No. 20-15564

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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

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; MARTIN WINTERKORN,

Defendants-Appellants.

Appeal from the United States District Court for the Northern District of California, No. 3:15-md-02672-CRB, Hon. Charles R. Breyer

MOTION OF AMICI CURIAE THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, AND THE ALLIANCE FOR AUTOMOTIVE INNOVATION FOR LEAVE TO FILE AMICUS BRIEF IN SUPPORT OF DEFENDANTS-APPELLANTS

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Pursuant to Federal Rule of Appellate Procedure 29(a), proposed amici curiae the Chamber of Commerce of the United States of America ("Chamber"), the Securities Industry and Financial Markets Association ("SIFMA"), and the Alliance for Automotive Innovation respectfully move the Court to grant leave to file the attached brief. Amici previously sought and received leave from this Court to file a brief in support of Defendants-Appellants' petition to appeal. Defendants Appellants have consented to the filing of this brief. Plaintiff-Appellee Puerto Rico Government Employees and Judiciary Retirement Systems Administration, however, has advised amici that it does not consent. Amici thus seek this Court's leave to file their brief.

The Chamber is the world's largest business federation. It represents approximately 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 the courts, Congress, and the Executive Branch. To that end, the Chamber regularly files amicus briefs in cases, including securities appeals like this one, that raise issues of concern to the nation's business community. *E.g.*, *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019) (joint brief with SIFMA).

SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of the industry's nearly one million employees, SIFMA advocates on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. SIFMA serves as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. SIFMA also provides a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, DC, is the U.S. regional member of the Global Financial Markets Association ("GFMA"). For more information, visit http://www.sifma.org.

Formed in 2020, the Alliance for Automotive Innovation is the singular, authoritative, and respected voice of the automotive industry. Focused on creating a safe and transformative path for sustainable industry growth, the Alliance for Automotive Innovation represents the manufacturers producing nearly 99 percent of cars and light trucks sold in the U.S. The newly established organization, a combination of the Association of Global Automakers and the Alliance of Automobile Manufacturers, is directly involved in regulatory and policy matters affecting the light-duty vehicle market across the country. Members include motor vehicle manufacturers, original equipment suppliers, as well as technology and other automotive-related companies. The Alliance for Automotive Innovation is headquartered in Washington, DC, with offices in Detroit, MI and Sacramento, CA. For more information, visit http://www.autosinnovate.org.

As this Court recognized when it granted amici's motion to participate at the petition stage, amici have a strong interest in this case. Many of amici's members are subject to the U.S. securities laws, and they would be adversely affected were this Court to affirm the district court's expansion of the *Affiliated Ute* presumption of reliance. Under the district court's approach, securities-fraud plaintiffs would be able to avoid their obligation to prove reliance on the defendant's purportedly misleading statements simply by characterizing their claims as focused on the defendant's corresponding "omissions." The result would be to make class certification a near certainty in all such cases, while simultaneously depriving defendants of an otherwise-available defense. Amici have long been concerned about the costs that securities class actions impose on the American economy. Any expansion of *Affiliated Ute* would threaten to further increase those costs.

Amici's proposed brief will also help this Court. Given their broad and diverse membership, amici are particularly able to assess the degree to which a judicial decision will affect both future cases and business interests more generally. As the proposed brief details, this Court's affirmance of the decision below would likely contribute to what has already been a significant increase in costly class-action securities-fraud litigation. Amici are well-positioned to explain how this increased litigation has a detrimental effect on *all* U.S. public companies and investors, not just defendants in securities suits.

For these reasons, amici respectfully request that the Court grant leave to file the accompanying brief in support of Defendants-Appellants.

Dated: July 17, 2020

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this motion complies with the length limits of Ninth Circuit Rule 27-1 because this motion contains 704 words excluding those parts authorized by Fed. R. App. P. 32(f), which, when divided by 280 as provided by Ninth Circuit Rule 32-3, yields a page count less than or equal to twenty pages as required by Ninth Circuit Rule 27-1(1)(d).

I further certify that this motion complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this motion has been prepared in a proportionally spaced typeface using Microsoft Word 2016 in Times New Roman 14-point font.

Dated: July 17, 2020

s/ Deanne E. Maynard
Deanne E. Maynard

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the CM/ECF system on July 17, 2020.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

Dated: July 17, 2020

s/ Deanne E. Maynard
Deanne E. Maynard

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Defendants-Appellants.

