appended to the Offering Memoranda, which predated the Memoranda and were prepared by VW AG, not VWGoAF. (*See generally* Dkt. Nos. 2898–1, 2898–2, 2898–3; 2896–6.) The other allegations, however, are sufficient to support Plaintiff's control-person claim. That Winterkorn was a detail-oriented executive of VW AG—the guarantor of VWGoAF's bonds—and that he controlled the content of the Memoranda, supports that he had "specific control over the preparation and release of the allegedly misleading false and misleading statements," which supports control-person liability. *Bao v. SolarCity Corp.*, No. 14–cv–01435–BLF, 2015 WL 1906105, at *5 (N.D. Cal. Apr. 27, 2015).

IV. Personal Jurisdiction—Winterkorn

Winterkorn also challenges personal jurisdiction. (Dkt. No. 2895 at 16–23.) He made a similar challenge in the ADR action, which the Court rejected. (*See* Jan. 4, 2017 Order, Dkt. No. 2636 at 33–40.) The only difference here is that the bondholders' action is based on a different connection between Winterkorn and the forum—specifically, the Offering Memoranda.

Plaintiff contends that the Court has specific jurisdiction over Winterkorn. Plaintiff must therefore make a prima facie showing that the suit "arise[s] out of or relate[s] to [Winterkorn's] contacts with the forum." *Bristol-Myers Squibb Co. v. Superior Court of Cal.*, 137 S. Ct. 1771, 1780 (2017) (emphasis and citations omitted). "In other words, there must be 'an affiliation between the forum and the underlying controversy, principally, [an] activity or an occurrence that takes place in the forum State and is therefore subject to the State's regulation.' " *Id.* (alteration in original) (quoting *Goodyear Dunlop Tires Opers., S.A. v. Brown*, 564 U.S. 915, 919 (2011)). To ensure that specific jurisdiction does not offend due process, the exercise of jurisdiction must also be reasonable. *See Lake v. Lake*, 817 F.2d 1416, 1421 (9th Cir. 1987).

It is undisputed that the relevant forum is the United States. *See Sec. Inv'r Prot. Corp. v. Vigman*, 764 F.2d 1309, 1315 (9th Cir. 1985) (holding that, because the Exchange Act provides for nationwide service of process, "the question becomes whether the party has sufficient contacts with the United States, not any particular state"). The relevant question is accordingly whether the bondholders' action against Winterkorn arises out of his contacts with the United States.

***17** In the ADR action, the Court concluded that plaintiffs had established a direct nexus between their claims and Winterkorn's contacts with the United States, because Winterkorn intentionally made, and signed off on, false statements in Volkswagen's quarterly and annual reports regarding the emissions scandal, and those reports were "expressly directed at United States investors as part of Volkswagen's compliance with SEC Rule 12g3–2(b)." (Dkt. No. 2636 at 37–38.) Like the financial reports in the ADR action, the bond Offering Memoranda at issue here were intentionally directed at the United States. The Memoranda governed bonds that were denominated in U.S. dollars and distributed to U.S.-based investment banks to sell to U.S. investors. (Compl. ¶¶ 3, 15.)

Winterkorn does not dispute the connection between Offering Memoranda and the United States. He instead asserts that Plaintiff has made no showing that he was involved with the Memoranda. As stated elsewhere in this Order, Plaintiff has made such a showing. VW AG was the guarantor of the

VWGoAF bonds and, as VW AG's CEO, Winterkorn was able to and did "control the content of the various offering memoranda." (Compl. ¶ 27.) Winterkorn's involvement with reviewing or preparing the Offering Memoranda is sufficient to support specific jurisdiction over him in this matter. *See In re LDK Solar Secs. Litig.*, No. C 07–05182 WHA, 2008 WL 4369987, at *6 (N.D. Cal. Sept. 24, 2008) ("Defendants purposefully availed themselves of the forum by taking advantage of this nation's laws and its capital markets, and in so doing purposefully directed a fraud at investors" in the U.S.).

Winterkorn also argues that requiring him to defend this case in the United States would be unfair and unreasonable. (*See* Dkt. No. 2895 at 20–23.) Because Winterkorn's reasonableness arguments are not materially different than those made and rejected in the ADR action (*see* Dkt. No. 2636 at 39–40), the Court does not reconsider those arguments here.

CONCLUSION

For the reasons discussed above, the Court ORDERS as follows:

(1) Defendants' motions to dismiss Plaintiff's Section 10(b) claims are GRANTED as to Defendants Horn and VWGoA.

(2) Defendants' motions to dismiss Plaintiff's Section 10(b) claims are DENIED as to Defendants Winterkorn, VW AG, and VWGoAF. Plaintiff, however, may not base its Section 10(b) claims on the financial statements appended to the May 15, 2014 Offering Memorandum, or on statements outside the Offering Memorandum.

(3) Horn's motion to dismiss Plaintiff's Section 20(a) claims against him is GRANTED.

(4) Winterkorn's motion to dismiss Plaintiff's Section 20(a) claims against him is DENIED.

(5) Winterkorn's motion to dismiss for lack of personal jurisdiction is DENIED.

Because it is not a certainty that Plaintiff cannot allege facts sufficient to address the deficiencies identified above, the Court gives Plaintiff leave to amend its Complaint. Plaintiff shall file a new amended complaint within 30 days of this Order.

IT IS SO ORDERED.

All Citations

Not Reported in Fed. Supp., 2017 WL 3058563, Fed. Sec. L. Rep. P 99,817

Footnotes

1 (*See also* Defendants' Post-Argument Letter Brief, Dkt. No. 3416–1 (citing similar authorities).)

2 These quotations are from the Gottweis memo itself, which the Corporate Defendants attached to their motion to dismiss, and which the Court may consider under the "incorporation by reference" doctrine. *Knievel v. ESPN*, 393 F.3d 1068, 1076 (9th Cir. 2005). In the June 28, 2017 ADR Order (Dkt. No. 3392 at 10), the Court instead quoted from the ADR Amended Complaint's summary of the Gottweis memo, as the parties did not provide the memo as part of the motion to dismiss the ADR Amended Complaint. The substance of the quotations is the same.

3 Pointing to Plaintiff's bond purchase order, which Plaintiff attached as an exhibit to its motion seeking appointment as Lead Counsel (Dkt. No. 1759–3), Horn argues that Plaintiff actually purchased the bonds on May 15, 2014 and that May 23, 2014 is therefore not a relevant date. (Dkt. No. 2893 at 11.) The purchase order does list May 15, 2014 as the "Trade Date," but it also includes May 23, 2014 in the top right corner, which supports Plaintiff's position that the purchase was not finalized until then. The exact mechanics of the purchase are not abundantly clear. At this stage in the proceedings, the Court therefore draws all reasonable inference in Plaintiff's favor, *see Usher v. City of Los Angeles*, 828 F.2d 556, 561 (9th Cir. 1987), and takes as true the allegation that Plaintiff's purchase was not finalized until May 23, 2014.

Exhibit D

2018 WL 1142884
United States District Court, N.D. California.

IN RE: VOLKSWAGEN "CLEAN DIESEL" MARKETING, SALES PRACTICES, AND PRODUCTS LIABILITY LITIGATION
This Order Relates to: MDL Dkt. Nos. 3909, 3911
BRS v. Volkswagen AG, No. 16-cv-3435
("Bondholders Securities Action")

MDL No. 2672 CRB (JSC)
|
Signed 03/02/2018

ORDER GRANTING DEFENDANTS' MOTIONS TO DISMISS THE BONDHOLDERS' FIRST AMENDED CLASS ACTION COMPLAINT

CHARLES R. BREYER, United States District Judge

***1** This Order addresses motions to dismiss a putative securities-fraud class action filed by a bondholder of Volkswagen Group of America Finance LLC (VWGoAF). The action is based on allegations that VWGoAF and related defendants made false and misleading statements to prospective VWGoAF bondholders about Volkswagen's emission-reducing technology and its compliance with emission standards. These statements were misleading, Plaintiff asserts, because Volkswagen was engaged in an almost decadelong scheme to cheat on emission tests through the use of a defeat device in as many as 11 million vehicles worldwide. (FAC ¶ 252.)

A disputed issue at the pleading stage of this case has been whether Plaintiff has adequately pled reliance, i.e., that it relied on Defendants' emission-related statements when it decided to purchase VWGoAF bonds. The Court previously held that Plaintiff could rely on a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), because Plaintiff primarily alleges fraudulent omissions as opposed to misstatements. *See In re Volkswagen "Clean Diesel" Mktg., Sales Practices & Prod. Liab. Litig.*, MDL No. 2672 CRB (JSC) ("*VW Bondholders*"), 2017 WL 3058563, at *14-15 (N.D. Cal. July 19, 2017). Defendants have asked the Court to reconsider that holding based on *Waggoner v. Barclays PLC*, 875 F.3d 79 (2d Cir. 2017), which is a recent decision in which the Second Circuit held that the *Affiliated Ute* presumption does not apply when the only omission alleged is of the truth that an affirmative misstatement misrepresents.

The Court has considered *Waggoner* and finds the decision persuasive. Accordingly, the Court deviates from its earlier decision and holds that Plaintiff may not rely on the *Affiliated Ute* presumption to plead reliance. Having determined that *Affiliated Ute* does not apply, the Court considers whether Plaintiff may plausibly allege reliance by other means—either by way of the "fraud on the market" presumption of reliance under *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), or by a theory of direct reliance based on an acknowledgement clause in the bond Offering Memoranda. As currently pled, the Court concludes that Plaintiff cannot rely on either of these alternative theories.

Because reliance is not sufficiently pled, the Court GRANTS Defendants' motions to dismiss the amended complaint, with leave to amend. In light of the holdings with respect to reliance, the Court does not consider at this time other issues that were raised in the motions.

BACKGROUND

I. The Bond Offerings

On three occasions in 2014 and 2015, VWGoAF issued U.S.-dollar denominated bonds to institutional investors. (FAC ¶ 3.) VWGoAF is a wholly-owned subsidiary of Volkswagen Group of America, Inc. (VWGoA), and the bonds were guaranteed by Volkswagen AG. (FAC ¶ 22.) Each of these corporate entities is a defendant in this case, along with Martin Winterkorn (the former CEO of Volkswagen AG) and Michael Horn (the former CEO of VWGoA).

***2** VWGoAF issued the bonds in private placements, which were led primarily by U.S.-based investment banks. (FAC ¶ 15.) The bonds were exempt from registration with the SEC under Rule 144A, and accordingly could be purchased only by qualified institutional buyers—institutional investors with at least $100 million in securities under management. (FAC ¶¶ 1, 3.) *See* 17 C.F.R. § 230.144A(a)(1)(i). After the initial offerings, the bonds traded in a secondary market. (FAC ¶ 3.)

Each of the three initial offerings was made pursuant to an Offering Memorandum. The Memoranda are dated May 15, 2014, November 12, 2014, and May 19, 2015. (FAC ¶ 4.) Each Memorandum includes legal and financial disclosures, the terms of the offering, and an overview of Volkswagen's business. Within the business overview

section, each Memorandum highlights Volkswagen's efforts to research and develop emission-reducing technology (the "R&D statements"). An example of an R&D statement is that "Volkswagen's top priority for research and development in [recent years has been] to develop engines and drivetrain concepts to reduce emissions." (FAC ¶ 227(a).) The Memoranda also include regulatory-risk statements; for example, that "Volkswagen's vehicles must comply with increasingly stringent requirements concerning emissions." (FAC ¶ 227(d).)

Lead Plaintiff purchased bonds in the first of the three offerings, which was governed by the May 15, 2014 Offering Memorandum.

II. The Bondholders' Lawsuit

In the fall of 2015, Volkswagen publicly disclosed that it had installed an emissions defeat device in as many as 11 million vehicles worldwide. (FAC ¶ 252.) After the disclosure, the value of VWGoAF bonds dropped, and Plaintiff responded by filing this putative class action on behalf of all institutional investors that purchased VWGoAF bonds between May 23, 2014 and September 22, 2015. The putative class includes both investors that purchased VWGoAF bonds in the initial offerings, and investors that purchased the bonds in a secondary market. (FAC ¶ 352.)

Plaintiff alleges that the emission-related statements in the Offering Memoranda were misleading because Defendants failed to disclose Volkswagen's use of the defeat device, and that a significant number of Volkswagen's vehicles' on-road emissions greatly exceeded legal limits. These omissions rendered the R&D statements misleading, Plaintiff asserts, because these statements "implied that Volkswagen had already reduced vehicle emissions," which was not true for a significant number of vehicles. (FAC ¶ 228(c).) Plaintiff contends that the omissions also made the regulatory-risk statements misleadingly because those statements "implied that Volkswagen's vehicles were compliant with all such emissions regulations and requirements." (FAC ¶ 228(d).) Plaintiff contends that, together, these omissions and affirmative statements violated Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b–5(b), which make it unlawful for any person, in connection with the sale of a security, "to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b–5(b).

Lead Plaintiff also previously sought to base its claims on statements outside the Offering Memoranda, "including in various interim and annual reports, press releases, and Corporate Social Responsibility and Sustainability Reports issued by Volkswagen during the class period." *VW Bondholders*, 2017 WL 3058563, at *4. The Court previously rejected this theory:

> ***3** Near the front of May 2014 Offering Memorandum, at the top of the page and in bold-faced type, is the statement that "**You should rely only on the information contained in this Offering Memorandum**" when considering this investment. In accepting the Memorandum, "Investors also acknowledge[d] that ... they ha[d] relied only on the information contained in this document" in making an investment decision.
>
> Based on this instruction and acknowledgment, Plaintiff, as an institutional investor with more than $100 million in securities under management, could not reasonably have relied on statements outside the May 2014 Offering Memorandum and the appended financial statements in making its investment decision.

Id. at *5 (alterations in original) (citations omitted).

