APPENDICES

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APPENDIX A

United States Court of Appeals
For the Second Circuit

August Term, 2020

Argued: June 4, 2021

Decided: August 23, 2023

Amended: October 31, 2024

Docket No. 20-1643-cv

NEW ENGLAND CARPENTERS GUARANTEED ANNUITY AND PENSION FUNDS,

Lead Plaintiff-Appellant,

STANLEY NEWMARK, IRVING LICHTMAN REVOCABLE LIVING TRUST, JUPITER CAPITAL MANAGEMENT,

Plaintiff-Movant-Appellants,

SHARON ALBANO, Individually and On Behalf of All Others Similarly Situated,

Consolidated-Plaintiff-Movant-Appellant,

JOHN SACHETTI, Individually and On Behalf of All Others Similarly Situated,

Consolidated-Plaintiff,

JOEL RUBEL, Individually and On Behalf of All Others Similarly Situated,

Plaintiff,

v.

DONALD T. DECARLO, SUSAN C. FISCH, ABRAHAM GULKOWITZ, GEORGE KARFUNKEL, JAY J. MILLER,

Consolidated-Defendants-Appellees,

AMTRUST FINANCIAL SERVICES, INC., BARRY D. ZYSKIND, RONALD E. PIPOLY, JR., BDO USA, LLP, RBC CAPITAL MARKETS, LLC, UBS SECURITIES LLC,

CITIGROUP GLOBAL MARKETS INC., KEEFE, BRUYETTE & WOODS, INC., MORGAN STANLEY & CO. LLC,
Defendants-Appellees.

Before:
LOHIER, NARDINI, *Circuit Judges*
KOVNER, *Judge*.[*]

The Appellants, investors in the securities of AmTrust Financial Services, Inc., appeal from a judgment of the United States District Court for the Southern District of New York (Kaplan, J.) dismissing their complaint for failure to state a claim under Sections 11, 12, and 15 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 against AmTrust, various AmTrust corporate officers and board members, AmTrust's outside auditor, and multiple underwriters of AmTrust's sale of securities. The District Court determined that certain public misstatements relating to AmTrust's recognition of revenue generated by its extended warranty contracts and the expenses associated with its payment of discretionary employee bonuses were non-actionable statements of opinion. We conclude that these misstatements of opinions were actionable under the circumstances alleged in the Appellants' complaint. We further conclude that the District Court erred in dismissing the Appellants' claims under Section 10(b) and Rule 10b-5 against AmTrust's outside auditor. We identify no error in the District Court's dismissal of the Appellants' remaining claims. We therefore **AFFIRM** in substantial part, **VACATE** in part, and **REMAND** the case for further proceedings.

ANDREW S. LOVE (Susan K. Alexander, Robbins Geller Rudman & Dowd LLP, San Francisco, CA; Samuel H. Rudman, David A. Rosenfeld, Mark T. Millkey,

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[*] Judge Rachel P. Kovner, of the United States District Court for the Eastern District of New York, sitting by designation.

William J. Geddish, Avital O. Malina, Robert D. Gerson, Vincent M. Serra, Robbins Geller Rudman & Dowd LLP, Melville, NY; Jeremy A. Lieberman, Pomerantz LLP, New York, NY; Thomas J. McKenna, Gainey McKenna & Egleston, New York, NY; Kim E. Miller, Kahn Swick & Foti, LLC, New York, NY, *on the brief*), Robbins Geller Rudman & Dowd LLP, San Francisco, CA, *for* Plaintiffs-Appellants.

STEVEN M. FARINA (John S. Williams, Matthew J. Greer, *on the brief*), Williams & Connolly LLP, Washington, D.C., *for* Defendants-Appellees AmTrust Financial Services, Inc., Barry D. Zyskind, Ronald E. Pipoly, Jr., Donald T. DeCarlo, Susan C. Fisch, Abraham Gulkowitz, George Karfunkel, and Jay J. Miller.

TIMOTHY E. HOEFFNER (Jason D. Gerstein, Ludwig von Rigal, *on the brief*), McDermott Will & Emery LLP, New York, NY, *for* Defendant-Appellee BDO USA, LLP.

GREGG L. WEINER (Christopher Thomas Brown, Ropes & Gray LLP, New York, NY; William T. Davison, Ropes & Gray LLP, Boston, MA), Ropes & Gray LLP, New York, NY, *for* Defendants-Appellees Morgan Stanley & Co. LLC, Citigroup Global Markets Inc., UBS Securities LLC, RBC Capital Markets, LLC, and Keefe, Bruyette & Woods, Inc.

LOHIER, *Circuit Judge*:

When is a statement of opinion that reflects some subjective judgment nevertheless actionable under the federal securities laws?

On April 4, 2017, AmTrust Financial Services, Inc., one of the country's largest publicly traded property and casualty insurers, restated five years of its financial results to correct what it acknowledged were significant errors in its annual and quarterly reports filed with the Securities and Exchange Commission ("SEC"). Among other things, AmTrust disclosed that it had improperly recognized most of the expected revenue from certain extended warranty contracts at the start rather than over the life of the contracts. AmTrust also reported that it had improperly accounted for certain discretionary employee bonuses by treating the bonuses as expenses in the year they were paid rather than the year they were earned by employees.

AmTrust's restatement spurred the Appellants in this case, all investors in AmTrust securities,[1] to sue AmTrust, its officers (the "Officer Defendants," and, together with AmTrust, the "AmTrust Defendants"), members of its board of directors (the "Director Defendants"),[2] its former auditor,[3] and certain underwriters of AmTrust securities (the "Underwriter Defendants"), [4] for misstating the company's financial condition and results in violation of Sections 11, 12, and 15 of the Securities Act of 1933 (the "Securities Act"), and Section 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and the corresponding Rule 10b-5.