Appeal from the United States District Court for the Northern District of California, No. 3:15-md-02672-CRB, Hon. Charles R. Breyer

BRIEF OF CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, AND THE ALLIANCE FOR AUTOMOTIVE INNOVATION AS AMICI CURIAE SUPPORTING APPELLANTS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, amici certify the following:

The Chamber of Commerce of the United States of America is a non-profit business federation. The Chamber has no parent corporation, and no publicly held corporation owns 10 percent or more of its stock.

The Securities Industry and Financial Markets Association has no parent corporation, and no publicly held corporation owns 10 percent or more of its stock.

The Alliance for Automotive Innovation is a non-profit trade association. It has no parent corporation, and no publicly held corporation owns 10 percent or more of its stock.

Dated: July 17, 2020

s/ Deanne E. Maynard
Deanne E. Maynard

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INTEREST OF AMICI CURIAE[1]

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. It represents approximately 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 the courts, Congress, and the Executive Branch. To that end, the Chamber regularly files amicus briefs in cases, like this one, that raise issues of concern to the nation's business community.

The Securities Industry and Financial Markets Association ("SIFMA") is the leading trade association for broker-dealers, investment banks, and asset managers operating in the United States and global capital markets. On behalf of the industry's nearly one million employees, SIFMA advocates on legislation, regulation, and business policy affecting retail and institutional investors, equity and fixed income markets, and related products and services.

The Alliance for Automotive Innovation is a non-profit trade association representing the manufacturers, tier-one suppliers, and value-chain partners that

[1] Pursuant to Rule 29(a)(4)(E), amici affirm that no counsel for a party authored this brief in whole or in part and that no person other than amici, their members, or their counsel made any monetary contributions intended to fund the preparation or submission of this brief.

produce nearly 99 percent of all cars and light-duty trucks sold in the United States. The Alliance for Automotive Innovation was formed in January 2020 by the combination of the nation's two largest automobile associations, the Association of Global Automakers and the Alliance of Automobile Manufacturers.

Amici have a strong interest in this important case. Many of amici's members are subject to the U.S. securities laws, and they will be adversely affected by an expansion of the *Affiliated Ute* presumption of reliance. Amici have long been concerned about the costs that securities class actions impose on the American economy. If affirmed, the district court's decision threatens to further increase those costs.

INTRODUCTION AND SUMMARY OF ARGUMENT

Reliance on a defendant's alleged deception is an "essential element" of securities fraud. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159 (2008). There can be no liability without "the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury." *Id*. (quotation marks omitted).

In *Affiliated Ute Citizens of Utah v. United States*, the Supreme Court recognized a narrow exception to a plaintiff's obligation to prove such reliance. 406 U.S. 128 (1972). Courts may presume reliance where a plaintiff's theory of liability rests on (1) an omission, rather than an affirmative statement, (2) by a defendant who has breached a special duty of disclosure owed to the plaintiff. *Id.* at 153-54. If either condition is absent, the exception does not apply, and (absent another presumption) the plaintiff must affirmatively prove it in fact relied on the challenged statements.

Yet the district court here absolved the plaintiff of its obligation to satisfy this reliance requirement. In doing so, the court ventured far beyond *Affiliated Ute*'s narrow bounds. The court presumed reliance on what were ultimately alleged *misstatements*—not omissions—made by a party without any special duty of disclosure to the plaintiff. That outcome effectively writes the reliance requirement out of securities law.

Left undisturbed, the district court's decision would swell the already rising tide of securities fraud class actions, which have increased dramatically in recent years. Driven by new trends in headline-inspired litigation—and seeking to capitalize on the pressure even innocent companies feel to settle—these suits are bigger and more costly than ever before. Accepting the district court's expansion of *Affiliated Ute* would further accelerate this trend by making class certification a near certainty in many additional cases and depriving defendants of an otherwise-available defense. Neither private industry nor the public benefit from such speculative suits brought to extract settlements in the face of potentially massive damage awards. To the contrary, the recent surge in securities class actions has harmed American businesses and investors alike by increasing the costs of insurance premiums and forcing companies to hold in reserve funds that might otherwise be devoted to capital expenditures. These problems may only worsen given the current economic uncertainty. This Court should reverse.