DISCUSSION

To withstand Defendants' motions to dismiss, Plaintiff's complaint must include allegations that plausibly support each element of its Section 10(b) / Rule 10b–5 claims. [1] *See Ashcroft v. Iqbal*, 556 U.S. 662, 678-79 (2009). One such element is reliance: that Plaintiff relied upon the statements that it asserts were misleading. *See Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 37-38 (2011).

"The traditional (and most direct) way a plaintiff can demonstrate reliance is by showing that he was aware of a company's statement and engaged in a relevant transaction —*e.g.*, purchasing common stock—based on that specific misrepresentation." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2407 (2014) (citation omitted). In two scenarios, however, a plaintiff may establish a rebuttable presumption of reliance without individualized proof. The Court previously held that one of these presumptions—the *Affiliated Ute* presumption—applies in this case.

I. The *Affiliated Ute* Presumption of Reliance

Under *Affiliated Ute*, a presumption of reliance "is generally available to plaintiffs alleging violations of section 10(b) based on omissions of material fact." *Binder v. Gillespie*, 184 F.3d 1059, 1063 (9th Cir. 1999). The theory behind this presumption is that direct proof of reliance in omission cases requires "proof of a speculative negative"—that "I would not have bought had I known." *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975). To relax this "difficult evidentiary burden," *id.*, *Affiliated Ute* allows reliance to be presumed in omission cases "when the information withheld is material," *Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009). In cases in which, as here, both omissions and misrepresentations are alleged, the presumption is only appropriate if "the case can be characterized as one that primarily alleges omissions." *Binder*, 184 F.3d at 1064.

A. The Court's July 2017 Order

Defendants previously argued that the *Affiliated Ute* presumption is inapplicable in this case because "Plaintiff's claims are overwhelmingly based on alleged affirmative misstatements." (Dkt. No. 2897 at 24.) It is therefore not a case that "primarily alleges omissions," Defendants asserted. In support of this argument, Defendants noted that the original complaint "contains no less than 18 pages of supposedly 'false and misleading statements.' " (*Id.* (citations omitted).)

***4** In its July 2017 order, the Court disagreed, holding that the *Affiliated Ute* presumption applies because "Plaintiff's case can be characterized as one that primarily alleges omissions." *VW Bondholders*, 2017 WL 3058563, at *14. Specifically, the Court reasoned that:

> The heart of the case, as Plaintiff notes, is that Volkswagen misled bond purchasers by failing to disclose its use of a defeat device in its "clean diesel" vehicles. Although the Complaint also alleges misrepresentations, it does so primarily to frame the omission as misleading, which is necessary given that Section 10(b) does not create an affirmative duty to disclose all material information. *Matrixx*, 563 U.S. at 44.

Id. (citation omitted). With respect to Defendants' argument that the original complaint contained no less than 18 pages of allegedly false and misleading statements, the Court noted that:

> Almost all of those statements ... are outside the Offering Memorandum, in interim and annual reports (Compl. ¶¶ 203-14), press releases (*id.* ¶¶ 218-26), and Corporate Social Responsibility and Sustainability Reports (*id.* ¶¶ 227-30). These are the same materials that Defendants argue cannot be considered given that the Offering Memorandum expressly limited the universe of materials that investors could consider. Defendants cannot have it both ways—arguing that, on the one hand, these statements should not be considered, but that, on the other hand, these statements make Plaintiff's claims "overwhelmingly based on alleged affirmative misstatements." (Dkt. No. 2897 at 25.)

Id.

B. Defendants' Request for Reconsideration

Defendants' prior argument for why the *Affiliated Ute* presumption should not apply can be characterized as a counting argument. *Affiliated Ute* does not apply here, Defendants argued, because Plaintiff's complaint alleges more misrepresentations than it does omissions. In their motions to dismiss the amended complaint, Defendants instead argue that the *type* of omission alleged by Plaintiff does not support the *Affiliated Ute* presumption. Specifically, Defendants argue that the *Affiliated Ute* presumption does not apply when the only omission is of the truth that an affirmative misstatement misrepresents.

The Second Circuit recently reached this holding in *Waggoner*, 875 F.3d 79. Investors in that case asserted that Barclays violated Rule 10b–5(b) by omitting information that made certain affirmative statements misleading. For example, investors alleged that Barclays told them that a proprietary tool would allow them to "choose which trading styles they interacted with" on a specialized trading platform, so they could avoid high-frequency traders. *Id.* at 87. The investors asserted that this statement and others were misleading because Barclays failed to disclose that the tool did not apply to a significant portion of the trades conducted on the platform. *Id.* at 90.

Similar to this Court's reasoning in its July 2017 order, the district court in *Waggoner* held that the *Affiliated Ute* presumption applied because "a case could be made that it is the material omissions, not the affirmative statements, that are

the heart of this case." *Id.* at 91. The Second Circuit disagreed. Noting that "the labels 'misrepresentation' and 'omission' are of little help," the Second Circuit reasoned that "what is important is to understand the rationale" of the *Affiliated Ute* presumption, which is that in cases where "no positive statements exist ... reliance as a practical matter is impossible to prove." *Id.* at 95 (quoting *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88, 93 (2d Cir. 1981)). Reliance was not impossible to prove in the case before it, the Second Circuit held, because the investors had alleged that Barclays made multiple affirmative statements, and the omission was only of "the truth that the statement[s] misrepresent[ed]." *Id.* at 96. As a result, the Second Circuit concluded that the *Affiliated Ute* presumption was inapplicable. *Id.*

***5** Several district courts have also held, like the Second Circuit in *Waggoner*, that the *Affiliated Ute* presumption does not apply where the only alleged omission is of the truth that an affirmative misstatement misrepresents. *See, e.g.*, *Loritz v. Exide Tech.*, No. 2:13-cv-02607-SVW-E, 2015 WL 6790247, at *1-3, 21 (C.D. Cal. July 21, 2015) (looking at the rationale behind *Affiliated Ute*—the "difficulty of proving a 'speculative' negative"—and concluding that this difficulty "does not apply to this case," where Exide Technologies failed to disclose lead and arsenic emissions, which rendered certain affirmative statements about the company's compliance with environmental regulations misleading); *In re Interbank Funding Corp. Sec. Litig.*, 668 F. Supp. 2d 44, 50-51 (D.D.C. 2009) ("Given the difficulty of drawing semantic distinctions between omissions and misrepresentations.... [it is important to] understand the rationale [behind *Affiliated Ute*: that in cases where] no positive statements exist ... reliance as a practical matter is impossible to prove. Reliance is not 'impossible to prove' in this case because Radin did offer positive statements.... [As a result,] plaintiffs easily could have alleged that they directly relied on Radin's assertions in deciding whether to buy, sell, or hold their Interbank securities.") (internal quotation marks omitted).

The Court finds the reasoning in *Waggoner* and in these district court decisions persuasive. Although the Ninth Circuit has stated that the *Affiliated Ute* presumption may be available in cases that "allege both misstatements and omissions" if the case can be characterized as one that "primarily alleges omissions," *Binder*, 184 F.3d at 1064, the Ninth Circuit has not offered detailed guidance on how to distinguish a complaint that "primarily alleges omissions" from one that alleges omissions, but not primarily. And despite the statement in *Binder* that the *Affiliated Ute* presumption may be available in cases that "allege both misstatements and omissions," it appears that the Ninth Circuit has yet to uphold the use of the presumption in such a scenario. *Cf. Binder*, 184 F.3d at 1063-64 (affirming district court's determination that the presumption did not apply where the "complaint contains both allegations of omissions and misrepresentations, and at the very least, must be characterized, as the district court noted, as 'a mixed case of misstatements and omissions' "); *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 667 (9th Cir. 2004) (holding that the presumption did not apply where plaintiffs' claims "are mixed claims based on *both* affirmative misrepresentations and omissions"). [2]

The Ninth Circuit has also recognized a need to "maintain[ ] the well-established distinction, for purposes of the *Affiliated Ute* presumption, between omission claims, on the one hand, and misrepresentation and manipulation claims, on the other." *Desai*, 573 F.3d at 941. In *Desai*, the court held that a stock market manipulation scheme could not be characterized as an omissions claim because "[a]ny fraudulent scheme requires some degree of concealment, both of the truth and of the scheme itself." *Id.* (citation omitted). Because of this overlap, the court reasoned that "[w]e cannot allow the mere fact of this concealment to transform the alleged malfeasance into an omission rather than an affirmative act." *Id.* (quoting *Joseph v. Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000), *abrogated on other grounds by Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 2042 (2017)). Instructive to this case, especially in light of *Waggoner*, the *Desai* court went on to embrace the purpose behind the *Affiliated Ute* presumption as the touchstone in determining when the presumption applies:

> ***6** To [allow the manipulation to be characterized as an omission claim] would permit the *Affiliated Ute* presumption to swallow the reliance requirement almost completely. Moreover, it would fail to serve the *Affiliated Ute* presumption's purpose since this is not a case where reliance would be difficult to prove because it was based on a negative.

Desai, 573 F.3d at 941 (quoting *Joseph*, 223 F.3d at 1163).

After considering the Second Circuit's decision in *Waggoner*, and after reviewing the above district court decisions

and Ninth Circuit caselaw addressing the *Affiliated Ute* presumption in light of *Waggoner*, the Court concludes that whether the *Affiliated Ute* presumption of reliance is applicable is a decision that should be based on whether the presumption's purpose—of avoiding the need to prove a speculative negative—is implicated. Here, it is not. Similar to *Waggoner*, Plaintiff's claims are predicated on affirmative statements that Defendants are alleged to have made—specifically, the R&D and regulatory-risk statements in the bond Offering Memoranda. Plaintiff contends that these statements were misleading because Defendants did not disclose Volkswagen's emissions fraud. (FAC ¶ 228(c), (d).) In other words, the omission is of the truth that certain affirmative statements allegedly misrepresent.

Either Plaintiff and the other putative class members relied on the R&D and regulatory-risk statements in purchasing VWGoAF bonds or they did not. And if they did not, they should not be able to overcome this shortfall by characterizing their claims as primarily alleging omissions. *See Joseph*, 223 F.3d at 1162 ("In an attempt to take advantage of the *Affiliated Ute* presumption, an artfully-pleaded complaint can recharacterize as an omission conduct which more closely resembles a misrepresentation."). The Court therefore reconsiders its July 2017 decision and holds that Plaintiff may not rely on the *Affiliated Ute* presumption to plead reliance. [3]

II. The *Basic* Presumption

The second scenario in which a plaintiff may establish a rebuttable presumption of reliance in a Section 10(b) / Rule 10b–5 case is when the "fraud on the market" theory of reliance applies. *See Basic*, 485 U.S. 224. Having determined that the *Affiliated Ute* presumption does not apply, the Court considers for the first time whether Plaintiff may rely on the *Basic* presumption to plead reliance.

***7** As explained by the Supreme Court, the *Basic* presumption is based on the idea that:

> [T]he market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations.... [Thus], rather than scrutinize every piece of public information about a company for himself, the typical investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price—the belief that it reflects all public, material information. As a result, whenever the investor buys or sells stock at the market price, his reliance on any public material misrepresentations may be presumed for purposes of a Rule 10b–5 action.

Halliburton, 134 S. Ct. at 2408 (citations omitted).

For *Basic* to apply, Plaintiff must plausibly allege "(1) that the alleged misrepresentations were publicly known, (2) that they were material, (3) that the stock [or bonds] traded in an efficient market, and (4) that the plaintiff traded the stock [or bonds] between the time the misrepresentations were made and when the truth was revealed." *Id.*

Defendants argue that Plaintiff has not satisfied the third of these elements, asserting that Plaintiff's pleading does not plausibly support an "efficient market" for the VWGoAF bonds. The Court agrees. In support of the "efficient market" element, Plaintiff alleges that

> at all relevant times, the market for the Volkswagen Bonds was efficient for the following reasons, among others:
>
> (a) Volkswagen communicated with eligible Bond purchasers via offering memoranda bearing the same or substantially similar information;
>
> (b) Volkswagen filed periodic public reports readily available to all actual Bondholders and potential bondholders;
>
> (c) Volkswagen regularly communicated with the public via established market communication mechanisms, including through regular disseminations of press releases ... and through other wide-ranging public disclosures ...;
>
> (d) Volkswagen was followed extensively by the media and by numerous securities analysts employed by major brokerage firms who wrote over 495 analyst reports about Volkswagen during the Class Period, which were publicly available and entered the public market place;

(e) Analysts for major credit rating agencies provided ratings on the Bonds in their initial offering and throughout the Class Period; and

(f) [T]he market value of the Bonds was sizeable during the Class Period and prices reacted promptly to the dissemination of new public information regarding Volkswagen.

(FAC ¶ 347.)

These allegations focus almost exclusively on the post-offering market for the VWGoAF bonds; that is, once the bonds were trading. But Plaintiff purchased VWGoAF bonds in an initial offering, not in a secondary market. The relevant question in determining whether Plaintiff is entitled to a presumption of reliance, then, is not whether the bonds traded in an efficient market, but whether the initial-offering market was efficient. With respect to the initial offering, the amended complaint includes limited detail on how prices were set, and whether the offering prices were subject to change based upon market information disseminated prior to the offerings. Without allegations of this type, the amended complaint does not plausibly support that Plaintiff purchased VWGoAF bonds in an efficient market. As a result, Plaintiff may not presently rely on the *Basic* presumption to plead reliance. *See Plichta v. SunPower Corp.*, 790 F. Supp. 2d 1012, 1022 (N.D. Cal. 2011) ("[U]nder *Iqbal* and *Twombly* plaintiffs must allege a sufficient factual basis for any contention that the debentures were traded on a well-developed and efficient market.").

