No. ______

IN THE

Supreme Court of the United States

BOCA RATON FIREFIGHTERS AND POLICE PENSION FUND,

Petitioner,

v.

ROBERT J. BAHASH, THE MCGRAW-HILL COMPANIES, INC. AND HAROLD MCGRAW, III,

Respondents.

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

PETITION FOR A WRIT OF CERTIORARI

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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?

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PETITION FOR A WRIT OF CERTIORARI

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 App. 1a-7a) is unpublished.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 The court of appeals' order denying rehearing en banc (*id*. 29a-30a) is unpublished. The court of appeals' and the district court's prior opinions in this case (*id*. 31a-46a, 47a-50a) are unpublished.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 to 28 U.S.C. § 1254(1).

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 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.

STATEMENT OF THE CASE

1. Standard & Poor's ("S&P") (a division of respondent the McGraw-Hill Companies, Inc.) (¶30)[1] rates securities, assessing the likelihood that the debts bundled within them will be repaid and assigning a letter grade rating. (¶¶45, 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" (¶275), and in common parlance is "junk." As a practical matter, without a credit rating, debt securities cannot be sold. (¶61)

S&P competes with other ratings agencies for market share among securities issuers. (¶¶23, 414) S&P's biggest competitor is Moody's. (¶23) The third

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[1] "¶__" 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)

largest competitor is Fitch. (¶¶152, 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. (¶48)

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"). (¶¶1, 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. (¶¶54, 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. (¶¶62, 76) For example, RMBS backed by risky mortgages will themselves be risky. If and when the underlying mortgages default, the returns to RMBS investors suffer as well.

During the Class Period, both the underlying residential loans and the structured financial instruments evolved significantly. (¶¶52-62) 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. (¶¶23, 52) These "subprime" loans were pooled and securitized as RMBS, which were in

turn bundled into even more opaque CDOs. (¶60) 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. (¶¶23, 101) S&P rated approximately 10,000 RMBS in 2006 and 2007 alone. (¶¶23, 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 ratings models to rate those securities as AAA and investment grade in order to preserve and increase its market share. (¶¶5, 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. (¶23) 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 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."

(¶23)

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." (¶479) Yet, internal memoranda document respondents' decision to continue to use "assumptions that are

inconsistent with historical data" because the new, accurate model would impair "potential business opportunities." (¶¶185, 187) Similarly, while respondents publicly told McGraw-Hill investors that S&P's ratings were based on "predetermined, nonnegotiable and publicly available criteria" (¶491), 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." (¶119)

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 "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

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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.

'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 *ECA, 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. 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 (¶22), 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"? (¶165)

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

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

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. (¶5) 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. (¶¶187, 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 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." (¶479) Yet, internal emails reveal that the decisive concern was actually upsetting "too many clients and jumping the gun ahead of Fitch and Moody's." (¶308)

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." (¶484) 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." (¶166)

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 would, of course, violate our internal rules . . . . [W]e do not engage in such behavior." (¶484) 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. (¶319)

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 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), 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.

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 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), 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 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 related' to [respondents] credit-ratings service" were not actionable. Pet. App. 40a-41a. 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 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 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" 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.

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 stand in stark contrast to the behavior alleged." *Id*. at *6.[4]

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

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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.

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.'" *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: "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]

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*

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[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 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.").

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.* 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]

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[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

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 conflict with the Second Circuit's holding in this case.

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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").

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 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 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 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,

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July 20, 2015

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 13-4039-cv

Claude A. Reese, Individually and on behalf of all others similarly situated,

Plaintiff,

Boca Raton Firefighters and Police Pension Fund,

Plaintiff-Appellant,

v.

Robert J. Bahash, The McGraw-Hill Companies, Inc., Harold McGraw, III,

Defendants-Appellees.

Appeal from an order of the United States District Court for the Southern District of New York
(Sidney H. Stein, Judge)

SUMMARY ORDER

UPON DUE CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the order of the District Court is AFFIRMED.

Plaintiff Boca Raton Firefighters and Police Pension Fund, on behalf of itself and a putative class of former shareholders of The McGraw-Hill Companies, Inc. ("McGraw-Hill"), appeals from the District Court's September 24, 2013 order denying plaintiff's motion for relief from judgment pursuant to Federal Rule of Civil Procedure 60(b)(2) and plaintiff's motion for leave to amend its complaint pursuant to Federal Rules of Civil Procedure 15(a) and (d). We assume the parties' familiarity with the underlying facts, the procedural history of the case, and the issues on appeal.

BACKGROUND

Plaintiff brought this putative securities fraud class action nearly seven years ago against The McGraw-Hill Companies, Inc. and two of its executive officers alleging violations of the Securities and Exchange Act of 1934. Plaintiff alleges that the company's financial services division, Standard & Poor's ("S&P"), made material misstatements touting the integrity, independence, and surveillance of its ratings of residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs") when, according to plaintiff, ratings criteria were in fact driven by defendants' desire to preserve market share, please clients, and increase profits. After nearly five years of litigation and affording plaintiff multiple opportunities to amend its complaint, the District Court dismissed plaintiff's second amended complaint for failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6). *Reese v. McGraw-Hill Cos.*, No. 08 Civ. 7202, 2012 WL 9119573 (S.D.N.Y. Mar. 30,

2012). We affirmed. *See Boca Raton FirefighterS&Police Pension Fund v. Bahash*, 506 F. App'x 32 (2d Cir. 2012).

Several months after this Court affirmed the District Court's dismissal, plaintiff filed a motion for relief from judgment and a motion for leave to amend its complaint. Plaintiff cited supposedly "newly discovered evidence"—in the form of a complaint filed by the U.S. Department of Justice against McGraw-Hill and S&P in the U.S. District Court for the Central District of California, and a previously sealed deposition transcript of S&P's former head of RMBS ratings from another case—which plaintiff contends cures the defects in its second amended complaint.[1] After thoroughly reviewing plaintiff's lengthy submissions, the District Court denied the motions, finding that the new evidence "would not have changed [the District] Court's previous ruling and is cumulative of plaintiffs' previous allegations in its nature and purpose, if not in all its details." *Reese v. McGraw-Hill Cos.*, 293 F.R.D. 617, 623 (S.D.N.Y. 2013).[2] This appeal followed.

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[1] We previously denied plaintiff's motion to take judicial notice of the deposition transcript during plaintiff's prior appeal. *Boca Raton*, 506 F. App'x at 36 n.4.

[2] Plaintiff also filed a motion to file a supplemental brief with additional, recently discovered evidence, which the District Court also denied in its September 24, 2013 order. Plaintiff does not appeal the denial of that motion. Appellant's Br. 6 n.4.

DISCUSSION

We review a district court's denial of relief from judgment for abuse of discretion. *Devlin v. Transp. Commc'ns Int'l Union*, 175 F.3d 121, 132 (2d Cir. 1999). Rule 60(b)(2) provides that a court "may relieve a party or its legal representative from a final judgment, order, or proceeding for . . . newly discovered evidence that, with reasonable diligence, could not have been discovered" within twenty-eight days after the entry of judgment. Fed. R. Civ. P. 60(b)(2). "A motion for relief from judgment is generally not favored and is properly granted only upon a showing of exceptional circumstances." *United States v. Int'l Bhd. of Teamsters*, 247 F.3d 370, 391 (2d Cir. 2001). The party seeking relief from judgment bears the burden of meeting the following "onerous" standard:

> (1) the newly discovered evidence was of facts that existed at the time of trial or other dispositive proceeding, (2) the movant must have been justifiably ignorant of them despite due diligence, (3) the evidence must be admissible and of such importance that it probably would have changed the outcome, and (4) the evidence must not be merely cumulative or impeaching.

