No. 23-980

In the Supreme Court of the United States

FACEBOOK, INC., ET AL., PETITIONERS,

v.

AMALGAMATED BANK, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR *AMICI CURIAE* LAW PROFESSORS AND FORMER OFFICIALS OF THE SECURITIES AND EXCHANGE COMMISSION SUPPORTING PETITIONERS

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TABLE OF CONTENTS

Page

INTERESTS OF *AMICI CURIAE* 1

INTRODUCTION AND SUMMARY OF ARGUMENT 2

ARGUMENT 2

I. THE NINTH CIRCUIT'S RULE WOULD UNDERMINE THE SEC'S RISK-DISCLOSURE REGIME AND HURT INVESTORS 2

A. The SEC's Risk-Disclosure Regime 3

B. The Decision Below Contravenes the SEC'S "Materiality" Requirement and Will Lead to Information Overload and "Overwarning" 5

II. THE NINTH CIRCUIT'S RULE ERODES RULE 9(b)'S PROTECTIONS AGAINST IMPROPER SECURITIES FRAUD LITIGATION 10

CONCLUSION 15

TABLE OF AUTHORITIES

Cases Page(s)

Air & Liquid Sys. Corp. v. *DeVries*,
586 U.S. 446 (2019) 9

Basic Inc. v. *Levinson*,
485 U.S. 224 (1988) 5, 7, 13

Blue Chip Stamps v. *Manor Drug Stores*,
421 U.S. 723 (1975) 10

In re Bristol-Myers Squibb Co. CVR Sec. Litig.,
658 F. Supp. 3d 220 (S.D.N.Y. 2023) 13

Cerveny v. *Aventis, Inc.*,
855 F.3d 1091 (10th Cir. 2017) 9

Clark Cnty. Sch. Dist. v. *Breeden*,
532 U.S. 268 (2001) 14

CTIA–The Wireless Assoc. v. *City of Berkeley*,
487 F. Supp. 3d 821 (N.D. Cal. 2020) 9

Dura Pharmaceuticals, Inc. v. *Broudo*,
544 U.S. 336 (2005) 2, 10

In re Facebook Inc. Sec. Litig.,
87 F.4th 934 (9th Cir. 2023) 6

Ford Motor Credit Co. v. *Milhollin*,
444 U.S. 555 (1980) 8

In re Gilead Scis. Sec. Litig.,
536 F.3d 1049 (9th Cir. 2008) 13

Goldman Sachs Grp., Inc. v. *Ark. Tchr. Ret. Sys.*,
594 U.S. 113 (2021) 11, 13

Halliburton Co. v. *Erica P. John Fund, Inc.*,
573 U.S. 258 (2014) 12

Katyle v. *Penn Nat'l Gaming, Inc.*,
637 F.3d 462 (4th Cir. 2011) 10

Lormand v. *US Unwired, Inc.*,
565 F.3d 228 (5th Cir. 2009) 10

Cases—Continued Page(s)

Mass. Ret. Sys. v. *CVS Caremark Corp.*,
716 F.3d 229 (1st Cir. 2013)..10

Merck Sharp & Dohme Corp. v. *Albrecht*,
587 U.S. 299 (2019)..8

In re Nuvelo, Inc., Sec. Litig.,
668 F. Supp. 2d 1217 (N.D. Cal. 2009)..13

O'Neal v. *Ferguson Constr. Co.*,
237 F.3d 1248 (10th Cir. 2001)..14

O'Neil v. *Crane Co.*,
266 P.3d 987 (Cal. 2012)..9

In re Odyssey Healthcare, Inc. Sec. Litig.,
424 F. Supp. 2d 880 (N.D. Tex. 2005)..11

Provenz v. *Miller*,
102 F.3d 1478 (9th Cir. 1996)..6

Robinson v. *McNeil Consumer Healthcare*,
615 F.3d 861 (7th Cir. 2010)..9

TSC Industries v. *Northway, Inc.*,
426 U.S. 438 (1976)..5, 7

U.S. Aviation Underwriters, Inc. v. *United States*,
562 F.3d 1297 (11th Cir. 2009)..9

