No. 24-1151

IN THE
Supreme Court of the United States

BDO USA, LLP,

Petitioner,

v.

NEW ENGLAND CARPENTERS GUARANTEED ANNUITY AND PENSION FUNDS, ET AL.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Brief of The Chamber of Commerce of the United States of America as *Amicus Curiae* in Support of Petitioner

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INTERESTS OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America (the Chamber) is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases, like this one, that raise issues of concern to the nation's business community.

The Chamber's membership has a powerful interest in the reversal of the erroneous Second Circuit decision below. Under the Second Circuit's novel and misguided holding, alleged misstatements of compliance with Public Company Accounting Oversight Board ("PCAOB") auditing standards are material for securities-law purposes, even if the substance of the audit would not be changed if the standards were followed to the letter. Plaintiffs in other cases will likely argue that this holding should be extended far outside the context in which it was announced—including in securities-law cases involving statements of compliance with other kinds of professional standards and practices, such as underwriting practices and valuation procedures. The decision below thus threatens onerous liability under the securities laws for numerous experts who make insubstantial alleged misstatements

[1] Pursuant to Rule 37, counsel for *amicus curiae* affirm that all parties were timely notified of the filing of this brief. No counsel for a party authored this brief in whole or in part and no entity or person, other than *amicus*, its members, or its counsel, made any monetary contribution intended to fund the preparation or submission of this brief.

in materials directed toward investors. That liability would, in turn, harm American businesses and the American economy.

INTRODUCTION AND SUMMARY OF ARGUMENT

This Court has repeatedly recognized the potential for private securities litigation "to injure 'the entire U.S. economy.'" *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 81 (2006) (quoting H. Rep. No. 104-369, at 31 (1995) (Conf. Rep.)). On that basis, the Court has rebuffed various efforts to expand liability under the securities laws. See, *e.g.*, *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994) (discussing Rule 10b-5 litigation). And the Court has specifically recognized that an "unnecessarily low" "standard of materiality" could well subject a "corporation and its management" to "liability for insignificant omissions or misstatements." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 448 (1976); see *Basic Inc.* v. *Levinson*, 485 U.S. 224, 231-232 (1988) (materiality requirement satisfied where "disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" (citation omitted)).

Here, the Second Circuit's decision sets aside that careful approach—and does so in a harmful way. The Second Circuit held that an auditor's alleged misstatement of compliance with PCAOB auditing standards was material under Section 10(b) and Rule 10b-5, even though nothing substantive about the audit changed once the standards were followed. App.34a-35a; see App.153a. In so holding, the Second Circuit split from one other court of appeals and created serious tension with several others. Pet.12-19. It also violated the long-standing, settled requirement that a plaintiff

demonstrate a link between the alleged misstatement and the alleged harm. See Pet.26-29.

Making matters worse, plaintiffs in other cases will likely argue that the Second Circuit's holding should extend outside of the legal and factual context at issue here to cases that arise under different statutes or involve statements regarding different kinds of accepted professional standards or practices. This case involves Section 10(b) and Rule 10b-5, but other securities statutes likewise make actionable material misstatements and omissions regarding compliance with such standards or practices and have historically required the same showing of materiality as Section 10(b) and Rule 10b-5. Plaintiffs therefore may argue that the Second Circuit's materiality holding should be applied under those other statutes as well, where it could do even more damage than in cases brought under Section 10(b) and Rule 10b-5. Further, although this case involves auditor statements regarding PCAOB standards, materials directed to investors often contain statements by other kinds of experts, such as appraisers and lawyers, that they have followed accepted standards or practices in their fields, and plaintiffs often bring claims alleging that those statements of compliance are untrue. Plaintiffs in such cases will likely argue that those statements should be treated as material just as the statements at issue in this case were—no matter how insubstantial any alleged lack of compliance with the relevant standards or practices actually was.

Given the Second Circuit's prominence in the field of securities law, other courts may adopt its erroneous materiality holding. This Court's review is urgently needed to prevent that misguided approach to materiality from affecting securities-law cases in the Second Circuit and around the country.

