BOCA RATON FIREFIGHTERS & POLICE PENSION FUND v. BAHASH

No. 15-88

Supreme Court of the United States

July 20, 2015

Reporter
2015 U.S. S. Ct. Briefs LEXIS 2451

BOCA RATON FIREFIGHTERS AND POLICE PENSION FUND, Petitioner, v. ROBERT J. BAHASH, THE MCGRAW-HILL COMPANIES, INC. AND HAROLD MCGRAW, III, Respondents.

Type: Petition for Writ of Certiorari

Prior History: On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

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Counsel

[*1] Susan K. Alexander, Andrew S. Love, Matthew S. Melamed, ROBBINS GELLER RUDMAN & DOWN LLP, San Francisco, CA, Thomas C. Goldstein, Counsel of Record, Tejinder Singh, GOLDSTEIN & RUSSELL, P.C., Bethesda, MD.

Title

PETITION FOR A WRIT OF CERTIORARI [*6]

Text

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S. C. § 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally [*5] with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission in any action brought under paragraph (1) or (3) of section 78u (d) of this title), unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,

(b) To 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, or

(c) To engage 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 any security.

QUESTION PRESENTED

Whether a verifiably false factual statement about a matter of obvious importance to a company can nevertheless constitute inactionable "puffery" under the federal securities laws?

Petitioner Boca Raton Firefighters and Police Pension Fund respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the Second Circuit, (Pet. App. 1a-7a) is unpublished. The district court's opinion (*id*. 8a-28a) is reported at *293 F.R.D. 617.* The court of appeals' order denying rehearing en banc (*id*. 29a-30a) is unpublished. The court of appeals' and the district court's prior opinions in this case (*id*. 31a-46a, 47a-50a) are unpublished.

JURISDICTION

The Second Circuit issued its decision on September 8, 2014 and denied petitioner's timely petition for rehearing on February 20, 2015. On May 8, 2015, Justice Ginsburg extended the time to file this Petition to and including June 19, 2015. No. 14A1155. On June 8, the time to file was further extended to July 20, 2015. *Id*. This Court has jurisdiction pursuant [*7] to *28 U.S.C. § 1254*(1).

STATEMENT OF THE CASE

1. Standard & Poor's ("S&P") (a division of respondent the McGraw-Hill Companies, Inc.) (P30) [1] rates securities, assessing the likelihood that the debts bundled within them will be repaid and assigning a letter grade rating. (PP45, 61) Like other ratings agencies, S&P's highest rating for a security is AAA, followed by AA, A, BBB, BBB-, BB+, BB, B, CCC, CC, C, and D. Any security rated below BBB- is not "investment grade" (P275), and in common parlance is "junk." As a practical matter, without a credit rating, debt securities cannot be sold. (P61)

S&P competes with other ratings agencies for market share among securities issuers. (PP23, [*8] 414) S&P's biggest competitor is Moody's. (P23) The third largest competitor is Fitch. (PP152, 186-187) Issuers pay the ratings agency of their choice to issue ratings for their securities and prefer for the securities to be rated as highly as possible. (P48)

Between October 21, 2004 and March 11, 2008 (the putative "Class Period"), S&P rated structured finance transactions including residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs"). (PP1, 3) These structured finance instruments function similarly to each other: an arranger, typically an investment bank, collects a pool of underlying assets (for RMBS, the underlying assets are residential mortgages, and for CDOs, they are asset-backed securities, including RMBS--which serve as "collateral"), and places those assets in a trust. (PP54, 58) The trust then issues new debt securities, permitting investors to participate in the returns of the pool of bundled loans. (*Id*.) Naturally, the quality of these securities depends on the quality of the assets in the pool. (PP62, 76) For example, RMBS backed by risky mortgages will themselves be risky. If and when the underlying mortgages default, [*9] the returns to RMBS investors suffer as well.

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[1] "P_" references are to particular paragraphs of the operative Third Amended Complaint, filed with the district court on March 28, 2013, as Exhibit 1 to the Declaration in Support of the Motion for Relief from Judgment and Leave to Amend. (District Court Docket No. ("Dkt.") 64)

During the Class Period, both the underlying residential loans and the structured financial instruments evolved significantly. (PP52-62) Lending practices became increasingly aggressive and underwriting standards increasingly relaxed. (*Id*.) Banks extended mortgages without verifying borrowers' income and asset information ("stated income" loans) and created products with increasingly creative combinations of "interest-only" rates and balloon payments. (PP23, 52) These "subprime" loans were pooled and securitized as RMBS, which were in turn bundled into even more opaque CDOs. (P60) One credit agency reported that the average percentage of subprime RMBS in the collateral pools of CDOs it rated grew from 43.3% in 2003 to 71.3% in 2006. (*Id*.)

