No. 23-980

In The Supreme Court of the United States

FACEBOOK, INC., ET AL.,

Petitioners,

v.

AMALGAMATED BANK, ET AL.,

Respondents.

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

BRIEF OF WASHINGTON LEGAL FOUNDATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

PAGE

INTEREST OF AMICUS CURIAE 1

REASONS FOR GRANTING THE PETITION............1

ARGUMENT...4

I. The Petition should be granted so that the Court can address the appropriate scope of risk disclosures that all public companies must make...4

A. The Ninth Circuit wrongly held that prospective risk disclosures must describe past manifestations of the risk 4

B. The Ninth Circuit's decision exacerbates the existing circuit split.......7

C. The Ninth Circuit's decision undermines important public policy goals 10

II. The Petition should be granted so that the Court can clarify the pleading standard for loss causation...14

A. Rule 9(b) should apply to allegations of loss causation 16

B. The Ninth Circuit erred by applying Rule 9(b) in name only............................18

C. If left unaddressed, the Ninth Circuit's ruling will invite meritless suits............19

CONCLUSION 23

TABLE OF AUTHORITIES

CASES **PAGE(S)**

Acosta Orellana v. CropLife Int'l,
711 F. Supp. 2d 81 (D.D.C. 2010)........................17

In re Alphabet Sec. Litig.,
1 F.4th 687 (9th Cir. 2021)................................5, 9

Basic Inc. v. Levinson,
485 U.S. 224 (1988)..................................11, 12, 16

Bell Atl. Corp. v. Twombly,
550 U.S. 544 (2007)..18

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975)..21

Bondali v. Yum! Brands, Inc.,
620 F. App'x 483 (6th Cir. 2015) 4, 5, 6, 8

Cal. Pub. Emps.' Ret. Sys. v. ANZ Secs., Inc.,
582 U.S. 497 (2017)..1

Chiarella v. United States,
445 U.S. 222 (1980)..16

Clinton v. Sec. Benefit Life Ins. Co.,
63 F.4th 1264 (10th Cir. 2023)............................17

Const. Laborers Pension Trust for S. Cal. v. Marriott, Int'l, Inc.,
31 F.4th 898 (4th Cir. 2022)........................8, 9, 11

Dura Pharms., Inc. v. Broudo,
544 U.S. 336 (2005)...........................14, 15, 17, 22

Emps.' Ret. Sys. of R.I. v. Williams Cos., Inc.,
889 F.3d 1153 (10th Cir. 2018)..............................5

Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.,
594 U.S. 113 (2021)..1

In re Harman Int'l Indus., Inc. Sec. Litig.,
791 F.3d 90 (D.C. Cir. 2015)..................................9

Humana, Inc. v. Indivior, Inc.,
2022 WL 17718342 (3d Cir. Dec. 15, 2022).........17

Ind. Pub. Ret. Sys. v. Pluralsight, Inc.,
45 F.4th 1236 (10th Cir. 2022)...............................9

Karth v. Keryx Biopharmaceuticals, Inc.,
6 F.4th 123 (1st Cir. 2021)..................................8, 9

Katyle v. Penn Nat'l Gaming, Inc.,
637 F.3d 462 (4th Cir. 2011).............15, 17, 18, 19

Lormand v. US Unwired, Inc.,
565 F.3d 228 (5th Cir. 2009)............................9, 15

Morrison v. Nat'l Austl. Bank Ltd.,
561 U.S. 247 (2010)..14

Ohio Pub. Emps. Ret. Sys. v. Fed. Home Loan Mortg. Corp.,
830 F.3d 376 (6th Cir. 2016)...............................15

Prime Mover Capital Partners L.P. v. Elixir Gaming Techs., Inc.,
898 F. Supp. 2d 673 (S.D.N.Y. 2012) 16

Rabin v. NASDAQ OMX PHLX LLC,
712 F. App'x 188 (3d Cir. 2017) 16

Set Capital LLC v. Credit Suisse Grp. AG,
996 F.3d 64 (2d Cir. 2021) 9

Tellabs, Inc. v. Makor Issues & Rights, Ltd.,
551 U.S. 308 (2007) 12

Thompson v. Relationserve Media, Inc.,
610 F.3d 628 (11th Cir. 2010) 16

In re Vivendi, S.A. Sec. Litig.,
838 F.3d 223 (2d Cir. 2016) 12

Williams v. Globus Med., Inc.,
869 F.3d 235 (3d Cir. 2017) 9

STATUTES & REGULATIONS

15 U.S.C. § 78u-5 13

17 C.F.R. § 229.101(a) 6

17 C.F.R. § 229.105 .... 4, 6

17 C.F.R. § 229.503(c) 4

17 C.F.R. § 240.10b-5(b) 5, 6

Modernization of Regulation S-K Items
101, 103, and 105, 85 Fed. Reg. 63,726
(Oct. 8, 2020) 11