The United States District Court for the Southern District of New York (Kaplan, J.) dismissed the third amended complaint (the "Complaint") under Federal Rule of Civil Procedure 12(b)(6), holding that none of the

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[1] The named plaintiffs are New England Carpenters Guaranteed Annuity and Pension Funds, Stanley Newmark, Irving Lichtman Revocable Living Trust, Jupiter Capital Management, Sharon Albano, John Sachetti, and Joel Rubel.

[2] The Officer Defendants are Barry D. Zyskind (at all relevant times AmTrust's President and Chief Executive Officer ("CEO")) and Ronald E. Pipoly Jr. (at all relevant times AmTrust's Executive Vice President and Chief Financial Officer ("CFO")). The Director Defendants are Donald T. DeCarlo, Susan C. Fisch, Abraham Gulkowitz, George Karfunkel, and Jay J. Miller.

[3] BDO USA, LLP ("BDO").

[4] RBC Capital Markets, LLC, UBS Securities LLC, Citigroup Global Markets Inc., Keefe, Bruyette & Woods, Inc., and Morgan Stanley & Co. LLC.

misstatements were actionable under the securities laws. We agree with the District Court's dismissal of the claims relating to most of the misstatements, and we therefore AFFIRM in substantial part. But as we explain below, we disagree with the District Court's dismissal of the Appellants' claims under Sections 11, 12(a)(2), and 15 of the Securities Act against AmTrust, its officers and directors, and the Underwriter Defendants related to AmTrust's accounting for revenue generated by its extended warranty contracts and the expenses associated with discretionary employee bonuses. We also conclude that the District Court should not have dismissed the Appellants' claims under Section 10(b) of the Exchange Act and corresponding Rule 10b-5 against BDO. We therefore VACATE the judgment insofar as it dismisses those claims and REMAND to the District Court for further proceedings consistent with this opinion.

BACKGROUND

I. FACTUAL BACKGROUND

The following facts, which we assume to be true for purposes of this appeal, are drawn from the Complaint and the documents it incorporates by reference. *See Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 708 (2d Cir. 2011).

AmTrust provides workers' compensation, commercial automobile insurance, general liability, and extended service and warranty coverage. As relevant to this appeal, AmTrust promotes and markets extended service plans ("ESPs")—essentially extended warranties. AmTrust receives two types of revenue from its ESP business. First, AmTrust and its subsidiaries sell contractual liability insurance to various retailers, covering the obligations that the retailers assume as part of the ESPs. Second, retailers pay AmTrust "for marketing and administrative services," including "call center services," related to the ESPs. Joint App'x 67, 82. During the relevant time, AmTrust "recognize[d] revenue related to promotion, marketing and administration services at the time of the sale of ESP[s]" but "defer[red] a portion of service revenue based upon an estimate of administrative services to be provided in future periods." Joint App'x at 82.

Starting in 2010, AmTrust made a number of acquisitions that fueled much of its corporate growth. The acquisition most relevant to this appeal closed in 2010, when AmTrust bought Warrantech, a publicly traded company focused on providing ESPs and warranty programs for retailers, dealers, distributors, and manufacturers that became, after the acquisition, a core part of AmTrust's business. Prior to the acquisition, the SEC had investigated Warrantech's practice of recognizing the full amount of the revenue it received from its ESPs and other service contracts at the time the contract was entered and the initial sale of services commenced (we will at times refer to this as the "time-of-sale" approach). The SEC had instructed Warrantech instead to recognize the revenue generated by those contracts on a straight-line basis over the life of the contracts. Warrantech publicly announced that it would comply with the SEC's guidance, abandoned its time-of-sale approach, and revised its method of recognizing revenue relating to the ESPs. For reasons that are unclear, AmTrust, though aware of the SEC's prior guidance to the contrary, reverted back to the original time-of-sale approach after it acquired Warrantech.

From 2012 to 2016 the price of AmTrust stock, which traded on the NASDAQ Global Market, skyrocketed. The company's gross written premiums, a central measure of its financial condition, grew from $2.75 billion to $7.95 billion. Yet as early as 2013, financial commentators and analysts began speculating publicly about AmTrust's actual financial condition. One commentator reported that AmTrust may have used accounting gimmicks to inflate its earnings and net equity. A financial journal, Barron's, questioned AmTrust's accounting practices.

The bad press failed to slow AmTrust's growth. In November 2015 AmTrust filed a preliminary prospectus supplement and prospectus supplement with the SEC announcing an offer of 5 million shares of common stock (the "November 2015 Offering") pursuant to a registration statement filed on June 11, 2015 (the "2015 Registration Statement"). The transaction, underwritten by Defendants Citigroup Global Markets Inc. ("Citigroup") and Morgan Stanley & Co. LLC ("Morgan Stanley"), occurred on November 11, 2015 and raised $320 million. In September 2016 AmTrust filed another preliminary prospectus supplement and prospectus supplement under the 2015 Registration Statement, this time announcing that the company planned to offer American depositary shares in a transaction (the "September 2016 Offering") underwritten by Morgan Stanley, UBS Securities LLC ("UBS"), RBC Capital Markets, LLC ("RBC"), and Keefe, Bruyette & Woods, Inc. ("KBW"). The prospectus supplement accompanying the September 2016 Offering incorporated by reference AmTrust's annual financial report on Form 10-K for the year ending December 31, 2015, its 10-Q report for the quarter ending March 31, 2015, and various other reports the company had previously filed with the SEC. The September 2016 Offering raised $278.2 million.