ARGUMENT

I. The Second Circuit's Decision Could Sweep Far Beyond the Specific Legal And Factual Context In Which It Arose

A. The Second Circuit's Materiality Holding Could Be Applied To Other Securities Statutes That Have A Materiality Element

The Second Circuit held below that a statement of compliance with PCAOB standards was material under Section 10(b) and Rule 10b-5, even though the substance of the audit would not have changed had the standards been followed. That alone makes the decision below highly consequential, as those provisions have a "broad scope." *United States* v. *Willis*, 737 F. Supp. 269, 273 (S.D.N.Y. 1990); see *Chiarella* v. *United States*, 445 U.S. 222, 226 (1980) (Section 10(b), which is implemented by Rule 10b-5, "was designed as a catch-all clause to prevent fraudulent practices"); 15 U.S.C. 78j(b) (prohibiting "any manipulative or deceptive device" "in connection with the purchase or sale of any security"); 17 C.F.R. 240.10b-5 (forbidding making "any untrue statement of a material fact" or omitting "to state a material fact * * * in connection with the purchase or sale of any security").

But that is not all. Plaintiffs in other cases will likely argue that the Second Circuit's holding should extend to still *more* claims, including claims brought under Sections 11(a) and 12(a)(2) of the Securities Act and Section 18 of the Exchange Act asserting that there has been a false statement of compliance with

professional standards or practices.[2] Where one of those statutes applies, plaintiffs may bring a claim under it in addition to, or instead of, a claim under Section 10(b) and Rule 10b-5.

Sections 11(a) and 12(a)(2) of the Securities Act and Section 18 of the Exchange Act cover somewhat different ground than Section 10(b) and have somewhat different elements—but the materiality requirement under all of those statutes has been understood to be the same. Plaintiffs thus could argue that the Second Circuit's incorrect materiality holding extends to claims brought under those other provisions. If that argument were to succeed, the Second Circuit's materiality approach would have a particularly powerful and distorting effect on claims involving professional standards or practices that are brought under the other provisions, because such claims do not require certain elements that are required by Section 10(b) and Rule 10b-5 and that can pose independent barriers to asserting violations of the securities laws. See Matthew

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[2] That list is not exclusive, as plaintiffs may argue that the Second Circuit's holding should extend to other statutes as well. Various statutes protecting shareholder interests likewise have a materiality requirement that overlaps with the materiality requirement in Section 10(b) and Rule 10b-5. See *In re NAHC, Inc. Securities Litig.*, 306 F.3d 1314, 1331 (3d Cir. 2002) ("This definition of materiality is the same for both § 10(b) and § 14(a) claims."); *Greenfield* v. *Flying Diamond Oil Corp.*, 1980 WL 1376, *7 (S.D.N.Y. Feb. 26, 1980) ("The considerations of * * * materiality * * * apply with equal force to section 10(b) and section 14(e)."). Plaintiffs can assert claims under those shareholder-protective laws to challenge a false statement of compliance with a standard or practice in documents provided to shareholders, such as following certain analyses for fairness opinions. See generally *Varjabedian* v. *Emulex*, 888 F.3d 399, 402 (9th Cir. 2018) (describing statement with summary of "the processes" that were "followed" when "rendering [a fairness] opinion").

Joonho Jeon, *Broker-Dealer Responsibility in Regulation D Transactions*, 17 Fordham Urban L.J. 63, 66 (1988) ("an aggrieved purchaser who cannot prove" an element under Section 10(b) and Rule 10b-5 "may seek relief under [S]ection 11" and Section 12(a)(2)). In that scenario, application of the Second Circuit's materiality holding could well be the deciding factor as to whether claims under Sections 11(a), 12(a)(2), and 18 are able to move forward.

A closer examination of those provisions demonstrates the effect that the holding below could have outside of the Section 10(b) and Rule 10b-5 context:

Sections 11(a) and 12(a)(2) of the Securities Act. Sections 11(a) and 12(a)(2) are "Securities Act siblings with roughly parallel elements." *In re Morgan Stanley Info. Fund Securities Litig.*, 592 F.3d 347, 359 (2d Cir. 2010); see 15 U.S.C. 77k(a); 15 U.S.C. 77*l*(a)(2). Section 11(a) provides a cause of action for purchasers of securities to sue over material misstatements and omissions in "registration statement[s]." 15 U.S.C. 77k(a). Section 12(a)(2) permits suits over securities purchases made "pursuant to a materially false or misleading 'prospectus or oral communication.'" *In re Adams Golf, Inc. Securities Litig.*, 381 F.3d 267, 273 (3d Cir. 2004).