SEC Statement and Guidance on Public
Company Cybersecurity Disclosures, 83
Fed. Reg. 8,166 (Feb. 26, 2018) 11

LEGISLATIVE MATERIALS

H.R. Rep. No. 104-369 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730 13

OTHER AUTHORITIES

Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821 (2021) 22

Emily Strauss, *Is Everything Securities Fraud?* 12 U.C. IRVINE L. REV. 1331 (2022) 22

Evan Hill, Note, *The Rule 10b-5 Suit: Loss Causation Pleading Standards in Private Securities Fraud Claims After* Dura Pharmaceuticals, Inc. v. Broudo, 78 FORD. L. REV. 2659 (2010) 15

Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811 (2009) 18

Merritt B. Fox & Joshua Mitts, *Event-Driven Suits and the Rethinking of Securities Litigation*, 78 BUS. L. 1 (2023) 20

Richard A. Booth, *Loss Causation and The Materialization of Risk Doctrine in Securities Fraud Class Actions*, 75 BUS. L. 1791 (2020)..20, 21, 22

INTEREST OF AMICUS CURIAE

Washington Legal Foundation (WLF) is a non-profit, public-interest law firm and policy center with supporters nationwide.[1] Founded in 1977, WLF promotes and defends free enterprise, individual rights, limited government, and the rule of law. WLF often appears as an amicus before this Court in disputes over the proper scope of the federal securities laws. *See, e.g.*, *Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.*, 594 U.S. 113 (2021); *Cal. Pub. Emps.' Ret. Sys. v. ANZ Secs., Inc.,* 582 U.S. 497 (2017).

WLF is concerned that the decision below will force companies to include voluminous and stale information in risk disclosures that are intended to provide investors with a concise description of potential *future* harms. WLF also believes that the Ninth Circuit's ruling exemplifies the harm caused when courts fail to apply the required heightened pleading standard to loss causation allegations in securities fraud cases.

REASONS FOR GRANTING THE PETITION

The Court should grant the Petition to resolve two separate and important questions that were wrongly decided by the Ninth Circuit, have divided

[1] No party's counsel authored any part of this brief. No person other than Washington Legal Foundation or its counsel contributed any money to the preparation or submission of this brief. All parties received timely notice of WLF's intent to file this brief.

lower courts, and implicate important public policy concerns.

First, the Ninth Circuit's decision wrongly requires that a company describe in its SEC-required risk disclosures all instances in which a company has encountered a stated risk, even if the incident in question was fully resolved and caused no material harm to the company. Risk disclosures are not intended to retread the past or cover immaterial information. The relevant SEC rule (Item 105) calls for disclosure of only prospective risk. And Rule 10b-5, the basis of the Ninth Circuit's ruling, has a materiality requirement that precludes its application to non-disclosure of a past event not known or understood to have an ongoing, material effect on the company.

Besides being wrong, the decision exacerbates a pre-existing circuit split. Consistent with Item 105, the Sixth Circuit has held that risk disclosures need discuss only *future* risks. Other circuit courts have held that a risk disclosure should describe instances in which a risk has manifested itself, but only if the incident is known or all but certain to have a material effect on the company going forward. Only the Ninth Circuit has held that a company must disclose past manifestations of risks, even if they are not known or understood to be material at the time.

The Ninth Circuit's ruling will force companies to include extensive, immaterial information about past incidents in their risk disclosures. This will harm investors who look to SEC filings to find information relevant to their investment decisions. Moreover, companies will be subject to potentially frivolous securities litigation based on forward-looking risk

disclosures, which is exactly the outcome Congress sought to avoid when it passed the Private Securities Litigation Reform Act (PSLRA) and included a safe harbor for these statements.

Second, the decision below highlights a longstanding circuit split on the loss causation pleading standard. Some courts have applied Federal Rule of Civil Procedure 9(b)'s heightened pleading standard, which is consistent with the language and purpose of the rule. Others apply only the notice pleading standard in Federal Rule of Civil Procedure 8.

Here, the Ninth Circuit initially applied Rule 8, but later amended the opinion to include citations to Rule 9(b). Despite the switch, the Ninth Circuit's loss causation analysis did not change. In effect, the Ninth Circuit wrongly treated Rule 9(b) as no more stringent than Rule 8.

Applying a notice pleading standard for loss causation is problematic, especially as the plaintiffs' bar has turned its focus to "event-driven" securities litigation based on *external events* outside the company's control. Under the proper pleading standard, however, these types of cases are more likely to be dismissed on loss causation grounds. If the Court does not provide further guidance, the current use of notice pleading in several circuits risks converting the federal securities laws into a form of investor insurance—a result this Court consistently has sought to avoid.