In re Zofran (Ondansetron) Prods. Liab. Litig.,
57 F.4th 327 (1st Cir. 2023)..9

Regulations and Rules

47 Fed. Reg. 11,380 (Mar. 16, 1982)..5

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17 C.F.R. § 229.105..3

17 C.F.R. § 240.12b-2..5

Fed.R.Civ.P. 8(a)(2)..10

Regulations and Rules—Continued Page(s)

Fed.R.Civ.P. 9(b) 10

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Anne Beatty et al., *Are Risk Factor Disclosures Still Relevant? Evidence from Market Reactions to Risk Factor Disclosures Before and After the Financial Crisis*, 36 Contemp. Acct. Res., 805 (2019) 4

Donald C. Langevoort, *Toward More Effective Risk Disclosure for Technology-Enhanced Investing*, 75 Wash. U. L. Q. 753, 759 (1997) 8

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Matt Levine, *Money Stuff: Everything Everywhere Is Securities Fraud* (June 26, 2019), https://bloom.bg/43xNFby 12

Matthew C. Turk, *Securitization Reform After the Crisis: Regulation by Rulemaking or Regulation by Settlement?*, 37 Rev. Banking & Fin. L. 861 (Spring 2018) 12

Merritt B. Fox and Joshua Mitts, *Event-Driven Suits and the Rethinking of Securities Litigation*, 78 Bus. Law. 1 (Winter 2022-2023) 11

Stephen M. Shapiro et al., Supreme Court Practice § 4.5 (11th ed.) 10

Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 Baylor L. Rev. 139 (2006) 8, 9

Troy A. Paredes, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 81 Wash. U. L. Q. 417 (2003) 7, 8

INTERESTS OF *AMICI CURIAE*[1]

Amici curiae are law professors and former officials of the Securities and Exchange Commission ("SEC"). They have spent years studying and advising on the federal securities laws, the SEC's enforcement practices, and securities class action litigation. They have an interest in the appropriate construction and operation of the laws in those areas. Amici are:[2]

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Andrew N. Vollmer: Senior Affiliated Scholar, Mercatus Center at George Mason University; former Professor of Law, General Faculty, University of Virginia School of Law; former Deputy General Counsel of the SEC; former partner in the securities enforcement group of Wilmer Cutler Pickering Hale and Dorr LLP.

Amici are unanimous in their view that the Ninth Circuit's decision below not only is wrong and contrary to the SEC's risk-disclosure regime, but also that it will hinder and confuse investors seeking to understand the material risks of their investments and confound companies trying to comply with SEC disclosure obligations.

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[1] No counsel for a party authored this brief in whole or in part. No person other than amici or their counsel made a monetary contribution to its preparation or submission. The parties were given timely notice of this filing.

[2] The views in this brief are those of the amici curiae only and not necessarily of any of the institutions with which they are or have been affiliated. The names of the institutions are included for identification only.

INTRODUCTION AND SUMMARY OF ARGUMENT

This case is a textbook example of a case warranting this Court's review because it is the result of circuit court conflicts on issues of nationwide importance: the integrity of the SEC's disclosure regime and the pleading standard for loss causation, which provide critical checks on securities class action abuse.

As petitioners ably demonstrate, review is needed to resolve a circuit conflict and provide certainty and uniformity on the critical standards for risk factor disclosures. Amici further submit that review is needed to correct the Ninth Circuit's outlier standard, which contravenes the SEC's efforts to make the "risk factors" section in companies' public disclosures more effective. Among other deficiencies, the Ninth Circuit's standard encourages "information overload" and "overwarning," which studies and common sense show prevent investors from making informed decisions.

This case also presents the ideal vehicle to resolve another divide on an important prophylactic to litigation abuse: the pleading standard for alleging loss causation. This Court's decision in *Dura Pharmaceuticals, Inc.* v. *Broudo*, 544 U.S. 336 (2005), left this question open. Since then, developments in securities litigation, including the proliferation of event-driven litigation, underscore the need to resolve this question and stem abusive securities class actions.