In what has been widely named a "race-to-the-bottom" market share war, S&P and the other ratings agencies rated thousands of these securities each year. (PP23, 101) S&P rated approximately 10,000 RMBS in 2006 and 2007 alone. (PP23, 99) As the quality of the underlying housing loans declined and the RMBS and CDO products increasingly bundled "junk" loans, S&P intentionally adjusted its [*10] ratings models to rate those securities as AAA and investment grade in order to preserve and increase its market share. (PP5, 101)

The United States Senate's Permanent Subcommittee on Investigations spent 18 months investigating the role of S&P and other ratings agencies in causing the 2008 global financial crisis. (P23) Following more than 100 interviews and depositions, review of over a million pages of documentary evidence, and consultation with dozens of government, academic, and private sector experts on banking, securities, financial, and legal issues, the Subcommittee made several factual findings, three of which are central here:

. "From 2004 to 2007, . . . Standard & Poor's used credit rating models with data that was inadequate to predict how high risk residential mortgages, such as subprime, interest only, and option adjustable rate mortgages, would perform." . "By 2006, … Standard & Poor's. knew their ratings of residential mortgage backed securities (RMBS) and collateralized debt obligations (CDOs) were inaccurate, revised their rating models to produce more accurate ratings, but then failed to use the revised model to re-evaluate existing RMBS and [*11] CDO securities, delaying thousands of rating downgrades and allowing those securities to carry inflated ratings that could mislead investors."

. "Mass downgrades by . . . Standard & Poor's, including downgrades of hundreds of subprime RMBS over a few days in July 2007, . . . and downgrades by Standard & Poor's of over 6,300 RMBS and 1,900 CDOs on one day in January 2008, shocked the financial markets, helped cause the collapse of the subprime secondary market, triggered sales of assets that had lost investment grade status, and damaged holdings of financial firms worldwide, contributing to the financial crisis."

(P23)

2. This securities fraud lawsuit relates to respondents' false public statements about the nature of S&P's ratings and the internal process at S&P--directed by respondents--for reaching those ratings. For example, respondents publicly told McGraw-Hill investors that "[t]ightening criteria may have an adverse impact on our market share, but we will continue to develop and adjust our criteria to reflect how changing conditions impact credit risk." (P479) Yet, internal memoranda document respondents' decision to continue to use "assumptions that are [*12] inconsistent with historical data" because the new, accurate model would impair "potential business opportunities." (PP185, 187) Similarly, while respondents publicly told McGraw-Hill investors that S&P's ratings were based on "predetermined, nonnegotiable and publicly available criteria" (P491), internal email documents a meeting of senior management "to discuss adjusting criteria for rating CDOs of real estate assets this week because of the ongoing threat of losing deals." (P119)

Complaints initially were filed in the United States District Court for the District of Columbia, but the matter was transferred to the Southern District of New York. (Dkt. 1) Following the extensive United States Senate hearing, referenced above, petitioner Boca Raton Firefighters and Police Pension Fund requested and was granted leave to amend its complaint to incorporate substantial facts revealed at the hearing. (Dkt. 33, 36)

The district court had federal question jurisdiction. *15 U.S.C. § 78aa;28 U.S.C. § 1331.* It dismissed the complaint and entered judgment on April 2, 2012, concluding *inter alia* that respondents' public statements regarding S&P's [*13] "independent and objective analysis" were "mere commercial puffery." [2] Pet. App. 48a.

3. The Second Circuit affirmed. *Id*. 31a-46a. It explained that "we will not credit mere business 'puffery,' which we have defined In this context as 'statements [that] are too general to cause a reasonable investor to rely upon them.'" *Id*. 39a-40a (quoting *EGA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 206 (2d Cir. 2009)).* The court rejected petitioner's argument that the statements were not puffery because they related specifically to the credit ratings business, as opposed to respondents' integrity in general, holding that "[t]he 'puffery' designation . . . stems from the generic, indefinite nature of the statements at issue, not their scope." *Id*. 40a-41a.

