No. 20-1364

IN THE

Supreme Court of the United States

BOFI HOLDING, INC., *et al.*,

Petitioners,

v.

HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM,

Respondent.

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

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REPLY BRIEF FOR PETITIONERS

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August 11, 2021

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

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REPLY BRIEF FOR PETITIONERS

In its opposition ("Opp."), respondent asserts that *Sapssov v. Health Management Associates*, 608 Fed. Appx. 855 (11th Cir. 2015), does not create a sufficiently mature circuit split on whether a separate lawsuit's unproven allegations of corporate misconduct can serve as a corrective disclosure under *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005). The reasons offered fail: This Court properly considers unpublished decisions when evaluating circuit splits, *Sapssov*'s relevant holding was not *dictum* and *Sapssov* cannot be distinguished in a manner that reconciles the split. Hence, the circuit divide is real and well-defined, and this case presents the opportunity to resolve it.

On whether it is proper to infer from a stock price drop that a corrective disclosure revealed the "truth," respondent dismisses any conflict between the decision below and this Court's decisions. The conflict is undeniable, however, and respondent's efforts to explain it away fall short.

On whether this Court should use this opportunity to reconsider *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), respondent points to this Court's decision to uphold *Basic* in *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014) (*Halliburton II*), and argues *stare decisis* forecloses any possibility of ever revisiting the question. But *stare decisis* here is weak, and *Basic*'s fundamental economic premises continue to meet criticism and sow confusion in the lower courts. There is no reason to delay further in correcting course.

I. The Circuits Are Divided Over Whether Public Allegations Can, Without More, Reveal "the Truth"

A. An Unpublished Decision Can Generate a Circuit Split

Contrary to respondent's assertions (Opp. 11, 15), an unpublished decision can create a circuit conflict warranting review. It is still a "decision" under Supreme Court Rule 10(a), and nothing in Rule 10(a) prevents this Court from considering it. Hence, this Court grants review to resolve conflicts resting on unpublished decisions. *See, e.g.*, *Lamps Plus, Inc. v. Varela*, 139 S. Ct. 1407, 1413 (2019) (unpublished decision alone on one side of circuit split); *E. Associated Coal Corp. v. Mine Workers*, 531 U.S. 57, 61 (2000) (same); *Lynce v. Mathis*, 519 U.S. 433, 436 (1997) (same). It also grants review when an unpublished decision deepens an existing conflict. *See, e.g.*, *Old Chief v. United States*, 519 U.S. 172, 177 (1997); *Burlington N. R.R. v. Okla. Tax Comm'n*, 481 U.S. 454, 460 (1987). And when evaluating a circuit split as a basis for review, this Court does not distinguish between published and unpublished decisions. *See Henderson v. United States*, 135 S. Ct. 1780, 1784 n.2 (2015) (describing circuit split and citing both published and unpublished decisions); *Carter v. United States*, 530 U.S. 255, 260 (2000) (same).

Respondent's argument (Opp. 11-13) that petitioners rely upon *Meyer v. Greene*, 710 F.3d 1189 (11th Cir. 2013), as the basis for any conflict also fails. *Sapssov* is the Eleventh Circuit decision on which the circuit split directly rests. Pet. 13.

B. *Sapssov* Conflicts With *Norfolk County* and the Decision Below

In *Sapssov*, the Eleventh Circuit held that a civil lawsuit's whistleblower allegations disclose no actual wrongdoing and cannot alone serve as a corrective disclosure. *Sapssov*, 608 Fed. Appx. at 863. As the petition ("Pet.") demonstrates (Pet. 13-16), this holding stands in opposition to the Sixth Circuit's decision in *Norfolk County Retirement Systems v. Community Health Systems*, 877 F.3d 687, 697 (6th Cir. 2017), and the Ninth Circuit's decision below. Pet. 15a.-16a. Contrary to respondent's assertion (Opp. 16-17), *Sapssov* is not distinguishable on the ground that the alleged corrective disclosure in that case was an analyst's summary of the whistleblower lawsuit (the "Skolnick Report") instead of the whistleblower lawsuit itself, which "the market disregarded." *Sapssov*, 608 Fed. Appx. at 864. *Sapssov* specifically identifies the whistleblower allegations as "the basis of the 2012 Skolnick Report." *Id.* at 863. Although respondent stresses *Sapssov* "had no occasion to consider a complaint the market actually credited" (Opp. 17), respondent does not explain how the relevant holding in *Sapssov* would have been any different had it analyzed the lawsuit allegations directly. *Sapssov* articulates a *categorical rule* that applies regardless of the market's reaction, if any, to a lawsuit's misconduct allegations. *See id.* at 863-64.