This case is an appropriate and efficient vehicle for the Court to address these two longstanding divisions among the circuits.

ARGUMENT

I. The Petition should be granted so that the Court can address the appropriate scope of risk disclosures that all public companies must make.

A company filing a Form 10-K must include in the document a "risk factor section," in which the company provides a concise discussion of "material factors that make an investment in the registrant or offering speculative or risky." 17 C.F.R. § 229.105 (Item 105).[2] The "risk factor" disclosures required by Item 105 are intended to alert investors to the possibility of *future* harms. *See Bondali v. Yum! Brands, Inc.*, 620 F. App'x 483, 491 (6th Cir. 2015).

The Ninth Circuit's ruling, however, effectively creates an affirmative obligation to disclose any past occurrence of a stated risk, even if the effect is not known or understood to be material at the time of the disclosure. *See* Pet. App. 23a–25a. This rule is unsupported by law, diverges from the remainder of the circuits that have considered the issue, and has significant public policy ramifications.

A. The Ninth Circuit wrongly held that prospective risk disclosures must describe past manifestations of the risk.

Under Rule 10b-5, the anti-fraud rule promulgated under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), a company is prohibited from omitting "a material fact necessary in

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[2] The filing at issue here occurred in 2017. The "risk factors" provision was then codified at 17 C.F.R. § 229.503(c) (2017).

order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b). A statement is misleading, however, only if it creates a false impression about the true situation in the minds of investors. *See, e.g.*, *Emps.' Ret. Sys. of R.I. v. Williams Cos., Inc.*, 889 F.3d 1153, 1164 (10th Cir. 2018) ("To be actionable under the securities laws, an omission must be misleading; in other words it must affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists." (citation omitted)).

In this case, the Ninth Circuit held that a risk disclosure can become "a materially misleading statement when it 'speaks entirely of as-yet-unrealized risks' when the risks have 'already come to fruition.'" Pet. App. 25a (quoting *Berson v. Applied Signal Tech.*, 527 F.3d 982, 987 (9th Cir. 2008)); *see also In re Alphabet Sec. Litig.*, 1 F.4th 687, 699 (9th Cir. 2021). But the Ninth Circuit did not even attempt to explain why or how a risk disclosure—which inherently concerns only *future* events—could create *any* misimpression in the minds of reasonable investors about the *past* or *present*, much less a misleading impression about whether certain events that *could occur* in the future have *already occurred*.

The plain meaning of "risk" belies the notion that a risk disclosure could mislead investors about the past or present. Risk is commonly understood as a forward-looking concept: one that concerns the "*possibility* of loss, injury, disadvantage, or destruction." *Bondali*, 620 F. App'x at 491 (quoting Webster's Third New International Dictionary 1961 (1986)) (emphasis in original). "Risk disclosures"

therefore serve a singular purpose: to identify and disclose to investors issues that could affect the company *in the future*. *See id.*

Further, nothing in Item 105 itself would lead a reasonable investor to believe that a risk disclosure would catalog past manifestations of the risk. *See* 17 C.F.R. § 229.105. Unlike other SEC rules, Item 105 does not have a "lookback" period for which the company must report on risks it encountered within a set number of years. *See, e.g.*, 17 C.F.R. § 229.101(a) (2018) (former version of Item 101(a) that required companies to report on certain business developments within the past five years). Indeed, the SEC has never issued guidance suggesting that companies should provide backward-looking risk disclosures, much less found it prudent to expand Item 105 to mandate the disclosure of past incidents. The Ninth Circuit's ruling unduly expands the scope of the rule by judicial fiat.

The Ninth Circuit's holding—that a company has an affirmative obligation to disclose materialized risks in tandem with its discussion of future risks—is particularly unsound because it fails to properly account for the materiality element of Rule 10b-5. The court held that "[b]ecause Facebook presented the prospect of a breach as purely hypothetical when it had already occurred, such a statement could be misleading even if the magnitude of the ensuing harm was still unknown." Pet. App. 24a–25a. As Judge Bumatay noted in his dissent, however, the majority effectively held "it's enough that a breach had occurred, never mind whether the breach led to a discernable effect on Facebook's reputation or business at the time." *Id.* at 46a. Without any sort of

meaningful materiality threshold, a company would be forced to disclose every risk that had ever manifested itself, even if the incident had no meaningful impact and was successfully addressed. It cannot be the case that a company is required to disclose "every bad thing that ever happened to it" every time it talks about the future risks facing its business (which it is required to do by regulation). *Id.* at 46a–47a.