4. [*14] While the matter was pending on appeal, deposition testimony in separate litigation was unsealed and became available, establishing that respondents intentionally chose to boost market share rather than use available accurate ratings criteria. [3] For example, Dr. Frank Raiter, S&P's Managing Director and Head of RMBS Ratings (P22), testified that by 2006 respondents knew S&P's ratings of RMBS and CDOs were inaccurate, but nonetheless rejected a new, more accurate ratings model, saying "we already [have] 94, 95 percent [market share]," so "if we're not going to gain more revenue why should we spend the money" to get "a better model"? (P165)

5. Shortly after the Second Circuit's mandate issued, the United States Department of Justice filed a civil fraud complaint against respondent McGraw-Hill. *See United States v. McGraw-Hill Cos., Inc.*, No. CV 13-0779 DC (JCGx) (C.D. Cal. Feb. 4, 2013). The [*15] government's complaint was based on precisely the same statements that petitioner had alleged to be false, but was supported by substantial additional evidence recovered by subpoena, demonstrating that respondents intentionally chose market share gains over the accuracy of S&P's ratings. (P5) For example, an internal report established that respondents created a ratings model, called E3, that captured some of the changes in the mortgage market, but then "toned down and slowed down [the] roll out of E3 to the market, pending further measures to deal with . . . negative results" and even created an alternative version of the model, called "E3 Low," directing analysts to use it to rate securities that could not pass E3. (PP187, 190, 193)

6. Based on the new evidence from the unsealed depositions and the Department of Justice's complaint, petitioner filed a motion for relief from judgment under Federal Rule of Civil Procedure 60(b)(2) as well as a motion to amend the complaint, attaching the proffered Third Amended Complaint, which alleges that respondents' statements about S&P's ratings of securities were knowingly and verifiably false.

For example, respondents acknowledged that increasing [*16] the stringency of ratings "can in fact have an adverse impact on whether [investment banks] come to Standard & Poor's or not," but told McGraw-Hill investors that "that's not what we're concerned about. We're concerned about calling it as it is." (P479) Yet, internal emails reveal that the decisive concern was actually upsetting "too many clients and jumping the gun ahead of Fitch and Moody's." (P308)

Publicly, respondents told McGraw-Hill investors that "giving in to 'market capture' would reduce the very value of the rating, and is not in the interest of the rating agency." (P484) But, S&P's Chief Criteria Officer for Global RMBS Ratings testified that an available model that was more accurate than the one being used "could have been released months ago . . . if we didn't have to massage the sub-prime and Alt-A numbers to preserve market share." (P166)

Publicly, respondents told McGraw-Hill investors that "[i]n theory, one way to increase revenue would be for us to weaken our criteria to ensure that a transaction that would not have been economically viable can take place. This

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[2] The district court also dismissed claims regarding respondents' statements about S&P's surveillance policies and their financial statements. Those claims are not presently at issue.

[3] Petitioner unsuccessfully requested judicial notice of the existence of this evidence. Pet. App. 46a

would, of course, violate our internal rules . . . . [W]e do not engage in such behavior. [*17] " (P484) Privately, when respondents discovered that a particular security, the Delphinus CDO, did not pass S&P's ratings test, respondents worked until after midnight, scaling back the criteria, until three of the four CDO tranches "passed" and then rated all four tranches as investment grade. (P319)

7. The district court denied the motion, concluding that the "new facts do not alter the previous conclusion that the statements are 'generic' and 'indefinite'" -- a "determination [that] dealt with the nature of the statements themselves." Pet. App. 25a. The court concluded that "[n]ew facts purportedly demonstrating that profits, client satisfaction, and market share were considerations in S&P's rating of securities would not . . . have changed the outcome of this case." *Id*. 26a.

8. The Second Circuit affirmed. The court of appeals held that new evidence showing that S&P prioritized "market share and profits" over the "independence" and "integrity" of its ratings did "not alter the 'generic, indefinite nature' of the statements at issue or demonstrate why they are false." Pet. App. 5a. The court of appeals again held that respondents' "statements are too general [*18] to cause a reasonable investor to rely upon them as a guarantee that ratings would not be made without [sic] regard to profits, market share, or client feedback." *Id*.

Judge Straub dissented. He would have held that "the new evidence" was "sufficient to assert that the statements previously found to be but puffery were not believed when made and may provide the basis for actionable material misrepresentations with the requisite scienter." *Id*. 7a.