ARGUMENT

I. THE NINTH CIRCUIT'S RULE WOULD UNDERMINE THE SEC'S RISK-DISCLOSURE REGIME AND HURT INVESTORS

Lower courts are divided on what information companies must include in the required "risk factors" section of their Form 10-Ks, Form 10-Qs, and other public

filings to comply with Item 105 of Regulation S-K, 17 C.F.R. § 229.105. One circuit has held that risk disclosures need not discuss past instances when a risk came to fruition, and six other circuits have concluded that companies must disclose past events only if the companies knew the events had harmed or would inevitably harm the business. The Ninth Circuit below rejected all these approaches, holding that risk disclosures must include past instances when the risks came to fruition even where the companies had no basis to believe that those events would harm the business. The circuit conflict alone warrants this Court's review, as petitioners demonstrate. Review is also warranted to prevent the Ninth Circuit's outlier approach from undermining the SEC's risk-disclosure regime and hurting investors.

A. The SEC's Risk-Disclosure Regime

SEC rules require risk disclosures from certain market participants. Since 2005, subject companies have been required to describe the material risks of an investment in the company's securities in both annual and periodic reports filed with the SEC pursuant to Regulation S-K ("Reg S-K").

Over time, concerns emerged that disclosures were becoming too long and detailed while at the same time less effective. In 2016, the SEC investigated its disclosure regime under Reg S-K and issued a concept release that emphasized a significant number of concerns it had received about the growing length of risk factor disclosures. See Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,955 (Apr. 22, 2016). In 2019 a prominent "study found that registrants increased the length of risk factor disclosures from 2006 to 2014 by more than 50 percent in terms of word count * * * and that this increase in risk factor word count may not be associated with better disclosure." Modernization of Regulation S-K Items 101, 103, and 105,

85 Fed. Reg. 63,726, 63,743 n.198 (Oct. 8, 2020) (citing Anne Beatty et al., *Are Risk Factor Disclosures Still Relevant? Evidence from Market Reactions to Risk Factor Disclosures Before and After the Financial Crisis*, 36 Contemp. Acct. Res., 805 (2019)).

In 2020, the SEC amended the disclosure requirements "to address the lengthy and generic nature of the risk factor disclosure presented by many registrants." *Id.* at 63,742. The SEC cited comment letters and the 2019 study, which attributed the growing length of risk factor disclosure to the fear of litigation for failing to disclose risks that later materialized. See *id.* at 63,742, 63,743. Recognizing that repetitive and generic risk disclosure can "obscure relevant information or render it difficult to evaluate the importance of the information," 2016 Concept Release at 23,995, the SEC amended Item 105 of Reg S-K, requiring that if a company's risk factor disclosure section exceeds 15 pages, the company must provide a summary risk factor disclosure that is no longer than two pages. The amendment further changed the standard for disclosure from the "most significant" risks to "material" risks, with the aim that it would "result in risk factor disclosure that is more tailored to the particular facts and circumstances of each registrant, which should reduce the disclosure of generic risk factors and potentially shorten the length of the risk factor discussion, to the benefit of both investors and registrants." 2020 Amendments Release at 63,744.

As discussed next, the Ninth Circuit's decision contravenes the SEC's goal of risk factors that are "more tailored" to the "material risks."

B. The Decision Below Contravenes the SEC'S "Materiality" Requirement and Will Lead to Information Overload and "Overwarning"

In addition to resolving the circuit conflict, see Pet. 18-23, this Court should intervene to address two core problems with the Ninth Circuit's rule.

1. The Ninth Circuit's approach waters down Reg S-K Item 105's "materiality" limitation by requiring companies to make overly cautious risk disclosures for past events even when the company has no reason to suspect those events will harm the business in the future.

Materiality is a guiding principle under federal securities laws used by the SEC since 1937. See 2016 Concept Release at 23,925. In 1982, the SEC formally adopted this Court's materiality standard articulated in *TSC Industries* v. *Northway, Inc.*, 426 U.S. 438 (1976). See Adoption of Integrated Disclosure System, 47 Fed. Reg. 11,380, 11,393-94 (Mar. 16, 1982). And in 1988, this Court applied the materiality standard from *TSC Industries* to Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78rr, and Rule 10b-5, 17 C.F.R. 240.10b-5. See *Basic Inc.* v. *Levinson*, 485 U.S. 224, 232 (1988).