ARGUMENT

I. THE DISTRICT COURT MISAPPLIED THE NARROW *AFFILIATED UTE* EXCEPTION TO THE RELIANCE REQUIREMENT

A. The *Affiliated Ute* Presumption Applies Only To Omissions In Breach Of A Special Duty To Disclose

Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b–5 prohibit making a material misstatement or omission in connection with the purchase or sale of a security. 15 U.S.C. § 78m; 17 C.F.R. § 240.10b-5. To recover for a violation of section 10(b) and Rule 10b–5, a plaintiff must prove, among other things, "a material misrepresentation or omission by the defendant" and "reliance upon the misrepresentation or omission." *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455, 460-61 (2013).

Requiring "proof of reliance ensures that there is a proper 'connection between a defendant's misrepresentation and a plaintiff's injury.'" *Erica P. John Fund, Inc. v. Halliburton Co.*, 563 U.S. 804, 810 (2011) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988)). "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." *Id.*

The application of this reliance requirement depends, in part, on the nature of the plaintiff's claims—specifically, whether plaintiff is challenging a defendant's statements or instead its failure to speak. In general, only a defendant's statements can give rise to liability. *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44-45 (2011). Thus, under Rule 10b–5(b), the failure to affirmatively provide information is fraudulent only where disclosure is needed "'to make the statements *made*, in light of the circumstances under which they were made, not misleading.'" *Retail Wholesale & Dep't Store Union Local 338 Ret. Fund v. Hewlett-Packard Co.*, 845

F.3d 1268, 1278 (9th Cir. 2017) (emphasis added) (quoting Rule 10b–5); *see Brody v. Transitional Hospitals Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002) (Rule 10b–5 does not "contain[] a freestanding completeness requirement; the requirement is that any public statements companies make that could affect security sales or tender offers not be misleading or untrue."). Omissions, standing alone, are actionable only if the defendant has a "duty to disclose." *Matrixx*, 563 U.S. at 44. Such a duty "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). Companies have no general "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).

In *Affiliated Ute*, the Supreme Court held that, for a narrow category of omissions claims, courts may presume reliance rather than require a plaintiff to prove it. 406 U.S. at 153. There, members of the Ute Indian tribe brought securities fraud claims against a bank that had been designated as a transfer agent for the stock of a corporation formed to manage tribal assets. *Id.* at 136-37. The bank and the tribe members were in a special relationship, as the bank had agreed to advise and act on their behalf when it sold their stock. *Id.* at 152. But two assistant managers induced tribe members to sell their shares without disclosing that the bank employees were personally profiting from the sales or that the shares were selling for a higher price on a secondary resale market. *Id.* at 153. Because the bank employees owed an "affirmative duty" to the sellers, and the case "involv[ed] primarily a failure to disclose," the Court concluded that "positive proof of reliance is not a prerequisite to recovery." *Id.*

Affiliated Ute thus held that courts may presume reliance where (1) a plaintiff's case turns on the defendant's nondisclosure, not the defendant's statements, and (2) a special relationship of trust imposed a duty to disclose on the defendant. *Id.* If either requirement is absent, the plaintiff must demonstrate reliance through traditional means of proof. Both requirements for invoking the presumption follow directly from the logic that justifies this narrow exception.

First, the *Affiliated Ute* presumption of reliance is limited to omissions cases because, like the fraud-on-the-market presumption, it "serve[s] to assist courts in managing circumstances in which direct proof, for one reason or another, is rendered difficult." *Basic*, 485 U.S. at 245. Courts have "embraced the [*Affiliated Ute*] presumption because of the difficulty of proving 'a speculative negative'—that the plaintiff relied on what was not said." *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999). No such evidentiary difficulties arise in cases where a plaintiff alleges affirmative misstatements: if a plaintiff claims that a defendant's statements were false or rendered misleading by other facts that the defendant failed to disclose, the plaintiff may show that it in fact relied on those challenged statements.

This Court has recognized as much. Specifically, it has "maintained 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 v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009). Accordingly, *Affiliated Ute* does not apply "to cases that allege both misstatements and omissions unless the case can be characterized as one that primarily alleges omissions." *Binder*, 184 F.3d at 1064. In so holding, this Court has joined numerous other circuits, which have likewise recognized that the presumption applies only where "reliance as a practical matter is impossible to prove" because "no positive statements exist." *Waggoner v. Barclays PLC*, 875 F.3d 79, 95 (2d Cir. 2017); *see also In re Interbank Funding Corp. Sec. Litig.*, 629 F.3d 213, 215 (D.C. Cir. 2010); *Cox v. Collins*, 7 F.3d 394, 395-96 (4th Cir. 1993); *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356 (5th Cir. 1987); *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749, 756-57 (11th Cir. 1984).