Petitioner sought rehearing *en banc*, which was denied. Pet. App. 29a-30a.

9. This Petition followed.

REASONS FOR GRANTING THE WRIT

This case raises an important and recurring question in securities fraud law that has divided the lower courts.

In order to plead securities fraud, a plaintiff must allege that the misstatements or omissions were material, *i.e*., that a reasonable investor would regard the false or omitted information as "having significantly altered the 'total mix' of information made available" about a security. *Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2413 (2014)* (quotation marks omitted). The materiality inquiry is "inherently fact-specific," *Basic Inc. v. Levinson, 485 U.S. 224, 236 (1988),* [*19] and a court should only determine that statements lack materiality at the motion-to-dismiss stage if there is no reasonable argument to the contrary, *i.e*., if it is obvious that no reasonable investor could have regarded the statement as important. *See IBEW Local Union No. 58 Pension Trust Fund & Annuity Fund v. Royal Bank of Scotland Grp., PLC, 783 F.3d 383, 390 (2d Cir. 2015);City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 681 (6th Cir. 2005);Weiner v. Quaker Oats Co., 129 F.3d 310, 317 (3d Cir. 1997).*

"Puffery" has evolved as a shorthand term for describing certain "vague statements of optimism" upon which no reasonable investor would rely and which are, therefore, not material. *E.g., Ore. Pub. Emps. Ret. Fund v. Apollo Grp. Inc., 774 F.3d 598,606 (9th Cir. 2014)* (quotation marks omitted); *Grossman v. Novell, Inc., 120 F.3d 1112, 1119 (10th Cir. 1997);Hoxworth v. Blinder, Robinson & Co., Inc., 903 F.2d 186, 200 (3d Cir. 1990).* But there is no single definition of what constitutes "puffery," and different courts thus apply irreconcilable interpretations. [*20]

In the Second Circuit, an overly broad puffery definition threatens to usurp the fundamental concept that materiality is inherently fact-specific and context-sensitive. That court of appeals holds--in conflict with decisions of this Court and other circuits--that even a knowingly and verifiably false statement of fact regarding a central aspect of a company's business can constitute inactionable puffery as a matter of law if a court deems the wording sufficiently "general." Certiorari is warranted to address these conflicts.

I. The Second Circuit's Decision Conflicts With This Court's Recent *Omnicare* Decision.

On March 24, 2015, this Court decided *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund, 135 S. Ct. 1318 (2015).* The Court there recognized that even statements of opinion are actionable under the securities fraud laws in three circumstances: first, when the speaker does not truly believe the statement; second, when the opinion claims to be based on a false statement of fact; and third, when the statement omits important facts about how the opinion was formed. *Id. at 1327-29.*

The Court's [*21] opinion discusses puffery. Analyzing a statement by a hypothetical CEO that "[t]he TVs we manufacture have the highest resolution available on the market," the Court explained that this assertion "is not mere puffery, but a determinate, verifiable statement about her company's TVs." *Id. at 1326.* Even if the statement had been phrased as an opinion, *i.e.*, "I believe our TVs have the highest resolution available on the market," the Court determined that it would be actionable if the CEO "knew that her company's TVs only placed second" because it would convey the untrue fact of the CEO's own belief. *Id*. The statement would also be actionable if the CEO had said "I believe our TVs have the highest resolution available because we use a patented technology to which our competitors do not have access," if in fact the company did not use the referenced technology. *Id. at 1327.*

The Second Circuit's puffery rule is inconsistent with *Omnicare* because the Second Circuit deems both the speakers' knowing falsity and the "verifiability" of a statement irrelevant. In *City of Pontiac Policemen's & Firemen's Retirement System v. UBS AG, 752 F.3d 173, 183 (2d Cir. 2014),* [*22] for example, the court of appeals held that even if "statements were knowingly and verifiably false when made," that would not overcome "their generality, which is what prevents them from rising to the level of materiality required to form the basis for assessing a potential investment." Similarly in this case, the court of appeals held that petitioner's new evidence--showing that contrary to their public statements, respondents knew S&P did not employ "predetermined, nonnegotiable, and publicly available criteria and assumptions," all of which are verifiable facts--did not "alter the 'generic, indefinite nature' of the statements at issue." Pet. App. 5a (citing Pet. App. 14a); *see also id*. 25a.