***8** As Defendants note, a number of courts have declined to apply *Basic* in cases involving newly issued securities. *See, e.g.*, *In re Initial Pub. Offering Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006) (holding that the *Basic* presumption was unavailable because "the market for IPO shares is not efficient"); *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990) ("[T]he fraud on the market theory ... does not apply to cases involving fraud on a primary market for newly issued tax-exempt municipal bonds."); *In re Enron Corp. Sec. Deriv. & ERISA Litig.*, 529 F. Supp. 2d 644, 771-72 (S.D. Tex. 2006) ("[P]rimary markets [for Enron debt] ... cannot qualify as open markets."). These decisions demonstrate that Plaintiff faces a heavy burden to plausibly allege that there was an efficient market for newly issued VWGoAF bonds. At this point, however, it is not a certainty that an amendment of the complaint to address the above shortcomings would be futile. The Court therefore gives Plaintiff leave to amend its complaint to add any allegations that it believes support *Basic*'s application.

III. Direct Reliance

Putting aside presumptions of reliance, Plaintiff alleges, for the first time in the amended complaint, that a portion of the putative class plausibly relied directly on the statements at issue. Specifically, Plaintiff alleges that investors that purchased VWGoAF bonds in an initial offering—as opposed to in a secondary market—plausibly relied on the statements at issue "based on an express, uniform acknowledgement, and representation" in each Memorandum that, by accepting the Memorandum, each Offering investor '*relied on the information contained in this document.*' " (FAC ¶ 349 (emphasis added).) Plaintiff argues that this clause supports that each purchaser of VWGoAF bonds in the offerings (1) was aware of the allegedly misleading statements and omissions therein, and (2) purchased the bonds based on them.

Defendants argue that the acknowledgement clause alone is not sufficient to plead reliance. To plausibly plead reliance, and to do so with the particularity required by Rule 9(b), they assert that Plaintiff must also allege, for example, "that the person who placed the trade read the allegedly misleading statements in the May 15, 2014 Offering Memorandum upon which Plaintiff's claims depend." (Dkt. No. 3911 at 25-26.) Plaintiff has not included such an allegation in the amended complaint. And at a hearing on the motions to dismiss, counsel for Plaintiff could not confirm whether, if given leave to amend, he would be able to allege in good faith that Plaintiff actually read the Offering Memorandum. (*See* Feb. 1, 2018 Hr'g Tr., Dkt. No. 4715 at 53.)[4]

If the May 15, 2014 Offering Memorandum included the acknowledgment clause alleged in paragraph 349 of the amended complaint, the Court would be inclined to conclude that the clause at least supports a plausible inference of direct reliance. At the time of the offering, Plaintiff was an institutional investor with at least $100 million in securities under management. VWGoAF in turn was a debt-issuing vehicle for one of the world's largest automobile manufacturers. These were sophisticated parties, and if they had agreed to include a clause in the Offering Memorandum providing that investors had relied on the information contained therein, it would be reasonable to conclude that Plaintiff had done just that.

***9** Yet Plaintiff's phrasing of the acknowledgement clause is not a direct quote from the May 15, 2014 Offering Memorandum. Instead, the Memorandum contains the following two acknowledgment clauses, which both appear under the bold title **IMPORTANT NOTICE**:

> [1] **You should rely only on the information contained in this Offering Memorandum.**
>
> [2] Investors also acknowledge that (i) they have not relied on the Initial Subscribers or any person affiliated with the Initial Subscribers in connection with any investigation of the accuracy of any information contained in this Offering Memorandum or their investment decision; and (ii) they have relied only on the information contained in this document, and that no person has been authorized to give any information or make any representation concerning the Issuer, the Guarantor or its subsidiaries or the Notes (other than as contained in this document) and, if given or made, any such other information or representation should not be relied upon as having been authorized by the Issuer, the Guarantor or the Initial Subscribers.

(Stanley Decl., Dkt. 2896–6 at 4-5.)

The acknowledgement clause alleged in the amended complaint does not have the same meaning as clause [1] in the Offering Memorandum. Clause [1] uses the auxiliary verb "should." (*See id.* ("You *should* rely only on the information contained in this Offering Memorandum.") (emphasis added).) You "should rely" is a prescription. Without more, it does not plausibly support that Plaintiff *did* rely on information in the Memorandum.

Clause [2](ii) is closer in kind to the acknowledgement clause alleged in the amended complaint, except that clause [2](ii) uses the word "only," which Plaintiff has omitted. (*Compare* FAC ¶ 349 (investors "relied on the information contained in this document"), *with* Stanley Decl., Dkt. 2896–6 at 4 (investors "have relied *only* on the information contained in this document") (emphasis added).) "Only" adds additional meaning to the clause. That investors "have relied *only* on the information contained in this document" means that they have not relied on information *outside* the document. Indeed, because of this clause—and clause [1], which also uses the word "only"—the Court previously held that Plaintiff could not base its claims on statements outside the Offering Memorandum, such as in Volkswagen press releases and annual reports. *See VW Bondholders*, 2017 WL 3058563, at *5. Because the acknowledgement clause alleged in the amended complaint does not use the word "only," this meaning is missing in Plaintiff's version.

Even with the word "only," clause [2](ii) also arguably has a second meaning: that investors have relied on the information contained *within* the Offering Memorandum. The clause uses the phrase "have relied," not "should rely." And although the word "only" negates reliance on material outside the Memorandum, it may not necessarily negate reliance on information contained within the Memorandum. This second meaning is subtle, however, and it is clear from context that only the first meaning was intended.

Starting with the IMPORTANT NOTICE header, eight pages of the Offering Memorandum follow that include a variety of cautionary notes to investors. These include that the Memorandum was prepared by Volkswagen "solely for use in connection with the proposed offering;" that VWGoAF and Volkswagen AG have not authorized anyone to provide investors with different information; that Initial Subscribers (which were investment banks) do not warrant that the information in the Memorandum is accurate; that the SEC has not approved or disapproved of the bonds; and that VWGoAF, Volkswagen AG, and Initial Subscribers do not represent the legality of an investment in the Notes by purchasers. (Stanley Decl., Dkt. 2896–6 at 4; *see also id.* at 5-11 (including additional cautionary notes and warnings).)

***10** These are liability disclaimers. They seek to prevent investors from claiming that they reasonably thought they could rely on sources of information other than the Memorandum, or that they thought the Initial Subscribers or the SEC had approved of the accuracy of the Memorandum. An acknowledgment that investors have relied *only* on the information in the Offering Memorandum in making their investment decisions—and not on anything outside the Memorandum—accomplishes the same goal. It signals that if investors intend to rely on extrinsic information, they do so at their own risk, and that their reliance on such information will not be justifiable. A statement that investors have relied on the information within the Memorandum does not further the same purpose. It effectively confirms that investors have performed a certain level of due diligence, which is less of a cautionary note and more of an attestation. Such a statement would be out of place.

The other statements within clause [2] also do not support such a reading. Clause [2](i) states that investors acknowledge that "they have not relied on the Initial Subscribers ... in

connection with ... their investment decision." (*Id.*) Again, the focus is on preventing investors from justifiably relying on information outside the Memorandum, not on confirming that investors have actually relied on information within the Memorandum. The second part of Clause [2](ii) is similar. (*See id.* (investors acknowledged that they "have relied only on the information contained in this document, *and* that no person has been authorized to give any information or make any representation concerning the Issuer, the Guarantor or its subsidiaries or the Notes (*other than as contained in this document*)") (emphasis added).)

Because Plaintiff relies on the Memorandum is asserting that reliance is well pled, the Court looks directly at the acknowledgment clauses therein rather than at Plaintiff's paraphrasing of the clauses in the amended complaint. *See Knievel v. ESPN*, 393 F.3d 1068, 1076 (9th Cir. 2005) (explaining that, under the "incorporation by reference" doctrine, a court resolving a motion to dismiss may "take into account documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the plaintiff's pleading") (internal quotation marks omitted). Given the context in which the clauses appear, the Court concludes that the clauses' only reasonable meaning is that investors, by accepting the Memorandum, agreed not to rely on extrinsic materials in making their investment decisions. The clauses therefore do not carry the meaning that Plaintiff contends they do: that investors actually relied on all of the information within the Memorandum.

Because the acknowledgement clauses alone do not plausibly support that Plaintiff read and relied on the statements in the Offering Memorandum that are at issue in this case, direct reliance is not well pled. To plausibly plead direct reliance, Plaintiff must also allege that one or more of its agents actually read the Memorandum and relied on the statements therein that are at issue. The Court gives Plaintiff leave to amend its complaint to include the missing allegations, to the extent Plaintiff can do so in good faith.

CONCLUSION

Having concluded that Plaintiff has not sufficiently pled reliance, the Court GRANTS Defendants' motions to dismiss the amended class action complaint. Because it is not a certainty that Plaintiff cannot allege facts sufficient to address the deficiencies identified above, the Court gives Plaintiff leave to amend the complaint. Plaintiff shall file a new amended complaint within 30 days of this Order.

IT IS SO ORDERED.

All Citations

Not Reported in Fed. Supp., 2018 WL 1142884, Fed. Sec. L. Rep. P 100,039

Footnotes

1 Plaintiff also brings "control person" claims under Section 20(a) of the Exchange Act. An element of a "control person" claim is a primary violation of the federal securities laws. *See Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1061 (9th Cir. 2000). The Section 20(a) claims are therefore derivative of the Section 10(b) / Rule 10b–5 claims, which are the primary violations that Plaintiff alleges.

2 Arguably, the Ninth Circuit upheld the use of the *Affiliated Ute* presumption in a mixed case in *Blackie*, 524 F.2d 891, where the plaintiffs asserted that the defendants' financial statements misrepresented particular line items because they failed to include adequate reserves for uncollectable accounts and obsolete inventory. *Id.* at 903-06. But in *Binder*, the Ninth Circuit referred to *Blackie* as a pure omissions case and stated that, before *Binder*, the Circuit "ha[d] not squarely decided ... whether the [*Affiliated Ute*] presumption may be invoked in a case involving ... both omissions and misrepresentations." *Id.* at 1063-64; *see also id.* at 1068 (Reinhardt, J., dissenting in part) (referring to *Blackie* as "a pure omissions case"). *Blackie* is therefore not instructive in considering when a case that alleges both misstatements and omissions can be characterized as one that "primarily alleges omissions." *Binder*, 184 F.3d at 1064.

3 As the above analysis suggests, and as Defendants argue, it may be that the *Affiliated Ute* presumption is only available for claims under Rule 10b–5 subsections (a) and (c), and not for claims under subsection (b), because claims under Rule 10b–5(b) are inherently tied up with affirmative statements and therefore do not require proof of a speculative negative. *See Matrixx*, 563 U.S. at 44 (noting that Rule 10b–5(b) "do[es] not create an affirmative duty to disclose," and that disclosure is necessary only "to make the statements made ... not misleading" (quoting 17 C.F.R. § 240.10b–5(b)). There is some out-of-circuit authority for this limitation. *See Smith v. Ayres*, 845 F.2d 1360, 1363 (5th Cir. 1988) ("By the terms of [Rule 10b–5], a presumption of reliance would not arise where the plaintiff's case is grounded in the second

subsection."). The Second Circuit's holding in *Waggoner* did not sweep this broadly, however. Nor has the Ninth Circuit suggested that *Affiliated Ute* applies only in claims under subsections (a) and (c). Because the Court's reasoning does not require it to resolve this question, the Court declines to do so.

4 Defendants focus on the May 15, 2014 Offering Memorandum because it is the Memorandum that governed Plaintiff's investment. The Court also focuses on that Memorandum for the same reason. Plaintiff must first establish its own standing to sue before the claims of other putative class members, which are based in part on other Offering Memoranda, are considered. *See Lierboe v. State Farm Mut. Auto. Ins. Co.*, 350 F.3d 1018, 1022 (9th Cir. 2003) ("If the individual plaintiff lacks standing, the court need never reach the class action issue." (quoting 3 Herbert B. Newberg on Class Actions § 3:19, at 400 (4th ed. 2002))).

Exhibit E

328 F.Supp.3d 963
United States District Court, N.D. California.

IN RE: VOLKSWAGEN "CLEAN DIESEL" MARKETING, SALES PRACTICES, AND PRODUCTS LIABILITY LITIGATION
This Order Relates To: Dkt. Nos. 5019, 5021, 5153

MDL No. 2672 CRB (JSC)
|
Signed 09/07/2018

Synopsis
Background: Bondholders brought securities fraud action against automobile manufacturer and its officers, alleging that research and development and regulatory-risk statements related to bond sales were materially misleading, in violation of Section 10(b) and Rule 10b–5(b), because manufacturer failed to disclose that it was using a defeat device in many of the diesel vehicles it was selling, which enabled manufacturer to deceptively pass emission tests and to sell vehicles that emitted certain pollutants at levels up to 40 times the legal limits. Manufacturer moved to dismiss and bondholders moved to amend complaint.

Holdings: The District Court, Charles R. Breyer, J., held that:

bondholder pleaded reliance with required particularity;

bondholder's complaint alleged strong inference of scienter by chief executive officer (CEO); and

CEO exercised requisite control over manufacturer and subsidiary.

Motions denied.

***966 ORDER RE: (1) DEFENDANTS' MOTIONS TO DISMISS THE VW BONDHOLDERS' SECOND AMENDED CLASS ACTION COMPLAINT; (2) PLAINTIFF'S MOTION TO AMEND THE COMPLAINT**

CHARLES R. BREYER, United States District Judge

This order addresses whether the allegations in a Volkswagen bondholder's second amended complaint (1) satisfy the reliance element of its Section 10(b) and Rule 10b–5(b) claims against Volkswagen and related defendants, (2) give rise to a strong inference of scienter as to defendant Michael Horn and Volkswagen Group of America, Inc., and (3) are sufficient to support Section 20(a) control person claims against Horn. The order also addresses whether the bondholder should be given leave to amend its complaint for a third time to add insider trading claims.

BACKGROUND

On three occasions in 2014 and 2015, Volkswagen Group of America Finance LLC ("VWGoAF") issued U.S.-dollar denominated bonds to institutional investors. (SAC ¶ 3.) VWGoAF issued the bonds in private placements, which were led primarily by U.S.-based investment banks. (SAC ¶ 15.) The bonds were exempt from registration with the SEC under Rule 144A and so could be purchased only by qualified institutional buyers. (SAC ¶¶ 1, 3.) After the initial offerings, the bonds traded in a secondary market. (SAC ¶ 3.)