AmTrust's prospects took a turn for the worse in 2017. In February and March 2017 AmTrust announced that accounting errors had prompted it to delay the filing of its 10-K for the year ending December 31, 2016 and that it needed more time to complete its consolidated financial statements. On April 4, 2017, AmTrust finally filed its Form 10-K for 2016. The 2016 10-K included restated financial results for the years ending December 31, 2012, 2013, 2014, 2015, and 2016, as well as each interim period during 2015 and 2016. The restatement revealed that the company's income and earnings had been significantly overstated since 2012.[5]

The restatement identified two material accounting errors. First, according to a press release that AmTrust issued describing the errors, AmTrust had mistakenly relied on the "upfront recognition of a portion of warranty contract revenue associated with administration services, . . . instead of deferring recognition of the revenue over the life of the contract." Joint App'x 208. In other words, AmTrust had "historically recognized the majority of revenue related to administrative services at the time of sale of ESP," but had "revised its application of the revenue recognition guidance to record revenue related to administration services on a straight-line basis over the term of the ESP contracts." Joint App'x 80. The second accounting error was that discretionary employee "bonuses . . . were expensed in the year paid but . . . should have been accrued [as an expense] in the year earned based on" accepted accounting standards. Joint App'x 208. The restatement also identified other "miscellaneous adjustments" to AmTrust's financial statements that the company concluded were not material.[6] Joint App'x 208.

[5] To use the annual financial results for 2015 as an example, the errors meant that income before other income, income taxes, equity in earnings of unconsolidated subsidiaries, and non-controlling interest was overstated by 16.79 percent; income before income taxes, equity in earnings of unconsolidated subsidiaries, and non-controlling interest was overstated by 17.04 percent; net income was overstated by 11.56 percent; net income attributable to AmTrust common stockholders was overstated by 12.62 percent; diluted earnings per share was overstated by 12.45 percent; comprehensive income was overstated by 22.94 percent; and comprehensive income attributable to AmTrust Financial Services, Inc. was overstated by 23.55 percent. *See* Joint App'x 213–14.

[6] Although the Appellants challenged other statements below, they do not press those arguments on appeal and, as a result, we do not consider them.

II. PROCEDURAL BACKGROUND

The Appellants commenced this putative class action in March 2017, after AmTrust first publicly disclosed the accounting errors at issue in this case. Although there are two slightly different class periods during which the Appellants purchased AmTrust securities—the first between February 14, 2013 and April 10, 2017 (the "AmTrust Class Period") and the second between March 3, 2014 and April 10, 2017, during which BDO served as AmTrust's outside auditor (the "BDO Class Period")—for our purposes, the distinction is immaterial. The Appellants eventually filed a second amended complaint asserting claims under Sections 11, 12(a)(2), and 15 of the Securities Act, 15 U.S.C. §§ 77k, 77l(a)(2), 77o, Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a), and Rule 10b–5, 17 C.F.R. § 240.10b–5. The District Court dismissed the second amended complaint without prejudice, concluding for the most part that the alleged misstatements were nonactionable statements of opinion. The Appellants filed a third amended complaint (the operative complaint here), which the District Court also dismissed, largely for the same reasons, this time with prejudice.

This appeal followed.

DISCUSSION

We review the District Court's dismissal under Rule 12(b)(6) *de novo*, accepting all factual allegations as true and drawing all reasonable inferences in favor of the Appellants. *Olagues v. Icahn*, 866 F.3d 70, 74 (2d Cir. 2017).

I. THE SECURITIES ACT CLAIMS AGAINST THE AMTRUST DEFENDANTS AND THE DIRECTOR DEFENDANTS

We begin with the Appellants' claims against the AmTrust Defendants and the Director Defendants under Sections 11 and 15 of the Securities Act, as well as their claims against AmTrust under Section 12(a)(2) of the Securities Act. The Act requires that companies issuing securities make a "full and fair disclosure of information" in connection with a public offering. *Pinter v. Dahl,* 486 U.S. 622, 646 (1988); *see Fed. Hous. Fin. Agency for Fed. Nat'l Mortg. Ass'n v. Nomura Holding Am., Inc.*, 873 F.3d 85, 98 (2d Cir. 2017). The Act aims to protect investors and to "achieve a high standard of business ethics in the securities industry." *Lorenzo v. SEC*, 139 S. Ct. 1094, 1103 (2019) (quotation marks omitted); *see also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1466 (2d Cir. 1996). It thus permits purchasers of a public company's securities to sue the company and certain corporate officers for any material misstatements or for the omission of material information in the company's registration statements filed with the SEC.

Section 11 of the Act, for example, provides:

> In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . [may] sue.

15 U.S.C. § 77k(a); *see Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175, 179 (2015). So "[i]n the event of such a misdeed, the statute provides for a cause of action by the purchaser of the registered security against the security's issuer, its underwriter, and certain other statutorily enumerated parties." *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 358 (2d Cir. 2010). "Section 15, in turn, creates liability for individuals or entities that 'control[ ] any person liable' under section 11." *Id.* (quoting 15 U.S.C. § 77o). And as relevant to this appeal, Section 12(a)(2) similarly imposes liability on any person who offers or sells

a security by means of a prospectus containing material misrepresentations or omissions.[7]

Appellants' principal challenge under the Securities Act relates to the two accounting errors described above that AmTrust identified in its restatement as materially affecting its reported income during the relevant time: (1) its recognition of revenue from administration services based on the time-of-sale approach; and (2) its decision to record discretionary bonus payments as expenses the year in which they were paid rather than the year in which the bonuses were actually earned.

Relying largely on the Supreme Court's decision in *Omnicare* and our decision in *Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011), the District Court determined that AmTrust's financial statements reflected the exercise of subjective judgment and were thus non-actionable statements of opinion. *Cf. Omnicare*, 575 U.S. at 184 (noting that an executive who expressed "a view, not a certainty" "could not be liable for a false statement of fact"). We respectfully disagree with this particular conclusion of the very able and experienced District Judge, who did not have the benefit of our latest guidance in this area. *See*

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[7] Section 12(a)(2) provides, in relevant part:

> Any person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable . . . to the person purchasing such security from him . . . .