Id. at 392. "Properly applied, Rule 60(b) strikes a balance between serving the ends of justice and preserving the finality of judgments." *Nemaizer v. Baker*, 793 F.2d 58, 61 (2d Cir. 1986). A court abuses it discretion only when "(1) its decision rests on an error of law or a clearly erroneous factual finding; or (2)

cannot be found within the range of permissible decisions." *Johnson v. Univ. of Rochester Med. Ctr.*, 642 F.3d 121, 125 (2d Cir. 2011) (per curiam).

After review of the record and relevant case law, we conclude that the District Court was well within its discretion in denying plaintiff's motion for relief from judgment and motion for leave to amend for the reasons stated in its September 24, 2013 order. As the District Court found, the new evidence does not alter the District Court's and this Court's previous conclusion that defendants' statements regarding the "independence" and "integrity" of their ratings constitute "mere commercial puffery." *Boca Raton*, 506 F. App'x at 34, 37 (citing *City of Omaha, Neb. Civilian Emps.' Ret. Sys. v. CBS Corp.*, 679 F.3d 64, 67 (2d Cir. 2012)). Alleged new evidence showing that, for example, S&P slowed the roll out of a new ratings model that might negatively affect CDO ratings, S&P analysts discussed that CDO issuers were upset by subprime RMBS ratings downgrades, or S&P may have been concerned about market share and profits, does not alter the "generic, indefinite nature" of the statements at issue or demonstrate why they are false. *Id.* at 37. As the District Court correctly observed, these statements are too general to cause a reasonable investor to rely upon them as a guarantee that ratings would not be made without regard to profits, market share, or client feedback. *See ECA, Local 134 IBEW*

Joint Pension Trust of Chicago v. JP Morgan Chase Co., 553 F.3d 187, 206 (2d Cir. 2009).[3]

The District Court also did not abuse its discretion in deciding that the new evidence fails to demonstrate with particularity why defendants' statements regarding their surveillance practices were false. *See* Fed. R. Civ. P. 9(b) (requiring fraud claims to be "state[d] with particularity"). Alleged new evidence showing that, for example, RMBS downgrades did not result in immediate downgrades of CDOs collateralized by those securities, or S&P analysts sometimes based their CDO ratings on older default rate assumptions, does not demonstrate with particularity why defendants' statements that ratings were "reviewed regularly," or that the surveillance process was "fully integrated," were false. Put simply, the alleged misstatements do not state precisely how or when S&Ps ratings would be updated, and the new evidence does not show with particularity how S&P's surveillance process was inconsistent with those statements.

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[3] Plaintiff also argues that the District Court committed legal error by considering the "nature of the statements themselves" without regard to the context of the new evidence. Appellant's Br. 30-31; *see Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1321 (2011) (stating that materiality is "a fact-specific inquiry" requiring consideration of "source, content, and context"). The District Court, however, plainly analyzed the alleged misstatements in light of the new evidence and found that "plaintiffs have not show[n] why these statements are misleading as a result of their new evidence." *Reese*, 293 F.R.D. at 624.

Because the District Court's denial of plaintiff's motion for relief from judgment was well within its discretion, its denial of plaintiff's motion for leave to amend was likewise not an abuse of discretion.

CONCLUSION

We have considered all of plaintiff's remaining arguments and find them to be without merit. Accordingly, we **AFFIRM** the September 24, 2013 order of the District Court.

FOR THE COURT:

Catherine O'Hagan Wolfe, Clerk

STRAUB, Circuit Judge, dissenting:

I respectfully dissent because I believe the new evidence to be 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*. Therefore, I would remand for such further consideration.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

No. 08-Civ.-7202 (SHS) Sept. 24, 2013

Claude REESE, Individually and on Behalf of All Others Similarly Situated, Plaintiff,

v.

The McGRAW-HILL COMPANIES, INC., Harold McGraw III, and Robert Bahash, Defendants.

OPINION & ORDER

SIDNEY H. STEIN, District Judge.

This securities fraud action was filed on behalf of a putative class of former shareholders of The McGraw-Hill Companies, Inc. to recover losses incurred as a result of the company's alleged misstatements made by Standard & Poor's ("S&P"), its financial services division. Plaintiffs brought claims against McGraw-Hill and two of its executives—Harold McGraw III and Robert Bahash—pursuant to Section 10(b) and Rule 10b-5, as well as Section 20(a) of the Securities Exchange Act of 1934. This Court previously dismissed plaintiffs' second amended complaint for failure to state a claim pursuant to

Federal Rule of Civil Procedure 12(b)(6). *See Reese v. McGraw-Hill Cos.,* No. 08 Civ. 7202(SHS), 2012 WL 9119573, 2012 U.S. Dist. LEXIS 83753 (S.D.N.Y. March 30, 2012), *aff'd sub nom. Boca Raton Firefighters and Police Pension Fund v. Bahash,* 506 Fed.Appx. 32 (2d Cir. 2012).

Nearly one year after the issuance of this Court's Order, interim lead plaintiff Boca Raton Firefighters and Police Pension Fund filed a motion seeking: (1) the extraordinary remedy of relief from final judgment pursuant to Federal Rule of Civil Procedure 60(b)(2) and (2) leave to amend the complaint for the third time pursuant to Federal Rules of Civil Procedure 15(a) and (d), citing new facts that allegedly would have changed the outcome. Almost two months later, plaintiffs filed an additional motion seeking leave to file a "Supplemental Memorandum with Additional, Recently Discovered Evidence" in support of their Rule 60(b)(2) motion.

Because the purported new facts set forth by plaintiffs would not have changed the outcome of the Court's previous decision, those motions are denied.

I. BACKGROUND

Plaintiffs based their securities fraud claims on allegations of egregious mismanagement by S&P of its ratings business—specifically of its ratings of residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs") backed by those securities. According to the complaint, S&P's ratings of these financial instruments were motivated not by an interest in the quality and accuracy of those ratings, but by S&P's profits and its need to maintain

market share—resulting in inaccurate and biased results. Taking these allegations as true, the Court nevertheless found that certain alleged misstatements were commercial puffery, that plaintiffs failed to allege with particularity circumstances demonstrating that other alleged misstatements were false, and that they failed to allege scienter adequately. Plaintiffs now urge that, because certain newly discovered facts correct these defects, this Court should rescind its previous dismissal of the complaint with prejudice.

A. Procedural History

This litigation began with the filing of a complaint in 2007 in the U.S. District Court for the District of Columbia. That court appointed Boca Raton Firefighters and Police Pension Fund, which had purchased shares of McGraw-Hill on the open market between October 2004 and March 2008, as interim lead plaintiff. Plaintiffs filed a consolidated class action complaint in May 2008, and the parties consented to a transfer of the litigation to the Southern District of New York in June 2008. Thereafter, plaintiffs filed in this Court an amended complaint in December 2008 and a second amended complaint in July 2010.

Following plaintiffs' multiple opportunities to correct their pleadings, the Court dismissed the second amended complaint for failure to state a claim in a March 30, 2012 Order. *Reese,* 2012 WL 9119573, 2012 U.S. Dist. LEXIS 83753. That Order was affirmed in all respects by the U.S. Court of Appeals for the Second Circuit. *Boca Raton Firefighters,* 506 Fed.Appx. 32.