This distinction reflects the structure of Rule 10b–5 itself. Subsections (a) and (c) prohibit "any device, scheme, or artifice to defraud" and any fraudulent "act, practice, or course of business." 17 C.F.R. § 240.10b-5(a), (c). Such schemes include fraudulent nondisclosure in violation of a special duty to disclose. *See Affiliated Ute*, 406 U.S. at 152-53. By contrast, subsection (b)—which plaintiff has invoked here—targets affirmative misstatements and ancillary omissions that make those statements misleading. 17 C.F.R. § 240.10b-5(b). Because a claim under this subsection "always rests upon an affirmative statement of some sort," the *Affiliated Ute* "presumption of reliance [does] not arise." *Smith v. Ayres*, 845 F.2d 1360, 1363 (5th Cir. 1988).

Second, and relatedly, the *Affiliated Ute* presumption is further limited to circumstances in which a defendant has breached a special duty of disclosure, because in such cases it can be presumed the plaintiff has relied on a party with whom it has a relationship of trust. *Affiliated Ute* rests on the common-sense understanding that it would be unfair to require a plaintiff to face the evidentiary difficulties of proving reliance on an omission when the omission itself was the product of a defendant's breach of a special duty. After all, the very imposition of this special duty reflects the long-established principle that such a plaintiff is entitled to rely on the defendant to provide complete disclosure of all material information. *See Chiarella*, 445 U.S. at 230.

That justification does not extend to parties involved in other types of transactions. Absent a relationship of trust between the parties, there is no reason to assume a plaintiff would rely on a defendant to disclose all material information. In such circumstances, "it is only sensible to put plaintiffs to their proof that they individually relied on the [defendant's] omissions." *Regents of the Univ. of Cal. v. Credit Suisse First Bos. (USA), Inc.*, 482 F.3d 372, 385 (5th Cir. 2007).

B. The District Court Wrongly Expanded *Affiliated Ute*

Understanding the district court's error—and how its decision contravenes the established limits on *Affiliated Ute*'s presumption of reliance—requires a brief overview of the underlying claim in this case. Plaintiff-appellee Puerto Rico Government Employees and Judiciary Retirement Systems Administration bought bonds from defendant-appellant Volkswagen Group of America Finance LLC. *In re Volkswagen "Clean Diesel" Mktg.*, 328 F. Supp. 3d 963, 966 (N.D. Cal. 2018) ("*Bondholders III*"). Volkswagen's bond offering memorandum stated, among other things, that Volkswagen's "top priority" for research and its "focal point" for development was reduced emissions. *Id.* at 967. And it noted that such technology was important in light of "increasingly stringent [regulatory] requirements concerning emissions." *Id.*

After the federal Environmental Protection Agency announced that Volkswagen had admitted to installing "defeat device[s]" to evade emissions standards, plaintiff filed this securities fraud action. *In re Volkswagen "Clean Diesel" Mktg.*, 3:15-MDL-02672 CRB (JSC), 2017 WL 3058563, at *1 (N.D. Cal. July 19, 2017) ("*Bondholders I*"). Its theory was that the statements contained in the bonds' offering memorandum had been materially misleading given the failure to disclose Volkswagen's use of defeat devices. *Bondholders III*, 328 F. Supp. 3d at 973-74.

Volkswagen moved for summary judgment on the ground that plaintiff failed to prove reliance. After no less than three opinions over three years wrestling with the issue (*see Bondholders I*, 2017 WL 3058563, at *14-15; *In re Volkswagen "Clean Diesel" Mktg.*, 3:15-MDL-02672 CRB (JSC), 2018 WL 1142884, at *3-6 (N.D. Cal. Mar. 2, 2018) ("*Bondholders II*"); *Bondholders III*, 328 F. Supp. 3d at 973-78), the district court applied the *Affiliated Ute* exception and presumed plaintiff's reliance. *In re Volkswagen "Clean Diesel" Mktg.*, 3:15-MDL-02672 CRB (JSC), 2019 WL 4727338, *1-3 (N.D. Cal. Sept. 26, 2019) ("*Bondholders IV*").