15 U.S.C. § 77l(a)(2).

Abramson v. Newlink Genetics Corp., 965 F.3d 165 (2d Cir. 2020).

In *Fait*, we explained that "when a plaintiff asserts a claim under section 11 or 12 based upon a [defendant's alleged] belief or opinion . . . liability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed." *Fait*, 655 F.3d at 110. But we have since recognized that the Supreme Court in *Omnicare*, which was decided after *Fait*, unequivocally "rejected the proposition that there can be no liability based on a statement of opinion unless the speaker disbelieved the opinion at the time it was made." *Abramson*, 965 F.3d at 175. By pointing out that a statement of opinion, even if believed, may nonetheless be actionable if it contains a factual misstatement or is rendered misleading by the omission of material facts, *Omnicare* expanded the scope of issuer liability for statements of opinion. Nevertheless, *Fait* continues to guide us in distinguishing between a statement of fact and a statement of opinion in the first place.

So what distinguishes a fact from an opinion under the federal securities laws? In general, a fact is "a thing done or existing or an actual happening," while an opinion is "a belief, a view, or a sentiment which the mind forms of persons or things." *Omnicare*, 575 U.S. at 183 (quotation marks omitted). A statement of fact "expresses certainty about a thing," while a statement of opinion does not. *Id.* Statements of opinion often include qualifying language (like "I believe" or "I think") that conveys a lack of certainty about the thing being expressed, marks the statement as reflecting the speaker's impression or point of view rather than an objective truth, and makes it easier to identify the statement as one of opinion rather than fact. *See id.* at 183–84.

But not all statements of opinion include such qualifying language. In *Fait*, for example, we held that unqualified estimates of goodwill and loan loss reserves were statements of opinion because the estimates were clearly "subjective . . . rather than objective factual matters." *Fait*, 655 F.3d at 111 (quotation marks omitted). Certain statements address issues so plainly subjective, we reasoned, that the statement is one of opinion not just by virtue of the words used but also because of the nature of the information conveyed. In *Fait*, we characterized the inquiry as turning on whether the relevant statement reflects the speaker's determination of "a matter of objective fact" or instead expresses the speaker's judgment about a matter that lacks "any objective standard." *Id.* at 109–10 (quotation marks omitted). The latter statement, we said, is "inherently subjective." *Id.* at 113.

The rule we articulated in *Fait* was narrowly invoked in the context of estimates of goodwill and loan loss reserves, both of which we characterized as inherently requiring a substantial exercise of judgment. Estimates of goodwill "depend on management's determination of the 'fair value' of the assets acquired and liabilities assumed." *Id.* at 110. Absent "any objective standard such as market price that" the company "should have but failed to use in determining" the value of its assets, "an estimate of the fair value of those assets will vary depending on the particular methodology and assumptions used." *Id.* at 110–11. Likewise, in *Omnicare*, the Supreme Court described an opinion variously as a statement that "in ordinary usage . . . does not imply . . . definiteness . . . or certainty," or as a statement that "rest[s] on grounds insufficient for complete demonstration." 575 U.S. at 183 (quotation marks omitted).

If a statement turns on the exercise of subjective judgment, a plaintiff will be unable to establish that it is false merely by showing that other reasonable alternative views exist. Where those alternatives exist, the speaker making the statement (expressing an opinion) can choose among them without running afoul of the federal securities provisions at issue here. *See Omnicare*, 575 U.S. at 189–90 ("Reasonable investors understand that opinions sometimes rest on a weighing of competing facts.") This is true even if most of the existing facts cut against the statement.

But opinions lead double lives. Most obviously, as the Supreme Court clarified in *Omnicare* and our Court more recently observed in *Abramson*, an opinion may implicitly convey "facts about how the speaker has formed the opinion—or, otherwise put, about the speaker's basis for holding that view." *Omnicare*, 575 U.S. at 188; *see Abramson*, 965 F.3d at 175–76. In the context of a securities transaction, a reasonable investor expects that opinion statements "rest on some meaningful . . . inquiry," "fairly align[] with the information in the issuer's possession at the time," and do not "reflect baseless, off-the-cuff judgments," *id.* at 188–90; *see Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1093 (1991) (noting that even "conclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading"). If, for example, "a registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself," then the issuer may be liable under Section 11's omissions clause even though the statements convey an opinion. *Omnicare*, 575 U.S. at 189. "By increasing the ability of plaintiffs to plead material omissions with respect to statements of opinion . . . , *Omnicare* reduced the significance of district courts' classification of statements as those of fact or opinion." *Abramson*, 965 F.3d at 176.

Opinions are thus actionable under Section 11 of the Securities Act not only when "the speaker did not hold the belief she professed," *Omnicare*, 575 U.S. at 185–86, but also if the statement of opinion contains embedded statements of fact that are untrue, or the statement omits information whose omission conveys false facts about the speaker's basis for holding that view and makes the opinion statement misleading to a reasonable investor, *id.* at 186–88; *see Abramson*, 965 F.3d at 175; *Fait*, 655 F.3d at 111 (noting that opinion "statements may be actionable if they misstate the opinions or belief held, or, in the case of statements of reasons, the actual motivation for the speaker's actions, and are false or misleading with respect to the underlying subject matter they address" (emphasis omitted)). The standard for opinion liability presents "no small task for an investor" seeking to plead that an opinion is misleading. *Omnicare*, 575 U.S. at 194.