Here, S&P executives touted the accuracy of their ratings models, knowing all the while that the models were inadequate to address the securities S&P was rating. Like the CEO who lies about the technology in her company's televisions, S&P executives made knowingly false statements about their rating technology.

Given the facial discrepancy between the Second Circuit's rule and this Court's pronouncements in *Omnicare*, it would be appropriate to grant, vacate, and remand the case so [*23] that the court of appeals can apply the correct standard.

II. The Courts Of Appeals Are Divided Over Whether Verifiable Statements Can Constitute Puffery.

In the alternative, plenary review is warranted to clarify the standard in puffery cases across the nation. Different courts adopt different formulations of the puffery rule, and the fragmentation undermines the enforcement of the securities laws.

1. The Second Circuit adopts the most expansive interpretation of puffery, holding that even if a factual statement directly related to a company's key business is "knowingly and verifiably false when made," it may constitute puffery if its wording is nevertheless "general." *City of Pontiac Policemen's & Firemen's Ret. Sys., 752 F.3d at 183.*

Applying this standard, the Second Circuit has repeatedly found statements by corporate officials to be inactionable puffery--even at the pleading stage. In its first opinion in this case, affirming dismissal, the court of appeals explained that "[t]he 'puffery designation . . . stems from the generic indefinite nature of the statements at issue, not their scope," so that even statements that were "'directly [*24] related' to [respondents] credit-ratings service" were not actionable. Pet. App. 40a-4la. In its second opinion, affirming denial of the Rule 60(b) motion, the Second Circuit held that none of the new evidence petitioner obtained altered "the 'generic, indefinite nature' of' S&P's public statements, which the court concluded were "too general to cause a reasonable investor to rely upon them as a guarantee that ratings would not be made without [sic] regard to profits, market share, or client feedback." *Id*. 5a.

While this case presents a particularly egregious puffery finding, such findings are commonplace in the Second Circuit, which has often relied on puffery analysis to sidestep the materiality inquiry properly reserved for a fact-finder and affirm the dismissal of fraud complaints as a matter of law. *See, e.g.,* IBEW Local Union No. 58 Pension Trust Fund & Annuity Fund v. Royal Bank of Scotland Grp., PLC, 783 F.3d 383, 392 (2d Cir. 2015) (deeming "puffery" statements that the integration following an acquisition was "off to a promising start" and that management's "positive view . . . has been confirmed" when the acquisition was actually an "unmitigated [*25] disaster"); ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 205-06 (2d Cir. 2009) (characterizing as immaterial "puffery" statements that a bank's risk management processes were "highly disciplined" and "set the standard for integrity" when the claim was that "poor financial discipline led to liability in the WorldCom litigation and involvement in the Enron scandal").

2. The Sixth, Ninth, Tenth, and D.C. Circuits apply a more stringent standard to a puffery defense--especially at the motion-to-dismiss stage--holding that when a statement is capable of objective verification, it cannot be puffery.

Recognizing that the materiality standard and puffery exception are "vague and provide little guidance in close cases," the Sixth Circuit has admonished courts to "tread lightly at the motion-to-dismiss stage, engaging carefully with the facts of a given case and considering them in their full context" in order to avoid "prematurely dismissing suits on the basis of our intuition." In re Omnicare, Inc. Sec. Litig., 769 F.3d 455, 472 (6th Cir. 2014).

In the Sixth Circuit, therefore, "[t]he key is whether the proposition [*26] at issue can be proven or disproven using standard tools of evidence." City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 674 (6th Cir. 2005). In *City of Monroe*, the defendant tire company's products had failed, causing two road deaths. The company responded by saying that "[w]e continually monitor the performance of all our tire lines, and the objective data clearly reinforces our belief that these are high-quality, safe tires," and further claiming that "[p]roperly inflated and maintained Firestone ATX . . . tires are among the safest tires on the road today." Id. at 661. The court of appeals held that the statement was actionable because a court "could test [the statement] against record evidence." Id. at 674. It therefore permitted the lawsuit to proceed.

Under the Sixth Circuit's precedents, the complaint in this case would not have been dismissed. It is possible to test whether the criteria that S&P applied to RMBS were in fact the same "predetermined" and "publicly available" criteria that it promised to apply; and it is equally possible to determine whether S&P's ostensibly "nonnegotiable" [*27] criteria were in fact agreed after negotiation with issuers. These statements, like Bridgestone's claim to have support in "objective data," were provably false, and therefore would not have been dismissed as "puffery" in the Sixth Circuit.