B. Dismissal of Plaintiff's Complaint and Affirmance of that Dismissal

The Court assumes the parties' familiarity with the orders dismissing plaintiffs' complaint and affirming that decision, but highlights certain aspects of their analyses upon which this Opinion focuses. Plaintiffs alleged that S&P and certain of its executives defrauded investors by making numerous material misstatements, which fell into three general categories. The two categories at issue here are statements representing the stringency, independence, and integrity of S&P's credit ratings process (*see, e.g.,* Second Am. Compl. ¶ ¶ 349, 351, 362) and statements regarding S&P's ongoing surveillance of the credibility of its ratings (*see, e.g., id.* ¶ ¶ 271, 325, 327).[1]

In the memoranda of law supporting the motion to reopen, plaintiffs emphasize several allegedly misleading statements by S&P executives from the second amended complaint regarding the integrity of the company's ratings:

- A statement by Executive Vice President Vickie Tillman during a July 2007 conference call in which she stated, inter alia, that "[t]ightening criteria may have an adverse impact on [S&P's] market share, but [the company] will continue to develop and adjust [its] criteria to reflect how

[1] Plaintiffs do not challenge the Court's dismissal of their securities fraud claims alleging misrepresentations or omissions in McGraw-Hill's financial statements; they omit those allegations from the proposed third amended complaint.

changing conditions impact credit risk." (*Id.* at ¶ 349.)

- Tillman's answer to a question on the same July 2007 call, in which she explained that S&P "raised [its] requirements in terms of ratings" in early 2007 for "collateralized mortgage-backed securities," despite the fact that this action could "have an adverse impact on whether [investment banks] come to Standard & Poor's or not, but that's not what [S&P is] concerned about. We're concerned about calling it as it is." (*Id.* at ¶ 351.)
- A statement by individual defendant McGraw during a September 2007 Goldman Sachs conference that S&P has "institutional safeguards in place to ensure the independence and integrity of [its ratings] opinions." (*Id.* at ¶ 362.)
- Another statement by McGraw during that conference explaining that S&P does not differentiate between the financial products it rates, but rather "appl[ies] its own predetermined, nonnegotiable, and publicly available criteria and assumptions to the facts presented"—even though "there may be more dialogue between S&P and an issuer in [a] structured finance transaction." (*Id.*)

Plaintiffs similarly draw the Court's attention to certain alleged misstatements regarding S&P's ongoing surveillance of the credibility of its ratings from the second amended complaint:

- A statement by Executive Managing Director of Structured Finance Ratings Joanne Rose during a July 2005 conference in which she explained that

S&P has a "dedicated surveillance unit to oversee the continuing credibility of [its] ratings" and that the ratings are "regularly reviewed" and back tested "to show their credibility over time." (*Id*. at ¶ 271.)

- A statement by McGraw during a March 2007 conference that "S&P has [a] fully integrated surveillance process for residential mortgage-backed securities and CDOs . . . mean[ing] that S&P will determine what effect, if any, the increase in delinquencies on certain sub-prime mortgages has on both its rated residential mortgage-backed security transactions, and those collateralized debt obligations transactions which hold residential backed securities." (*Id*. at ¶ 325.)

All of these statements are selective excerpts from long block quotes in plaintiffs' second amended complaint, which included over 100 pages of such allegations.

In its Order dismissing the second amended complaint, the Court determined that the alleged misstatements in the first category were not actionable because they constituted "mere commercial puffery." *Reese,* 2012 WL 9119573 at *1, 2012 U.S. Dist. LEXIS 83753 at *3. The claimed misstatements in the second category were not actionable because the complaint did not state with particularity how S&P's alleged misconduct with regard to its ratings surveillance rendered the statements fraudulent. *Id.* at *1-2, 2012 U.S. Dist. LEXIS 83753 at *4. Finally, the Court found that plaintiffs had not set forth facts to support an inference "that either McGraw or

Bahash knew of facts or had access to information that contradicted either man's statements," and therefore failed to demonstrate scienter. *Id.* at *2, 2012 U.S. Dist. LEXIS 83753 at *5.

On appeal, the Second Circuit panel affirmed this Court in all respects in a December 2012 Summary Order. First, it wrote that the statements representing the independence and integrity of S&P's ratings were commercial puffery because of their "generic, indefinite nature." *Boca Raton Firefighters,* 506 Fed.Appx at 37. It further determined that plaintiffs had not demonstrated with particularity how or why S&P's statements about its ratings surveillance were materially false, instead "leaving the District Court to search the long quotations in the complaint for particular false statements, then determine on its own initiative how and why the statements were false." *Id.* at 38. Finally, the Second Circuit found that the particularity requirement had not been met with regard to demonstrating scienter. *Id.* at 39.

C. The Allegedly "Newly Discovered Evidence"

Plaintiffs represent that, since this Court's dismissal of the second amended complaint and the Second Circuit's affirmance of that decision, they have learned certain new information that merits the exceptional remedy of relief from judgment. Plaintiffs derive these new facts from two sources.

The first and primary source is a 119-page complaint filed by the Department of Justice (the

"DOJ complaint") against McGraw-Hill and S&P on February 4, 2013 in the U.S. District Court for the Central District of California.[2] The DOJ complaint contains detailed factual allegations about S&P's mismanagement of its RMBS and CDO ratings during the majority of the proposed class period in this case.[3]

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[2] *See United States v. McGraw-Hill Cos., Inc., et al.,* No. CV 13-0779 DOC(JCGx), 2013 WL 3762259, 2013 U.S. Dist. LEXIS 99961 (C.D. Cal. July 16, 2013). That district court recently denied defendants' motion to dismiss the government's complaint, which alleges that McGraw-Hill and S&P committed mail fraud, wire fraud, and financial institution fraud. *Id.* The government is seeking civil penalties for the alleged violations of those criminal fraud statutes pursuant to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, 12 U.S.C. § 1833a. *Id.* at *3-4, 2013 U.S. Dist. LEXIS 99961 at *9-10. The opinion denying McGraw-Hill's motion to dismiss makes clear the distinctions between that action and this one in several respects: (1) that case alleges specific, verifiable representations by S&P and specific facts showing that these representations were false and misleading; and (2) the government in that case alleges S&P defrauded the end users of its ratings, whereas this case was brought by S&P shareholders, to whom the accuracy of S&P's ratings matters only insofar as it rendered statements upon which shareholders relied when purchasing McGraw-Hill securities materially false or misleading. *Id.* at *7-8, 2013 U.S. Dist. LEXIS 99961 at *21. Moreover, and perhaps most significantly, this action alleges violations of civil securities laws, which require a showing of different elements to state a plausible claim for relief than the criminal fraud statutes referenced in the DOJ complaint.

[3] The DOJ complaint alleges that fraudulent ratings took place between September 2004 and October 2007. (DOJ Compl. ¶ 7.) The proposed class period in this action is October 2004 through March 2008. (Pls.' Mem. of Law at 2.)

(DOJ Compl., Ex. 2 to Decl. of David J. George, Esq. dated March 28, 2013.) The allegations in the DOJ action include specific representations about the existence and content of numerous documents, as well as certain alleged events, that plaintiffs argue support their securities fraud claims. Plaintiffs highlight the following such documents and events described in the DOJ complaint:

- a July 2005 internal S&P report, which explained that S&P had slowed its roll out of a new ratings model due to its negative impact on CDO ratings (DOJ Compl. ¶ 178);
- a July 2007 internal email explaining that CDO issuers were upset that subprime RMBS ratings downgrades were affecting their ability to issue CDOs and stating that the collateral underlying certain deals was likely to be downgraded immediately after their closing (*id*. at ¶ 254);
- S&P analysts' decision to rate a newly created CDO (the "Delphinus CDO") in July 2007 despite the fact that the rating of the assets underlying at least one of the CDO's tranches indicated that the collateral could not support the deal's proposed structure (*id*. at ¶ 264);
- a July 2007 internal email explaining that planned changes in RMBS ratings would "result in unprecedented CDO downgrades"—and that "all of this is firewalled and highly confidential" (*id*. at ¶ 251);
- the content of a March 2007 internal presentation revealing, inter alia, that recent RMBS

downgrades had not yet resulted in downgrades of CDOs collateralized by those securities (*id*. at ¶ 233(i));

- a June 2007 internal surveillance report explaining that the ratings performance of RMBS continued to be "predominately negative," particularly with regard to 2006 vintage RMBS and the lowest-rated tranches of subprime RMBS broadly (*id*. at ¶ 239(c));
- an April 2007 internal analysis showing that the actual average default rate of 2005 and 2006 vintage subprime RMBS was significantly higher than the assumptions upon which analysts had based their ratings of CDOs backed by these securities (*id*.at 235(d)); and
- an allegation that an unnamed executive "regularly expressed frustration to her colleagues" about the fact that certain S&P executives were preventing her from downgrading the ratings of poorly performing subprime RMBS (*id*. at ¶ 211).