This rule was essential to the result in *Sapssov* and not *dictum*, as respondent contends. Opp. 1, 13, 18-19. *Sapssov* addressed two alleged corrective disclosures—an announced regulatory investigation (the "OIG investigation") and the Skolnick Report—both standing alone and combined. *Id.* at 863. Because the OIG investigation was held to be "without more" an insufficient corrective disclosure that only "portend[ed]" fraud, the court examined whether the whistleblower allegations, as summarized in the Skolnick Report, revealed the falsity of the defendants' alleged previous statements. *Id*. The court's conclusion that the two alleged corrective disclosures failed to reveal the truth, whether "[t]aken independently or combined," necessarily rested on its having determined that the whistleblower lawsuit "was not proof of fraud because a civil suit is not proof of liability." *Id.* at 863-64. Contrary to respondent's assertions (Opp. 16-17), the Skolnick Report did not fail as a corrective disclosure *only* because it summarized "already-public information."

Respondent also suggests (Opp. 18-19) that *Sapssov* is at odds with *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282 (11th Cir. 2011), where the Eleventh Circuit observed that a "corrective disclosure can come from any source, and can take any form . . . so long as it reveals to the market the falsity of the prior misstatements." *FindWhat*, 658 F.3d at 1311 n.28 (internal quotation marks and brackets omitted). But this observation, to the extent it expresses a rule, also identifies the exception: The disclosure must be able to "reveal[] to the market the falsity of the prior misstatements." *Id*. In the Eleventh Circuit, a publicly announced regulatory investigation is one example of a disclosure that cannot independently reveal falsity. *See, e.g.*, *Meyer*, 710 F.3d at 1201. Pursuant to the holding in *Sapssov*, unproven allegations are another. *Sapssov*, 608 Fed. Appx. at 863. That unproven misconduct allegations standing alone are insufficient under *Sapssov* does not mean they cannot serve, consistent with *FindWhat*, as a partial corrective disclosure when combined with a later confirming disclosure or event. *Sapssov* is consistent with, and correctly expresses, Eleventh Circuit law.

The well-defined circuit split needs no further "percolation." Opp. 11, 21.

C. The Question Presented Is Well-Stated

Contrary to respondent's criticism (Opp. 19-21), the first question presented is not vague or indefinite. Indeed, it expressly limits itself to the specific question on which the courts of appeals are divided. The phrase "disputed public allegations" refers to the alleged corrective disclosure each court of appeals encountered: publicly filed allegations in a civil complaint. *See* App. 16a; *Norfolk County*, 877 F.3d at 696; *Sapssov*, 608 Fed. Appx. at 858, 863. The phrase "corroborating disclosure or event" has the meaning it has in the decision below. *See* App. 17a (stating district court incorrectly held that "to adequately plead loss causation, the shareholders had to identify an *additional disclosure that confirmed the truth* of Erhart's allegations" (emphasis added)); *see also* App. 30a (describing the majority panel as holding that public allegations may "count as a 'corrective disclosure' . . . even if there is no additional *evidence or disclosure corroborating* them" (emphasis added)).

D. The Decision Below Is Wrong

Despite its efforts to defend the decision below as correct (Opp. 21-26), respondent never directly confronts the inherent inability of unproven allegations to reveal that wrongdoing actually occurred.[1] *Sapssov* recognized this. *Sapssov*, 608 Fed. Appx. at 863. So did Judge Lee's partial dissent. *See* App. 33a-34a. It is no answer to assert, as the Sixth and Ninth Circuits

[1] By definition, allegations are accusations lacking substantiation. *See Allegation*, Black's Law Dictionary (11th ed. 2019) (defining "allegation" as "a statement, not yet proved").

say and as respondent repeats (Opp. 15, 19), that every corrective disclosure can be considered an allegation of some sort. Doing so fails to acknowledge the one-sided, self-serving and uncertain nature of a lawsuit's yet-untested and uncorroborated allegations. This quality distinguishes civil complaint allegations from disclosures that are factual and concrete, such as company disclosures, external auditor opinions and government regulatory findings.

The decision below holds that as long as the court can infer that the market perceives public misconduct allegations to be true, no additional corroborating event or disclosure is needed for the allegations to serve as a corrective disclosure. App., 17a-18a. This means loss causation can rest on allegations that are completely false if the market can and does incorrectly perceive them as true.[2] This cannot be what *Dura* intended when holding that a plaintiff must plead and prove that the stock price dropped in reaction to disclosure of "the truth." *Dura*, 544 U.S. at 342.