The Ninth Circuit has similarly held that "[s]tatements by a company that are capable of objective verification are not 'puffery' and can constitute material misrepresentations." Ore. Pub. Emps. Ret. Fund v. Apollo Grp. Inc., 774 F.3d 598, 606 (9th Cir. 2014). In Warshaw v. Xoma Corp., 74 F.3d 955, 957-58 (9th Cir. 1996), executives at a pharmaceutical company reacted to the Food & Drug Administration's rejection of their first Phase III clinical study by assuring the market that concerns were "unfounded," and the rejection did "not in any way imply a delay or setback in the agency's review of" the drug, that the company was "encouraged by the progress FDA is making," and that in the company's view, approval was "imminent." Because these "optimistic statements allegedly contravened the unflattering facts in Xoma's possession," the complaint survived a motion to dismiss. Id. at 960. [*28]

The United States District Court for the Central District of California's consideration of the very statements at issue in this case illuminates the tension between the Second and Ninth Circuits' puffery standards. Applying the Ninth Circuit's rule, the district court held that respondents' statements were not puffery, and refused to dismiss the government's complaint against respondent McGraw-Hill. *See* United States v. McGraw-Hill Cos., No. CV 13-0779 DOC JCGx, 2013 WL 3762259 (C.D. Cal. July 16, 2013). Describing respondents' effort to minimize the import of their statements as "deeply and unavoidably troubling when you take a moment to consider its implications," the district court concluded that "S&P's statements were not a 'general, subjective claim' about the avoidance of

conflicts of interest, but rather a promise that it had 'established policies and procedures to address the conflicts of interest through a combination of internal controls and disclosure.'" *Id*. at *5. In other words, respondents were not engaging in puffery by "setting out vague goals" for the future, but instead making "specific assertions of current and ongoing policies that [*29] stand in stark contrast to the behavior alleged." *Id*. at *6. [4]
[*30]

The district court's decision in *McGraw-Hill Companies* never reached the Ninth Circuit because the district court's holding denying the motion to dismiss was interlocutory, and because the case settled before trial. That fact highlights an important point about this circuit split: the reported cases on this question dramatically understate the import of the split. Most jurisdictions are far less solicitous of the puffery defense than the Second Circuit. And so defendants either do not attempt to contest materiality at the pleading stage, or they lose in the district court in orders that cannot be appealed. Consequently, the other courts of appeals are issuing fewer puffery decisions than the Second Circuit, but the standard in those circuits is still critically important to the outcomes of cases there.

Based on the district court's holding in *McGraw-Hill Companies*, which simply applied settled Ninth Circuit law, it is highly likely that this case would have been decided differently in that circuit.

The Tenth Circuit has likewise "distinguished between statements that are material and those that are 'mere puffing . . . not capable of objective verification.'" [*31] *In re Level 3 Commc'ns, Inc. Sec. Litig., 667 F.3d 1331, 1339 (10th Cir. 2012)* quoting *Grossman v. Novell, Inc., 120 F.3d 1112, 1119 (10th Cir. 1997)).* Thus, when executives commented that the progress of integrating a new company in an ongoing merger was "ahead of plan," "under budget," and "substantially done," those statements were deemed actionable because "'[e]ach of these statements could have, and should have had, some basis in objective and verifiable fact.'" *Id*. at 1340-41 (quoting *Grossman, 120 F.3d at 1123).Cf. IBEW Local Union No. 58 Pension Trust Fund & Annuity Fund, 783 F.3d at 392* (Second Circuit case holding that statements praising a disastrous merger were puffery).