Plaintiffs are likely to argue that the Second Circuit's approach to materiality under Section 10(b) and Rule 10b-5 in the decision below should also govern in cases arising under Sections 11(a) and 12(a)(2) that involve a statement of compliance with an accepted professional standard or practice. Courts have treated the materiality requirement under Sections 11(a) and 12(a)(2) the same way that they have treated the materiality requirement under Section 10(b) and Rule 10b-5. See, *e.g.*, *In re Donald J. Trump Casino Securities Litig.–Taj Mahal Litig.*, 7 F.3d 357, 369 (3d Cir.

1993) (observing that the same materiality standard applies across Section 10(b), Rule 10b-5, Section 11(a), and Section 12(a)(2)); *Rombach* v. *Chang*, 355 F.3d 164, 178 n.11 (2d Cir. 2004) (same). And the types of documents containing misstatements that plaintiffs may sue over under Sections 11(a) and 12(a)(2) include statements regarding compliance with accepted professional standards or practices. See, *e.g.*, *In re SunEdison, Inc. Securities Litig.*, 300 F. Supp. 3d 444, 498 (S.D.N.Y. 2018) (Section 11 claim focused on statement of compliance with auditing standards); *In re AOL Time Warner, Inc. Securities and "ERISA" Litig.*, 381 F. Supp. 2d 192, 216 (S.D.N.Y. 2004) (same under Section 12).

But there is one important difference between claims under Section 10(b) and Rule 10b-5 and claims under Sections 11(a) and 12(a)(2): the latter claims "do not require a showing of scienter, reliance, or loss causation, and require Plaintiffs to show only that Defendants issued or signed a registration statement containing an untrue statement of a material fact" or an omission of a material fact. *Tongue* v. *Sanofi*, 816 F.3d 199, 209 (2d Cir. 2016) (internal quotation marks omitted). In other words, Section 11(a) and 12(a)(2) claims lack many of the elements of Section 10(b) and Rule 10b-5 claims—which means that whether the statement at issue is material is a central question under Sections 11(a) and 12(a)(2). As one court of appeals put it, as to such claims "[t]he crucial questions are: '[W]as there a misrepresentation? And, if so, was it objectively material?'" *In re Constar Int'l Inc. Securities Litig.*, 585 F.3d 774, 784 (3d Cir. 2009).

Accordingly, if the Second Circuit's materiality holding were applied to Sections 11(a) and 12(a)(2), that would make an enormous difference to the disposition of claims brought under those statutes. If such a claim

is based on a misstatement about compliance with some professional standard or practice, a plaintiff would, as a practical matter, have to adequately allege or establish only a single element: a factual misrepresentation or omission. A plaintiff would have virtually no burden regarding materiality, because it would not matter how minor the deviation from the relevant standard or practice actually was or what effect the deviation had in the real world. The Second Circuit's approach to materiality thus could often be the decisive factor in whether a Section 11(a) or 12(a)(2) claim goes forward—because elements like scienter that might pose an independent obstacle for plaintiffs simply are not a required part of claims under those provisions.

Section 18 of the Exchange Act. Section 18 of the Exchange Act permits suits for damages from the purchase or sale of a security in reliance on false or misleading statements of material fact contained in certain "document[s] or report[s] filed with the SEC pursuant to the Exchange Act." *In re Suprema Specialties, Inc. Securities Litig.*, 438 F.3d 256, 283 (3d Cir. 2006); see 15 U.S.C. 78r.