Each of the initial offerings was made pursuant to an Offering Memorandum. Lead Plaintiff, a public pension fund, purchased bonds on May 23, 2014 pursuant to the terms of a May 15, 2014 Offering Memorandum. (SAC ¶¶ 4, 16.) Within the Memorandum were certain statements ***967** about Volkswagen's R & D priorities and exposure to regulatory risks. An example of an R & D statement is that "Volkswagen's top priority for research and development in [recent years has been] to develop engines and drivetrain concepts to reduce emissions." (SAC ¶ 227(a).) An example of a regulatory-risk statement is that "Volkswagen's vehicles must comply with increasingly stringent requirements concerning emissions." (SAC ¶ 227(d).)

Plaintiff contends that the R & D and regulatory-risk statements were materially misleading, in violation of Section 10(b) and Rule 10b–5(b), because Defendants failed to disclose that Volkswagen was using a defeat device in many of the diesel vehicles it was selling in the United States and around the globe, which enabled Volkswagen to deceptively pass emission tests and to sell vehicles that emitted certain pollutants at levels up to 40 times the legal limits. (*E.g.*, SAC ¶¶ 7-8, 170, 228.) In *Bondholders I*,[1] the Court concluded that the R & D and regulatory-risk statements were plausibly misleading:

> The statements that Volkswagen's "top priority" and "focal point" for R & D was to develop engines that reduced emissions could have led a reasonable investor to conclude that Volkswagen was committed to emissions-reducing technology. A reasonable investor also could have concluded ... that Volkswagen's commitment to emissions-reducing technology was important for the Company's future success given the "increasingly stringent [regulatory] requirements concerning emissions" .... Together, the inference that arises from these statements is that Volkswagen was a good investment *because* of its commitment to emissions-reducing technology. That inference was misleading because Volkswagen was in its fifth year of a massive fraud to cheat emissions standards.

Bondholders I, 2017 WL 3058563, at *7 (alteration in original).

The Court in *Bondholders I* also concluded that Martin Winterkorn (the former CEO of Volkswagen AG ("VWAG")) and Michael Horn (the former CEO of Volkswagen Group of America, Inc. ("VWGoA")) plausibly made the statements in the Offering Memorandum, and that Winterkorn and VWAG (but not Horn and VWGoA) did so with scienter. *See id.* at *8-12. The Court also concluded that Plaintiff was entitled to a presumption of reliance under *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972), and that Section 20(a) control person claims were well pled as to Winterkorn, but not as to Horn. *See id.* at *14-16.

Plaintiff responded to *Bondholders I* by filing a first amended complaint. In *Bondholders II*,[2] the Court ruled on motions to dismiss the amended complaint. In its order, the Court reconsidered the element of reliance in light of new authority cited by Defendants and held that Plaintiff could not rely on *Affiliated Ute* to plead reliance. *Bondholders II*, 2018 WL 1142884, at *3-6. The Court also considered two other theories of reliance—direct reliance and fraud on the market—but concluded that neither was well pled. *Id.* at *6-10. Having determined that the reliance element was not satisfied, the Court dismissed the first amended complaint in its entirety with leave to amend. Plaintiff responded by filing the second amended complaint, and Defendants responded by filing separate ***968** motions to dismiss the second amended complaint, one by Horn and the other by the remaining Defendants.

DISCUSSION

I. Reliance

Plaintiff contends that reliance is now well pled under a direct-reliance theory, and that a presumption of reliance is also available under four different theories. The Court begins with the direct-reliance theory.

A. Direct Reliance

In the first amended complaint, Plaintiff asserted that it relied directly on the misleading statements at issue in the May 15, 2014 Offering Memorandum. Plaintiff made this argument even though it did not allege that any of its agents actually read the Memorandum. Instead, Plaintiff asserted that the Memorandum's text supported direct reliance because it effectively stated that investors had relied on the information contained in the Memorandum in making their investment decisions.

Because Plaintiff's argument depended on the language of the Memorandum and no party questioned the Memorandum's authenticity, the Court considered the actual language at issue under the incorporation by reference doctrine. *See VW Bondholders II*, 2018 WL 1142884, at *8-10 (citing *Knievel v. ESPN*, 393 F.3d 1068, 1076 (9th Cir. 2005)). Upon reviewing two acknowledgment clauses in the Memorandum and their surrounding content, the Court concluded that the clauses did not plausibly support that investors had in fact read the Memorandum, but only that "investors, by accepting the Memorandum, agreed not to rely on extrinsic materials in making their investment decisions." *Id.* at *10. Because the clauses did not carry the meaning asserted by Plaintiff, the Court held that Plaintiff had not plausibly pled direct reliance. The Court gave Plaintiff leave to amend the complaint to include the missing allegations, instructing that "[t]o plausibly plead direct reliance, Plaintiff must also allege that one or more of its agents actually read the Memorandum and relied on the statements therein that are at issue." *Id.*

Seeking to cure the previously noted deficiency, Plaintiff has added new allegations to the second amended complaint. Plaintiff now alleges that

> Pursuant to its relevant contractual investment agreement with its investment advisor, its investment guidelines as incorporated into

> that relevant contractual investment agreement, and fiduciary obligations owed to it by its investment advisor, Plaintiff, through its authorized investment advisor with complete investment discretion, reviewed and relied upon the information contained in the Offering Memorandum that corresponds to Plaintiff's Bond purchases, including the alleged omissions and misrepresentations.

(SAC ¶ 348.)

The new allegations support (1) that Plaintiff's investment advisor was acting as an authorized agent of Plaintiff; and (2) that Plaintiff, through its agent, "reviewed and relied upon" the Offering Memorandum, "including the alleged omissions and misrepresentations." (SAC ¶ 348.) Taking these allegations as true, they plausibly support direct reliance.

In arguing that Plaintiff's new allegations are insufficient to plead direct reliance, Defendants argue that more detail is needed to satisfy Rule 9(b). But paragraph 348 of the second amended complaint answers the basic "who, what, when, where, and how" questions needed to satisfy Rule 9(b). *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1106 (9th Cir. 2003).

***969** • **Who** read the Offering Memorandum? Plaintiff's "authorized investment advisor." (SAC ¶ 348.)

• **What** statements did the advisor read? The "information contained in the Offering Memorandum that corresponds to Plaintiff's Bond purchases, including the alleged omissions and misrepresentations." (*Id.*)

• **When** did Plaintiff's investment advisor read these statements? Given that the advisor is alleged to have "relied" on the information in the Memorandum (*id.*), it is reasonable to conclude that the advisor read the statements before executing the bond purchase.

• **Where** did Plaintiff's investment advisor read these statements? The allegations do not answer this question, but this question is of limited importance here. Defendants do not need to know whether the investment advisor read the statements in an office, on a plane, or somewhere else in order to adequately answer the complaint. *See Vess*, 317 F.3d at 1106 (explaining that Rule 9(b) only demands that allegations of fraud be "specific enough to give defendants notice of the particular misconduct so that they can defend against the charge") (citation omitted).

• And **how** did the investment advisor rely on these statements? By considering them before executing the bond purchase.

These answers are "specific enough to give defendants notice" so that they can "defend against the charge." *Vess*, 317 F.3d at 1106 (citation omitted). The allegations therefore satisfy Rule 9(b). Taking these allegations as true, they also plausibly support that Plaintiff, through its agent, directly relied on the misrepresentations at issue. [3]

B. Presumptions of Reliance

While Plaintiff has plausibly alleged that it relied directly on the statements at issue in the Offering Memorandum, Plaintiff also argues that it can invoke a presumption of reliance under several different theories. Having concluded that reliance is now well pled under a direct-reliance theory, the Court does not need to address whether a presumption of reliance is also appropriate. Nevertheless, because the parties have submitted extensive briefing on the question of whether a presumption of reliance applies, because the Court considered in *Bondholders I* and *II* whether a presumption would be available, and because the parties acknowledge that Plaintiff may have difficulty proving direct reliance on a class-wide basis, the Court again considers whether a presumption of reliance is appropriate.

***970 1. Market Based Presumptions**

Plaintiff contends that a presumption of reliance is appropriate under *Basic*'s fraud-on-the-market theory, as well as under two related theories, one termed "fraud created the market" and the other known as "fraud on the regulatory process." For the reasons discussed in the next three subsections, a presumption of reliance is not appropriate here under any of these theories.

a. Fraud on the Market

Basic's fraud-on-the-market presumption of reliance applies in securities-fraud cases when (1) the alleged misrepresentations were publicly known, (2) they were material, (3) the securities traded in an efficient market,

and (4) the plaintiff traded the securities between the time the misrepresentations were made and when the truth was revealed. *See Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258, 134 S.Ct. 2398, 2408, 189 L.Ed.2d 339 (2014) ("*Halliburton II* ") (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 238 n.27, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988)).

In *Bondholders II*, the Court held that Plaintiff had not satisfied the third of these elements, the "efficient market" requirement, and so could not invoke the presumption. This was because Plaintiff purchased VWGoAF bonds in an initial offering, not in a post-offering market, and did not allege that the initial-offering market was efficient. The Court gave Plaintiff leave to amend the complaint "to add any allegations that it believes support *Basic*'s application." *Bondholders II*, 2018 WL 1142884, at *8.

In the second amended complaint, Plaintiff has added allegations about how the VWGoAF bonds were originally priced. For example, Plaintiff alleges that the bonds' original price was dependent upon a number of factors, including the risk profile of Volkswagen, the credit rating of Volkswagen and the bonds, and the comparative yield of the bonds versus other investment-grade bonds. (SAC ¶¶ 356-58.) Plaintiff also alleges that these factors "reflect[ed] all publicly available information that [was] material to investors." (SAC ¶ 357.)

Even taking these allegations as true, they are insufficient to support the efficient-market element. The fraud-on-the-market presumption "is available *only* when a plaintiff alleges that a defendant made material misrepresentations or omissions concerning a security that is *actively traded* in an 'efficient market,' thereby establishing a 'fraud on the market.' " *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999) (emphasis added). Also, not only must the security be actively traded, but it must be "traded on *well-developed* markets." *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 811, 131 S.Ct. 2179, 180 L.Ed.2d 24 (2011) ("*Halliburton I* ") (emphasis added) (quoting *Basic*, 485 U.S. at 246, 108 S.Ct. 978). Plaintiff does not allege that it purchased an "actively traded" bond, much less one that traded on "well-developed markets." To the contrary, Plaintiff alleges that it purchased the VWGoAF bonds at issue directly from two investment banks in a Rule 144A private placement, not by trading in any market. (SAC ¶¶ 3, 15-16.) And the May 15, 2014 Offering Memorandum confirms that the bonds were "new issues of securities *for which there currently is no market.*" (Giuffra Decl., Ex. B at 6, Dkt. No. 5022-2 at 11 (emphasis added).)

Plaintiff asserts that it should at least have the opportunity to present expert evidence in support of the presumption at the class certification stage. But no expert evidence will change that Plaintiff purchased the bonds at issue at a time when the bonds were not "actively traded" on a "well-developed market." Plaintiff accordingly cannot rely on *Basic*'s fraud-on-the-market ***971** theory to prove reliance in this case.

b. Fraud Created the Market

Plaintiff alternatively seeks to rely on a variation of *Basic* for newly issued securities—known as the fraud-created-the-market presumption of reliance. Courts that have recognized this theory have limited its use to the narrow circumstance "where but for the fraud the securities would not have been marketable." *Lipton v. Documation, Inc.*, 734 F.2d 740, 747 (11th Cir. 1984); *see also Freeman v. Laventhol & Horwath*, 915 F.2d 193, 200 (6th Cir. 1990) (under the "fraud created the market" theory, the plaintiff must establish that "the securities could not have been marketed at any price absent fraud"). To be unmarketable, the securities must be "so lacking in basic requirements that [they] would never have been approved by the [issuing entity] nor presented by the underwriters had any one of the participants in the scheme not acted with intent to defraud or in reckless disregard of whether the other defendants were perpetrating a fraud." *Shores v. Sklar*, 647 F.2d 462, 468 (5th Cir. 1981).

The fraud-created-the-market presumption has "been criticized in many circuits and [the Ninth Circuit] ha[s] not accepted it." *Nuveen Mun. High Income Opportunity Fund v. City of Alameda*, 730 F.3d 1111, 1121 n.4 (9th Cir. 2013). But even if the presumption were available, it would not apply here. For despite the gravity of VW's emissions fraud, it is almost inconceivable that, but for the fraud, the credit markets would have completely shut out one of the world's largest automakers. Indeed, as alleged the price of Plaintiff's VWGoAF bonds fell only 3.02% after the fraud was revealed (SAC ¶ 257), suggesting that the bonds were far from worthless.

In arguing that the bonds would have been unmarketable but for the fraud, Plaintiff contends that Volkswagen was unable to issue any new debt securities for a period of over 18 months after the fraud was disclosed. But as alleged, Volkswagen was the one that initiated this pause in issuing new debt (SAC ¶ 365), and no allegations support that Volkswagen would have been unable to raise debt "at any price" after the fraud. *Freeman*, 915 F.2d at 200. Likewise, allegations

that Volkswagen's credit rating declined and that the cost of credit default swaps on Volkswagen debt increased after the fraud was disclosed (SAC ¶¶ 359-60), only support that Volkswagen was a riskier borrower after the disclosure, not that the company would have been unable to access credit markets.

Plaintiff has not established that the VWGoAF bonds at issue "could not have been marketed at any price absent fraud." *Freeman*, 915 F.2d at 200. As a result, the fraud-create-the-market presumption of reliance does not apply.

c. Fraud on the Regulatory Process

Adopted in *Arthur Young & Co. v. U.S. District Court*, 549 F.2d 686, 695 (9th Cir. 1977), the fraud-on-the-regulatory-process theory creates a presumption of reliance when "the purchaser of an original issue security relies, at least indirectly, on the integrity of the regulatory process and the truth of any representations made to the appropriate agencies and the investors at the time of the original issue." Plaintiff contends that the theory is valid, applies to unregistered securities, and relates not only to statements made to the SEC, but also to statements made to regulatory agencies governing business operations such as EPA. Defendants question whether the theory is still valid, but even if it is, they assert that the theory applies only to registered securities and statements made to agencies responsible for overseeing registered securities.