Information is material if there is a substantial likelihood that disclosure of the omitted fact would have been viewed as important by the reasonable investor. In adopting the materiality standard for risk disclosures under Item 105, the SEC likewise advised that "the term *material,* when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security." Modernization of Regulation S–K Items 101, 103, and 105, 84 Fed. Reg. 44,358, 44,376 (Aug. 23, 2019) (quoting 17 C.F.R. § 240.12b-2 (emphasis added)).

The Ninth Circuit's decision treats past events as material even if there is no reason to believe they will harm the business, undermining the purpose of the materiality requirement. Put simply, when there is no reason to believe a *past* event poses a *current* risk of business harm, the event is not a matter "to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security." *Ibid.*

The decision below is all the more troublesome because the court found the omission of the Cambridge Analytica data misuse was material even though it was widely known by the public in 2015 through news reports, well before the forward-looking risk factor statements on Facebook's 2016 Form 10-K was filed in February 2017. The Ninth Circuit drew this conclusion despite recognizing that "if the market has already 'become aware of the allegedly concealed information,' the allegedly false information or material omission 'would already be reflected in the stock's price' and the market 'will not be misled.'" *In re Facebook Inc. Sec. Litig.*, 87 F.4th 934, 948 (9th Cir. 2023) (quoting *Provenz* v. *Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996)).

The Ninth Circuit also incongruously found that a non-disclosure of a past event is material, even where the company includes a forward-looking risk factor about the same type of risk. A simple example illustrates the fallacy of the Ninth Circuit's reasoning. Retail stores use yellow wet-floor signs to warn customers of the potential risk of slipping. It would be absurd to assert that the wet-floor sign is misleading *unless* the retailer also posts a list of everyone who has slipped on wet floors in the past. Yet the Ninth Circuit's rule would render the store's slip-and-fall warning inadequate unless it also included all past falls, with no temporal limit.

2. The Ninth Circuit's decision also undermines the SEC's requirements aimed at "risk factor disclosure that is more tailored to the particular facts and circumstances of each registrant [to] reduce the disclosure of generic risk factors and potentially shorten the length of the risk factor discussion, to the benefit of both investors and registrants." 2020 Amendments Release at 63,744. If left standing, the decision below would encourage, if not require, companies to disclose the cumulative history of their business, no matter how immaterial to the risk of future business harm.

By "bring[ing] an overabundance of information within its reach," the Ninth Circuit's rule would require companies to "bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking." *Basic, Inc.*, 485 U.S. at 231 (in part quoting *TSC Industries*, 426 U.S. at 488). Regulators, courts, and scholars repeatedly have recognized the risks of "information overload" or "overwarning" in the securities and numerous other contexts. The principle is always the same: "more disclosure can mean less effective disclosure." Troy A. Paredes, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 81 Wash. U. L. Q. 417, 446 (2003).

"Studies show that at some point, people become overloaded with information and make worse decisions than if less information were made available to them." *Id.* at 419. "In particular, studies show that when faced with complicated tasks that involve vast quantities of information, people tend to adopt simplifying decision strategies that require less cognitive effort, but that are less accurate than more complex decision strategies." *Ibid.* "The net result of having access to more information, combined with using a less accurate decision strategy as the information load increases, is often an

inferior decision." *Ibid.* (discussing studies). "Borrowing Brandeis' terminology, in addition to being a disinfectant, sunlight can also be blinding." *Ibid.*

Information overload can result in investors becoming "overwhelmed and confused." *Id.* at 441. "Making matters worse, studies show that people do not always focus on the most relevant information but might become distracted by less relevant information." *Id.* at 442. "[T]he more information there is, the more each bit of it is diluted. The immediate and salient crowds out the less attention-grabbing." Donald C. Langevoort, *Toward More Effective Risk Disclosure for Technology-Enhanced Investing*, 75 Wash. U. L. Q. 753, 759 (1997) (footnote omitted). As a result, "[w]hen the average investor is presented with disclosure that is too long and complex to be processed efficiently, the overload can hinder informed decision-making and thereby defeat the very purpose of disclosure requirements." Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 Baylor L. Rev. 139, 162 (2006).