In reaching this conclusion, the district court acknowledged that plaintiff "base[d] its claims on certain affirmative statements in the bond offering memorandum." *Id.* at *1. But the court reasoned that the "'heart of the case' is an omission," and that the offering memorandum's statements were relevant only in that "they may have been rendered misleading by Volkswagen's failure to disclose its emissions fraud." *Id.* On that basis, the court concluded that *Affiliated Ute* applied. *Id.*[2]

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[2] The district court went on to conclude that defendant failed to rebut the presumption. Even though Volkswagen presented evidence that plaintiff never read its offering memorandum, the court declared that plaintiff would have "been made aware of" Volkswagen's use of defeat devices had the offering memorandum mentioned it. *Bondholders IV,* 2019 WL 4727338, at *3.

C. The District Court's Decision Contravenes Both Of *Affiliated Ute*'s Core Limitations

The district court's decision cannot be reconciled with either *Affiliated Ute* itself or this Court's precedent applying the *Affiliated Ute* presumption: plaintiff's claim satisfies neither of *Affiliated Ute*'s two core requirements.

First, plaintiff's theory of liability was ultimately based on alleged affirmative misstatements in the bond offering—and not, as *Affiliated Ute* would require, on supposed omissions. *Bondholders IV*, 2019 WL 4727338, at *1. Plaintiff thus faces no "difficulty of proving 'a speculative negative'" that could justify a presumption of reliance. *Binder*, 184 F.3d at 1064. Rather, plaintiff could prove reliance by ordinary means: demonstrating (if true) some connection between the alleged misstatements in the bond offering and its injury.

Second, and in any event, Volkswagen owed no special duty of disclosure to prospective bondholders (as the district court itself recognized). *Bondholders III*, 328 F. Supp. 3d at 986-87. With no relationship of trust between the parties, plaintiff had no reason to rely on Volkswagen to disclose all material information, and there is nothing unfair about requiring plaintiff to carry its ordinary burden of proof. *Regents of the Univ. of Cal.*, 482 F.3d at 385.

In reaching a contrary conclusion, the district court relied almost entirely on this Court's decision in *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975). That reliance was misplaced. Declaring that *Blackie* "involved both misstatements and omissions," the district court asserted that *Blackie* established *Affiliated Ute*'s applicability even when a plaintiff bases its claims in part on affirmative statements. *Bondholders III*, 328 F. Supp. 3d at 976. But in fact, the Court in *Blackie* characterized the claims at issue there as "cast in omission or non-disclosure terms." 524 F.2d at 905. And it is not even clear whether *Blackie* presumed reliance based on *Affiliated Ute*, or whether it grounded its decision in an early version of the fraud-on-the-market theory—which would separately justify a presumption of reliance. *See Amgen*, 568 U.S. at 492 (touting *Blackie* as "the leading pre-*Basic* fraud-on-the-market case"). Indeed, this Court in *Binder* subsequently made clear that it had never "squarely decided" whether the *Affiliated Ute* presumption can apply "in a case involving misrepresentations or both omissions and misrepresentations." *Binder*, 184 F.3d at 1063-64.

Thus, to the extent *Blackie* could be read to suggest that courts may presume reliance in mixed cases of misrepresentations and omissions, as the district court believed, this Court's subsequent decisions have since clarified that *Affiliated Ute* is limited to true omissions cases—that is, cases not involving affirmative misrepresentations. *Id.* at 1064; *see also Desai*, 573 F.3d at 941; *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 667 (9th Cir. 2004). The district court erred by departing from that well-established principle.

II. IF LEFT STANDING, THE DECISION BELOW WOULD IMPOSE SIGNIFICANT COSTS ON AMERICAN BUSINESSES AND THE PUBLIC

The district court's error has very real costs. The reliance requirement serves as a vital bulwark against all-too-prevalent abusive litigation practices. The legal and practical consequences of relaxing it, as the district court did here, would be significant.

In securities litigation, a presumption of reliance is often the key that unlocks the availability of class-action claims. Yet the district court's logic, if accepted, threatens to virtually ensure class certification in nearly all affirmative misrepresentation cases—dramatically expanding the exposure of securities defendants regardless of the merits of the underlying claims. Such an outcome would visit considerable harm on American businesses and investors.