Once again, plaintiffs in other cases could argue that the materiality holding in the decision below should apply to claims brought under Section 18 involving alleged noncompliance with professional standards and practices. As is true of Sections 11(a) and 12(a)(2), Section 18 has a materiality standard that has been treated identically to the materiality standard under Section 10(b) and Rule 10b-5. See *In re Sanofi Securities Litig.*, 87 F. Supp. 3d 510, 526-528 (S.D.N.Y. 2015) (treating materiality under Section 18 the same as under Section 10(b)). And the documents and reports covered by Section 18 include statements regarding compliance with accepted standards or practices. See *Deephaven Private Placement Trading, Ltd.* v. *Grant*

Thornton & Co., 454 F.3d 1168, 1175 (10th Cir. 2006) (Section 18 case involving document "stat[ing] that [auditor] conducted its audits in accordance with GAAS").

The elements of a Section 18 claim are not quite as distinct from the elements of a claim under Section 10(b) and Rule 10b-5 as are the elements of a claim under Sections 11(a) or 12(a)(2)—but there is one important way in which a Section 18 claim is far easier to plead and prove than a claim under Section 10(b) and Rule 10b-5. Plaintiffs proceeding under Section 18 "bear[] no burden of proving that the defendant acted with scienter or any particular state of mind." *In re Suprema*, 438 F.3d at 283. By contrast, plaintiffs proceeding under Section 10(b) and Rule 10b-5 must plead with particularity facts giving rise to a strong inference of the requisite state of mind—and, of course, must ultimately prove scienter. See *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 321 (2007) (setting forth what plaintiffs must plead regarding scienter). Notably, that scienter requirement is "a significant obstacle to obtaining a recovery" under Section 10(b) and Rule 10b-5. Larry A. Cerutti, *SEC Rule 10b-16: Should the Federal Courts Allow Sophisticated Investors to Recover?*, 18 Pac. L.J. 171, 189 (1986).

Again, then, if the Second Circuit's materiality holding were extended to Section 18 claims, that would make an outsized difference in how those claims are litigated and would make them much more plaintiff-friendly than they had previously been. The scienter requirement may independently bar a claim under Section 10(b) and Rule 10b-5 in a case in which the Second Circuit's materiality holding applies, but the same cannot happen with a Section 18 claim.

B. The Second Circuit's Materiality Holding Could Be Applied To Many Different Kinds of Statements In Investor-Facing Materials Of Compliance With Accepted Professional Standards Or Practices

The Second Circuit addressed a particular kind of alleged misstatement—namely, BDO's statement of compliance with PCAOB standards. App.34a. But there are many other kinds of statements of compliance with accepted professional standards or practices that appear in investor-facing documents and that investors may target in a lawsuit under Section 10(b) and Rule 10b-5 or under the various other securities laws discussed above. Pet.23. Numerous statements by experts such as appraisers, actuaries, lawyers, engineers, and others at least impliedly—and often expressly—represent that the expert has adhered to some applicable standard or otherwise used a sound method. See, *e.g.*, *Kitchens* v. *U.S. Shelter*, 1988 WL 108598, at *30 (D.S.C. June 30, 1988) (stating in a securities case that "the mere fact that an expert makes a report constitutes a representation *that it is based upon sound methods*" and that "failure to observe the methods and standards which the expert expressly or impliedly purports to adopt will result in a misrepresentation of fact").

Plaintiffs in other cases could argue that the Second Circuit's materiality holding extends to those other kinds of statements. Accordingly, if this Court leaves the decision below in place, the Second Circuit's decision could reverberate far beyond the factual scenario presented here—not only in cases that arise in that Circuit but also in cases that arise in other courts that choose to follow in the Second Circuit's footsteps.

Some examples of statements that could be affected by the Second Circuit's holding are the following:

Accounting standards. As BDO's petition explains, plaintiffs often bring claims under the securities laws challenging statements of compliance with Generally Accepted Accounting Principles (GAAP). See Pet.12-19 (citing *Adams* v. *Standard Knitting Mills, Inc.*, 623 F.2d 422 (6th Cir. 1980); *In re Stone & Webster, Inc.*, 414 F.3d 187 (1st Cir. 2005); *In re Daou Systems, Inc.*, 411 F.3d 1006 (9th Cir. 2005)).

Plaintiffs in such cases could argue that the Second Circuit's holding should apply to those kinds of claims just as it applies to the claims relating to PCAOB standards that are at issue here. If that argument were to succeed, then statements of compliance with GAAP would be treated as material in resolving securities-law claims.