The second source of new information is deposition testimony given by Frank Raiter, head of RMBS ratings for S&P, taken during discovery in a different suit[4] and unsealed on July 2, 2012.[5] Plaintiffs draw the

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[4] *See Abu Dhabi Commercial Bank v. Morgan Stanley & Co.,* No. 08 Civ. 7508(SAS), 2008 WL 6003117 (S.D.N.Y. April 26, 2013) (order approving stipulation of dismissal with prejudice). McGraw-Hill was also named as a defendant in *Abu Dhabi;* that suit was voluntarily dismissed with prejudice as to McGraw-Hill in April 2013.

Court's attention to two of Raiter's statements that they contend support their securities fraud claims: (1) that S&P refused to implement a new, superior ratings model, despite one being available, because it was satisfied with its current market share; and (2) that managers—specifically McGraw—conducted the business such that "profits were running the show." (Exs. 5, 6 to George Decl.)

Citing the aforementioned purported new evidence, plaintiffs filed this motion for relief from judgment on March 28, 2013.

On May 22, 2013, plaintiffs filed a motion for leave to supplement the March 28 motion with yet more claimed new evidence. This evidence consists of deposition testimony of two former high-level S&P executives, allegedly received from DOJ in May 2013. Those executives—Richard Gugliada, former global practice leader for CDOs, and Elwyn Wong, former managing director in the CDO group—testified that the need to increase profits and maintain market share became a factor in the CDO rating calculus, along with analytical concerns, after 2001. (Dep. of Richard Gugliada dated Dec. 13, 2011, Ex. A to Decl. of Samuel H. Rudman, Esq. dated May 22,2013; Dep. of Elwyn Wong dated Dec. 12, 2011, Ex. B. to Rudman Decl.)

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[5] The Second Circuit denied plaintiffs' motion to take judicial notice of the Raiter deposition in its order affirming this Court's initial dismissal of the case. *Boca Raton Firefighters,* 506 Fed.Appx. at 36 n.4, 39.

II. ANALYSIS

The Court discusses the two motions before it—the motion for relief for final judgment and the motion to supplement the original motion with "additional, recently discovered evidence"—in turn.

A. Motion for Relief from Judgment

Plaintiffs move for relief from final judgment pursuant to Rule 60(b)(2), which permits a court to vacate a previously entered final judgment on the basis of "newly discovered evidence that, with reasonable diligence, could not have been discovered" within twenty-eight days after the entry of judgment. Fed. R. Civ. P. 60(b)(2). A motion pursuant to Rule 60(b)(2) is "generally not favored" and is "properly granted only upon a showing of exceptional circumstances." *United States v. Int'l Bhd. of Teamsters,* 247 F.3d 370, 391 (2d Cir. 2001); *see also Nemaizer v. Baker,* 793 F.2d 58, 61 (2d Cir. 1986) ("Since 60(b) allows extraordinary judicial relief, it is invoked only upon a showing of exceptional circumstances.").

The decision whether to grant such a motion rests within the district court's sound discretion. *Int'l Bhd. of Teamsters,* 247 F.3d at 391. This discretion is exercised with the purpose of finding "a balance between serving the ends of justice and ensuring that litigation reaches an end within a finite period of time." *House v. Sec'y of Health & Human Servs.,* 688 F.2d 7, 9 (2d Cir. 1982). "[F]inal judgments should not be lightly reopened"—only when "substantial justice" requires it. *Nemaizer,* 793 F.2d at 61 (quoting *Seven Elves, Inc. v. Eskenazi,* 635 F.2d 396, 401 (5th Cir. 1981)) (quotation marks omitted).

A party seeking relief pursuant to Rule 60(b)(2) must meet an "onerous" standard, *Int'l Bhd. of Teamsters,* 247 F.3d at 392,and it has the burden of demonstrating each of the following four elements:

> (1) the newly discovered evidence was of facts that existed at the time of trial or other dispositive proceeding, (2) the movant must have been justifiably ignorant of them despite due diligence, (3) the evidence must be admissible and of such importance that it probably would have changed the outcome, and (4) the evidence must not be merely cumulative or impeaching.

Id.

Plaintiffs focus their argument on factor three, contending that the Court should grant the disfavored relief of rescinding its previous judgment because, had the above-referenced facts been included in their original complaint, the outcome of the Court's previous decision would have been different.[6] They claim the new facts correct two defects the Court identified in its

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[6] Plaintiffs also claim that they had exhaustively investigated their original claims, but were unable to discover the above-referenced facts prior to the filing of the DOJ complaint and the public disclosure of the Raiter deposition. (*See* George Decl. ¶ ¶ 49-61.) The Court assumes for the sake of argument that this assertion is true. Neither party disputes that the purported new evidence—all of which references events occurring or documents produced between 2005 and 2007—existed before March 2012, when this Court granted defendants' motion to dismiss the second amended complaint.

Order dismissing the complaint. First, plaintiffs urge that these facts demonstrate that S&P's statements about the integrity and independence of its ratings were not mere commercial puffery, but were demonstrably false statements that support an inference of scienter. Second, they contend that the new information demonstrates with particularity the falsity of S&P's statements about the ongoing surveillance of its ratings, as well as scienter in the issuance of those statements.

To demonstrate how the newly discovered evidence cures the defects that previously doomed their pleadings, plaintiffs have submitted a proposed, extremely lengthy, third amended complaint along with their motion, including the new allegations based on the facts from the DOJ complaint and the Raiter deposition. The proposed third amended complaint runs 525 paragraphs and 194 pages. (Ex. 1 to George Decl.)

The Court has reviewed these extensive submissions and finds that plaintiffs have failed to demonstrate that they are deserving of the discretionary relief afforded pursuant to Rule 60(b)(2). Plaintiffs' purported new evidence[7] would not have

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[7] Defendants challenge plaintiffs' proffered new evidence from the DOJ complaint on the ground that, because it originates from allegations in a complaint, it is not admissible. The Court does not dispute the uncontroversial proposition that mere allegations from a complaint are hearsay and therefore not admissible. *See, e.g., Rivera v. Metro. Transit Auth.,* 750 F. Supp. 2d 456, 461 (S.D.N.Y. 2010) ("An unsworn statement by a non-party in a

changed the outcome of the original decision because those allegations do not correct the pleading defects for which the Court dismissed its previous complaint.

Instead, plaintiffs' motion represents an attempt to reargue their prior motion. They select different carefully excerpted phrases from the large number of alleged misrepresentations included in the second amended complaint and claim that they were misleading based on alleged new facts that—although not specifically referenced in the second amended complaint—are of the same character as the facts plaintiffs previously claimed demonstrated falsity and scienter. The new evidence thus would not have changed this Court's previous ruling and is cumulative of plaintiffs' previous allegations in its nature and purpose, if not in all its details.