The problem of information overload or "overwarning" is well recognized in an array of contexts. For instance, this Court has recognized that consumer protection disclosures must avoid "information overload," because "*[m]eaningful* disclosure does not mean *more* disclosure." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 568, (1980) (discussing liability for a failure to disclose under the Truth in Lending Act). Drug labels that include too many warnings risk "overshadow[ing]" more important information. *Merck Sharp & Dohme Corp.* v. *Albrecht*, 587 U.S. 299, 304 (2019). And "[r]equiring a product manufacturer to imagine and warn" of risks based on "how its product might be used with other products or parts[,] []would impose a difficult and costly burden on manufacturers, while simultaneously

overwarning users." *Air & Liquid Sys. Corp.* v. *DeVries*, 586 U.S. 446, 454 (2019). Other courts and agencies have recognized the risks of overwarning; as one court put it: "To warn of all potential dangers would warn of nothing." *O'Neil* v. *Crane Co.*, 266 P.3d 987, 1006 (Cal. 2012) (quotation marks omitted).[3]

Unsurprisingly, the SEC and its officials have recognized that information overload can hinder informed decision-making. *E.g.*, Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,919 (Apr. 22, 2016) ("There is also a possibility that high levels of immaterial disclosure can obscure important information or reduce incentives for certain market participants to trade or create markets for securities."); Ripken, *supra*, at 162 ("Even former SEC Chairman Arthur Levitt noted that '[t]oo much information can be as much a problem as too little' and '[m]ore disclosure does not always mean better disclosure.'").

Nevertheless, the decision below demands that companies saturate their disclosures with overwhelming information about past events despite no reasonable belief that these events present risks of harm to the business. That may result in material information being overlooked or diluted and lead to worse, not better, decisions.

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[3] See, *e.g.*, *In re Zofran (Ondansetron) Prods. Liab. Litig.*, 57 F.4th 327, 330 (1st Cir. 2023) ("[O]ne of [the FDA's] objectives is to prevent overwarning, which may deter appropriate use of medical products, or overshadow more important warnings." (quotation marks omitted)); *Cerveny* v. *Aventis, Inc.*, 855 F.3d 1091, 1102 (10th Cir. 2017) (same); *Robinson* v. *McNeil Consumer Healthcare*, 615 F.3d 861, 869 (7th Cir. 2010) (same); *U.S. Aviation Underwriters, Inc.* v. *United States*, 562 F.3d 1297, 1300 (11th Cir. 2009) (noting "the dangers of over warning" in forecasting turbulence to aircraft pilots); *CTIA – The Wireless Assoc.* v. *City of Berkeley*, 487 F. Supp. 3d 821, 834 (N.D. Cal. 2020) (agreeing with FCC that city ordinance on risks of cell phone usage presented risk of overwarning).

II. THE NINTH CIRCUIT'S RULE ERODES RULE 9(b)'S PROTECTIONS AGAINST IMPROPER SECURITIES FRAUD LITIGATION

Under the existing state of the law, "[i]t is unclear whether a plaintiff may plead loss causation with 'a short and plain statement of the claim showing that the pleader is entitled to relief,' Fed.R.Civ.P. 8(a)(2)," or if the plaintiff must meet the rule that '"a party must state with particularity the circumstances constituting fraud,' Fed.R.Civ.P. 9(b)." *Mass. Ret. Sys.* v. *CVS Caremark Corp.*, 716 F.3d 229, 239 n.6 (1st Cir. 2013).[4]

The divide in the lower courts stems in part from *Dura Pharmaceuticals., Inc.* v. *Broudo*, 544 U.S. 336, 346 (2005), which declined to address the pleading standard for Rule 10b-5 cases. This Court often accepts review "where the decision below is premised upon a prior Supreme Court opinion whose implications are in need of clarification." Shapiro et al., Supreme Court Practice § 4.5 (11th ed.). That is the case here.