A. The District Court's Decision Would Dramatically Expand Securities Fraud Class Actions By Effectively Erasing The Reliance Requirement

Time and again, courts have recognized that "litigation under Rule 10b–5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975). Because "[t]he very pendency of the lawsuit may frustrate or delay normal business activity of the defendant," even suits with little chance of success at trial carry outsized settlement values. *Id.* at 740. That is especially true given "[t]he prospect of extensive deposition of the defendant's officers and associates and the concomitant opportunity for extensive discovery of business documents" in securities suits. *Id.* at 741. The Supreme Court thus has warned that "extensive discovery and the potential for uncertainty and disruption in a lawsuit allow plaintiffs with weak claims to extort settlements from innocent companies." *Stoneridge Inv. Partners*, 552 U.S. at 163.

Congress has attempted to guard against "abusive and manipulative securities litigation" in which "innocent parties are often forced to pay exorbitant 'settlements.'" H.R. Conf. Rep. No. 104-369, at 32 (1995) (discussing Private Securities Litigation Reform Act ("PSLRA")). By enacting the PSLRA, Congress imposed heightened pleading standards and a loss causation requirement on "any private action" arising under the Securities Exchange Act. *See* 15 U.S.C. § 78u–4(b).

Despite these efforts, the costs of defending federal securities actions, and the potential for massive liability, have continued to provide defendants with often overwhelming incentives to settle cases without regard to their underlying merit. These conditions only intensify in the context of class actions, where "[c]ertification of a large class may so increase the defendant's potential damages liability and litigation costs that he may find it economically prudent to settle and to abandon a meritorious defense." *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978).

Indeed, between 1997 and 2018, less than 1 percent of federal securities class actions reached a trial verdict. Stanford Clearinghouse, *Securities Class Action Filings: 2019 Year in Review* 16 (2020).[3] Over that same period, 49 percent of federal securities class actions ended in settlement. *Id.*

Rule 10b–5's reliance requirement plays a crucial role in stemming the tide of frivolous securities class actions that seek to capitalize on these incentives. A putative class may be certified only if, among other things, "questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). Because each individual plaintiff must generally prove reliance, the availability of a presumption of reliance is often determinative of whether a putative class satisfies this predominance requirement. *See, e.g., Desai*, 573 F.3d at 940 ("Whether or not [plaintiffs] can rely on a presumption of reliance determines whether their putative class can meet the requirements of Rule 23(b)(3). For without a class-wide presumption, Investors would have to prove reliance as to each class member individually."). Expanding the presumption of reliance would thus greatly increase the number of classes certified in securities actions, further enhancing plaintiffs' already considerable leverage to force settlements.

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[3] http://securities.stanford.edu/research-reports/1996-2019/Cornerstone-Research-Securities-Class-Action-Filings-2019-YIR.pdf.

Courts have already seen this dynamic at work in the context of the fraud-on-the-market presumption of reliance. In *Basic*, the Supreme Court held that a plaintiff can satisfy Rule 10b–5's reliance requirement by invoking the presumption that stock prices in an established, efficient market reflect all publicly available material information. 485 U.S. at 247. *Basic* unleashed a wave of securities class actions: "[T]he rate at which securities fraud class action suits were filed nearly tripled between April 1988, just after *Basic* was decided, and June 1991." Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 663 (1992). To this day, a substantial portion of securities litigation focuses on whether a putative class can presume reliance under the fraud-on-the-market theory, without which "the requirement that Rule 10b-5 plaintiffs establish reliance would ordinarily preclude certification of a class action seeking money damages." *Amgen*, 568 U.S. at 462-63.

But the fraud-on-the-market theory cannot be applied in every case. It does not apply, for example, where there is no established efficient market, as is the case for initial public offerings, or where securities are thinly traded. *See Miller v. Thane Int'l*, *Inc.*, 615 F.3d 1095, 1103 (9th Cir. 2010) (noting the "high bar" for plaintiffs to establish market efficiency and invoke the fraud-on-the-market presumption); *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006). Thus, in a substantial number of cases, securities plaintiffs cannot evade the traditional reliance requirement.

If left standing, the district court's decision here would open an entirely new front in securities class actions. The district court presumed reliance because defendant's alleged misrepresentations were purportedly "rendered misleading" by an omission. *Bondholders IV*, 2019 WL 4727338, at *1. Although plaintiff "base[d] its claims on certain affirmative statements in the bond offering memorandum," the court said that those statements were relevant only because of "Volkswagen's failure to disclose its emissions fraud." *Id.* But under that logic, *any* affirmative misstatement may be characterized as an omission. As this Court has noted, "[a]ll misrepresentations are also nondisclosures, at least to the extent that there is a failure to disclose which facts in the representation are not true." *Little v. First Cal. Co.*, 532 F.2d 1302, 1305 n.4 (9th Cir. 1976). That is precisely why this Court has emphasized 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.