To prevail on a claim that defendants "made material misrepresentations or omissions in violation of Section 10(b) and Rule 10b-5, [plaintiffs] must prove (1) a material misrepresentation or omission by the

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complaint in another lawsuit is hearsay when offered to prove the truth of that statement. It is not admissible."). That said, because plaintiffs are attempting to reopen this litigation at the motion to dismiss phase—a stage at which all allegations are assumed to be true—the Court focuses on the other deficiencies in their motion. *See Kurzweil v. Philip Morris Companies, Inc.,* No. 94 Civ. 2373(MBM), 1997 WL 167043 (S.D.N.Y. Apr. 9, 1997) ("On a Rule 12(b)(6) motion I must take plaintiffs' factual allegations to be true. *Conley v. Gibson,* 355 U.S. 41 (1957). This is the same standard I must apply to plaintiffs newly discovered evidence on a Rule 60(b)(2) motion.").

defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[8] *Matrixx Initiatives, Inc. v. Siracusano,* 131 S. Ct. 1309, 1317 (2011) (quoting *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148, 157 (2008)) (quotation marks omitted).

As with all fraud claims, securities fraud claims must meet the heightened pleading requirements of Federal Rule of Civil Procedure 9(b), which requires that the circumstances constituting fraud be stated with particularity. And, pursuant to the Private Securities Litigation Reform Act of 1995 ("PSLRA"), a party alleging securities fraud must identify each allegedly misleading statement, state the reasons why each statement was misleading, and "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b). "[I]n determining whether the

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[8] An element of plaintiffs' Section 20(a) claims is to properly allege a primary violation of the Exchange Act. *See ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,* 493 F.3d 87, 108 (2d Cir. 2007). The Court therefore focuses on the Section 10(b) and Rule 10b-5 claims, without which the Section 20(a) claims necessarily fall. *See, e.g., Int'l Fund Mgmt. S.A. v. Citigroup Inc.,* 822 F. Supp. 2d 368, 386 (S.D.N.Y. 2011) (dismissing control person claims for failure to plead a primary violation of the Exchange Act); *Vladimir v. Bioenvision Inc.,* 606 F. Supp. 2d 473, 496-97 (S.D.N.Y. 2009) (same).

pleaded facts give rise to a 'strong' inference of scienter, the court must take into account plausible opposing inferences." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,* 493 F.3d 87, 99 (2d Cir. 2007) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 323 (2007)).

The Court's previous ruling focused on elements one and two of the Section 10(b) and Rule 10b-5 test, finding plaintiffs' pleading lacking. Plaintiffs have failed to convince the Court that the new evidence to which they cite is "of such importance that it probably would have changed [this] outcome." *See Int'l Bhd. of Teamsters,* 247 F.3d at 392.

1. S&P's Statements Regarding the Integrity of Its Ratings

This Court previously held that S&P's statements regarding the integrity and independence of its ratings were "mere commercial puffery" and that such statements could not form the basis for a finding of Section 10(b) liability. *Reese,* 2012 WL 9119573, at *1-2, 2012 U.S. Dist. LEXIS 83753, at *3-4. Plaintiffs now highlight different passages from the second amended complaint and claim that new facts from the DOJ complaint and the Raiter deposition demonstrate that these statements are actionable. In general, plaintiffs claim that the new facts now render S&P's statements about the integrity and independence of its ratings misleading because they demonstrate that, on several occasions, S&P adjusted the content and application of its ratings criteria based on the desire to please clients, preserve market share, or increase profits.

The Court concludes that these new facts do not alter the previous conclusion that the statements are "generic" and "indefinite." *See Boca Raton Firefighters,* 506 Fed.Appx. at 37. That determination dealt with the nature of the statements themselves, which this Court and the Second Circuit concluded were not capable of "meaningfully altering the mix of available information about the company." *Id.*

Moreover, even if plaintiffs had somehow persuaded the Court that the new select phrases it emphasizes were specific enough to be proven false—which they have not—plaintiffs have not showed why these statements are misleading as a result of their new evidence. Take, for example, the most arguably definite statement: that S&P "appl[ies] its own predetermined, nonnegotiable, and publicly available criteria and assumptions to the fact presented"—couched by the caveat that "there may be more dialogue between S&P and an issuer in [a] structured finance transaction." (Second Am. Compl. ¶ 362.) Newly alleged facts—such as that S&P slowed the adoption of a new ratings model due to its negative impact on CDO ratings or that S&P analysts discussed that CDO issuers were upset by subprime RMBS ratings downgrades—do not demonstrate why this statement or others like it are false. (*See* DOJ Compl. ¶ ¶ 178, 254.)

At bottom, the fact remains that plaintiffs have not convinced the Court that it should alter its conclusion that S&P's statements about the integrity and independence of its ratings are not specific enough to amount to a guarantee that its ratings were made

without regard to profits, market share, or client feedback. *See Boca Raton Firefighters,* 506 Fed.Appx. at 37; *see also ECA, Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.,* 553 F.3d 187, 206 (2d Cir. 2009). New facts purportedly demonstrating that profits, client satisfaction, and market share were considerations in S&P's rating of securities would not, therefore, have changed the outcome of this case.

2. S&P's Statements Regarding Its Surveillance Practices

With regard to plaintiffs' allegations regarding the falsity of S&P's statements regarding its surveillance practices, this Court previously found that the complaint failed to set forth with particularity how these statements were misleading. *Reese,* 2012 WL 9119573, at *1-2, 2012 U.S. Dist. LEXIS 83753, at *4. Specifically, it found that allegations that ratings surveillance was "perpetually late" did not render statements false explaining that ratings were "reviewed regularly" and that the surveillance process was "fully integrated . . . mean[ing] that S&P will determine what effect, if any, the increase in delinquencies on certain sub-prime mortgages has on both its rated residential mortgage-backed security transactions, and those collateralized debt obligations transactions which hold residential backed securities." (Second Am. Compl. ¶ 325.) Plaintiffs now draw the Court's attention to the same two statements from the second amended complaint and to "new" facts regarding the lag in time between downgrades in RMBS ratings and downgrades of CDOs that had

RMBS as a portion of their collateral to support its claim that S&P's statements regarding its ongoing surveillance of credit ratings were misleading.

The alleged new facts, however, are of the same character as the previous allegations and, as with the statements in the dismissed complaint, do not demonstrate with particularity how they render S&P's representations false. Plaintiffs seize on the phrase "fully integrated" to argue that the evidence demonstrating that downgrades to RMBS did not immediately result in downgrades to CDOs proves that S&P's statements were misleading. Taken in context, however, the statements do not provide any time frame for the integration of RMBS downgrades and any resulting CDO downgrades. Thus, new allegations that downgrades were not immediate and took place only after extensive internal discussions do not render S&P's statements false. The new facts, therefore, are cumulative of the previous allegations and are insufficient to convince the Court that the outcome of the motion to dismiss would have been different had those facts been included in the original pleadings.

Because plaintiffs cannot demonstrate each of the elements required to convince the Court to take the extraordinary step of reopening a dismissed action pursuant to Rule 60(b)(2), the Court declines to grant such relief. The interests of justice do not require it.

B. Motion to Supplement

"A motion under Rule 60(b) must be made within a reasonable time"; a party moving pursuant to Rule 60(b)(2) must do so "no more than a year after the

entry of the judgment or order." Fed. R. Civ. P. 60(c)(1). "The one-year period represents an extreme limit, and the motion may be rejected as untimely if not made within a 'reasonable time' even though the one-year period has not expired."11 Charles Alan Wright & Arthur R. Miller, *Federal Practice & Procedure* § 2866 (3d ed. 2013).

Plaintiffs' motion to file a supplemental memorandum in support of its Rule 60(b)(2) motion is essentially a second motion pursuant to Rule 60(b)(2). It was submitted well over a year after the issuance of this Court's Order dismissing the case and is dismissed as untimely. Even if it were not untimely, however, the motion would nonetheless be denied on the ground that the additional newly discovered facts it purports to introduce are of the same nature as the facts previously alleged in both the second amended complaint and in plaintiffs' initial motion for relief from judgment. Amendment of the motion would be futile.