So one of the more straightforward ways a statement of opinion may be actionable is if it contains an embedded statement of fact that is not true. In other words, the opinion may be false or misleading if the embedded fact is not one as to which reasonable minds can differ. This occurs where, for example, there is an accepted method for assessing whether the statement is true, but the statement is not justified by the accepted method and clearly contradicts the facts on which it purports to rest. Consider the following example from *Abramson*:

> A statement structured, 'I believe that x is so because y has occurred,' contains the factual and falsifiable statement, 'y has occurred.' If y has in fact not occurred, the statement of opinion is actionable because an embedded but complete 'statement of a material fact' . . . can be proven false.

Abramson, 965 F.3d at 175.

Statements of opinion are also actionable as false or misleading under Section 11's omission clause if the opinion "omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement [of opinion] itself." *Omnicare*, 575 U.S. at 188; *see Abramson*, 965 F.3d at 175 ("[P]laintiffs can allege that a statement of opinion, without providing critical context, implied facts that can be proven false."). "With respect to this [alternative] basis for challenging a statement of opinion, *Omnicare* held that the appropriate perspective for identifying whether a statement of opinion implies facts is that of the reasonable investor." *Abramson*, 965 F.3d at 175.

Mindful of these background principles, we conclude that the Appellants have stated a claim under Section 11 of the Securities Act against the AmTrust Defendants and the Director Defendants based on AmTrust's past recognition of revenue for extended warranty contracts using the time-of-sale approach, as well as its practice of recording discretionary bonuses as expenses when they were paid rather than earned.[8] For the same reasons, we vacate the District Court's dismissal of the Appellants' Section 12(a)(2) claims against AmTrust arising from the same misstatements. *See In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d at 359.

The Appellants claimed that the Defendants were also liable for improper reporting of acquisition costs, foreign exchange gains and losses, software costs, interest expenses, intercompany transactions, and other

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[8] The District Court dismissed the Appellants' control-person liability claim under Section 15 of the Securities Act against AmTrust's officers and directors because it found no primary liability under Section 11. Because we conclude that the Appellants have stated a claim for primary liability for the statements about the accounting treatment of warranty contracts and bonuses, we vacate the District Court's dismissal of the corresponding Section 15 claims against Zyskind, Pipoly, DeCarlo, Fisch, Gulkowitz, Karfunkel, and Miller and remand for further proceedings consistent with this opinion. *See In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d at 358 (noting that "the success of a claim under section 15 relies, in part, on a plaintiff's ability to demonstrate primary liability under section[] 11").

accounting-related statements. They do not challenge the District Court's dismissal of those claims on appeal, and we therefore affirm the judgment insofar as it dismissed the claims. We focus instead, as do the Appellants, on the claims relating to the extended warranty contracts and the bonuses.

A. THE EXTENDED WARRANTIES

We turn first to AmTrust's practice of recognizing "upfront" most of the revenue generated from its extended warranty contracts during the relevant time. In a March 2017 media release, AmTrust clarified that this revenue recognition practice was "based on the interpretation of ASC [Accounting Standards Codification] 605, Revenue Recognition, used in the previously filed financial statements related to multiple-element revenue recognition." Joint App'x 670. The company conceded, however, that it should have instead "deferr[ed] recognition of the revenue over the life of the contract."[9] Joint App'x 670. The restatement acknowledged that the time-of-sale approach resulted in material misstatements regarding AmTrust's income and revenue associated with the warranty contracts. Specifically, it explained:

> The Company has historically recognized the majority of revenue related to administration services at the time of the sale of ESP. However, the Company revised its application of the revenue recognition guidance to record revenue related to

[9] The Accounting Standards Codification ("ASC") is the "source of authoritative generally accepted accounting principles," commonly referred to as "GAAP," published by the Financial Accounting Standards Board ("FASB") "to be applied by nongovernmental entities" such as AmTrust. Financial Accounting Standards Board, *Accounting Standards Codification: Overview and Background* 105-10-05-1 (2020), https://asc.fasb.org/1943274/2147479442; *see also Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 93 (2d Cir. 2016) (relying on FASB standards as a source of GAAP).

> administration services on a straight-line basis over the term of the ESP contracts. This correction of an error, *which created an overstatement of service and fee income and an overstatement of other expenses that were also recognized upfront in current periods*, required a restatement of the Company's previously issued financial statements.

Joint App'x 568 (emphasis added).

On appeal, AmTrust describes its initial representations about the revenue related to administrative services for ESPs as statements of opinion, not fact, because its determination of when to recognize the revenue associated with ESPs was a subjective judgment call. In particular, AmTrust explains that its pre-restatement decision to recognize this revenue upfront was "based on its interpretation of the accounting guidance regarding 'multiple-element revenue recognition,'" including ASC 605-25-25-5. AmTrust Br. 31. ASC 605-25-25-5 governs when a "delivered item or items shall be considered a separate unit of accounting." Under that accounting standard, revenue from these multi-element arrangements (also known as bundled contracts or sales) can be recognized upon delivery only if the contracts or services "have value to the customer on a standalone basis." ASC 605-25-25-5(a), *superseded by* Accounting Standard Update No. 2014-09 (May 28, 2014). Lastly, AmTrust observes that a contract or service has "value on a standalone basis if [it is] sold separately by any vendor or the customer could resell [it] on a standalone basis." *Id.*

The company suggests that assessing value to the customer on a standalone basis—that is, determining whether the administrative services revenue received from vendors who administer the warranty programs is separable from revenue generated by the warranty coverage provided to customers—is an inherently subjective enterprise. The problem with this argument is that AmTrust has never actually contended that its customers can resell the administrative services associated with the warranty contracts at issue here on a standalone basis or that vendors are able to sell them separately. Nothing in the Complaint suggests that doing so is even possible, and although AmTrust maintains that there are other ways to determine a contract's "value on a standalone basis" under the services section of ASC 605 that require judgment calls, nothing in the text of ASC 605, including ASC 605-25-55-1, on which AmTrust also relies, refers to other methods for determining value.