In sum, because a risk disclosure concerns *prospective* harms, it cannot be read to imply that the risk has not already manifested itself in some form. The Ninth Circuit put a heavy thumb on the scale by framing the question as whether the disclosures "speak[] *entirely of as-yet-unrealized* risks." Pet. App. 25a (citation omitted) (emphasis added). This Court should take this opportunity to clarify whether a prospective risk disclosure reasonably can be construed, for purposes of securities fraud liability, as informing investors that the disclosed risks are "as-yet unrealized."

B. The Ninth Circuit's decision exacerbates the existing circuit split.

This Court's review would also help clarify the overall muddled jurisprudence about "risk disclosures" in the federal circuit courts. With the Ninth Circuit's ruling, there is now a highly fractured circuit split, with lower courts lacking guidance on whether forward-looking risk disclosures are actionable for failure to include historical information, and if so, under what circumstances. *See* Pet. at 18–22.

The Sixth Circuit correctly recognizes that a company need not recount current or past events in

its forward-looking risk disclosures. *Bondali*, 620 F. App'x at 491. As the Sixth Circuit has explained, "cautionary statements are 'not actionable to the extent plaintiffs contend defendants should have disclosed risk factors 'are' affecting financial results rather than 'may' affect financial results.'" *Id.* (citation omitted). After all, the purpose of risk disclosures is to "warn an investor of what harms *may* come to their investment. They are not meant to educate investors on what harms are currently affecting the company." *Id.* The Sixth Circuit's reasoning is even more compelling when applied to *past* harms the company has experienced as the result of the risks in question.

Moreover, both the Sixth and Fourth Circuits have held that statements about future risks by themselves are immaterial because "a reasonable investor would be unlikely to infer anything regarding the current state of a corporation's compliance, safety, or other operations from a statement intended to educate the investor on *future* harms." *Id.*; *Const. Laborers Pension Trust for S. Cal. v. Marriott, Int'l, Inc.*, 31 F.4th 898, 902 n.2 (4th Cir. 2022) (citing *Bondali*, 620 F. App'x at 491). Thus, these statements cannot form the basis for a securities fraud claim no matter what information allegedly is omitted from them. *Id.*

Six circuits (the First, Second, Third, Fifth, Tenth, and District of Columbia) have said that a company should disclose certain materialized risks when making risk disclosures, but *only if* the company knows those events will have, or are all but certain to have, a material negative impact on its business. *See Karth v. Keryx Biopharmaceuticals,*

Inc., 6 F.4th 123, 137–38 (1st Cir. 2021); *Set Capital LLC v. Credit Suisse Grp. AG*, 996 F.3d 64, 85–86 (2d Cir. 2021); *Williams v. Globus Med., Inc.*, 869 F.3d 235, 242 (3d Cir. 2017); *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 249–50 (5th Cir. 2009); *Ind. Pub. Ret. Sys. v. Pluralsight, Inc.*, 45 F.4th 1236, 1256–57 (10th Cir. 2022); *In re Harman Int'l Indus., Inc. Sec. Litig.*, 791 F.3d 90, 104 (D.C. Cir. 2015); *see also* Pet. at 19–22 (discussing the holdings in these cases). In other words, the company must have understood the "near certainty" of "financial disaster" or comparable harm caused by the materialization of the risk. *Karth*, 6 F.4th at 138.[3]

The decision below thus represents a severe departure from the other circuits, even those that have held Rule 10b-5 could potentially apply to an omission of a past event from a risk disclosure. No other circuit has found that a company must disclose the prior materialization of a risk not known or understood to have an ongoing or future material effect on the company's business.

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[3] In *Marriott*, the Fourth Circuit held that risk disclosures are not material as a matter of law, *see supra* p. 8, but also cited the Ninth Circuit's decision in *Alphabet* to note that a risk disclosure could be misleading if it "speak[s] entirely of as-yet-unrealized risks and contingencies and do[es] not alert the reader that some of these risks may have already come to fruition." 31 F.4th at 904 (quoting *Alphabet*, 1 F.4th at 703–04) (cleaned up). The court found that even under that lenient standard, however, the plaintiff failed to adequately plead that the risk disclosure at issue was misleading. *Id.*

C. The Ninth Circuit's decision undermines important public policy goals.

Granting review and clarifying that only *future* risks need to be disclosed as part of a company's "risk disclosures"—or alternatively, that the circumstances under which past events must be disclosed are limited—will have several important public policy benefits far beyond this case.