Valuation procedures. Another statement that may be the subject of a securities claim is a statement of compliance with appropriate or accepted valuation procedures. Numerous securities-law suits have been premised on allegedly false statements involving such procedures. See, *e.g.*, *Pension Committee of Univ. of Montreal Pension Plan* v. *Banc of America Securities, LLC*, 446 F. Supp. 2d 163, 173 (S.D.N.Y. 2006) (allegations involving "false statements about the[] procedures for ensuring accurate valuations of the Funds," which purportedly were not followed); *In re Lehman Bros. Securities and ERISA Litig.*, 799 F. Supp. 2d 258, 311 (S.D.N.Y. 2011) (allegation that statement "that Lehman adopted SFAS 157 for determining 'fair value'" was "materially false and misleading"); *FDIC* v. *RBS Acceptance Inc.*, 611 F. Supp. 3d 1089, 1094 (D. Colo. 2020) (allegations regarding prospectus supplement stating that "[e]very mortgage loan [was] se-

cured by a property that ha[d] been appraised by a licensed appraiser in accordance with the Uniform Standards of Professional Appraisal Practice [("USPAP")] of the Appraisal Foundation").

Plaintiffs could try to extend the Second Circuit's materiality holding to encompass such suits—thus making those suits easier for plaintiffs to assert and to win, even if the valuation-procedure mistake is an exceedingly minor one that causes no one any harm. The fact pattern in *Kitchens* provides a useful example of how an extension of the Second Circuit's decision could meaningfully alter the course of such suits. That case involved a prospectus statement "represent[ing] that the $5.50" per share valuation "had been determined properly by using a valuation process that was appropriate for the industry." 1988 WL 108598, at *30; see *ibid.* (explaining the prospectus contained a "representation that the valuation was done in accordance with generally accepted valuation procedures"); *ibid.* (discussing "representation that this valuation was done in a proper way appropriate for the industry"). The court found that the valuation was *not* conducted under a "method that was appropriate to the industry" and that the value of the shares was actually "substantially *less* than $5.50 per share." *Id.* at *32 (emphasis added).

On that basis, the district court concluded that the prospectus's representation about following appropriate and generally accepted valuation procedures was material under Section 11 of the Securities Act. 1988 WL 108598, at *33. Notably, the court found materiality only *after* ascertaining that failure to follow the appropriate valuation method meant that the value of the shares stated in the prospectus was inflated. In the court's view, the fact that the actual value of the shares was lower than stated "would have been viewed

by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic*, 485 U.S. at 231-232 (citation omitted); see *Freedman* v. *Value Health, Inc.*, 2000 WL 630916, at *5 (D. Conn. Mar. 24, 2000) (permitting securities-law claim alleging failure to disclose facts that "would materially impact the price of [the company's] shares" (citation omitted)).

If the Second Circuit's misguided decision were to be extended to this context, however, the alleged misstatement in *Kitchens*—that a particular valuation procedure was followed when in fact it was not—would be deemed material *even if* a court found that the failure to follow valuation procedures *did not* affect the value of the shares in any way. It would be enough for materiality that disclosure of the omitted fact (i.e., failing to comply with an appropriate valuation procedure) "would have alerted investors to potential problems" with the valuation at issue and that the misstatement of compliance would have "subjected unknowing investors to the risk that" the company's valuation was "unreliable." App.36a.

Loss-reserves estimates. Insurance companies "promise to pay clients' claims resulting from insured events, such as sickness or accidents." Noah A. Gold, *Corporate Criminal Liability: Cooperate, and You Won't Be Indicted*, 8 Geo. J. L. & Pub. Pol'y 147, 149 (2010). "To account for the risks they take on and the inevitable payments they will have to make to clients, insurance companies set aside a certain fraction of all premiums as 'loss reserves.'" *Ibid.*