In further support of their respective arguments, both the Appellants and AmTrust turn to ASC 605-20-25-3, which provides:

> [R]evenue from separately priced extended warranty or product maintenance contracts shall be deferred and recognized in income on a straight-line basis over the contract period except in those circumstances in which *sufficient historical evidence indicates* that the costs of performing services under the contract are incurred on other than a straight-line basis.

ASC 605-20-25-3 (emphasis added), *superseded by* Accounting Standards Update No. 2014-09 (May 28, 2014). On one hand, the Appellants suggest that ASC 605-20-25-3 establishes an objective standard that generally requires the recognition of this revenue on a straight-line basis. On the other hand, AmTrust defends the District Court's decision by relying on the exception contained in ASC 605-20-25-3, claiming that the determination of whether historical evidence is sufficient to permit non-straight-line treatment is "a quintessential question of judgment" and that the standard is thus inherently subjective. AmTrust Br. 30–31.

For its part, the District Court concluded that the restated financial statements were non-actionable opinions because determining the sufficiency of historical evidence that would support incurring costs on a non-straight-line basis "inherently requires a subjective judgment as to whether the exception applies." Spec. App'x 89. As the District Court itself recognized, however, the determination that AmTrust's statements are opinion, not fact, is not necessarily the end of the analysis. Spec. App'x 42 ("The claim will survive . . . if plaintiffs have alleged adequately that the statement was an untrue or misleading statement of opinion."); *see Abramson*, 965 F.3d at 176.

The Appellants respond that they have alleged the objectively determinable *absence* of historical evidence necessary to support the non-straight-line accounting approach that AmTrust applied. *See* Joint App'x 152 ("ASC Topic No. 605 . . . does not permit the method of recognition employed by AmTrust without historical evidence demonstrating the appropriateness of such method, historical evidence AmTrust acknowledges it never possessed."). AmTrust's reliance on the sufficiency of historical evidence to justify its accounting treatment, the Appellants contend, runs headlong into the Complaint's allegation, which at this stage we accept as true, that there was in fact *no* historical evidence to support its approach.

We agree with the Appellants that subjective judgments about the sufficiency of historical evidence to support a particular accounting treatment presuppose the existence of *some* historical evidence. Indeed, AmTrust now acknowledges that it should have recorded revenue for its warranty contracts on a straight-line basis in reliance on ASC 605-20-25-3. And no one disputes that GAAP permits time-of-sale recognition only if *some* historical evidence justified doing so. At the pleading stage, we think the alleged absence of such evidence, if accepted as true, means that AmTrust's representations about the warranty contract revenue reported in its historical consolidated financial statements misled investors to conclude that the company was aware of some historical evidence in support of recognizing the revenue on a non-straight-line basis, when in (alleged) fact it was not. In other words, AmTrust is plausibly alleged to have "sa[id] one thing and [held] back another." *Omnicare*, 575 U.S. at 192.

We therefore conclude that AmTrust's financial statements relating to the warranty contract revenue reported in its historical consolidated financial statements were actionable statements of opinion under Section 11, and we vacate the District Court's dismissal of the Appellants' Section 11 claims against the AmTrust Defendants and the Director Defendants arising from those statements.

B. THE DISCRETIONARY BONUSES

We turn next to AmTrust's practice of expensing certain discretionary employee bonuses in the year the bonuses were paid rather than the year the bonuses were earned.

According to the Complaint, in its restatement AmTrust "admitted that the financial statements it issued to investors during the relevant period were presented in violation of GAAP by failing to timely accrue compensation related expenses." Joint App'x 83. Specifically, AmTrust explained that:

> In prior years, the Company had expensed discretionary bonuses paid to its employees in the year the bonuses were paid because the Company did not consider the discretionary bonuses to be "probable," which is the standard required for accrual. Upon review of ASC 270, *Interim Reporting*, and ASC 450, *Contingencies*, management determined that its application was incorrect because, even though the bonuses were discretionary, the bonuses should have been

> estimated and expenses assigned to interim periods so that the interim periods bear a reasonable portion of the anticipated annual amount.

Joint App'x 83.

The parties agree that ASC 450 applies to determine how to account for these bonuses. Under ASC 450-20-25-2, companies should expense costs when it is "probable" that a liability has been incurred and when "[t]he amount of loss can be reasonably estimated" within a range.[10] AmTrust asserts that its decision to expense bonuses in the period they were paid rather than earned in its previously issued consolidated financial statements is a classic exercise of subjective judgment. Suggesting to investors that it is not "probable" that the company would pay bonuses at a future time is, the company asserts, merely stating a non-actionable opinion. Even assuming without deciding that these are statements of opinion, we are not persuaded.

In our view, there is some reason to conclude that the Appellants have plausibly alleged that AmTrust's method of deferring the recognition of expenses related to bonuses until the bonuses were paid (thus delaying the charge to income) was objectively improper rather than an exercise of subjective judgment. In particular, the Appellants allege that AmTrust had a practice of paying bonuses. The Complaint thus plausibly alleges that there was no basis to conclude that the continued payment of earned bonuses was not "probable" and that such bonuses therefore could not be expensed when earned. There is no dispute that the bonuses at issue on appeal were earned during the relevant periods and, as AmTrust's restatement eventually

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[10] *See also* ASC 450-10-55-3 ("Amounts owed for services received. . . are not contingencies even though the accrued amounts may have been estimated; there is nothing uncertain about the fact that those obligations have been incurred.")

acknowledged, that they should have been expensed during those periods. Although multiple accounting standards may have been relevant to determining when to expense a bonus, all of the standards in play here support the position that the bonuses should have been expensed in the year they were earned, not the year they were paid.[11] We are not aware of any GAAP provision on which AmTrust relied that suggests otherwise. And the fact that these GAAP standards, together or alone, are subject to misreading, misinterpretation, or misapplication, as happened here, does not necessarily mean that they entail an exercise of subjective judgment.