***972** Courts in other circuits have called the fraud-on-the-regulatory-process theory into question or rejected it. Some of these courts contend that the theory is based on a faulty premise that the regulatory process provides a check on fraud, when in fact the SEC does not read all of the publicly available information about an offering or vouch for the information's veracity. *See, e.g.*, *Malack v. BDO Seidman, LLP*, No. 08-0784, 2009 WL 2393933, at *12, 2009 U.S. Dist. LEXIS 67785 at *40-41 (E.D. Pa. Aug. 3, 2009). Others maintain that the theory would expand the SEC's role beyond its intended scope and create a form of investor's insurance. *See Joseph v. Wiles*, 223 F.3d 1155, 1165-66 (10th Cir. 2000).

Courts have also rejected the theory because they assert that the validity of *Arthur Young* was undercut by Justice White's partial concurrence in *Basic*, which was issued over a decade after *Arthur Young*. In his partial concurrence, Justice White noted that he agreed with the majority's "reject[ion] [of] that [fraud-on-the-market] theory, heretofore adopted by some courts." *Basic*, 485 U.S. at 251, 108 S.Ct. 978 (last alteration in the original). He then cited *Arthur Young* in a footnote as an example of a variation on the fraud-on-the-market theory that the majority opinion rejected, even though the majority did not mentioned *Arthur Young* or the fraud-on-the-regulatory-process theory. *See id.* at 251, 108 S.Ct. 978 n.2. Because of Justice White's comments, some courts have interpreted *Basic* as a rejection of *Arthur Young*. *See, e.g.*, *Eckstein v. Balcor Film Inv'rs*, 740 F.Supp. 572, 582 n.7 (E.D. Wis. 1990).

Despite Justice White's statements in *Basic* and the criticisms leveled by courts in other circuits, district courts in the Ninth Circuit have continued to recognize the fraud-on-the-regulatory-process theory, in large part because the Ninth Circuit has never expressly overruled *Arthur Young*. *See, e.g.*, *In re Metro. Sec. Litig.*, 532 F.Supp.2d 1260, 1302-03 (E.D. Wash. 2007) ("*Basic* did not overrule the extension of the 'fraud on the market' presumption.... *Basic* was not an initial stock offering case and said nothing to indicate that the 'fraud on the market' test should no longer be used in the related context of initial stock offerings as was done in *Arthur Young*."); *In re Jenny Craig Sec. Litig.*, No. 92-0845-IEG, 1992 WL 456819, at *5, 1992 U.S. Dist. LEXIS 22769, at *17 (S.D. Cal. Dec. 19, 1992) ("[A]lthough it has been widely criticized, the [fraud-on-the-regulatory-process theory] does not appear to have been overruled, and this Court is bound to follow it where applicable."); *In re Am. Cont'l Corp./ Lincoln Sav. & Loan Sec. Litig.*, 140 F.R.D. 425, 433 (D. Ariz. 1992) ("The Ninth Circuit ratified the fraud on the regulatory process doctrine in *Arthur Young*[.]").

Ultimately, this Court does not need to decide whether the theory is still viable, for even if it is, it does not apply in this case. By its terms, the theory applies only when "representations [are] made to the appropriate agencies and the investors at the time of original issue." *Arthur Young*, 549 F.2d at 695. That is to say, plaintiffs are only entitled to a presumption of reliance based on the theory if misrepresentations are made directly to a regulatory agency such as the SEC. *See Antonplulos v. N. Am. Thoroughbreds, Inc.*, No. 87-0979-G(CM), 1991 WL 185147, at *2 (S.D. Cal. Apr. 16, 1991) (concluding that the fraud-on-the-regulatory-process theory only applies when misrepresentations are made "directly to a regulatory agency" such as the SEC); *Lubin v. Sybedon Corp.*, 688 F.Supp. 1425, 1446 (S.D. Cal. 1988) (holding that the fraud-on-the-regulatory-process theory does not apply ***973** when an "exchange commission" has not certified the security).

The alleged misrepresentations at issue here were not made directly to a regulatory agency such as the SEC. As Plaintiff acknowledges, the VWGoAF bonds were "exempt from registration" with the SEC under Rule 144A of the U.S. Securities Act of 1933, 17 C.F.R. § 230.144A. (SAC ¶ 1). As a result, the SEC did not evaluate the bonds or the veracity of the Offering Memorandum. And indeed, the Offering Memorandum explicitly warned prospective investors that "[n]either the ... SEC[,] any state securities commission nor any other regulatory authority has approved or disapproved the securities, nor have any of the foregoing authorities passed upon or endorsed the merits of this Offering or the accuracy or adequacy of this Offering Memorandum." (Giuffra Decl., Ex. B. at ii, Dkt. No. 5022-2 at 4 (internal quotation marks omitted).)

Plaintiff asserts that the fraud-on-the-regulatory-process theory applies because this case is analogous to *Lincoln*, where the theory was applied based on misrepresentations to the Federal Home Loan Bank Board ("FHLBB"). Plaintiff maintains that Defendants similarly misled regulatory agencies governing its business operations, such as EPA and CARB. But the role of the FHLBB in *Lincoln* is not analogous to the role of EPA and CARB here, and so the comparison is not persuasive.

In *Lincoln*, the district court concluded that the plaintiffs were only entitled to a presumption of reliance under *Arthur Young* "if a network of misrepresentations or omissions to the Federal Home Loan Bank Board or other federal and state regulators *enabled the bond sales to go forward*." *Lincoln*, 140 F.R.D. at 434 (emphasis added). Here, there is no reason to believe that misrepresentations to EPA and CARB had any bearing on the viability of the bond offerings. Unlike the FHLBB in *Lincoln*, EPA does not function as a gatekeeper for securities offerings. And Plaintiff has not cited to any authority that would have given EPA the power to certify or suspend the VWGoAF bond offering based on the truthfulness of the statements in the Offering Memorandum. Even under *Lincoln*'s reading of *Arthur Young*, then, the fraud-on-the-regulatory-process theory does not apply here because Defendants' representations to EPA and CARB did not plausibly enable the bond sale to go forward.

Assuming, without deciding, that the fraud-on-the-regulatory-process theory remains valid in the Ninth Circuit, the theory does not apply here.

2. The *Affiliated Ute* Presumption

Turning away from market-based presumptions, Plaintiff alternatively argues that it can invoke a presumption of reliance under *Affiliated Ute*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741. A presumption of reliance is generally available under *Affiliated Ute* for plaintiffs alleging violations of Section 10(b) and Rule 10b–5 based on "omissions of material fact." *Binder*, 184 F.3d at 1063. The theory behind this presumption is that direct proof of reliance in omission cases requires "proof of a speculative negative"—that, "I would not have bought had I known." *Blackie v. Barrack*, 524 F.2d 891, 908 (9th Cir. 1975). To relax this "difficult evidentiary burden," *id.*, *Affiliated Ute* allows reliance to be presumed "when the information withheld is material." *Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009). In cases in which both omissions and misrepresentations are alleged, the presumption is only appropriate if the case can be characterized as "primarily a nondisclosure case." *Binder*, 184 F.3d at 1064. If instead the case is best characterized as "a positive misrepresentation ***974** case," the presumption is not available. *Id.*

a. This Court's Prior Orders

In *Bondholders I*, the Court held that Plaintiff could rely on *Affiliated Ute* to prove reliance. The Court reached this holding after explaining that, although Plaintiff's case is based on both misleading statements and omissions, the "heart of the case" is an omission—VW's failure to disclose its emissions fraud—and so the case can be characterized as "one that primarily alleges omissions." *Bondholders I*, 2017 WL 3058563, at *14.

The Court changed course in *Bondholders II*. In doing so, it relied on a recent decision by the Second Circuit, *Waggoner v. Barclays PLC*, 875 F.3d 79 (2d Cir. 2017). Investors in that case asserted that Barclays violated Rule 10b–5(b) by omitting information that made certain affirmative statements misleading. For example, investors alleged that Barclays told them that a proprietary tool would allow them to "choose which trading styles they interacted with" on a specialized trading platform, but that Barclays failed to disclose that the tool did not apply to a significant portion of the trades conducted on the platform. *Id.* at 90.

Similar to this Court's reasoning in *Bondholders I*, the district court in *Waggoner* had held that *Affiliated Ute* applied because "a case could be made that it is the material omissions, not the affirmative statements, that are the heart of this case." *Id.* at 91. The Second Circuit disagreed. Noting that "the labels 'misrepresentation' and 'omission' are of little

help," the Second Circuit reasoned that "what is important is to understand the rationale" of the *Affiliated Ute* presumption, which is that in cases where "no positive statements exist ... reliance as a practical matter is impossible to prove." *Id.* at 95 (quoting *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88, 93 (2d Cir. 1981)). Reliance was not impossible to prove in the case before it, the Second Circuit explained, because the investors had alleged that Barclays made multiple affirmative statements, and the omission was only of "the truth that the statement[s] misrepresent[ed]." *Id.* at 96.

This Court found *Waggoner*'s reasoning persuasive. The Court explained that *Waggoner*'s focus on the purpose behind *Affiliated Ute* was a helpful touchstone, which the Ninth Circuit had also identified. *See Bondholders II*, 2018 WL 1142884, at *5-6 (citing *Desai*, 573 F.3d at 941). And although the Ninth Circuit stated in *Binder* that *Affiliated Ute* may apply in cases that "allege both misstatements and omissions" if the case can be characterized as one that "primarily alleges omissions," 184 F.3d at 1064, the Court noted that "the Ninth Circuit has not offered detailed guidance on how to distinguish a complaint that 'primarily alleges omissions' from one that alleges omissions, but not primarily." *Bondholders II*, 2018 WL 1142884, at *5. The Court also explained that "despite the statement in *Binder* that the *Affiliated Ute* presumption may be available in cases that 'allege both misstatements and omissions,' it appears that the Ninth Circuit has yet to uphold the use of the presumption in such a scenario." *Id.*

Using *Waggoner*'s test, the Court reasoned that "whether the *Affiliated Ute* presumption of reliance is applicable is a decision that should be based on whether the presumption's purpose—of avoiding the need to prove a speculative negative—is implicated." *Bondholders II*, 2018 WL 1142884, at *6. "Here, it is not," the Court concluded. *Id.* Explaining why, the Court reasoned that

> Plaintiff's claims are predicated on affirmative statements that Defendants are alleged to have made—specifically, the ***975** R & D and regulatory-risk statements in the bond Offering Memoranda. Plaintiff contends that these statements were misleading because Defendants did not disclose Volkswagen's emissions fraud. In other words, the omission is of the truth that certain affirmative statements allegedly misrepresent.
>
> Either Plaintiff and the other putative class members relied on the R & D and regulatory-risk statements in purchasing VWGoAF bonds or they did not. And if they did not, they should not be able to overcome this shortfall by characterizing their claims as primarily alleging omissions.

Id. (citations omitted).

Having concluded that the presumption's purpose of avoiding the need to prove a speculative negative was not implicated, the Court reconsidered its decision in *Bondholders I* and held that Plaintiff could no longer rely on *Affiliated Ute* to plead reliance. *Id.*

b. Plaintiff's Request for Reconsideration [4]

Although the Court grounded *Bondholders II* in identifying whether *Affiliated Ute*'s purpose would be furthered by permitting Plaintiff to invoke the presumption, Plaintiff argues that the Court's analysis went too far. Plaintiff asserts that under the reasoning in *Bondholders II*, anytime a securities-fraud claim is brought under Rule 10b–5(b), the *Affiliated Ute* presumption will be unavailable. This is because Rule 10b–5(b) "do[es] not create an affirmative duty to disclose any and all material information." *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44, 131 S.Ct. 1309, 179 L.Ed.2d 398 (2011). Rather, a duty to disclose arises under Rule 10b–5(b) only when disclosure is "necessary ... to make *the statements made*, in light of the circumstances under which they are made, not misleading." 17 C.F.R. § 240.10b–5(b) (emphasis added). As a result, Rule 10b–5(b) cases will always be predicated on affirmative statements, and so Plaintiff reasons that the need to prove a speculative negative in such cases will not be implicated, at least under the reasoning in *Bondholders II.*

Plaintiff asserts that there are several problems with this result. First, Plaintiff contends that this result—the *Affiliated Ute* presumption not being available in Rule 10b–5(b) cases—would be inconsistent with the Ninth Circuit's decision in *Binder*. *Binder*, Plaintiff notes, was a Rule 10b–5(b) case, and yet rather than hold that the presumption would never be appropriate in Rule 10b–5(b) cases, *Binder* instructed courts to analytically characterize each "mixed case" of misstatements and omissions "as either primarily a nondisclosure case (which would make the presumption applicable), or a positive misrepresentation case." *Binder*, 184 F.3d at 1064. According to Plaintiff, this test suggests that *Affiliated Ute*'s presumption may be available in at least some Rule 10b–5(b) cases, so long as the case can be characterized as "primarily a nondisclosure case." *Id.*

Second, Plaintiff relatedly contends that *Bondholders II*'s reasoning would effectively cabin the availability of the *Affiliated Ute* presumption to cases that exclusively involve a failure to disclose, instead of cases that involve "*primarily* a nondisclosure," as *Binder* instructs. ***976** 184 F.3d at 1064 (emphasis added). "Primarily a nondisclosure," Plaintiff asserts, suggests that the presumption should be available in cases in which there are some affirmative statements but more significant omissions.