Though *Dura* did not resolve the question, the Court recognized the need for meaningful constraints on the loss causation element to prevent "a plaintiff 'with a largely groundless claim [from] simply tak[ing] 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 that the [discovery] process will reveal relevant evidence.'" *Dura*, 544 U.S. at 347 (quoting *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 741 (1975)). Twenty years later, that problem is worse than ever, underscoring the need for this Court to confirm that a more demanding pleading standard is required.

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[4] Compare, *e.g.*, *Lormand* v. *US Unwired, Inc.*, 565 F.3d 228, 258 (5th Cir. 2009) (applying Rule 8(a)(2)), with, *e.g.*, *Katyle* v. *Penn Nat'l Gaming, Inc.*, 637 F.3d 462, 471 (4th Cir. 2011) (applying Rule 9(b)).

1. Three trends in securities fraud litigation illustrate how a diminished loss-causation requirement encourages baseless fraud-by-hindsight lawsuits.

First, whereas common-law fraud typically requires a "misrepresentation," securities fraud cases have become plagued with omission-based theories. See, *e.g.*, *Goldman Sachs Grp., Inc.* v. *Ark. Tchr. Ret. Sys.*, 594 U.S. 113, 120 (2021). More and more, securities-fraud lawsuits allege fraud-by-hindsight, accusing companies of failing to disclose information that they could have included in an earlier public filing. See *ibid.*; see also, *e.g.*, Merritt B. Fox and Joshua Mitts, *Event-Driven Suits and the Rethinking of Securities Litigation*, 78 Bus. Law. 1, 1-3 (Winter 2022–2023). Omission-based lawsuits—like this one—often depend on a "partial disclosure," where the plaintiffs argue that a broad disclosure by the company triggered a duty to disclose certain specific, loosely related facts.

Rule 9(b) is especially important for partial disclosure theories because particularized pleading requires plaintiffs to identify precisely what allegedly should have been disclosed, and when. See *In re Odyssey Healthcare, Inc. Sec. Litig.*, 424 F. Supp. 2d 880, 892 (N.D. Tex. 2005) ("The particularity requirements of the PSLRA apply with equal force to omissions."). Only by identifying a specific omission—and tying that omission to an affirmative "partial" disclosure—can a court properly assess whether the alleged losses were *caused* by that omission, or by other market forces. See Fox, *supra*, at 1 ("In an event-driven case, the plaintiff points to a pre-disaster statement that allegedly underplayed the likelihood that the disaster would occur and argues that the disaster announcement was the corrective disclosure.").

Second, the problems underlying overbroad omission-based theories are aggravated by a rise in

"event-driven" securities fraud lawsuits. See Emily Strauss, *Is Everything Securities Fraud?*, 12 UC Irvine L. Rev. 1331, 1340 (2022) (detailing "event-driven" fraud actions); see also Matt Levine, *Money Stuff: Everything Everywhere Is Securities Fraud*, Bloomberg.com (June 26, 2019), https://bloom.bg/43xNFby. Event-driven cases follow a familiar pattern: A stock-price drops in response to a news source disclosing a negative event such as an oil spill, product recall, global pandemic, plant explosion, climate change, or data breach; plaintiffs' lawyers then scour 10-Ks and 10-Qs to see if the event is listed; if the event does not appear, those lawyers begin a class action alleging a failure to disclose the risk. See *ibid.* These event-driven lawsuits transform ordinary business turbulence into hundred-million dollar cases that bear little resemblance to the historical scope of securities fraud, much less the common law fraud on which the Rule 10b-5 cause of action is modeled. See *Halliburton Co.* v. *Erica P. John Fund, Inc.*, 573 U.S. 258, 284 (2014).

The problems inherent in event-driven litigation are exacerbated in cases in which the event triggers regulatory enforcement activity—through congressional hearings, official enforcement actions, or media "scandal" blitzes. In many instances, stock drops are caused by investors' fear of enforcement penalties rather than investors' purported misconceptions of the company's value. See, *e.g.*, Matthew C. Turk, *Securitization Reform After the Crisis: Regulation by Rulemaking or Regulation by Settlement?*, 37 Rev. Banking & Fin. L. 861, 892 (Spring 2018) (discussing the prosecution of Fabrice Tourre following the 2008 housing crash; in that case, fluctuations in stock prices could have been attributed to political pressure following the 2008 housing-market crash just as easily as other market forces).