First, the Ninth Circuit's rule, if left uncorrected, would impose a substantial and unnecessary burden on public companies. Securities class actions can be brought in any federal district court, and courts within the Ninth Circuit already field nearly a third of all federal securities class action filings each year. *See Securities Class Action Filings: 2023 Year in Review*, CORNERSTONE RESEARCH, at 27 (2023), https://bit.ly/49nPl8W. As a result, the Ninth Circuit's rule will become the de facto standard nationwide for lawsuits based on a company's risk disclosures. Because companies could face significant liability if they do not disclose past events in their forward-looking risk disclosures, companies will be forced to disclose massive amounts of immaterial information on issues like cybersecurity breaches, quality control deficiencies, supply chain problems, and any other "materialized risk" that can possibly impact their business (no matter how immaterial or easily remediated).

Second, the Ninth Circuit's rule arguably conflicts with the SEC's regulatory regime and policy goals for risk disclosures. As part of its recent amendments to Item 105, the SEC noted that "prescriptive requirements result in disclosure that is

not material to an investment decision and is costly to provide." Modernization of Regulation S-K Items 101, 103, and 105, 85 Fed. Reg. 63,726, 63,746 (Oct. 8, 2020). The amendments were intended "to improve disclosures for investors and to simplify compliance efforts for registrants" with a "thoughtful mix of prescriptive and principles-based requirements that should result in improved disclosures and the elimination of unnecessary costs and burdens." Press Release, *SEC Proposes to Modernize Disclosures of Business, Legal Proceedings and Risk Factors under Regulation S-K* (Aug. 18, 2019), https://bit.ly/3vzYvS0. Moreover, the SEC—and courts—have noted that in areas like cybersecurity companies should not "make detailed disclosures [of cybersecurity events] that could compromise [their] cybersecurity efforts—for example, by providing a 'roadmap' for those who seek to penetrate a company's security protections." SEC Statement and Guidance on Public Company Cybersecurity Disclosures, 83 Fed. Reg. 8,166, 8,169 (Feb. 26, 2018); *see also Marriott*, 31 F.4th at 905. The Ninth Circuit's rule would undermine the SEC's stated aims by making risk disclosures more prescriptive, unduly lengthy, and possibly harmful to the company and its investors.

Third, the Ninth Circuit's rule would harm investors because it will make it difficult to glean valuable information from a company's risk disclosures. To fend off securities litigation, companies will err on the side of providing "an overabundance of information," which this Court has expressly rejected as inimical to the investing public. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988). Indeed, as this Court has made plain, "bury[ing] the

shareholders in an avalanche of trivial information" is "a result that is hardly conducive to informed decisionmaking." *Id.* (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448–49 (1976)).

In contrast, the approach adopted by the Sixth Circuit (and the Fourth Circuit on the issue of materiality) poses no appreciable burden or harm to investors, who remain able under the federal securities laws to sue if a company has made statements of *current or historical fact* that are rendered misleading by the failure to disclose that a risk has already come to fruition. For example, investors often file securities lawsuits based on statements about a company's *current or historical* financial performance, where there are allegations that those statements were made when the company was aware of the materialization of risks calling the financial performance into question. *See, e.g.*, *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 251 (2d Cir. 2016) ("[A] reasonable investor could find [the company's] statements about high EBITDA growth misleading for [not disclosing the company's] liquidity risk."). Even without the Ninth Circuit's improper ruling, investors will continue to have avenues to seek redress when a company fails to disclose the materialization of a risk.

Finally, the Ninth Circuit's decision threatens to usher in a new wave of lawsuits based on companies' failure to disclose past incidents alongside risk disclosures, an outcome that would run contrary to Congress's stated desire to limit the proliferation of meritless securities litigation. As this Court has noted, one of the PSLRA's primary goals was "to curb frivolous, lawyer-driven litigation." *Tellabs, Inc. v.*

Makor Issues & Rights, Ltd., 551 U.S. 308, 322 (2007). Before the PSLRA, companies risked "open-ended liability" and "baseless and extortionate securities lawsuits" when they disseminated relevant information to the market. H.R. Rep. No. 104-369, at 32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 731. Recognizing that forward-looking statements often will turn out to be wrong, Congress included a "safe harbor" in the PSLRA barring claims based on these statements to achieve its goal of limiting abusive securities filings.

Specifically, the safe harbor incentivized companies to disclose potentially valuable information about a company's future prospects and risks, while offering the companies protection from meritless lawsuits for those statements. *See id.* at 42–43 (explaining that the statutory safe harbor was designed to reduce "[t]he muzzling effect of abusive securities litigation"). Under the PSLRA, a company can invoke the safe harbor's protection by providing "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." 15 U.S.C. § 78u-5(c)(1)(i). In other words, Congress offered companies a new layer of protection from frivolous securities lawsuits if they included "meaningful" risk disclosures in their securities filings.