Third, Plaintiff contends that *Bondholders II* is inconsistent with the Ninth Circuit's decision in *Blackie*, 524 F.2d 891, a case that involved both misstatements and omissions and in which the Ninth Circuit held that the plaintiffs could rely on *Affiliated Ute*'s presumption to prove reliance. Citing to *Blackie*, Plaintiff argues that the Court was incorrect when it stated in *Bondholders II* that "the Ninth Circuit has yet to uphold the use of the presumption" in cases that "allege both misstatements and omissions." *Bondholders II*, 2018 WL 1142884, at *5.

The Court acknowledged *Blackie* in *Bondholders II*, noting that it was arguably a "mixed case" of misstatements and omissions because the plaintiffs there asserted that the defendants' financial statements misrepresented particular line items by, among other things, failing to include adequate reserves for uncollectable accounts and obsolete inventory. *See id.* at *5 n. 2 (citing *Blackie*, 524 F.2d at 903-06). But what left the Court unsure of *Blackie*'s effect was the way *Binder* characterized the decision. Citing to *Blackie*, *Binder* stated that "[w]e have applied the *Affiliated Ute* presumption to cases that 'are, or can be, cast in omission or non-disclosure terms[,] ... [but] [w]e have not squarely decided ... whether the presumption may be invoked in a case involving misrepresentations or both omissions and misrepresentations.' " *Binder*, 184 F.3d at 1063-64. *Binder*, then, referred to the issue of whether *Affiliated Ute* applies to mixed cases of misrepresentations and omissions as an issue that the Ninth Circuit had not yet decided, even though *Blackie* seemed to have touched on that issue. And in dissent in *Binder*, Judge Reinhardt even stated that "*Blackie* was a pure omissions case." *Binder*, 184 F.3d at 1068 (Reinhardt, J. dissenting). As a result, the Court concluded in *Bondholders II* that *Blackie* was "not instructive in considering when a case that alleges both misstatements and omissions can be characterized as one that 'primarily alleges omissions.' " *Bondholders II*, 2018 WL 1142884, at *8 n.2 (quoting *Binder*, 184 F.3d at 1064).

Despite the somewhat confusing discussion of *Blackie* in *Binder*, *Blackie* does give the Court some pause. Because there were misstatements in that case—namely, inaccurate line items in financial reports—*Affiliated Ute*'s purpose of avoiding the need to prove a speculative negative was arguably not implicated there. And yet rather than concluding that the presumption was not available, as this Court did in *Bondholders II*, the Ninth Circuit held in *Blackie* that the plaintiffs could rely on the presumption to plead reliance.

Also giving the Court pause is Plaintiff's argument that the reasoning in *Bondholders II* would foreclose the use of *Affiliated Ute* in all Rule 10b–5(b) cases. On the one hand, such a result would not be ungrounded. The Fifth Circuit has held that *Affiliated Ute*'s presumption is only available for claims under subsections (a) and (c) of Rule 10b–5, and not for claims under subsection (b), because claims under Rule 10b–5(b) are inherently tied up with affirmative statements and therefore do not require proof of a speculative negative. In the Fifth Circuit's own words:

> By the terms of [Rule 10b–5], a presumption of reliance would not arise where the plaintiff's case is grounded in the second subsection. Subsection [(b)] requires disclosure only when necessary to make a statement made not misleading. For this reason, a subsection [(b)] claim always rests upon an affirmative statement of some sort, reliance on ***977** which is an essential element plaintiff must prove.... By contrast, under the first and third subsections the duty not to engage in a fraudulent 'scheme' or 'course of conduct' could be based primarily on an omission. Hence, the presumption could be warranted only under subsections one and three, but not under subsection two.

Smith v. Ayres, 845 F.2d 1360, 1363 (5th Cir. 1988). [5]

The Fifth Circuit's framework is also consistent with *Affiliated Ute* itself, for the claims in that case were not based on Rule 10b–5(b). The Supreme Court in *Affiliated Ute*

considered whether members of the Ute Indian Tribe were required to prove reliance affirmatively when they alleged that bank officers bought tribal members' restricted stock without disclosing the bank's creation of a secondary market in which the stock could be resold for profit. *See* 406 U.S. at 133-39, 92 S.Ct. 1456. The Court ruled that the tribal members' allegations were not based on misrepresentations under what is now Rule 10b–5(b), but instead on a " 'course of business' or a 'device, scheme or artifice' that operated as a fraud" under what are now subsections (a) and (c) of Rule 10b–5. *Id.* at 153, 92 S.Ct. 1456. Given the bank's relationship with the tribal members and its access to material information about the market for the members' shares, the Court held that the bankers had a duty to disclose the existence of this secondary market to the plaintiffs. *Id.* at 152-53, 92 S.Ct. 1456. The Court also held that "[u]nder the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery." *Id.* at 153, 92 S.Ct. 1456.

In *Affiliated Ute*, then, the predicate acts of fraud were omissions, not misstatements. *See Titan Group, Inc. v. Faggen*, 513 F.2d 234, 239 (2d Cir. 1975) (referring to *Affiliated Ute* as a case of "total non-disclosure"). There was therefore concern in *Affiliated Ute* that if the plaintiffs needed to affirmatively prove reliance they would essentially be required to prove a speculative negative—that they would have relied on information about the secondary market for tribal stock had the bank disclosed it. The same concern is not present in cases under Rule 10b–5(b), as claims under that subsection must be based on one or more false or misleading statements. As a result, plaintiffs bringing such claims are not necessarily required to prove a speculative negative in order to prove reliance; they can prove that they relied on the actual statements made.

On the other hand, the Ninth Circuit has not expressly held that *Affiliated Ute* applies only in claims under Rule 10b–5 subsections (a) and (c). And indeed, the Ninth Circuit's decision in *Binder*, which was a Rule 10b–5(b) case, suggests that *Affiliate Ute*'s presumption may be available in Rule 10b–5(b) cases if they "can be characterized as [cases] that primarily allege[ ] omissions." *Binder*, 184 F.3d at 1064. Also, despite the somewhat confusing characterization of *Blackie* in *Binder*, *Blackie* appears to have involved both misstatements and omissions, but the Ninth Circuit held that the *Affiliated Ute* presumption was nevertheless available in that case. *Blackie* too, then, suggests that in the Ninth Circuit the *Affiliated Ute* presumption may be available in cases that are based at least in part of affirmative misstatements.

***978** Given these difficulties, it is worth remembering that the question of whether *Affiliated Ute* applies is ultimately not one that needs to be answered at this stage in the litigation. Plaintiff has plausibly alleged that, through its investment advisor, it relied directly on the misleading statements in the Offering Memorandum. Those allegations are sufficient to support the reliance element at the pleading stage, while the question of whether Plaintiff can use *Affiliated Ute* to prove reliance on a class-wide basis is a question that needs to be resolved in considering class certification. Taking this procedural posture into account, the Court will not finally resolve at this time whether Plaintiff may invoke *Affiliated Ute*'s presumption of reliance to prove its case.

C. Reliance Summary

The element of reliance is now well pled under a direct-reliance theory, and so Plaintiff's case may proceed past the pleading stage. It is also clear that a presumption of reliance is *not* available under fraud-on-the-market, fraud-created-the-market, or fraud-on-the-regulatory-process theories. Whether a presumption of reliance is available under *Affiliated Ute* is a thornier issue. But because it is an issue that does not need to be finally resolved until the class certification stage, the Court will not finally resolve it at this time.

II. Scienter

In *Bondholders I*, the Court concluded that it was plausible that Winterkorn and Horn made the misleading R & D and regulatory-risk statements in the May 15, 2014 Offering Memorandum, and that Winterkorn and VWAG (but not Horn and VWGoA) made these statements intentionally or recklessly, i.e., with scienter. *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 991-92 (9th Cir. 2009) (discussing the scienter standard). Plaintiff has added allegations to the second amended complaint in an effort to cure the scienter shortfall for Horn and VWGoA. As discussed below, scienter is now well pled as to both of these defendants.

A. Analysis of Horn's Scienter in *Bondholders I*

In the original complaint, the earliest allegations supporting that Horn was aware of Volkswagen's emissions fraud were that, on the same date VWGoAF issued the May 15, 2014 Offering Memorandum, he received an email from the then-

head of Volkswagen's U.S. Regulatory Compliance Office, Oliver Schmidt, which indicated "that 500,000 [to] 600,000 vehicles in the United States from model years 2009 to 2014 could be affected by the diesel scandal[,]" that potential fines included " 'EPA: $37,500 and CARB: $5,500' per violation," and that, given the potential penalties, " '[t]he contents of this [ICCT] study cannot be ignored!' " (Compl. ¶ 290 (third and fourth alterations in complaint).) The ICCT study referenced was a study conducted at West Virginia University that was commissioned by the International Council on Clean Transportation. It indicated that during road tests Volkswagen's "clean diesel" vehicles emitted nitrogen oxides at levels up to 40 times the legal limits. (Compl. ¶ 151.)

Based on the timing of when Horn received the Schmidt email—the same day that the May 14, 2014 Offering Memorandum was issued and only a week before Plaintiff's bond purchase was finalized on May 23, 2014—the Court previously concluded that the email did not support a strong inference that Horn made the statements in the May 15, 2014 Offering Memorandum with scienter, or that his failure to correct the Offering Memorandum by May 23, 2014 was done with scienter. *See Bondholders I*, 2017 WL 3058563, at *11. In reaching this conclusion, the ***979** Court explained that "[e]ven if Plaintiff did not finalize its bond purchase until May 23, 2014, and Horn accordingly had time to read the Schmidt email before the transaction was complete, managers are permitted a reasonable amount of time to consider, digest, and investigate negative information before they disclose that information to the public." *Id.* And under the circumstances alleged, the Court reasoned that "it would have been reasonable for Horn to have obtained the Schmidt email and to have considered and investigated the issue for more than a week before disclosing the information to potential bondholders or the public." *Id.*

B. New Allegations of Horn's Scienter

Plaintiff now alleges that Horn first learned of the ICCT study on March 31, 2014, not on May 15, 2014. Specifically, Plaintiff alleges that on March 31 an Audi engineer warned Horn that soon a study would be published that showed that under real-world driving conditions VW's "clean diesel" vehicles "produced emissions up to nearly 40 times higher than allowed by EPA and CARB." (SAC ¶ 170; *see also id.* ¶¶ 77, 171.) Upon learning of this study, Plaintiff alleges that "Horn requested reports and analyses of the ICCT report from VWGoA's Environmental and Engineering Office." (SAC ¶ 77.) Horn allegedly asked for these reports in April 2014. (SAC ¶ 324.) "Managing engineers at VWAG and VWGoA (including several engineers who participated in the design and implementation of the defeat devices in the early-2000s) then provided documentation and information to numerous senior management officials including both Defendants Horn and Winterkorn." (SAC ¶ 171.)

The new allegations adjust the timeline with respect to when Horn first learned that Volkswagen's vehicles were significantly out of compliance with U.S. emission standards. Instead of being notified of the ICCT report on the day that the May 15, 2014 Offering Memorandum was released, and only one week before Plaintiff finalized its purchase of the bonds, on May 23, 2014, Plaintiff now alleges that Horn knew of the ICCT report seven weeks before May 23. Given the amount of time between when Horn is now alleged to have learned about the emissions issue and when Plaintiff's bond purchase was finalized, a strong inference arises that Horn acted with an intent to deceive or with deliberate recklessness when he failed to disclose in the May 15 Offering Memorandum that there was reason to believe that VW's "clean diesel" vehicles were significantly out of compliance with U.S. emission standards.

Horn and Volkswagen, on separate grounds, argue that the new allegations are still not sufficient to support scienter with respect to Horn, but their arguments are not persuasive.

First, Horn contends that the seven-week period between when he is alleged to have learned of the ICCT study and when the bond offering was finalized is still within the bounds of what courts have concluded is a reasonable period of time for managers to investigate potentially negative information before public disclosure. In support of this position, he cites to three cases that this Court previously relied on in concluding that "managers are permitted a reasonable amount of time to consider, digest, and investigate negative information before they disclose that information to the public." *Bondholders I*, 2017 WL 3058563, at *11 (citing *Slayton v. Am. Express Co.*, 604 F.3d 758, 763-64, 774, 777 (2d Cir. 2010) (affirming dismissal; taking two months to "ascertain and disclose future losses" is "both proper and lawful" (citation omitted)); *Higginbotham v. Baxter Intern., Inc.*, 495 F.3d 753, 760-61 (7th Cir. 2007) (affirming dismissal; disclosing ***980** accounting errors at subsidiary two months after discovery was within a "reasonable time" because "[p]rudent managers conduct inquiries rather than jump the gun with half-formed stories as soon as a problem comes to their attention"); *In re Yahoo! Inc. Sec. Litig.*, No. C 11-02732 CRB, 2012 WL 3282819, at *22 (N.D. Cal.

Aug. 10, 2012) (granting dismissal; relying on *Slayton* and *Higginbotham* and concluding that the defendants' disclosure of a corporate restructuring five weeks after receiving notice was reasonable)).

While the Court previously cited favorably to these decisions, they were context specific decisions, and the Court did not conclude that a specific period of time would be reasonable for investigation. Instead, the Court concluded that "it would have been reasonable for Horn to have obtained the [May 15, 2014] Schmidt email and to have considered and investigated the [emissions] issue for more than a week before disclosing the information to potential bondholders or the public." *Bondholders I*, 2017 WL 3058563, at *11. Under the facts alleged now, and drawing all reasonable inferences in Plaintiff's favor, the Court can no longer conclude that Horn's delay was reasonable as a matter of law.