III. CONCLUSION

For the reasons set forth above, plaintiffs' motion for relief from final judgment and for leave to amend their complaint for the third time on the basis of newly discovered evidence is denied (Dkt. No. 62), as is their motion seeking leave to file a supplemental memorandum with additional newly discovered evidence, (Dkt. No. 70).

SO ORDERED.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 20th day of February, two thousand fifteen.

Claude A. Reese, Individually and on behalf of all others similarly situated,

Plaintiff,

Boca Raton Firefighters and Police Pension Fund,

Plaintiff-Appellant,

v.

Robert J. Bahash, The McGraw-Hill Companies, Inc., Harold McGraw, III,

Defendants-Appellees.

ORDER No. 13-4039-cv

Appellant Boca Raton Firefighters and Police Pension Fund filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*. The panel that determined the appeal has considered the request for panel rehearing, and the active members of the

Court have considered the request for rehearing *en banc*.

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:

Catherine O'Hagan Wolfe, Clerk

APPENDIX D

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 12-1776-cv. Dec. 20, 2012

Boca Raton Firefighters and Police Pension Fund,

Plaintiff-Appellant,

v.

Robert J. Bahash, The McGraw-Hill Companies, Inc., Harold McGraw, III,

Defendants-Appellees.

Appeal from an order of the United States District Court for the Southern District of New York
(Sidney H. Stein, Judge)

SUMMARY ORDER

UPON DUE CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the order of the District Court is AFFIRMED.

Plaintiff-appellant Boca Raton Firefighters and Police Pension Fund (the "Fund"), a putative class representative of similarly situated purchasers of

McGraw-Hill stock between October 21, 2004 and March 11, 2008, alleges that defendants-appellees McGraw-Hill Companies, Inc., and two of its corporate officers (collectively, "McGraw-Hill") violated federal securities laws by making false and misleading statements about the operations of Standard & Poor's Ratings Services ("S&P"), a subunit of McGraw-Hill. In essence, the Fund alleges that officers of McGraw-Hill made public statements about the honesty and integrity of S&P's credit-ratings services while knowing that its ratings method was basically a sham. The Fund brought claims under Section 10(b) of the Securities Exchange Act of 1934, *see* 15 U.S.C. § 78j(b),[1] and Rule 10b-5, *see* 17 C.F.R. § 240.10b-5,[2]

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[1] 15 U.S.C. § 78j(b) provides, in relevant part, that it shall be unlawful:

> 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.

[2] 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

promulgated thereunder, and it asserted control-person liability in violation of § 20(a) of the Exchange Act, *see* 15 U.S.C. § 78t(a).[3] The Fund's legal theory depends not on the accuracy of the credit ratings themselves but rather on how securities-market participants would view McGraw-Hill's stock in light of the company's purportedly misleading statements about its credit-ratings services.

In an order dated March 30, 2012, the District Court dismissed the Fund's complaint under Rule 12(b)(6). The Court's analysis is succinct and worth quoting in full:

> The Complaint fails to set forth "enough facts to state a claim for relief that is plausible

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> 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.

[3] 15 U.S.C. § 78t(a) provides as follows:

> 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 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.

on its face." *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570 (2007). Although plaintiffs' Complaint identifies three categories of misstatements, none are actionable. In addition, the Complaint fails to allege facts sufficient to support an inference of scienter.

First, plaintiffs allege that S&P misled investors by representing that it had "market lead[ing] software," that it used "transparent and independent decision-making" to produce "independent and objective analysis," and that "excelled" in its role. (Compl. ¶¶ 253, 271, 290, 297.) These statements are mere commercial puffery. "[I]ntegrity and risk management are 'matters of great importance to investors,'" but general statements by a defendant that "it 'set the standard for best practices in risk management'" are "precisely the type of puffery" that may not undergird a Section 10b-5 claim. *In re JP Morgan Chase Sec. Litig.,* No. 02 Civ. 1282, 2007 U.S. Dist. LEXIS 22948, at *35-36 (S.D.N.Y. Mar. 28, 2007) (citations omitted), *aff'd sub nom., ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.,* 553 F.3d 187 (2d Cir. 2009).

Second, plaintiffs allege that defendants "misled the market as to the frequency and quality of its ratings surveillance" by concealing that S&P's surveillance was "perpetually late" and its surveillance group was "over-worked, under-staffed, and underfunded." (Compl. ¶ 256; *see also id.*

> ¶¶ 261, 270, 328.) Missing from plaintiffs' pleadings, however, are the statements that these alleged facts render misleading. Thus, this claim falls short of the PSLRA's particularity threshold, 15 U.S.C. § 78u-4(b).*See Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 321 (2007).
>
> Third, plaintiffs challenge McGraw-Hill's financial reports because "the overly positive statements describing those numbers were misleading in light of the concealed manner in which they were achieved." (Pls.' Opp. 14.) But plaintiffs admit that the reported earnings figures were accurate, (*see id.*), and a defendant's failure to disclose that its earnings were unsustainable is not securities fraud. *See In re Axis Capital Holdings Ltd. Sec. Litig.*, 456 F. Supp. 2d 576, 587 (S.D.N.Y. 2006).
>
> Finally, plaintiffs have failed to allege facts that constitute "strong circumstantial evidence of conscious misbehavior or recklessness." *ECA & Local 134*, 553 F.3d at 198. Plaintiffs have not set forth facts to support the inference that either McGraw or Bahash knew of facts or had access to information that contradicted either man's statements. *See Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 196 (2d Cir. 2008).

Dist. Ct. Op. 2-3.

On appeal, the Fund contests each aspect of the District Court's opinion. With regard to the Fund's

purported failure to allege actionable false or misleading statements, the Fund argues that McGraw-Hill's statements about its objectivity were not mere puffery, that it adequately pleaded misleading statements regarding McGraw-Hill's surveillance, and that McGraw-Hill's financial reports were misleading. With regard to scienter, the Fund argues that a plethora of pleaded facts supply a strong inference of scienter on the part of McGraw-Hill. We assume the parties' familiarity with the facts and procedural history of this case.

DISCUSSION

A.

We review *de novo* "the dismissal of a complaint under Rule 12(b)(6), accepting all factual allegations as true and drawing all reasonable inferences in favor of the plaintiff." *ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.,* 553 F.3d 187, 196 (2d Cir. 2009). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal,* 556 U.S. 662, 678 (2009) (internal quotation marks omitted). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* "[C]ourts must consider the complaint in its entirety," assessing "whether *all* of the facts alleged, taken collectively, give rise" to the required inferences. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 322-23 (2007).

Additionally, a complaint alleging a violation of § 10(b) and Rule 10b-5 must also satisfy the heightened pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure and the rules set out in the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). *See* 15 U.S.C. § 78u-4(b); *Tellabs,* 551 U.S. at 321. Under Rule 9(b), allegations of fraud must be "state[d] with particularity." Fed. R. Civ. P. 9(b). "To satisfy this requirement the plaintiff must (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Anschutz Corp. v. Merrill Lynch & Co.,* 690 F.3d 98, 108 (2d Cir. 2012) (internal quotation marks omitted). Moreover, the PSLRA requires that "securities fraud complaints 'specify' each misleading statement; that they set forth the facts 'on which [a] belief' that a statement is misleading was 'formed'; and that they 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 345 (2005) (quoting 15 U.S.C. § 78u-4(b)(1), (2)).

Section 10(b) "prohibit[s] the full range of ingenious devices that might be used to manipulate securities prices," but it does not reach mere "instances of corporate mismanagement." *Santa Fe Indus., Inc. v. Green,* 430 U.S. 462, 477 (1977). As the Supreme Court has explained, a contrary understanding of § 10(b) would "bring within the Rule a wide variety of corporate conduct traditionally left to state regulation," thus "posing a danger of vexatious litigation which could result from a widely expanded

class of plaintiffs under Rule 10b-5." *Id.* at 478-79. To prevail on their claim that McGraw-Hill violated § 10(b) and Rule 10b-5, the Fund must prove "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Matrixx Initiatives, Inc. v. Siracusano,* --- U.S. ----, 131 S. Ct. 1309, 1317 (2011) (quotation marks omitted). At issue in this appeal are the first two of these elements.