Attempting to defend the indefensible, respondent urges that "what actually happened in the market" should determine loss causation, "*and not whether the revelations were ultimately true or false*." Opp. 24 (emphasis added). This jolting statement is antithetical to any traditional understanding of causation from which the judicially implied Rule 10b-5 private right of action derives. *See Dura*, 544 U.S. at 341 (noting that the action is rooted in and "resembles" common-law actions for deceit and misrepresentation). Loss causation is a synonym for causation generally. *See*

[2] The danger of false misconduct allegations is particularly acute in whistleblower litigation, where claims require only the employee's "reasonabl[e] belie[f]" that an underlying legal violation occurred. *See, e.g.*, 18 U.S.C. § 1514A(a)(1).

Bastian v. Petren Res. Corp., 892 F.2d 680, 683 (7th Cir.) ("[W]hat securities lawyers call 'loss causation' *is* the standard common law fraud rule . . . , merely borrowed for use in federal securities fraud cases") (Posner, J.), *cert. denied*, 496 U.S. 906 (1990).

In the securities fraud realm, traditional causation means that "a person who 'misrepresents the financial condition of a corporation in order to sell its stock' becomes liable to a relying purchaser 'for the loss' the purchaser sustains 'when the *facts* . . . become generally *known*' and 'as a result' share value 'depreciate[s].'" *Dura*, 544 U.S. at 344 (quoting Restatement (Second) of Torts § 548A cmt. b (Am. L. Inst. 1977)) (emphasis added). Thus, traditional causation exists when the "facts" misstated or concealed are the same "facts" (wholly or partially) later revealed. But a false factual allegation has no ability to reveal an actually misstated or concealed "fact" that can then become "known." *See id*. Moreover, that the market erroneously perceives a false allegation as a "fact" cannot supply the missing causal connection as the market is still not reacting to an actual "fact" fraudulently misstated or concealed.

The decision below warps the traditional causation element to permit a plaintiff to premise causation on *false* allegations the market *mistakenly* believes to be true. But, as *Dura* holds, the Private Securities Litigation Reform Act "makes clear Congress' intent to permit private securities fraud actions for recovery where, *but only where*, plaintiffs adequately allege and prove the *traditional* elements of causation and loss." *Dura*, 544 U.S. at 346 (emphasis added). The decision below severs loss causation from its common law roots, and so must be wrong.

To excuse this error, respondent contends that whether a separate lawsuit's allegations "are themselves true is just the question of whether defendants' actionable statements were false." Opp. 22; 24.[3] Respondent thereby commits the syllogistic fallacy of drawing an affirmative conclusion from a negative premise. If *x* is false, *y* is not necessarily true because it is inconsistent with *x*. Rather, if a plaintiff is to show that "the truth ma[de] its way into the marketplace," *Dura*, 544 U.S. at 342, the corrective disclosure must be correct.

In sum, as Judge Lee observed, a securities fraud action alleging a corrective disclosure based on unsubstantiated allegations is "premature." App. 32a. A modest requirement that the plaintiff wait for a corroborating adverse disclosure or business event is more consistent with the regulatory scheme the federal securities laws impose. In the event of public company misconduct allegations, that scheme includes a framework designed to lead to confirming additional disclosures through the gatekeeping and oversight obligations imposed on audit committees, external auditors and regulators. *See, e.g.*, 15 U.S.C. § 78j-1(m) (independent audit committees must retain external auditors and develop procedures to investigate complaints involving auditing or internal controls issues); 15 U.S.C. § 78j-1(b) (external auditors aware of possible illegal act must determine whether act likely occurred, ensure audit committee and others are adequately informed, and, absent remedial action, inform SEC or resign from engagement); 15 U.S.C. § 7262 (external auditors

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[3] Respondent makes this argument even though it has announced that it does not plan to establish falsity at trial by proving the *Erhart* Complaint allegations were in fact true. Opp. 6.

must attest to effectiveness of internal accounting controls).

II. The Decision Below Conflicts with *Dura* and *Basic*

The decision below adopts a multi-factored approach to determine whether the market perceived unproven allegations as true and treated them as the "truth." App. 16a-17a. Under one factor—the degree to which the security's price declined—the Ninth Circuit uses the stock price drop to tautologically infer that the "truth" became "known" and caused the drop. *See* App. 17a. But *Dura* expresses the directly conflicting principle that, after the purchase of a security, a later lower price does not necessarily indicate a loss resulting from the "truth" having entered the market. *Dura*, 544 U.S. at 342-43. Hence, contrary to respondent's assertion that the petition seeks only "error correction" (Opp. 26), the decision below "decided an important federal question in a way that conflicts with [a] relevant decision[] of this Court." Supreme Court Rule 10(c).