Also, the time periods in the three cited decisions are distinguishable from the time period here in a material way. In each of those decisions, the relevant time period was between the defendants' discovery of potentially negative information and their disclosure of that information to shareholders following internal investigations. On this scale, the seven-week gap between Horn's March 2014 discovery of the emissions issue and the May 2014 bond offering is incomplete. For Horn did not disclose the emissions fraud seven weeks after he is alleged to have become aware of it; he disclosed the fraud *one-and-a-half years* later, on October 8, 2015, in testimony before Congress after EPA had determined that VW had "manufactured and installed defeat devices in certain model year 2009 through 2015 diesel light-duty vehicles." (SAC ¶ 246; *see also id.* ¶ 271.) And during that one-and-a-half-year period, Plaintiff alleges that supervisors at Volkswagen agreed to conceal the defeat device in response to questions from U.S. regulators. (SAC ¶ 173.) Given that Horn did not disclose the emissions issues until Volkswagen was actually caught, the inference that Horn acted with intent to deceive or with deliberate recklessness when he was silent at the time of the May 2014 offering is "cogent and at least as compelling" as the inference that he was still innocently conducting an investigation at that time. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007).

While Horn focuses on the length of time between the March 2014 email and the May 2014 offering, Volkswagen instead focuses on the content of the March disclosure. As alleged, Horn learned in March 2014 that certain Volkswagen vehicles did not comply with U.S. emission standards. (SAC ¶ 77.) But Plaintiff does not allege that Horn received any report suggesting the existence of an illegal defeat device in the vehicles prior to the May 15, 2014 Schmidt email. (SAC ¶ 302.) "There is a world of difference," VW argues, "between learning of an anomalous test result on March 31, 2014, to learning of the defeat device on May 15, 2014." (Dkt. No. 4422 at 23.)

Defendants' failure to disclose Volkswagen's use of the defeat device is indeed the primary omission upon which Plaintiff relies. *See Bondholders I*, 2017 WL 3058563, at *5 ("Plaintiff contends that the 'heart of this action' is Defendants' failure to disclose their massive defeat-device scheme."). But Plaintiff also alleges that Defendants omitted other information in ***981** the Offering Memorandum, including that a significant number of Volkswagen's vehicles were out-of-compliance with U.S emission standards. (*See, e.g.*, SAC ¶ 228(c) (alleging that the R & D statements in the Offering Memorandum were misleading, not only because Defendants failed to disclose the illegal defeat device, but also because the statements "implied that Volkswagen had already reduced vehicle emissions when in truth Volkswagen's diesel engines emitted more pollutants than Defendants represented.").) As alleged in the second amended complaint, Horn knew by March 31, 2014 that Volkswagen's vehicles were significantly out of compliance with U.S. emission standards. Given what he knew and when he knew it, a strong inference arises that he acted with intent to deceive or with deliberate recklessness when he failed to disclose this information to bond investors who participated in the May 2014 offering.

The second amended complaint cures the deficiency with respect to pleading a strong inference of scienter as to Horn.

C. VWGoA's Scienter

Because Horn was the CEO of VWGoA during the relevant period, the allegations supporting Horn's scienter are also sufficient to raise a strong inference of scienter as to VWGoA. *See In re ChinaCast Educ. Corp. Sec. Litig.*, 809 F.3d 471, 476 (9th Cir. 2015) ("[A] corporation is responsible for a corporate officer's fraud committed within the scope of his employment[.]").

III. Section 20(a) Claims Against Horn

Plaintiff also brings claims against Horn under Section 20(a) of the Exchange Act, asserting that he was a "control person" of VWGoA and VWGoAF. To prove a prima facie case under

Section 20(a), Plaintiff must prove: (1) a primary violation of federal securities laws, and (2) that Horn "exercised actual power or control over the primary violator." *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000). In *Bondholders I*, the Court held that a primary violation of the federal securities laws was sufficiently alleged as to VWGoAF, but the Court deferred considering the Horn control-person claims at that time. Now that scienter is also well pled as to VWGoA, the "primary violation" requirement is satisfied as to both VWGoA and VWGoAF. Whether the "actual power or control" requirement is satisfied is in dispute. [6]

There is no concrete test for establishing whether a defendant exercises actual power or control over the primary violator. The question "is an intensely factual" one and "involve[es] scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions." *Id.* (quoting *Kaplan v. Rose*, 49 F.3d 1363, 1382 (9th Cir. 1994)).

With respect to Horn's control over VWGoA and VWGoAF, Plaintiff first alleges that Horn was President and CEO of VWGoA throughout the class period, and that VWGoA was the direct parent company of VWGoAF. (SAC ¶¶ 22, 25, 394.) "[A]lthough a person's being an officer or director does not create any presumption of control, it is a sort of red light." *Arthur Children's Trust v. Keim*, 994 F.2d 1390, 1397 (9th Cir. 1993) (emphasis omitted). Horn's position as CEO of VWGoA is therefore indicative of control, at least as to VWGoA.

Plaintiff also alleges that Horn was personally involved with VWGoA's response ***982** to the ICCT study, as he "is believed to have requested reports from VWGoA's Environmental and Engineering Department about the results of the study." (SAC ¶ 394.) This allegation supports that Horn exercised "day-to-day oversight" over transactions at VWGoA that contributed to the ultimate fraud, which also supports a finding of control. *Howard*, 228 F.3d at 1065.

Similar allegations support Horn's control over VWGoAF. Specifically, that Horn was "provided with copies" of the VWGoAF bond Offering Memoranda "prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected." (SAC ¶ 27.) "Specific control over the preparation and release of the allegedly misleading false and misleading statements," like this, supports a finding of control. *Bao v. SolarCity Corp.*, No. 14-cv-01435-BLF, 2015 WL 1906105, at *5 (N.D. Cal. Apr. 27, 2015); *see also Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1441 (9th Cir. 1987) (directors' day-to-day oversight of company's operations and involvement with the financial statements at issue was sufficient to presume control over "the particular transactions giving rise to the alleged securities violation"), *overruled on other grounds as recognized in Flood v. Miller*, 35 F. App'x 701, 703 n.3 (9th Cir. 2002).

Horn argues that his role with VWGoA and VWGoAF was similar to the role of the Chairman and former CEO in *Paracor Finance, Inc. v. General Electric Capital Corp.*, 96 F.3d 1151, 1163-64 (9th Cir. 1996), which the Ninth Circuit held was a role that was insufficient to satisfy the "actual control" element. But the Chairman and former CEO in *Paracor* "was not authorized to act" on the debt offering at issue in that case, and "was not involved in the preparation of any of the offering materials." *Id.* at 1163-64. Plaintiff's allegations with respect to Horn are materially different, as Plaintiff alleges that Horn "had the ability and/or opportunity to prevent [the] issuance" of the bond Offering Memoranda, or to "cause them to be corrected." (SAC ¶ 27.) As alleged, Horn had the type of power and control over the allegedly misleading statements that the Chairman and former CEO in *Paracor* lacked.

Horn also notes that in *Howard*, 228 F.3d 1057, the Ninth Circuit determined that a CEO qualified as a control person because he "was authorized to participate in the release of the financial statements *and signed off the on the statements as correct.*" *Id.* at 1066 (emphasis added). Unlike in *Howard*, Horn argues that Plaintiff has failed to allege that he signed the Offering Memoranda, or that he otherwise had any involvement in or control over VWGoAF's bond offerings.

The Ninth Circuit did not hold in *Howard* that a Section 20(a) defendant must sign the documents at issue in order to qualify as a control person; singing the documents is simply one sign of control. And contrary to Horn's contention, the allegations do support that he was involved in or had control over the bond offerings, as Plaintiff alleges that he was "provided with copies" of the VWGoAF bond Offering Memoranda "prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected." (SAC ¶ 27.)

Together, the allegations are sufficient to support that Horn exercised actual power or control over VWGoA and VWGoAF. Because the allegations also support a primary

violation as to VWGoA and VWGoAF, the Section 20(a) control person claims against Horn are now well pled.

IV. Motion to Amend the Complaint

In opposition to Defendants' motions to dismiss the second amended complaint, ***983** Plaintiff asserted for the first time that when Defendants sold VWGoAF bonds in the initial offerings, they engaged in insider trading in violation of Section 10(b) and Rule 10b–5 subsections (a) and (c) and Section 20A of the Exchange Act because they sold the bonds without disclosing the emissions fraud. In raising these claims, Plaintiff noted that insider trading can be committed without affirmative statements, and so Plaintiff asserted that *Affiliated Ute*'s presumption of reliance would apply under this "pure omissions" theory. *See Binder*, 184 F.3d at 1063 (explaining that the *Affiliated Ute* presumption "is generally available to plaintiffs alleging violations of section 10(b) based on omissions of material fact").

Defendants responded in their reply by noting that these insider-trading claims were not included in the second amended complaint, to which Plaintiff responded by filing a motion to amend the second amended complaint to add the claims. (Dkt. No. 5153.) Defendants have opposed the amendment, arguing that the amendment would be futile. A proposed amended complaint is futile if it would immediately be "subject to dismissal," *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1298 (9th Cir. 1998), and if there is no reason to believe that "the deficiencies can be cured with additional allegations that are consistent with the challenged pleading and that do not contradict the allegations in the original complaint," *United States v. Corinthian Colleges*, 655 F.3d 984, 995 (9th Cir. 2011) (internal quotation marks omitted). That is the case here: the new claims are not meritorious, they would be immediately be subject to dismissal, and the Court cannot conceive of additional facts that would cure the deficiencies identified below.

A. Section 10(b) and Rule 10b–5 Insider Trading Claims

Under an insider trading theory of liability, Section 10(b) and Rule 10b–5 are violated (even if no affirmative statements are made) "when a corporate insider trades in securities of his corporation on the basis of material, nonpublic information." *Steginsky v. Xcelera Inc.*, 741 F.3d 365, 370 (2d Cir. 2014) (quoting *United States v. O'Hagan*, 521 U.S. 642, 651-52, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997)). A traditional corporate insider would be someone in senior management or a member of the board of directors. But the Ninth Circuit has held that "[a] corporate *issuer* in possession of material nonpublic information, must, like other insiders in the same situation, disclose that information to its shareholders or refrain from trading with them." *WPP Lux. Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1056 (9th Cir. 2011) (quoting *McCormick v. Fund Am. Cos.*, 26 F.3d 869, 876 (9th Cir. 1994)) (emphasis added). "Otherwise, a corporate issuer selling its own securities would be left to exploit its informational trading advantage, at the expense of the investors, by delaying disclosure of nonpublic negative news until after completion of the offering." *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1204 (1st Cir. 1996). The Second Circuit has also held that "the duty of corporate insiders to abstain from trading or to disclose material information applies to unregistered securities." *Steginsky*, 741 F.3d at 371.

So far so good for Plaintiff. All three corporate defendants could conceivably qualify as corporate issuers, as Plaintiff alleges that that VWAG, through VWGoA and VWGoAF, conducted the offerings and issued the bonds. (TAC ¶¶ 390, 397.) And the allegations support that all three entities were in possession of material nonpublic information about the emissions ***984** fraud at the time of the offerings. Where Plaintiff runs into trouble, however, is in establishing that Defendants had a duty to disclose this material information to purchasers of corporate *debt.*

To successfully bring a traditional insider trading claim, as is alleged here, a private plaintiff must establish that the defendant had a duty to disclose the information that was withheld. Addressing an insider trading claim in *Chiarella v. United States*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348 (1980), the Supreme Court explained that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." *Id.* at 235, 100 S.Ct. 1108. Such a duty arises, the Court stated, only when one party has information "that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them." *Id.* at 228, 100 S.Ct. 1108 (citation omitted); *see also Paracor*, 96 F.3d at 1157 (explaining that "parties to an impersonal market transaction owe no duty of disclosure to one another absent a fiduciary or agency relationship, prior dealings, or circumstances such that one party has placed trust and confidence in the other").

As to shareholders, the Ninth Circuit has held that "there is little doubt that the relationship between a corporation and its shareholders engenders the type of trust and confidence necessary to trigger the duty to disclose" material information

or abstain from trading. *McCormick*, 26 F.3d at 876 (citation omitted). But the overwhelming majority of courts have held that "corporations do *not* have a fiduciary relationship with their unsecured creditors, including debt security holders," because this relationship "is contractual rather than fiduciary." *Alexandra Glob. Master Fund, Ltd. v. Ikon Office Sols., Inc.*, No. 06 CIV. 5383 (JGK), 2007 WL 2077153, at *4 (S.D.N.Y. July 20, 2007) (emphasis added) (describing this rule as "well established" and collecting cases in support); *see also Lorenz v. CSX Corp.*, 1 F.3d 1406, 1417 (3d Cir. 1993) ("It is well-established that a corporation does not have a fiduciary relationship with its debt security holders, as with its shareholders."); Harvey L. Pitt & Karl A. Groskaufmanis, *A Tale of Two Instruments: Insider Trading in Non-Equity Securities*, 49 Bus. Law. 187, 213 (1993) ("[T]he prevailing notion of debt securities expressly rules out the fiduciary relationship that gives rise to a duty to abstain or disclose.").

The basis for this distinction between shareholders and debtholders (including bondholders) is that "a contractual entitlement to the repayment of a debt ... does not represent an equitable interest in the issuing corporation necessary for the imposition of a trust relationship with concomitant fiduciary duties." *Alexandra*, 2007 WL 2077153, at *5 (quoting *Simons v. Cogan*, 549 A.2d 300, 303, (Del. 1988)); *see also* Morey W. McDaniel, *Bondholders and Corporate Governance*, 41 Bus. Law 413, 413 (1986) ("Stockholders are owners; bondholders are creditors. Corporate law is for stockholders; contract law is for the debtholders."). There is also a well-established belief that bondholders, as creditors, can protect themselves —or alternatively that an indentured trustee can protect future bondholders—by negotiating the terms of the indenture agreements. *See, e.g.*, *Simons v. Cogan*, 542 A.2d 785, 789 (Del. 1987) ("Courts traditionally have directed bondholders to protect themselves against self-interested issuer action with explicit contractual provisions.... [A] heavy black-letter line bars the extension of corporate fiduciary protections to them." (quoting Bratton, *The Economics and Jurisprudence of Convertible Bonds*, 1984 Wis. L. Rev. 667, 668 (1984))).