B.

Having reviewed the pleadings *de novo,*[4] we agree with the District Court's well-reasoned analysis, which

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[4] The Fund also requests that we take judicial notice of the substance of materials recently unsealed in another case. That motion is denied, as the substance of the deposition testimony at issue is neither undisputed, nor relevant to the question at hand, which is whether the complaint presents sufficient allegations to survive a motion to dismiss. *See Garanti Finansal Kiralama A.S. v. Aqua Marine & Trading Inc.,* 697 F.3d 59, 63 n. 4 (2d Cir. 2012) (explaining why, with exceptions not applicable here, matters outside the pleadings are not properly within the scope of a court's review of a motion to dismiss under Rule 12); *Int'l Star Class Yacht Racing Ass'n v. Tommy Hilfiger U.S.A., Inc.,* 146 F.3d 66, 70-71 (2d Cir. 1998) (testimony from another case that is not common knowledge or derived from an unimpeachable source is not properly subject to judicial notice). For the same reason, we grant McGraw-Hill's motion to strike references in the Fund's reply brief to these materials. Under the circumstances, "we see no reason to allow [the Fund] to effectively amend [its] complaint

we briefly review. The Fund identifies a variety of statements allegedly constituting material misrepresentations or omissions by the defendant. "The materiality of a misstatement depends on whether 'there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to [act].'" *ECA,* 553 F.3d at 197 (quoting *Basic Inc. v. Levinson,* 485 U.S. 224, 231 (1988)). "In other words, in order for the misstatement to be material, 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'" *Id.* (quoting *Basic Inc.,* 485 U.S. at 231-32). This inquiry is "fact-specific" and "depends on all relevant circumstances." *Id.* We have further explained:

> Because materiality is a mixed question of law and fact, in the context of a Fed. R. Civ. P. 12(b)(6) motion, a complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.

Id. (internal quotation marks omitted; alteration in original). However, we will not credit mere business

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on appeal." *Kendall v. Emps. Ret. Plan of Avon Prods.,* 561 F.3d 112, 117 (2d Cir. 2009).

"puffery," which we have defined in this context as "statements [that] are too general to cause a reasonable investor to rely upon them." *Id.* at 206. For instance, generalizations about a company's business practices and integrity may be "so general that a reasonable investor would not depend on [those statements]." *Id.*

The statements alleged in the Fund's complaint regarding McGraw-Hill's integrity and credibility and the objectivity of S&P's credit ratings are the type of mere "puffery" that we have previously held to be not actionable. For instance, in a conference call in October 2004 to discuss McGraw-Hill's quarterly financial results, a McGraw-Hill representative asserted that S&P's recently posted code of practices and procedures "underscores our own dedication towards transparent and independent decision-making process." App'x 136-37 (¶ 253). In another conference call in July 2006, McGraw purportedly claimed that "[t]he integrity, reliability and credibility of S&P has enabled us to compete successfully in an increasingly global and complex market, and that is true today and we are confident it will be so in the future." *Id.* at 191-92 (¶ 302).

The Fund argues that these statements are distinguishable from the "puffery" we identified in *ECA* because McGraw-Hill's statements were "directly related" to its credit-ratings service and were not "about the general integrity of McGraw-Hill as a company." Appellant's Br. 48. The "puffery" designation, however, stems from the generic, indefinite nature of the statements at issue, not their

scope. *See City of Omaha, Neb. Civilian Emps.' Ret. Sys. v. CBS Corp.,* 679 F.3d 64, 67 (2d Cir. 2012) (distinguishing "matters of objective fact" from "misstatements regarding opinion" (internal quotation marks and alteration omitted)). Otherwise, we would "bring within the sweep of federal securities laws many routine representations made by investment institutions." *ECA,* 553 F.3d at 206. In short, no reasonable purchaser of McGraw-Hill common stock would view statements such as these as meaningfully altering the mix of available information about the company.

We also agree with the District Court's conclusion that the complaint's allegations with respect to McGraw-Hill's oversight and surveillance procedures "fall[ ] short of the PSLRA's particularity threshold." Dist. Ct. Op. 2 (citing 15 U.S.C. § 78u-4(b)). Indeed, the 280-page complaint consists in large part of large block quotations with italicized text, followed by a passage that reads "[t]he statements referenced in [the preceding paragraphs] were each materially false and misleading when made for the reasons set forth in ¶ 256 and the factual detail contained throughout this Complaint."[5] *See, e.g.,* App'x 147 (¶ 261); *id.* 153 (¶ 270); *id.* 162 (¶ 276); *id.* 168 (¶ 280); *id.* 179 (¶ 289). The frequently cross-referenced paragraph 256 says

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[5] As a preliminary matter, we note that this oft-repeated sentence is a grammatical nightmare. McGraw-Hill's statements were not "made for . . . the factual detail contained throughout this Complaint."

that the statements in three of the preceding paragraphs "were each materially false and misleading when made as they misrepresented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading." *Id.* at 139 (¶ 256). The paragraph then provides a bullet-point list (running over a page) of "true facts, which were then known to or recklessly disregarded by each of the Defendants." *Id.* Other paragraphs use the same structure, alleging "true facts" that were "then known to or recklessly disregarded by each of the Defendants," but these paragraphs do not identify or clearly cross-reference any facts demonstrating a strong inference of scienter.

As we explained above, a complaint alleging a violation of Rule 10b-5 must (1) meet the four-part requirement[6] under Rule 9(b); (2) "set forth the facts 'on which [a] belief' that a statement is misleading was 'formed,'; and [(3)] 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Dura Pharms.,* 544 U.S. at 345 (quoting 15 U.S.C. § 78u-4(b)(1), (2)). The Fund's complaint fell far short of this standard, basically leaving the District Court to search the long

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[6] To satisfy [Rule 9(b)] the plaintiff must (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Anschutz Corp.,* 690 F.3d at 107-08 (internal quotation marks omitted).

quotations in the complaint for particular false statements, and then determine on its own initiative how and why the statements were false and how other facts might show a strong inference of scienter. Needless to say, asking the Court to assess the truth of facts in light of "the factual detail contained throughout this Complaint," *see, e.g.,* App'x 147 (¶ 261), does not comport with our exhortation that plaintiffs "must demonstrate with specificity why and how" each statement is materially false or misleading. *Rombach v. Chang,* 355 F.3d 164, 174 (2d Cir. 2004).

Lastly, the Fund argues that McGraw-Hill's statements about its earnings were actionable, even though literally true, because they did not acknowledge the long-term unsustainability of its business model. *See* Appellant Br. 52-60. This argument is easily rejected. Whatever the scope of the responsibility not to make statements that constitute "half-truths," that surely does not apply to the reporting of unmanipulated corporate earnings. *See In re Int'l Bus. Machs. Corp. Sec. Litig.,* 163 F.3d 102, 108 (2d Cir. 1998) (noting that a report about current dividends "contain[ed] no long-term guarantee or assurance that the dividend will be paid at a specific level for a foreseeable time"). To the extent that investors might impute a positive corporate outlook from omissions in earnings reports, we have explained that general expressions of corporate optimism are "too indefinite to be actionable under the securities laws." *Id.* As the Sixth Circuit succinctly observed, "[i]t is clear that a violation of federal securities law cannot be premised upon a company's disclosure of accurate

historical data." *In re Sofamor Danek Group, Inc.,* 123 F.3d 394, 401 n. 3 (6th Cir. 1997).