But we do not need to decide whether these financial statements are statements of fact or, as AmTrust asserts, statements of opinion. *See Abramson*, 965 F.3d at 176. Even if they are statements of opinion (because, say, determining whether it is "probable" that the corporate officers would exercise their discretion to pay the bonuses at a future time is a matter of subjective judgment), we conclude that the statements are nonetheless actionable because the Complaint adequately alleges that it was improbable that the earned bonuses would not be paid. Accepting that allegation as true makes it quite plausible that the AmTrust Defendants did not base the company's statements of probability on a "meaningful . . . inquiry," that their statements did not "fairly align[] with the information in the issuer's possession at the time," and that there was no basis for AmTrust to state that the bonuses should be expensed in the year they were paid rather than earned. *Omnicare*, 575 U.S. at 188–89.

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[11] Under ASC 450-10-55, bonuses should have been expensed as incurred during the relevant period. ASC 710-10-25 likewise required AmTrust to expense an employee's right to be compensated when earned. And ASC 270 required the bonuses to be expensed as incurred in interim periods.

For these reasons, we conclude that the Complaint states a claim under Section 11 against the AmTrust Defendants and the Director Defendants arising from AmTrust's misrepresentation of reported income in its historical consolidated financial statements based on the erroneous accounting treatment relating to bonus payments.

C. SOX CERTIFICATIONS BY AMTRUST EXECUTIVES

The remaining Section 11 claims against the AmTrust Defendants are a different matter. They rest on certifications by company executives regarding, among other things, the accuracy of AmTrust's financial reporting, its conformity with GAAP, and the effectiveness of AmTrust's disclosure controls and procedures. The District Court concluded that these certifications were non-actionable statements of opinion. We agree.

First, the Officer Defendants, Zyskind (the CEO) and Pipoly (the CFO), attested to (1) the accuracy of AmTrust's financial reporting, (2) the effectiveness of the company's disclosure controls and procedures, and (3) their disclosure of any weaknesses in internal controls over the company's financial reporting in certifications mandated by Section 302 of the Sarbanes Oxley Act ("SOX"), 15 U.S.C. § 7241(a); *see also* 17 C.F.R. §§ 240.13a-14, 240.13a-15, 240.15d-15. Their certifications about the accuracy of AmTrust's financial reporting, including that financial statements were prepared in conformity with GAAP, signal that they are opinions by stating that they are "based on [the] knowledge" of the officer. *See* Joint App'x 103–04, 153. There is no allegation that the opinion is actionable on the ground that it was *not* based on the officer's knowledge.[12]

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[12] For the reasons discussed below, we disagree with the Appellants that the existence of the Warrantech SEC guidance letter demonstrates that the officers *knew* the financial reports were false or misleading or did not comply with GAAP, even with all reasonable inferences drawn in the Appellants' favor.

Similarly, we conclude that the two other challenged SOX certifications relating to (1) disclosure controls and procedures, and (2) internal control over financial reporting contain language that conveys management's subjective judgments about the company's internal controls and thus constitute statements of opinion.

The Appellants point to allegations that AmTrust later reversed course and that its restatement acknowledged a failure of internal controls. The Appellants insist that the reversal compels the inference that the SOX certifications were not believed when made. But AmTrust's change of opinion, standing alone, does not mean that the original certified opinions were disingenuous.[13] Nor is a genuinely held opinion that "turned out to be wrong" necessarily actionable. *Omnicare*, 575 U.S. at 186. In any event, as noted, the Complaint fails to adequately allege that the AmTrust executives who signed the certifications did not believe what they certified.

Finally, Appellants contend that the certifications were misleading because they falsely conveyed the existence of "some meaningful . . . inquiry" conducted by the certifying executives. Appellants' Br. 42 (quoting *Omnicare*, 575 U.S. at 188). But here too, the Complaint fails to allege any facts that establish a lack of meaningful inquiry, other than the fact that the certification turned out to be wrong.

For these reasons, we affirm the District Court's dismissal of the Appellants' Section 11 claims relating to the SOX certifications.

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[13] The Appellants reference in passing on appeal that the SOX certifications contained embedded statements of fact. *See* Appellants' Br. 41. We conclude that the argument is abandoned because the Appellants have failed to develop it. *See Zhang v. Gonzales*, 426 F.3d 540, 545 n.7 (2d Cir. 2005).

II. THE EXCHANGE ACT CLAIMS AGAINST THE AMTRUST DEFENDANTS

The District Court also dismissed the Appellants' claims against the AmTrust Defendants under Section 10(b) of the Exchange Act and Rule 10b-5. To survive a motion to dismiss under these provisions, "a plaintiff must allege that [each] defendant (1) made misstatements or omissions of material fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that the plaintiff's reliance was the proximate cause of its injury." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,* 493 F.3d 87, 105 (2d Cir. 2007); *see also Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 93 (2d Cir. 2016). Under the Private Securities Litigation Reform Act of 1995, moreover, a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with [scienter]." 15 U.S.C. § 78u–4(b)(2)(A).