Securities lawsuits have targeted statements about the actuarial methodologies that insurance companies use to estimate loss reserves. Some such suits have been dismissed on the ground that there is not a suffi-

cient allegation or sufficient showing that the statements in question were false. See *Malin* v. *XL Capital Ltd.*, 499 F. Supp. 2d 117, 137, 145-146 (D. Conn. 2007) (plaintiffs alleged that a company stated that it had a certain methodology for estimating loss reserves but that the company's "own actuarial and accounting policies were not" in fact "followed," and the court dismissed the claim on the ground that there was "no evidence" that those policies were not complied with); *Woolgar* v. *Kingstone Companies, Inc.*, 477 F. Supp. 3d 193, 215, 231-232 (S.D.N.Y. 2020) (plaintiffs alleged that an insurance company's SEC filings "falsely stated * * * that the Company's loss reserve process used standard actuarial reserving methodologies, considering all information known to [the Company] as of the date recorded," but the court concluded that the allegations were not sufficient to show falsity (internal quotation marks omitted)).

But not every case involving claims of false statements about loss-reserve methodologies will be so easily disposed of—which means that materiality questions may come to the fore and make the difference between an early dismissal and a burdensome summary-judgment and trial process. Where plaintiffs do sufficiently allege that a company's statement about its compliance with a particular actuarial methodology to estimate loss reserves was false because that methodology was not in fact followed, plaintiffs also may argue that the court should apply the approach taken by the Second Circuit in this case to conclude that the statement is material—even if nothing about the loss-reserve estimates would have changed if the company had adhered perfectly to the relevant methodology. And if that argument were accepted, all that would matter is that, if the allegedly false statement was re-

placed with a statement that the actuarial methodology was not followed, investors would have been "alerted * * * to potential problems in the company's" loss-reserve estimates, App.36a—which are "a 'key indicator' in evaluating a company's financial condition," Gold, 8 Geo. J. L. & Pub. Pol'y at 150.

Underwriting practices. Plaintiffs also frequently bring securities-law claims alleging misstatements about following certain underwriting practices. See, *e.g.*, *In re New Century*, 588 F. Supp. 2d 1206, 1226 (C.D. Cal. 2008) (describing allegations that defendants made "statements that [the company] observed standards of high-quality credit and underwriting" and that the company's actual "practices * * * utterly failed to meet those standards"); *Atlas* v. *Accredited Home Lenders Holding Co.*, 556 F. Supp. 2d 1142, 1154 (S.D. Cal. 2008) (allegations that defendants made statements about the company's underwriting practices that were "false and misleading," because "[d]efendants had caused [the company] to deviate from the company's publicly professed standards"); *Waterford Township Police & Fire Retirement Sys.* v. *Regional Management Corp.*, 2016 WL 1261135, at *2 (S.D.N.Y. Mar. 30, 2016) (allegations that statement in SEC filings about "sound underwriting standards" were untrue); *Lloyd* v. *CVB Fin. Corp.*, 2012 WL 12883522, at *20 (C.D. Cal. Jan. 12, 2012) ("Plaintiffs also allege that defendants made numerous false statements regarding their loan underwriting practices.").

Plaintiffs asserting such claims could argue that the Second Circuit's materiality holding should extend beyond the PCAOB-standard misstatements alleged in this case to statements about underwriting practices. Again, if that argument were to succeed, that could

change the result in an appreciable number of underwriting-practice cases. The fact pattern in *SEC* v. *Mozilo*, 2009 WL 3807124 (C.D. Cal. Nov. 3, 2009), illustrates why that is so. In that case, the SEC alleged that the defendants "made misleading statements of material fact regarding the quality of" a mortgage lender's "underwriting systems"—in particular, that the defendants made statements about the lender's use of "proprietary underwriting systems" when defendants were aware that the lender "was originating * * * increasing percentages of poor quality, subprime loans that did not comply with [the lender's] already lax underwriting guidelines." *Id.* at *4, 10; see *id.* at *11 (discussing allegations of "the virtual abandonment of prudent underwriting guidelines and the resulting proliferation of poor quality loans, during the same period [the lender] was touting the superior quality of its underwriting guidelines and its loan portfolio").