The Ninth Circuit, however, has turned this regulatory regime on its head: the very risk disclosures intended to protect companies from meritless litigation have now become a way for the plaintiffs' bar to file new cases. Unless this Court intervenes, plaintiffs' firms will continue to bring

securities suits based on risk disclosures even if the defendant has not actually made any other statements on the same topic. That is not what Congress intended in the PSLRA when it encouraged companies to provide meaningful cautionary statements, and the Court once again should step in to prune the ever-growing judicial oak of federal securities fraud liability. *See Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 276 (2010) (Section 10(b) "area of law is replete with judge-made rules, which give concrete meaning to Congress' general commands. * * * '[W]e deal with a judicial oak which has grown from little more than a legislative acorn.'" (citation omitted)).

II. The Petition should be granted so that the Court can clarify the pleading standard for loss causation.

Loss causation is one of six basic elements of a securities fraud claim under Section 10(b) and Rule 10b-5. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342 (2005). To establish loss causation, a plaintiff must plead and prove "a causal connection between the material misrepresentation and the loss." *Id.* While in *Dura* this Court established the general loss causation standard, it pointedly did *not* resolve whether plaintiffs must plead loss causation under the notice requirements of Rule 8 or the particularity requirements of Rule 9(b). *Id.* at 346 ("we assume, at least for argument's sake, that neither the Rules nor the securities statutes impose any special further requirement in respect to the pleading of proximate causation or economic loss").

In the nearly 20 years since *Dura* was decided, this question has sharply divided the lower courts.

See Evan Hill, Note, *The Rule 10b-5 Suit: Loss Causation Pleading Standards in Private Securities Fraud Claims After* Dura Pharmaceuticals, Inc. v. Broudo, 78 FORD. L. REV. 2659, 2663 (2010) ("The shortcomings of *Dura* are exemplified by the various loss causation pleading standards currently applied by the circuit courts."). Without specific guidance, several courts correctly have held that Rule 9(b) applies, while others have "followed" *Dura* and held that only Rule 8 applies.[4] The Petition explores the split at length. *See* Pet. at 28–31.

Below, the Ninth Circuit initially applied only Rule 8, *see* Pet. App. 87a–94a, but amended the opinion to insert citations to Rule 9(b), *see id.* at 33a–40a. Despite the change in citations, the Ninth Circuit did not change its substantive loss causation analysis, effectively treating Rule 9(b) and Rule 8 as functional equivalents. *See* Pet. at 31. The Ninth Circuit's Rule 8-like analysis is particularly problematic because it focused on allegations about the impact of an external event on the company's performance rather than allegations about any purported inflation of the stock price caused by the alleged misstatements that

[4] Putting aside the Ninth Circuit, the Fourth Circuit has recognized that Rule 9(b) applies to the loss causation element of securities fraud claims, whereas the Fifth and Sixth Circuits have held Rule 9(b) does not apply based on the misimpression that this Court decided the issue in *Dura*. *Compare Katyle v. Penn Nat'l Gaming, Inc.*, 637 F.3d 462, 471 (4th Cir. 2011), *with Lormand*, 565 F.3d at 255; *Ohio Pub. Emps. Ret. Sys. v. Fed. Home Loan Mortg. Corp.*, 830 F.3d 376, 384 (6th Cir. 2016). Other circuit courts have recognized the split, but have not directly ruled on the issue, leading to mixed results among district courts. *See* Pet. at 29–31 (discussing cases from First, Second, Seventh, and Tenth Circuits).

dissipated once the market learned of their purported falsity. If the Court does not intervene to provide further guidance on the appropriate pleading standard for loss causation, it could incentivize meritless suits and result in windfalls for plaintiffs.

A. Rule 9(b) should apply to allegations of loss causation.

"In alleging fraud," Rule 9(b) requires a plaintiff to "state with particularity the circumstances constituting fraud." FED. R. CIV. P. 9(b). Claims under Section 10(b) of the Exchange Act necessarily sound in fraud. *See Chiarella v. United States*, 445 U.S. 222, 234–35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud."). Indeed, this Court has looked specifically to common law fraud principles to "develop[]" its Section 10(b) and Rule 10b-5 jurisprudence. *See Basic*, 485 U.S. at 253 ("the case law developed in this Court with respect to § 10(b) and Rule 10b-5 has been based on doctrines with which we, as judges, are familiar: common-law doctrines of fraud and deceit").

Rule 9(b) "imposes similar requirements with respect to averments of fraud in connection with claims asserted on common law * * * bases" as it does for securities fraud claims under Section 10(b) and Rule 10b-5. *Prime Mover Capital Partners L.P. v. Elixir Gaming Techs., Inc.*, 898 F. Supp. 2d 673, 684 (S.D.N.Y. 2012), *aff'd*, 548 F. App'x 16 (2d Cir. 2013). As a result, courts have "rigorously applied" Rule 9(b) in assessing the adequacy of allegations as to the elements of Section 10(b) and Rule 10b-5 claims. *Rabin v. NASDAQ OMX PHLX LLC*, 712 F. App'x 188, 192 (3d Cir. 2017); *see also Thompson v.*

Relationserve Media, Inc., 610 F.3d 628, 633 (11th Cir. 2010) ("Because Rule 10b-5 sounds in fraud, the plaintiff must plead the elements of its violation with particularity.").