Third, there is an inherent logical flaw in securities fraud lawsuits based on a drop in stock price that significantly "lags" behind the alleged corrective disclosure by weeks or even months, as the July 2018 stock drop did here. See, *e.g.*, *In re Nuvelo, Inc.*, *Sec. Litig.*, 668 F. Supp. 2d 1217, 1226-1227 (N.D. Cal. 2009) ("This lag effect, according to the Ninth Circuit, did not per se render loss causation implausible." (citing *In re Gilead Scis. Sec. Litig.*, 536 F.3d 1049 (9th Cir. 2008))); compare *In re Bristol-Myers Squibb Co. CVR Sec. Litig.*, 658 F. Supp. 3d 220, 237 (S.D.N.Y. 2023) (noting that *In re Nuvelo* is "obviously not binding on this Court and [its] reasoning has been widely rejected by other courts").

Specifically, relying on a "lag" in the stock-price drop is incompatible with the "price inflation" theory of loss causation. Under that theory, "Plaintiffs typically try to prove the amount of inflation indirectly: They point to a negative disclosure about a company and an associated drop in its stock price; allege that the disclosure corrected an earlier misrepresentation; and then claim that the price drop is equal to the amount of inflation maintained by the earlier misrepresentation." *Goldman Sachs*, 594 U.S. at 123. Thus, the lawsuit "is premised on the theory that investors rely on the market price of a company's security, which in an efficient market incorporates *all* of the company's public misrepresentations." *Id.* at 117 (emphasis added).

The inference that an efficient market incorporates *all* public information is plainly inconsistent with a loss causation theory that depends on a substantial "lag" in the stock price drop. In the "impersonal, efficient market" that *Basic* envisioned, any corrective disclosure the company published would be absorbed promptly into the stock price. See *Basic*, 485 U.S. at 248. The notion that an efficient market will perfectly inflate a stock price in real time but then *deflate* the stock price on a delayed

timeline is logically inconsistent and inherently speculative.

2. The Ninth Circuit's lax approach to Rule 10b-5 pleading for loss causation—which effectively treated the Rule 9(b) and Rule 8 standards as one and the same—allowed all three problems in securities litigation discussed above to flourish in this case.

First, this is a half-truth or "partial disclosure" case. Plaintiffs' claims are based on the purported failure to disclose certain "details about Cambridge Analytica's data misuse," while "partially disclosing" other generalized risk statements. Second, this case falls squarely within the category of event-driven litigation in which a business disruption (and corresponding press attention) led to the drop in stock price rather than the March 2018 disclosure that forms the basis of Plaintiffs' causal theory here. See Pet. 33-34. Finally, not only did Facebook's drop in stock price "lag" behind the alleged disclosure, but the court endorsed an implausible "double-drop" theory in which the same purported disclosure caused "two stock drops, four months apart." Pet. 17; cf. *Clark Cnty. Sch. Dist.* v. *Breeden*, 532 U.S. 268, 273 (2001) (collecting cases holding that "temporal proximity must be 'very close'" to satisfy causation in employment context (quoting *O'Neal* v. *Ferguson Constr. Co.*, 237 F.3d 1248, 1253 (10th Cir. 2001)).

Rather than engage with the lack of particularity in Plaintiffs' allegations, the court below brushed aside the substantive flaws in Plaintiffs' loss-causation theory with a gesture to the case's early procedural posture. Pet.App.38 ("We emphasize that this case is at the very early motion to dismiss stage, and that discovery and further proceedings are necessary to illuminate the issues surrounding loss causation."). But the panel's reliance on the motion-to-dismiss context and the possibility of discovery is misplaced. For loss causation, both the

alleged corrective disclosure and the alleged loss are public and in *the plaintiff's* hands at the time the plaintiff files its complaint. If the plaintiff is unable to articulate a coherent theory of loss causation with particularity at the pleading stage, then it almost certainly will not be able to prove one, regardless of any discovery.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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