The district court in *Mozilo* ruled that the SEC adequately alleged that the statements were not only "false and misleading" but also material, because the lender's "core business * * * admittedly depended upon the quality of its loan production" and investors therefore would consider the "poor quality of [the lender's] underwriting practices and loan portfolio" important. 2009 WL 3807124, at *11. In other words, it was not enough for materiality that the defendants simply made statements about using certain underwriting practices that were allegedly false. Rather, the alleged statements were material because they affected the lender's loan portfolio, upon which its business depended—meaning that investors would care very much about the statements as part of the total mix of information available. *Ibid.*

But if the Second Circuit's misguided holding were extended to this context, it simply would not matter for materiality purposes whether those statements about underwriting practices misleadingly papered over a major weakness in the lender's business or instead related only to minor mistakes or missteps in underwriting practices that had no effect on the lender's business. The alleged statements would be material, with nothing more required from the plaintiffs than a mere "risk" of "unreliab[ility]." App.36a.

Legal compliance. Statements regarding legal compliance are frequent targets of securities lawsuits. Such statements represent that a company believes that it is complying with certain applicable laws. See, *e.g.*, *In re Lottery.com, Inc. Securities Litig.*, 715 F. Supp. 3d 506, 551 (S.D.N.Y. 2024) (statement in annual report by company "that—although it could not 'ensure that [its] activities * * * w[ould] not become the subject of regulatory or law enforcement proceedings'" the company "believe[d] that [it was] in compliance with all material domestic and international laws and regulatory requirements" (citation omitted)); *City of Westland Police and Fire Retirement Sys.* v. *MetLife, Inc.*, 129 F. Supp. 3d 48, 81 (S.D.N.Y. 2015) (statement in three SEC filings that "[w]e believe that any allegations that information about [our retained asset accounts] is not adequately disclosed or that the accounts are fraudulent or otherwise violate state or federal laws are without merit" (citation and emphasis omitted)).

Such statements may be deemed false in circumstances in which the company has not undertaken any meaningful legal analysis with the assistance of counsel. In *Omnicare, Inc.* v. *Laborers District Council Construction Industry Pension Fund*, 575 U.S. 175

(2015), this Court considered a portion of a "registration statement" expressing a company's "view of its compliance with legal requirements." *Id.* at 179; see *id.* at 179-180 (company stated that it believed its contract arrangements with certain parties "are in compliance with applicable federal and state laws," and that its contracts with pharmaceutical managers "are legally and economically valid arrangements"). The Court explained that statements of legal compliance impliedly represent that the company has "consulted a lawyer" and that the lawyer has undertaken "some meaningful legal inquiry." *Id.* at 188; see *Weiss* v. *SEC*, 468 F.3d 849, 855 (D.C. Cir. 2006) (reasoning that a legal opinion "includes an implied representation that the speaker rendered the opinion * * * with a reasonable basis," *i.e.*, that the speaker conducted "a reasonably sufficient examination of material legal and factual sources and [had] reasonable certainty as to the subjects addressed therein"). In this Court's view, statements of legal compliance "could be misleadingly incomplete" if the company did not in fact consult a lawyer or relied on "mere intuition" instead of a "meaningful legal inquiry." *Omnicare*, 575 U.S. at 188.

If the Second Circuit's materiality holding remains on the books, plaintiffs may well argue that it extends to statements of legal compliance. And if the holding were applied in the legal-compliance context, then the burden of proof for plaintiffs alleging that a company violated the securities laws when it represented legal compliance despite undertaking no meaningful legal inquiry would be significantly lightened. Such a representation would be treated as material, regardless of whether a more thorough legal inquiry would have made any difference to the *substance* of the statement

of legal compliance and regardless of whether the company was *in fact* complying with the relevant law.

II. The Second Circuit's Materiality Holding Will Increase The Cost Of Business And Harm The Economy

This Court has repeatedly recognized that if "[p]rivate securities fraud actions" are "not adequately contained," they "can be employed abusively to impose substantial costs on companies and individuals." *Tellabs*, 551 U.S. at 313. And it has specifically recognized the need to strike an appropriate balance in defining the materiality requirement imposed by various securities laws. As the Court has explained, "if the standard of materiality is unnecessarily low, * * * the corporation and its management [may] be subjected to liability for insignificant omissions or misstatements." *TSC*, 426 U.S. at 448; see *Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 38 (2011) (Court has been "careful not to set too low a standard of materiality" (citation omitted)).