The loss causation element of a federal securities fraud claim is rooted in common law fraud. *Dura,* 544 U.S. at 343–44 ("the common law has long insisted that a plaintiff in [a fraud or deceit] case show not only that had he known the truth he would not have acted but also that he suffered actual economic loss"). And courts frequently have identified the causation element of fraud-based claims as one of "the circumstances constituting fraud" that must be pleaded with particularity.[5] That analysis applies equally to securities fraud. It is logical to apply Rule 9(b)'s pleading standard for all elements of securities fraud, including loss causation. *See Katyle*, 637 F.3d at 471 n.5.

Applying Rule 9(b) to loss causation allegations in securities fraud cases also is consistent with the purpose of the rule, which is to raise the pleading bar

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[5] *See, e.g.*, *Clinton v. Sec. Benefit Life Ins. Co.*, 63 F.4th 1264, 1277 (10th Cir. 2023) ("[T]o adequately plead mail and wire fraud under Rule 9(b), Plaintiffs must allege * * * '*the consequences'* of the false representations." (emphasis added)); *Humana, Inc. v. Indivior, Inc.*, No. 21-2573, 2022 WL 17718342, at *4 (3d Cir. Dec. 15, 2022) ("If this Court cannot say how defendants' fraud caused Insurers' injury, it cannot say that Fed. R. Civ. P. 9(b) was satisfied."); *Acosta Orellana v. CropLife Int'l*, 711 F. Supp. 2d 81, 96 (D.D.C. 2010) ("In this Circuit, 'the circumstances that the claimant must plead with particularity include matters such as * * * what * * * the claimant lost as a consequence of the alleged fraud.'" (quoting *Chelsea Condo. Unit Owners Ass'n v. 1815 A. St., Condo. Grp., LLC*, 468 F. Supp. 2d 136, 146 (D.D.C. 2007)).

for "certain subjects understood to raise a high risk of abusive litigation." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 569 n.14 (2007) (citing FED. R. CIV. P. 9(b)). Indeed, the loss causation requirement was first "invigorated" by courts in securities fraud cases due to "policy concerns over excessive litigation." Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811, 820 (2009).

In sum, loss causation should be considered one of the "circumstances constituting fraud" subject to Rule 9(b)'s heightened pleading requirements given the fraud-based origin of the loss causation element and the language and purpose of the rule.

B. The Ninth Circuit erred by applying Rule 9(b) in name only.

The Ninth Circuit applied Rule 9(b) in name only. The substantive analysis did not change after the Ninth Circuit amended its opinion to insert references to Rule 9(b). *See* Pet. at 31. In effect, the Ninth Circuit treated Rule 9(b) as though it requires no more than Rule 8. This was wrong.

As this Court has held, Rule 9(b), when applicable, requires that "a plaintiff must state factual allegations with greater particularity than Rule 8 requires." *Twombly*, 550 U.S. at 569 n.14. For loss causation specifically, Rule 9(b) requires something akin to the rule adopted by the Fourth Circuit that a complaint "allege a sufficiently direct relationship between the plaintiff's economic loss and the defendant's fraudulent conduct." *Katyle*, 637 F.3d at 472. Under that formulation, the allegations must show with particularity that "the misrepresentation or omission was 'one substantial cause of the investment's decline in value.'" *Id.* (citation omitted).

Allegations of an "attenuated" connection are insufficient. *Id.*

Had the Ninth Circuit applied Rule 9(b) as outlined above, the outcome likely would have been different. The Ninth Circuit would have required the plaintiffs to plead particularized facts showing a specific and direct relationship between the July 2018 stock drop, which followed months after the supposed fraud was allegedly revealed to the market in March and June 2018, and the alleged misstatements themselves. But the Ninth Circuit held only that the complaint "plausibly plead[ed]" that the July 2018 stock drop "was caused by 'dramatically lowered user engagement, substantially decreased advertising revenue and earnings, and reduced growth expectations going forward' on account of the Cambridge Analytica and whitelisting scandals." Pet. App. 38a. In other words, the Ninth Circuit found loss causation "plausible" based on the drop in the stock price caused by the market's reaction to the operational impacts of Cambridge Analytica's misuse of Facebook data and the whitelisting issue rather than any revelation of the truth behind the alleged misstatements, which occurred much earlier than July 2018.