***985** The distinction between the duties owed to shareholders and bondholders is not without academic critique. *See* Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders*, 65 N.Y.U. L. Rev. 1165, 1179, 1184, 1187 (1990) (asserting that indenture agreements provide limited protection to bondholders and that although bondholders are not owners of the corporation they entrust their investments to corporate management in a manner similar to the way shareholders do). But those making these critiques have acknowledged that they "do not have a great deal of law supporting them." *Id.* at 1168 n.11.

Indeed, although Plaintiff has cited to a number of decisions in which courts have held that a corporate issuer has a duty to disclose material information or refrain from trading, almost all of those decisions involved trading with shareholders, not debt holders, and so are not on point. *See, e.g.*, *Steginsky*, 741 F.3d at 367, 370-71 (corporate insiders had a duty to disclose material nonpublic information before purchasing unregistered shares of stock in the company); *Spot Runner*, 655 F.3d at 1056 (explaining that a "corporate issuer in possession of material nonpublic information, must, like other insiders in the same situation, disclose that information to its *shareholders* or refrain from trading with them") (citation omitted) (emphasis added); *Shaw*, 82 F.3d at 1204 (discussing duty to disclose in the context of "a stock transaction"); *Sec. & Exch. Comm'n v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 840-42, 848 (2d Cir. 1968) (discussing duty to disclose in context of stock purchase by insiders).

Plaintiff does cite to two decisions in which courts have held that corporate insiders have a fiduciary relationship with their creditors or otherwise owe their creditors a duty to disclose material information. *See In re Worlds of Wonder Sec. Litig.*, No. C 87-5491, 1990 WL 260675, 1990 U.S. Dist. LEXIS 18396 (N.D. Cal. Oct. 19, 1990); *Little v. First Cal. Co.*, No. Civ. 74-71, 1977 WL 1054, 1977 U.S. Dist. LEXIS 13427 (D. Az. Oct. 17, 1977). *Worlds of Wonder* is distinguishable for this case and *Little* is not persuasive.

In *Worlds of Wonder*, the court held that corporate insiders owed fiduciary duties to those who held the company's convertible debt. Convertible debt is "something of a hybrid —basically a debt security, but with equity features." *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 940 (5th Cir. 1981). Because of this special status, it is not particularly surprising that the court in *Worlds of Wonder* held that the corporate insiders there owed fiduciary duties not only to the corporation's shareholders but also to its convertible debtholders. The VWGoAF bonds at issue here were not convertible and so there is no similar reason why Defendants' fiduciaries duties should be extended. [7]

As for *Little,* 1974 WL 431, 1977 U.S. Dist. LEXIS 13427, the district court there did hold that a controlling shareholder's agents (and by implication, the controlling shareholder) had a duty to disclose material information to purchasers of subordinated capital notes. *See id.* at *1, 5–6, 1977 U.S.

Dist. LEXIS 13427, at *1-3, 13-17. But the *Little* court did not address the distinction drawn by other courts between an insider's duty to disclose material information to its shareholders and the lack of such a duty to its debtholders. Instead, the court appeared to assume, as a starting point, that the controlling shareholder had ***986** a duty to disclose, and then turned its focus to the "open question" of whether the controlling shareholder's disclosure obligations were shared by its agents. *Id.* at *5, 1977 U.S. Dist. LEXIS 13427, at *14. *Little*, then, did not directly engage with the question at issue here. Also, *Little* is only one district court case, and a number of more recent decisions have held that a corporation does not have a duty to disclose material nonpublic information to its debt security holders. *See, e.g.*, *Lorenz*, 1 F.3d at 1417; *Alexandra*, 2007 WL 2077153, at *4. [8]

With the weight of authority supporting that corporate insiders do not owe fiduciary duties to purchasers of corporate debt, Plaintiff argues that Defendants, as corporate insiders, nevertheless had a duty to disclose the emissions fraud to VWGoAF bond purchasers simply because they were counterparties to the sale of the bonds. In support of this point, Plaintiff quotes from *SEC v. Bauer*, 723 F.3d 758 (7th Cir. 2013), where the court stated that corporate insiders have "an affirmative duty to disclose to the trading *counterparty* or abstain from trading." *Id.* at 769 (emphasis added). In the sentence immediately preceding the one just quoted, the *Bauer* court explained that this affirmative duty arises from the "relationship of trust and confidence between the *shareholders* of a corporation and those insiders who have obtained confidential information by reason of their position within that corporation." *Id.* (emphasis added) (quoting *Chiarella*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348). In light of this specific focus on the relationship between corporate insiders and shareholders, *Bauer* does not support a broad duty to disclose to any and all counterparties, as Plaintiff argues.

Plaintiff also relies on the SEC's decision *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 1961 WL 60638 (Nov. 8, 1961), in which the Commission concluded that an insider's disclosure responsibilities are not "limited to existing stockholders," but also extend to the "buying public." *Id.* at *5. Based on this statement in *Cady, Roberts* Plaintiff suggests that Defendants owed a duty to disclose the emissions fraud to the market at large. *Cady*, though, like most other cases on which Plaintiff relies, involved the sale of stock. Indeed, the Supreme Court in *Chiarella* discussed *Cady, Roberts* and explained that the Commission there "recognized a relationship of trust and confidence between the *shareholders* of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." 445 U.S. at 228, 100 S.Ct. 1108 (emphasis added). The sale of stock is simply not at issue here. Nor has Plaintiff cited to authority supporting that a corporation's bondholders can sidestep the fact that they do not have a fiduciary or similar relation of trust with the corporation—as needed to prevail on a traditional insider trading claim—by relying on the duties owed by the corporation to current and future shareholders.

"When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." *Chiarella*, 445 U.S. 222, 100 S.Ct. 1108, 63 L.Ed.2d 348. Defendants owed no such duty to Plaintiff because at the time they sold Plaintiff VWGoAF bonds Plaintiff was a ***987** prospective bondholder, not a current or future shareholder. Because of this shortcoming, Plaintiff's proposed Section 10(b) and Rule 10b–5 insider trading claims would be immediately subject to dismissal were the Court to permit Plaintiff to amend its complaint. There is also no reason to believe that the deficiencies in the pleading, which are based on Plaintiff's status as a bondholder, a status that is central to the other claims alleged (which are based on statements made to Plaintiff in a bond offering memorandum), can be cured with additional allegations. The Court therefore concludes that Plaintiff's proposed Section 10(b) and Rule 10b–5 subsection (a) and (c) insider trading claims are futile.

B. Section 20A Insider Trading Claim

Plaintiff also seeks to amend the complaint to add an insider trading claim under Section 20A of the Exchange Act, which provides a private right of action against "[a]ny person who violates any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information." 15 U.S.C. § 78t–1(a).

Congress enacted Section 20A as part of the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100–704, § 5, 102 Stat. 4677, 4680. The provision was added both to "codify the existence of a private right of action for insider trading violations," which had already been recognized as an implied right of action under Section 10(b) and Rule 10b–5, *Gordon v. Sonar Capital Mgmt. LLC*, 92 F.Supp.3d 193, 203 (S.D.N.Y. 2015), and to "alter the remedies available in insider trading cases." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 362, 111 S.Ct. 2773, 115 L.Ed.2d 321 (1991). Specifically,

given the "difficulties of ferreting out evidence sufficient to prosecute insider trading cases," *Jackson Nat. Life Ins. Co. v. Merrill Lynch & Co.*, 32 F.3d 697, 703 (2d Cir. 1994) (citation omitted), Congress added a five-year limitations period for Section 20A claims, which extended the limitations period well past that for claims brought under other sections of the Exchange Act. *See Gilbertson*, 501 U.S. at 359-60, 111 S.Ct. 2773.

As the Supreme Court explained in *Gilbertson*, "[t]he language of § 20A makes clear that ... Congress sought to alter the remedies available in insider trading cases, and *only* in insider trading cases." 501 U.S. at 362, 111 S.Ct. 2773. As a result, courts have held that in order to state a claim for violation of Section 20A, the plaintiff must first plead "a predicate insider trading violation of the Exchange Act." *In re Take-Two Interactive Sec. Litig.*, 551 F.Supp.2d 247, 309 (S.D.N.Y. 2008); *see also In re Countrywide Fin. Corp. Sec. Litig.*, 588 F.Supp.2d 1132, 1202 (C.D. Cal. 2008) (reasoning that the "*by* purchasing or selling" language of Section 20A "means that the predicate violation must be an act of insider trading").

The only predicate insider trading claims alleged by Plaintiff are for violation of Section 10(b) and Rule 10b–5 subsections (a) and (c). These insider-trading claims are not meritorious for the reasons discussed above. Plaintiff has therefore failed to plead "a predicate insider trading violation of the Exchange Act," *Take-Two*, 551 F.Supp.2d at 309, as necessary to bring a Section 20A claim. Further, because the predicate claims are futile, so is the Section 20A claim.

CONCLUSION

The allegations in the second amended complaint have cured previously noted deficiencies with respect to the elements of reliance and scienter. As a result, Plaintiff has now sufficiently pled Section 10(b) and ***988** Section 20(a) claims against Defendants and the parties may proceed with discovery. *See* 15 U.S.C. § 78u-4(b)(3)(B) (requiring that "all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss"). Defendants' motions to dismiss are DENIED.

Although Plaintiff has plausibly alleged that it relied directly on the misleading statements at issue in the May 2014 Offering Memorandum, Plaintiff is not entitled to a presumption of reliance under *Basic* or under the fraud-created-the-market or fraud-on-the-regulatory-process theories. The Court will, however, reconsider at the class certification stage whether Plaintiff may invoke a presumption of reliance under *Affiliated Ute*.

Plaintiff's motion to amend the complaint is DENIED. The insider trading claims that Plaintiff seeks to add are based upon nondisclosure. As a result, they would be actionable only if Defendants had information that Plaintiff was entitle to know "because of a fiduciary or other similar relation of trust and confidence." *Chiarella*, 445 U.S. at 228, 100 S.Ct. 1108. No such fiduciary duty or relation of trust existed because Plaintiff was a purchaser of corporate debt.

Defendants shall answer the complaint by Friday, September 28, 2018.

IT IS SO ORDERED.

All Citations

328 F.Supp.3d 963, Fed. Sec. L. Rep. P 100,259

Footnotes

1 *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prod. Liab. Litig.*, No. MDL 2672 CRB (JSC), 2017 WL 3058563 (N.D. Cal. July 19, 2017) [hereinafter *Bondholders I*].

2 *In re Volkswagen "Clean Diesel" Mktg., Sales Practices, & Prod. Liab. Litig.*, No. MDL 2672 CRB (JSC), 2018 WL 1142884 (N.D. Cal. Mar. 2, 2018) [hereinafter *Bondholders II*].

3 At the motion to dismiss hearing, Defendants questioned the factual basis for the allegations that Plaintiff's investment advisor reviewed and relied upon the relevant information contained in the Offering Memorandum. (*See generally* Aug. 3, 2018 Hr'g at 4-15.) Whether factual allegations have evidentiary support is not a Rule 8 or Rule 9 issue, it is a Rule 11 issue. *See* Fed. R. Civ. P. 11(b)(3) (providing that the factual contentions made in pleadings must, to the best of the attorney's knowledge, "have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery"). Defendants focus on the factual basis for these allegations therefore does not alter the Court's conclusion that the allegations support the element of reliance under Rules 8(a) and

9(b). *See* *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007) (explaining that on a motion to dismiss under Rule 12(b)(6), the court proceeds "on the assumption that all the allegations in the complaint are true (even if doubtful in fact)").

4 This is not a true motion for reconsideration because an amended complaint "supercedes the original complaint and renders it without legal effect." *Lacey v. Maricopa Cty.*, 693 F.3d 896, 927 (9th Cir. 2012) (en banc); *see also* *O'Connor v. Uber Techs., Inc.*, 58 F.Supp.3d 989, 995-96 (N.D. Cal. 2014) (permitting defendants to use a motion to dismiss an amended complaint as a means to challenge claims that were previously deemed well pled without satisfying the more demanding reconsideration standard in Civil L.R. 7-9).

5 A person violates Rule 10b–5(a) by "employ[ing] any device, scheme, or artifice to defraud" in connection with the purchase or sale of a security. 17 C.F.R. § 240.10b–5(a).
A person violates Rule 10b–5(c) by "engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person" in connection with the purchase or sale of a security. 17 C.F.R. § 240.10b–5(c).

6 In *Bondholders I*, the Court held that Section 20(a) claims against Winterkorn, which asserted that he was a control person of VWGoA and VWGoAF, were well pled. *See Bondholders I*, 2017 WL 3058563, at *15-16.

7 Also, contrary to *Worlds of Wonder*, other courts have refused to extend fiduciary duties to the holders of convertible debt. *See, e.g.*, *Simons*, 542 A.2d at 791 (reasoning that the "risks that the fiduciary duty concept was designed to address" do not arise until convertible bonds are actually converted into stock).

8 Plaintiff also relies on *SEC v. Rorech*, 720 F.Supp.2d 367, 376 (S.D.N.Y. 2010), but the court there did not hold that corporate insiders owe fiduciary duties to debtholders. Instead, the court noted that a salesperson selling high-yield debt owed a "duty of confidentiality" to its employer, Deutsche Bank, not to engage in "conduct constituting secreting, stealing, or purloining of material non-public information." *Id.* at 409. No similar "employer-imposed fiduciary duty" is implicated here.

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Form 6. Representation Statement

Instructions for this form: http://www.ca9.uscourts.gov/forms/form06instructions.pdf

Appellant(s) *(List **each** party filing the appeal, do not use "et al." or other abbreviations.)*

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CERTIFICATE OF SERVICE

I, William H. Wagener, hereby certify that on February 3, 2020, I caused to be electronically filed the foregoing Petition for Permission to Appeal and its Exhibits with the Clerk of the Court for the U.S. Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

I certify that all participants in this case have been served via both U.S. mail and E-mail.

/s/ William H. Wagener
William H. Wagener

Attorney for Defendants-Appellants Volkswagen AG, Volkswagen Group of America, Inc. and Volkswagen Group of America Finance, LLC

Dated: February 3, 2020