"Precisely these dangers are presented" by the Second Circuit's holding that a statement of compliance with PCAOB standards is material, even if there is no effect on the substance of the audit opinion. *TSC*, 426 U.S. at 449. As BDO's petition explains, the Second Circuit's decision expands potential liability for auditors who certify compliance with PCAOB standards but make technical or minor mistakes that do not affect the outcome of the audit. Pet.20. And for all of the reasons explained above, that significant expansion of potential liability could affect not just outside auditors like BDO but also appraisers, actuaries, lawyers, and other experts who assert in investor-facing materials their compliance with an accepted professional standard or practice. See pp. 10-19, *supra*.

The resulting burden could be immense. The threat of damages liability under Section 10(b) and Rule 10b-5 as well as under other securities laws can be crushing. See, *e.g.*, Alan S. Ritchie, *The Proposed "Securities Private Enforcement Reform Act": The Introduction of Proportionate Liability Into Rule 10b-5 Litigation*, 42 Clev. St. L. Rev. 339, 351 (1994) (explaining the potential for liability "for huge amounts of damages in class actions by shareholders" in "Rule 10b-5 litigation"); *In re Clearly Canadian Securities Litig.*, 1999 WL 707737, at *5 (N.D. Cal. Sept. 3, 1999) (criticizing "irrational damage awards"). What is more, defendants in securities cases are forced "to expend large sums even for pretrial defense." *Central Bank*, 511 U.S. at 189 (discussing Rule 10b-5 litigation).

With the Second Circuit's materiality holding smoothing the way for plaintiffs to survive a motion to dismiss and even a motion for summary judgment, there will be tremendous pressure on "defendants * * * to favor settlement over trial," Ritchie, 42 Clev. St. L. Rev. at 351—including in cases involving claims of insubstantial misstatements that did not harm investors. As this Court has explained, "[t]he extensive discovery and the potential for uncertainty and disruption" in a securities suit can "allow plaintiffs with weak claims to extort settlements from innocent companies." *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta*, 552 U.S. 148, 163 (2008) (declining to expand reach of Section 10(b) and Rule 10b-5 private right of action). Even if a defendant has "substantial defenses," it may prudently choose to "abandon" them and settle "in order to avoid the expense and risk of going to trial." *Central Bank*, 511 U.S. at 189.

The end result would be to "frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Blue Chip Stamps* v. *Manor*

Drug Stores, 421 U.S. 723, 740 (1975). The "increased costs incurred by professionals" like auditors "because of the litigation and settlement costs under" securities laws "may be passed on to their client companies." *Central Bank*, 511 U.S. at 189. In turn, those costs would be "incurred by the company's investors," who are supposed to be the "intended *beneficiaries*" of securities laws. *Ibid.* (emphasis added). Accordingly, the Second Circuit's holding would increase the costs of doing business, with no corresponding benefit—only a windfall to plaintiffs who are effectively relieved of the burden of pleading and proving an essential element of their claim. See Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 Duke L.J. 945, 948 (1993).

Those effects would be particularly pronounced because of the Second Circuit's outsized importance in the field of securities law. Venue will often lie in the Second Circuit in securities cases, and a "high volume of securities fraud cases" are brought there. Barbara L. Trencher & Niall O'Hegarty, 'Apuzzo' *Invites Aiding and Abetting Securities Fraud Enforcement Actions*, at 2, N.Y.L.J. (Sept. 19, 2012); see Pet.24-25. Courts outside the Second Circuit "routinely look" to the resulting body of caselaw "for guidance." Trencher & O'Hegarty, *supra.* And that is so even when the Second Circuit issues a dubious decision. See, *e.g.*, *Morrison* v. *National Australia Bank Ltd.*, 561 U.S. 247, 260 (2010) (describing D.C. Circuit deferring to the Second Circuit due to its "preeminence in the field of securities law"); see *id.* at 276 (Stevens, J., concurring) (describing Second Circuit as "[t]he Mother Court of securities law"). This Court's review is therefore urgently warranted.

CONCLUSION

For the foregoing reasons and those stated by BDO, the Court should grant the petition.

Respectfully submitted,

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