Under the Tenth Circuit's standard, petitioner's claim would have been permitted to proceed. At a minimum, the question whether S&P applies "predetermined, nonnegotiable, and publicly available criteria and assumptions" to rate securities is a factual statement that can be objectively verified. And it is an important one. As Vickie Tillman, who was then executive vice president of Credit Market Services for S&P, admitted: [*32] "The fundamental service provided by a rating agency such as S&P is to issue an independent opinion on the creditworthiness of securities, which speaks to the likelihood that investors will receive payments of interest and principal on time." Vickie Tillman, *Don't Blame the Rating Agencies*, Wall St. J., Aug. 31, 2007, http://www.wsj.com/articles/SB118852499512414246. [5]
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[4] In rejecting respondents' arguments, the district court in California attempted to distinguish this case in two ways, neither of which mitigates the tension between the rulings. First, the district court reasoned that the first version of petitioner's complaint was less specific than the United States' complaint.McGraw-Hill Cos., 2013 WL 3762259, at *7. But in seeking reconsideration, petitioner supplemented its complaint with the very allegations made in the United States' complaint, so that distinction no longer exists. Second, the district court reasoned that petitioner, as an investor in McGraw-Hill, was not necessarily similarly situated with investors who relied on S&P's ratings to purchase debt securities. *Id*. at *8. But that has no bearing on whether the statements were puffery, *i.e.*, whether they were verifiable, or general, or whatever the test may be. Furthermore, to the extent petitioner is differently situated from the investors who relied on S&P ratings, that only makes respondents' statements about ratings *more likely* to be material to petitioner: respondents were trying to sell the quality of their ratings to the investing public, and so the public had a greater reason to suspect respondents' sales pitch; but as a shareholder in the company, petitioner had every reason to believe that it was receiving accurate information.

[5] Courts are more likely to find materiality when, as here, a misrepresentation relates either to a company's key products or to ongoing controversies--as opposed to the company's prospects or integrity in general.*See, e.g., Mulligan v. Impax* Labs., Inc., 36 F. Supp. 3d 942, 968 (N.D. Cal. 2014) ("It is reasonable to believe that investors in the pharmaceutical industry--an industry where regulatory compliance, not to mention consistency and sanitation in production, is essential--would find [FDA warnings] disconcerting. This is especially the case when the very core of Impax's business-its manufacturing facilities--was in potential jeopardy."); *Ross v. Career Educ. Corp*., No. 12 C 276, 2012 WL 5363431, at *8 (N.D. Ill Oct. 30, 2012) (finding

The D.C. Circuit recently followed the Sixth, Ninth, and Tenth Circuits, limiting "puffery" to "'generalized statements of optimism that are not capable of objective verification,'" and agreeing that statements constituting puffery "employ terms that are 'too squishy, too untethered to anything measurable, to communicate anything that a reasonable person would deem important to a securities investment decision.'" *In re Harman Int'l Indus. Sec. Litig.*, No. 14-7017, F.3d , 2015 WL 3852089, at *15 (D.C. Cir. June 23, 2015) (quoting *Grossman, 120 F.3d at 1119;City of Monroe Emps. Ret. Sys., 399 F.3d at 671).* In *Harman*, the D.C. Circuit declined to characterize as puffery a statement in an Annual Report that "[s] ales of aftermarket products … were very strong during fiscal 2007." *Id*. at *4. "[G]iven the context in which it was made, according to the allegations in the complaint, we conclude that the 'very strong' statement in the FY 2007 Annual Report is plausibly understood as a description of historical fact rather than unbridled corporate optimism, *i.e.*, immaterial puffery." *Id* [*34] . at *16. This was true even though the statement did "not contain its own metric." *Id*. at *17.

Because the D.C. Circuit applies the same standard as the Sixth, Ninth, and Tenth Circuits, petitioner's claim would likely have been decided differently in that circuit for the reasons explained above.

4. The Third, Eighth, and Eleventh Circuits have not opined on the precise question at issue here: whether a verifiably false statement of fact can constitute puffery. However, their cases at least suggest that the result in this case would have been different. [6]
[*35]

The Third Circuit held that when health insurer Aetna assured investors of its "disciplined" pricing practices, it was engaged in puffery because "no reasonable investor could infer that 'dedication to disciplined pricing,' a vague and subjective statement, meant Aetna had applied (or failed to apply) a static, across-the-board formula to determine the price of premiums charged for all products and services." *In re Aetna, Inc. Sec. Litig., 617 F.3d 272, 284 (3d Cir. 2010).* But here, S&P claimed to apply predetermined, publicly available, nonnegotiable criteria to every security it rated--*i.e.*, a specific formula--and so it is likely that the Third Circuit would reach a different result in this case.

The Eleventh Circuit, interpreting Georgia law, has held that a statement is puffery if it "is not the sort of empirically verifiable statement that can be affirmatively disproven." *Next Century Commc'ns Corp. v. Ellis, 318 F.3d 1023, 1028 (11th Cir. 2003).* Under that standard, the statements in this case would not be puffery, and so if the Eleventh Circuit adopted the same standard for federal securities law purposes, the result would [*36] conflict with the Second Circuit's holding in this case.