By instead applying *Affiliated Ute* where the defendants' *statements*—rather than their silence in the face of an independent duty to disclose—were the necessary trigger for any possible liability, the district court's approach would "permit the *Affiliated Ute* presumption to swallow the reliance requirement almost completely."

Id. Every securities fraud claim involves a misrepresentation or an omission. If, to invoke *Affiliated Ute*, a plaintiff need only assert that a defendant's misrepresentations were misleading given other information not disclosed, reliance would be presumed in nearly every case. That, in turn, would remove an obstacle to class certification, thereby further expanding the number of cases in which securities fraud classes are certified, and further increasing the already enormous pressure on defendants to settle securities fraud class actions without regard to the claims' merits. Thus, by effectively rendering the reliance requirement obsolete, the district court's rule would ensure that businesses would be inundated with even more frivolous litigation.

B. The District Court's Rule Would Impose Significant Costs On American Companies And Investors

This could not be a worse time to expand *Affiliated Ute*. The country is facing an explosion of securities class actions. In 2019, "[p]laintiffs filed 428 new securities class actions across federal and state courts, the highest number on record and nearly double the 1997-2018 average." Stanford Clearinghouse, *supra*, at 5. "Core filings" (those excluding merger-and-acquisition-related claims) exceeded even the 2008 surge caused by the financial crisis. *Id.* In just one year, 5.5 percent of all U.S. exchange-listed companies were subject to core filings, and similar filings against non-U.S. companies rose to an all-time high. *Id.* at 11-12. Nearly 90 percent of filings in 2019 included Rule 10b–5 claims, and more than a fifth of all core federal securities class actions were filed in this Circuit. *Id.* at 10, 38.

2019 was no anomaly. "Each of the last three years—2017 through 2019—has been more active than any previous year" in terms of filing intensity. *Id.* at 3. These cases are "larger than before and therefore threaten much higher litigation and settlement costs than cases filed in prior years—nearly three times larger than the average for 1997 to 2017." U.S. Chamber Institute for Legal Reform, *Containing the Contagion: Proposals to Reform the Broken Securities Class Action System* 2 (Feb. 2019).[4] And unlike previous litigation booms, the recent growth in filings is not attributable to an economic downturn causing widespread stock-price plunges. Stanford Clearinghouse, *supra*, at 3.

Recent litigation has also been increasingly driven by a small subset of attorneys. A 2019 study found that, for five years in a row, just three law firms appeared as counsel of record for plaintiffs in more than half of all initial complaints in core filings in the United States. Stanford Clearinghouse, *Securities Class Action Filings: 2018 Year In Review* 36 (2019).[5] These firms' cases were dismissed at a higher rate than those of other firms. *Id.* at 37. This increased activity has also

[4] https://www.instituteforlegalreform.com/uploads/sites/1/Securites-Class-Action-System-Reform-Proposals.pdf.

[5] https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review.

coincided with a rise in the appointment of individuals as lead plaintiffs over traditional institutional investors—another factor correlated with frivolous lawsuits. *Id.* at 36-37.

The growth of securities litigation is in part attributable to the surge in "event-driven" cases like this one. A new pattern of litigation has emerged where plaintiffs rush to file securities claims immediately after unfavorable news coverage causes a drop in a corporation's stock prices, alleging that the company should have disclosed the risks or misconduct that led to the price drop. U.S. Chamber Institute for Legal Reform, *supra*, at 9. These litigants routinely seize on vague, innocuous statements that (they allege) take on new meaning in light of the latest headline news. For example, plaintiff here bases its theory of liability in part on Volkswagen's wholly unremarkable statement that its "vehicles must comply with increasingly stringent requirements concerning emissions." *Bondholders III*, 328 F. Supp. 3d at 967. Requiring plaintiffs to prove reliance on such banal statements would ordinarily keep most suits from proceeding (or, at the very least, preclude certification of a class). But the district court's approach to presuming reliance removes one of the few checks on runaway event-driven securities litigation.