C.

Given the lack of actionable false or misleading statements, we need not proceed any further, though we also agree with the District Court's assessment that the complaint failed to "'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Dura Pharms.,* 544 U.S. at 345 (quoting 15 U.S.C. § 78u-4(b)(2)(A)). As it is understood in this context, scienter refers to "a mental state embracing intent to deceive, manipulate, or defraud" investors. *Matrixx Initiatives,* 131 S. Ct. at 1323 (quotation marks omitted).[7] Applying the relevant pleading standards, "we require the complaint to allege facts that give rise to a strong inference of fraudulent intent." *In re Carter-Wallace, Inc., Sec. Litig.,* 220 F.3d 36, 39 (2d Cir. 2000) (internal quotation marks omitted).

The Fund's complaint left the District Court to determine on its own initiative how and why the other alleged facts in the 280-page complaint might show a strong inference of scienter, thus falling far short of

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[7] "In addition to intent, recklessness is a sufficiently culpable mental state for securities fraud in this circuit. . . . Recklessness is defined as 'at the least, an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" *ECA*, 553 F.3d at 198 (quoting *Novak v. Kasaks*, 216 F.3d 300, 308 (2d Cir. 2000)).

the particularity required in fraud claims brought under § 10(b) and Rule 10b-5. This defect is especially problematic here, where the underlying theory of securities fraud vacillates within the complaint. For instance, the complaint criticizes S&P for being more focused on "pragmatic business decision[s]" than serving the interests of those who relied on its ratings, App'x 99 (¶ 172), and that its business practices reflected a "scheme to pursue market share at all costs," *id.* at 104 (¶ 181). Elsewhere, executives are alleged to have defrauded McGraw-Hill investors by acting "to the benefit of the Company." *Id.* at 112 (¶ 209). These statements would seem to negate—not support—a strong inference of intent to defraud McGraw-Hill investors.

In the end, the complaint relies on an assumption that McGraw-Hill executives were prescient, understanding not only the weaknesses of the services they were offering but also the imminent detrimental effect that those weaknesses would have on the company's stock price once the financial markets collapsed. *See, e.g.,* App'x 26 (¶ 12), *id.* at 172 (¶ 284). This is a prescience that the complaint does not adequately demonstrate. Whatever the failings of S&P's business model, the well-pleaded factual allegations do not give rise to a strong inference that McGraw-Hill executives misled investors about S&P's services in an effort to artificially inflate McGraw-Hill's stock price.

CONCLUSION

We have considered the Fund's arguments on appeal and find them to be without merit. Accordingly,

for the reasons stated above, we **AFFIRM** the judgment of the District Court.

Moreover, for the reasons stated above, the Appellant's motion for judicial notice (dated August 10, 2012) is **DENIED,** and the Appellees' motion to strike (dated August 23, 2012) is **GRANTED.**

APPENDIX E

IN THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK

No. 08-Civ.-7202 (SHS) Mar. 30, 2012

Claude REESE, Individually and on Behalf of All Others Similarly Situated, Plaintiff,

v.

The McGRAW-HILL COMPANIES, INC., Harold McGraw III, and Robert Bahash, Defendants.

ORDER

SIDNEY H. STEIN, District Judge.

This is a securities fraud action brought on behalf of a putative class of McGraw-Hill shareholders to recover for "Defendants' false and misleading statements regarding McGraw-Hill's true financial circumstances and future business prospects. . . ." (Second Amended Complaint ("Complaint") ¶ 3.) Plaintiffs assert a violation of Section 10(b) of the Exchange Act of 1934 and Rule 10b-5, and a violation of Section 20(a) of the Exchange Act of 1934.

Pending before the Court are four motions; plaintiffs' two motions for judicial notice; defendants' motion to dismiss the second amended complaint for

failure to state a claim pursuant to Federal Rule of Civil Procedure 12(b)(6); and plaintiffs' motion to modify the stay of discovery. The Court resolves each motion as set forth below.

A. The Court grants the motions for judicial notice.

Both the April 13, 2011 U.S. Senate Permanent Subcommittee on Investigations' Staff Report entitled "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse" and the existence of an Illinois civil action against McGraw-Hill and S&P pursuant to the Illinois Unfair Trade Practices Act are matters of public record. The Court takes judicial notice of their existence. *Global Network Commc'ns, Inc. v. City of New York,* 458 F.3d 150, 157 (2d Cir. 2006).

B. The Court grants defendants' motion to dismiss.

The Complaint fails to set forth "enough facts to state a claim for relief that is plausible on its face." *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570 (2007). Although plaintiffs' Complaint identifies three categories of misstatements, none are actionable. In addition, the Complaint fails to allege facts sufficient to support an inference of scienter.

First, plaintiffs allege that S&P misled investors by representing that it had "market lead[ing] software, that it used "transparent and independent decision-making" to produce "independent and objective analysis," and that "excelled" in its role. (Compl. ¶¶ 253, 271, 290, 297.) These statements are mere commercial puffery. "[I]ntegrity and risk management

are 'matters of great importance to investors,'" but general statements by a defendant that "it 'set the standard for best practices in risk management'" are "precisely the type of puffery" that may not undergird a Section 10b-5 claim. *In re JP Morgan Chase Sec. Litig .,* No. 02 Civ. 1282, 2007 U.S. Dist. LEXIS 22948, at *35-*36 (S.D.N.Y. Mar. 28, 2007) (citations omitted), *aff'd sub nom. ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.,* 553 F.3d 187 (2d Cir. 2009).

Second, plaintiffs allege that defendants "misled the market as to the frequency and quality of its ratings surveillance" by concealing that S&P's surveillance was "perpetually late" and its surveillance group was "over-worked, under-staffed, and underfunded." (Compl. ¶ 256; *see also id.* ¶¶ 261, 270, 328.)Missing from plaintiffs' pleadings, however, are the statements that these alleged facts render misleading. Thus, this claim falls short of the PSLRA's particularity threshold, 15 U.S.C. § 78u-4(b). *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 321 (2007).

Third, plaintiffs challenge McGraw-Hill's financial reports because "the overly positive statements describing those numbers were misleading in light of the concealed manner in which they were achieved." (Pls.' Opp. 14.) But plaintiffs admit that the reported earnings figures were accurate, (*see id.*), and a defendant's failure to disclose that its earnings were unsustainable is not securities fraud. *See In re Axis Capital Holdings Ltd. Sec. Litig.,* 456 F. Supp. 2d 576, 587 (S.D.N.Y. 2006).

Finally, plaintiffs have failed to allege facts that constitute "strong circumstantial evidence of conscious misbehavior or recklessness." *ECA & Local 134,* 553 F.3d at 198. Plaintiffs have not set forth facts to support the inference that either McGraw or Bahash knew of facts or had access to information that contradicted either man's statements. *See Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.,* 531 F.3d 190, 196 (2d Cir. 2008.)

C. The Court denies the motion to modify the stay of statutory discovery as moot.

As the Court has granted defendants' motion to dismiss the Complaint, plaintiffs' motion to modify the statutory stay of discovery is moot.

Accordingly, IT IS HEREBY ORDERED that:

1. Plaintiffs' motion that the Court take judicial notice of the April 13, 2011 U.S. Senate Permanent Subcommittee on Investigations' Staff Report (Dkt. No. 45) is granted;

2. Plaintiffs' motion that the Court take judicial notice of the existence of an Illinois civil action against McGraw-Hill and S&P (Dkt. No. 52) is granted;

3. Defendants' motion to dismiss the Complaint pursuant to Fed. R. Civ. P. 12(b)(6) (Dkt. No. 40) is granted;

4. Plaintiffs' motion to modify the statutory stay of discovery (Dkt. No. 49) is denied as moot.

SO ORDERED.