C. If left unaddressed, the Ninth Circuit's ruling will invite meritless suits.

Allowing a notice pleading standard for loss causation allegations will enable meritless securities fraud cases to advance beyond the motion-to-dismiss stage. This is particularly true given the current trend towards "event-driven securities litigation" (*i.e.*, securities class actions based on external events that

drive down a company's stock price). *See generally* Merritt B. Fox & Joshua Mitts, *Event-Driven Suits and the Rethinking of Securities Litigation*, 78 BUS. L. 1 (2023). These external events have included data security breaches, sexual harassment allegations, commercial litigation, allegations that a drug or product has side effects or caused injury, and regulatory investigations or enforcement actions.

Event-driven securities litigation typically is pleaded using a "materialization of the risk" theory, in which the plaintiff alleges the company underplayed its vulnerability to the risk of the external event. *See* Richard A. Booth, *Loss Causation and The Materialization of Risk Doctrine in Securities Fraud Class Actions*, 75 BUS. L. 1791, 1792–93 (2020). Professor Booth has posited that "[a]lthough this [materialization] doctrine is well established, its ultimate effect" in the context of event-driven securities litigation "is to overcompensate investors, thus encouraging excessive securities litigation and chilling voluntary disclosure." *Id.* at 1791.

Professor Booth illustrated this phenomenon through an example of event-driven securities litigation arising from the Deepwater Horizon explosion and oil spill. There, the plaintiffs based their claims on purported misstatements about BP's safety practices. Professor Booth noted that "[a]ssuming the allegations to be true," and the truth had become known earlier, "the pre-event market price of BP stock would have been a bit lower, reflecting additional risk." *Id.* Thus, "if the plaintiffs recovered an amount equal to pre-spill price inflation, they would be in exactly the same financial position as if they had bought knowing the truth." *Id.*

Yet the losses at issue were much larger than the "pre-spill price inflation" because there was a steep drop in the stock price after news broke of the disaster. As Professor Booth noted, "most of the price decline following the event" was attributable to "the prospect of cash outflows resulting from cleanup, repairs, fines, settlements, and possibly an increase in the cost of capital." *Id.* It would be "excessive" to "compensate buyers for these consequential losses" through the federal securities laws as "the law is quite clear that investors may recover under SEC Rule 10b-5 only for the loss actually caused by a misrepresentation." *Id.* at 1791, 1796 (citing *Dura*, 544 U.S. at 345–46).

If left intact, the Ninth Circuit's loss causation analysis using a notice pleading standard would allow investors to recover losses for alleged misstatements that cause no loss at all. For example, if the market learns of new information that corrects a prior alleged misstatement, but the stock price does not react, a plaintiff would have no claim. But if a later event, disaster, or consequential harm merely relates to that same alleged misstatement in some way, a plaintiff could point to the stock drop caused by the market's reaction to that event to satisfy its pleading burden.

While the Ninth Circuit took comfort in applying a lax pleading standard for loss causation "at the very early motion to dismiss stage," this justification ignores the reality of securities litigation and the pressure to settle given potential exposure to massive liability. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975) (warning against "permit[ting] a plaintiff with a largely groundless claim to simply take up the time of a

number of other people, with the right to do so representing an in terrorem increment of the settlement value, rather than a reasonably founded hope"). Securities class actions rarely reach trial, and settlement discussions "happen[] in the shadow of the law." Booth, 75 BUS. L. at 1803. "The pressure to settle even claims with a low probability of success is compounded in event-driven cases" because "the application of 10b-5 jurisprudence in event-driven securities cases has been inconsistent, leading to great uncertainty for defendants." Emily Strauss, *Is Everything Securities Fraud?* 12 U.C. IRVINE L. REV. 1331, 1351 (2022).[6]

The federal securities laws were not enacted "to provide investors with broad insurance against market losses" caused by external events impacting the company, "but to protect them against those economic losses that misrepresentations actually cause." *Dura*, 544 U.S. at 345. This principle would be turned on its head if loss causation is subject to a pleading standard that can be satisfied without particularized allegations reflecting a sufficiently direct relationship between the misstatements and the alleged loss. The uniform adoption of a more searching pleading standard under Rule 9(b) will bring clarity to this area of federal law and curb

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[6] *See also* Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821, 1852–53 (2021) ("The difficulties associated with terminating event-driven securities litigation at the motion to dismiss or class certification stage, coupled with the costs of discovery and extremely large potential damage awards typical in this sort of litigation, means that the risk of vexatious litigation is high.").

attempts to leverage large damage figures to extract an *in terrorem* settlement.

CONCLUSION

This Court should grant the Petition, resolve the existing circuit splits, and provide guidance on (a) whether a company must disclose all past incidents alongside the risk disclosures in their SEC filings, and (b) the proper pleading standard for loss causation.

Respectfully submitted,

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