The recent surge in securities class actions has inflicted considerable costs on American businesses and investors. More than 7 percent of S&P 500 companies in 2019, and more than 9 percent in 2018, were subject to core federal securities filings, up from just above 1 percent in 2014. Stanford Clearinghouse, *2019 Year*, *supra*, at 12; U.S. Chamber Institute for Legal Reform, *supra*, at 11. Propelled by increasing settlement values and event-driven litigation, premiums for directors' and officers' liability insurance have skyrocketed, and the availability of such policies continues to lag behind demand. *See* Carl E. Metzger & Brian H. Mukherjee*, Challenging Times: The Hardening D&O Insurance Market*, Harvard Law School Forum on Corporate Governance (Jan. 29, 2020).[6] To account for the inevitability of future settlements, companies with greater exposure to securities litigation must hold significantly more cash on hand while reducing capital expenditures. Matteo Arena & Brandon Julio, *The Effects of Securities Class Action Litigation on Corporate Liquidity and Investment Policy*, 50 J. OF FIN. AND QUANTITATIVE ANALYSIS 251, 251 (2015). In this environment, some U.S. companies may avoid going public altogether, depriving the investing public of valuable opportunities. There are now fewer than half the 7,400 publicly traded companies that were listed on U.S. exchanges in 1996. Michael Wusterhorn & Gregory Zuckerman, *Fewer Listed Companies: Is that Good or Bad for Stock Markets?* WALL STREET JOURNAL (Jan. 4, 2018).

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[6] https://corpgov.law.harvard.edu/2020/01/29/challenging-times-the-hardening-do-insurance-market/

The costs imposed by rampant event-driven securities class actions will likely only increase with current economic volatility and the COVID-19 health crisis. Heightened levels of securities class action filings in past years have corresponded with market turbulence, such as the dot-com bust and the 2008 financial crisis. Stanford Clearinghouse, *2019 Year*, *supra*, at 3. Companies have already seen an early wave of event-driven coronavirus-related suits and "expect to see an uptick in shareholder litigation stemming from alleged omissions and misrepresentations concerning COVID-19." Gabriel K. Gillett et al., *New COVID-19 Securities Developments: Class Action Omissions Theory and SEC Enforcement Actions*, American Bar Association (May 20, 2020).[7]

Meanwhile, no purported benefits of these lawsuits have materialized. Private securities fraud litigation is theoretically intended to serve two goals: "compensat[ing] injured investors" and "deter[ring] fraud and manipulation by exposing those contemplating unlawful conduct to the threat of private damage liability." *Berner v. Lazzaro*, 730 F.2d 1319, 1323 (9th Cir. 1984). But contrary to the compensatory rationale, the result of most class-securities settlements is simply a wealth transfer between two innocent (and often overlapping) groups of shareholders: those who currently own the company's stock and those who

[7] https://www.americanbar.org/groups/litigation/committees/securities/practice/2020/covid-19-securities-class-actions-sec-enforcement/.

purchased the company's stock during the class period. U.S. Chamber Institute for Legal Reform, *Risk and Reward: The Securities-Fraud Class Action Lottery* 4 & n.16 (Feb. 2019).[8] And because high defense costs raise insurance premiums, the price of which is passed on to shareholders, "it is an open question as to whether the typical securities class action settlement actually produces any net recovery" at all. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1547 (2006). The deterrence rationale has fared little better. The power of even frivolous securities class actions to generate massive settlements may have caused over-deterrence. That carries its own substantial downsides—including the prospect that issuers of securities may avoid speaking as much as possible, depriving the market of valuable information. *See* Mahoney, *supra*, at 655.

In sum, what little benefit (if any) the public derives from unbridled securities class actions has been surpassed by their costs. If affirmed, the district court's erroneous expansion of *Affiliated Ute* would place a further burden on U.S. companies already facing numerous frivolous securities class actions.

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[8] https://www.instituteforlegalreform.com/uploads/sites/1/Risk_and_Reward_WEB_FINAL.pdf.

CONCLUSION

This Court should reverse the order of the district court.

Dated: July 17, 2020

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with Fed. R. App. P. 29(a)(5) because it contains 5,272 words excluding those parts authorized by Fed. R. App. P. 32(f).

This brief complies with the typeface requirements of Fed. R. App. P. 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 Office Word 2016 in 14-point Times New Roman font.

Dated: July 17, 2020

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the CM/ECF system on July 17, 2020.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

Dated: July 17, 2020

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