Finally, in the related context of false advertising claims under the Lanham Act, the Eighth Circuit has explained that:

> Puffery and statements of fact are mutually exclusive. If a statement is a specific, measurable claim or can be reasonably interpreted as being a factual claim, *i.e.*, one capable of verification, the statement is one of fact. Conversely, if the statement is not specific and measurable, and cannot be reasonably interpreted as providing a benchmark by which the veracity of the statement can be ascertained, the statement constitutes puffery.

Am. Italian Pasta Co. v. New World Pasta Co., 371 F.3d 387, 391 (8th Cir. 2004). If the Eighth Circuit applies the same standard to securities fraud claims, it would necessarily hold that the Second Circuit's puffery standard is too

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materiality when statements were "not broad, commendatory, or generally optimistic statements regarding the overall health of the business," but instead conveyed that the company "had rectified a long period of sustained compliance problems.").

[6] The Fourth and Seventh Circuit have likewise decided puffery cases without opining on the precise question at issue here.*See, e.g.,* Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588, 596 (7th Cir. 2006), *as modified on denial of reh'g* (July 10, 2006), *vacated and remanded on other grounds*, 551 U.S. 308 (2007) ("The crux of materiality is whether, in context, an investor would reasonably rely on the defendant's statement as one reflecting a consequential fact about the company. If the statement amounts to vague aspiration or unspecific puffery, it is not material."); Marsh Grp. v. Prime Retail, Inc., 46 F. App'x 140, 145-46 (4th Cir. 2002) (holding that statements regarding intent to pay future dividends were puffery because they were not "supported by specific statements of fact").

broad, and that petitioner's claim should proceed.

5. The split warrants this Court's immediate attention because it creates a real incentive for forum shopping and needless collateral litigation over venue as plaintiffs seek to avoid the Second Circuit and defendants seek to move cases there. The [*37] risk is real because many securities defendants will be subject to suit in multiple jurisdictions. But such gamesmanship wastes party and judicial resources, and undermines the uniform enforcement of the securities laws.

III. The Question Presented Is Of Surpassing Importance.

Certiorari is also warranted because the question presented is of vital importance to investors, issuers, and third parties like rating agencies. This litigation concerns a major contributor to the global financial crisis, but its impact is by no means limited to that context. As the cases in the split illustrate, the question whether statements are material arises constantly and creates substantial compliance concerns. Understanding which statements are actionable and which are not will go a long way toward clarifying the boundaries of the Exchange Act.

Clarifying the materiality and puffery standard applicable to a motion to dismiss will also assist the bar by providing guidance regarding when it does and does not make sense to sue. If an issuer's statements are likely to be deemed puffery, then plaintiffs are unlikely to conduct a further investigation costing hundreds of thousands [*38] of dollars. Instead, the case can end early and voluntarily and may not be filed at all. But the current ambiguous and fractured standards make it difficult for parties to predict how a court will regard a defendant's statements.

Finally, it makes no difference that this Petition arises after the denial of a motion under Federal Rule of Civil Procedure 60(b). Although the Rule imposes a heightened standard for relief on district courts and affords them discretion, the district court in this case exercised that discretion by flatly concluding that the statements in the complaint are immaterial as a matter of law notwithstanding their verifiability. "A district court would necessarily abuse its discretion if it based its ruling on an erroneous view of the law," *Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 405 (1990),* and so if the district court--following circuit precedent--applied the wrong puffery standard, then the lower courts should consider the case again under the correct one.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

Susan K. Alexander
Andrew S. Love
Matthew [*39] S. Melamed
ROBBINS GELLER RUDMAN &DOWD LLP
Post Montgomery Center
One Montgomery St.
Suite 1800
San Francisco, CA 94104

Thomas C. Goldstein
Counsel of Record
Tejinder Singh
GOLDSTEIN & RUSSELL, P.C.7475 Wisconsin Ave.
Suite 850
Bethesda, MD 20814
(202) 362-0636
tg@goldsteinrussell.com

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[SEE APPENDIX A IN ORIGINAL]

[SEE APPENDIX B IN ORIGINAL]

[SEE APPENDIX C IN ORIGINAL]

[SEE APPENDIX D IN ORIGINAL]

[SEE APPENDIX E IN ORIGINAL]