Respondent concedes "*Dura* could be read to say that a price drop *alone* is not enough to show that a disclosure caused" a drop, but insists that what it calls the price drop's "features" are still appropriately considered. Opp. 26. But the Ninth Circuit uses the price drop itself, indeed its sheer magnitude, to infer "the market treat[ed] allegations in [Erhart's Complaint] as sufficiently credible to be acted upon as truth." App. 18a. Again, this contravenes *Dura*'s foundational premise that a lower price, *regardless of how low*, does not necessarily mean the "relevant truth" entered the market. *Dura*, 544 U.S. at 342-43.[4]

Respondent attempts to downplay this conflict, arguing that under the Ninth Circuit's approach the market's reaction is "merely one consideration" and not "case dispositive." Opp. 27-28. The price drop, however, unquestionably drove the Ninth Circuit's decision. App. 17a (singling out what it called the "price plunge[]" and stating "[a] price drop of that magnitude would not be expected in response to whistleblower allegations perceived as unworthy of belief").

Respondent insists "the Ninth Circuit's analysis was exactly right." Opp. 27. This rings hollow. The Ninth Circuit's approach is flawed as it relies upon stock price movements to gauge what a singular anthropomorphized efficient market "believes" or "perceives" to be true, offending the efficient capital markets theory as recognized in *Basic*. *Basic* observes that an efficient market reacts to all material public information, both true and false. *See Basic*, 485 U.S. at 246. Hence, the price reaction to a disclosure cannot establish the disclosure's truth or falsity.

The Ninth Circuit's approach also increases the risk of false-positive loss causation determinations where, as here, a mismatch exists between alleged misstatements (often generic) and allegations of misconduct. *Compare, e.g.*, App. 6a ("We have made significant investments in our overall compliance infrastructure over the past several quarters.") *with* App. 48a (BofI "falsely responded to an SEC subpoena requesting

[4] It also violates the general axiom of logic, recognized by this Court, that correlation cannot imply causation. *See Brown v. Ent. Merchs. Ass'n*, 564 U.S. 786, 800 (2011) (emphasizing distinction between correlation and causation).

information about a specific account by indicating that BofI had no information about that account"). This mismatch impedes any inference that the existence and magnitude of a back-end price decline reflect the efficient market's reaction to the "truth" the fraud allegedly misstated or concealed. *See Goldman Sachs Grp., Inc. v. Ark. Tchr. Ret. Sys.*, 141 S. Ct. 1951, 1961 (2021) (when evaluating a defendant's price impact evidence to rebut the fraud-on-the-market presumption of reliance, "a mismatch between the contents of the misrepresentation and the corrective disclosure" makes it "less likely that the specific disclosure actually corrected the generic misrepresentation, which means that there is less reason to infer front-end price inflation—that is, price impact—from the back-end price drop"). Here, the Ninth Circuit's approach (which uses a price reaction to determine whether the market perceived the corrective disclosure as true) applies even when there is mismatch between specific back-end disclosures and generic front-end misstatements, and so fails to account for "mismatch." The incompatibility of the decision below with *Goldman Sachs* is another indication that the Ninth Circuit's misguided loss causation approach conflicts with this Court's decisions.

III. This Court Should Reconsider *Basic*

"Logic, economic realities, and our subsequent jurisprudence have undermined the foundations of the *Basic* presumption, and *stare decisis* cannot prop up the facade that remains." *Halliburton II*, 573 U.S. at 285 (Thomas, J., concurring). This was true in 2014. It is true today.

Respondent does not dispute that this case presents an appropriate vehicle by which to review *Basic*. Rather, it argues that *stare decisis* principles weigh against overruling precedent that "Congress can change if it wants." Opp. 30. But the *Basic* presumption is judicially created, and "[i]t is inconsistent with the Court's proper role to ask Congress to address . . . a premise of this Court's own creation." *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2096 (2018). The Court should therefore revisit *Basic*, "whether or not Congress can or will act in response." *Id*. at 2097. The grant of *certiorari* in *Halliburton II* itself demonstrates that *stare decisis* imposes no limit on this Court's discretion to grant review for the purpose of assessing *Basic*'s continuing validity. That purpose justified review then, and it justifies review now.

CONCLUSION

The petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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