In contrast to the Securities Act claims under Section 11, which do not require a showing of scienter,[14] the central question with respect to the Appellants' claims under the Exchange Act is whether the Complaint adequately "pleaded facts giving rise to a strong inference that the . . . Defendants acted with 'scienter, a mental state embracing intent to deceive, manipulate, or defraud.'" *In re Advanced Battery Techs., Inc.*, 781 F.3d 638, 644 (2d Cir. 2015) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007)). Scienter may be established by alleging facts "(1) showing that the defendants had both

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[14] As we explained in *Fait*, "[w]hile issuers are subject to virtually absolute liability under section 11, the remaining potential defendants under sections 11 and 12(a)(2) [of the Securities Act] may be held liable for mere negligence." *Fait*, 655 F.3d at 109 (cleaned up). And "in contrast to claims brought pursuant to section 10(b) of the [Exchange Act], claims under sections 11 and 12 do not require allegations of scienter." *Id.*

motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI Commc'ns*, 493 F.3d at 99; *see Set Cap. LLC v. Credit Suisse Grp. AG*, 996 F.3d 64, 78 (2d Cir. 2021). Any allegation of conscious misbehavior or recklessness should be "viewed holistically and together with the allegations of motive and opportunity" to determine whether the complaint supports a strong inference of scienter. *Set Cap. LLC*, 996 F.3d at 78. Although "the requisite intent of the alleged speaker of the fraud need not be alleged with great specificity," *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 267 (2d Cir. 1996), the "inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Tellabs*, 551 U.S. at 314; *see also In re Advanced Battery*, 781 F.3d at 644; *ECA & Loc. 134 IBEW Joint Pension Tr. of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009).

Keeping that standard in mind, we agree with the District Court that the Complaint does not adequately allege that the AmTrust Defendants acted with scienter.

First, the Complaint does not adequately plead scienter based on the AmTrust Defendants' motive and opportunity to commit fraud. Urging otherwise, the Appellants rely on the AmTrust Defendants' financial incentives to keep share prices high and to fuel the company's acquisition strategy. But the desire to sustain "the appearance of corporate profitability" is not itself the kind of incentive or motivation that raises an inference of scienter. *Chill*, 101 F.3d at 268. The Appellants also direct us to allegations that Pipoly and other top executive officers (but, notably, not Zyskind or the Board Defendants) sold a significant number of shares of AmTrust stock during the AmTrust Class Period. In doing so, however, the Appellants acknowledge that Pipoly's significant selloff began several months before the

AmTrust Class Period, a fact that renders his stock sales during this class period less unusual. *See Ark. Pub. Emps. Ret. Sys. v. Bristol-Myers Squibb Co.*, 28 F.4th 343, 355 (2d Cir. 2022).

Nor does the Complaint allege facts that provide "strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI Commc'ns*, 493 F.3d at 99. We have explained that "[s]cienter based on conscious misbehavior . . . requires a showing of deliberate illegal behavior, a standard met when it is clear that a scheme, viewed broadly, is necessarily going to injure." *Gould v. Winstar Commc'ns, Inc.*, 692 F.3d 148, 158 (2d Cir. 2012) (quotation marks omitted). Recklessness, meanwhile, entails "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *ECA*, 553 F.3d at 198 (quotation marks omitted). None of the facts alleged in the Complaint— including the "magnitude" of the restatement and the duration of the period it covered—satisfy these requirements. Joint App'x 213. In determining whether the AmTrust Defendants acted with scienter, it is not enough that it took a period of years for AmTrust to acknowledge its significant accounting errors.

Finally, the Appellants argue that the AmTrust Defendants did not believe their accounting judgments regarding the early recognition of revenue on the administration-service fees connected to AmTrust's warranty program. The Appellants allege that AmTrust knew its accounting treatment was wrong because Warrantech, the company AmTrust acquired in 2010, announced in its Form 10-K for the year ending March 31, 2006 that it had changed its revenue-recognition practices regarding its warranty contracts in response to SEC guidance. In particular, the Complaint alleges that AmTrust must have known, or recklessly disregarded, that the SEC earlier had advised Warrantech that its time-of-sale approach was improper and that its warranty business compelled a straight-line revenue recognition approach. But we think that AmTrust's subsequent resort to a time-of-sale approach for the contracts, though wrong, is more plausibly explained by the changes to the guiding accounting principles since 2006 to which AmTrust points us, or to AmTrust's negligence.[15] *See* AmTrust Br. 42–44. Negligence, even in a "heightened form," is not sufficient to allege scienter. *Novak v. Kasaks*, 216 F.3d 300, 312 (2d Cir. 2000).

For these reasons, we conclude that the Complaint fails to raise a strong inference of scienter, and we affirm the dismissal of the Appellants' claims against the AmTrust Defendants under Section 10(b) and Rule 10b–5.[16] We also affirm the District Court's corresponding dismissal of the Appellants' control-person claim under Section 20(a) of the Exchange Act because such a claim is "necessarily predicated on a primary violation of securities law." *Rombach v. Chang*, 455 F.3d 164, 177–78 (2d Cir. 2004).

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[15] The Appellants also call our attention to purported "red flags" in the form of press coverage criticizing AmTrust's accounting practices generally, although none of the press articles mentions the two central accounting issues that led to AmTrust's restatement. Given the generality of these media reports, we are not persuaded that they support an inference of scienter that is at least as compelling as any opposing inference of nonfraudulent intent.

[16] We have applied the holding in *Omnicare* to claims brought under Section 10(b) of the Exchange Act. *See Tongue v. Sanofi*, 816 F.3d 199, 209–10 (2d Cir. 2016). Because, as we previously concluded, the Officer Defendants' certifications are non-actionable statements of opinion, we also affirm the dismissal of the Appellants' Section 10(b) claims based on these certifications. *See City of Omaha, Neb. Civilian Emps.' Ret. Sys. v. CBS Corp.*, 679 F.3d 64, 67–68 (2d Cir. 2012) (noting that Section 10(b) and Section 11 claims "share a material misstatement or omission element").

III. THE SECURITIES ACT CLAIMS AGAINST THE UNDERWRITER DEFENDANTS

The Appellants also assert claims against the Underwriter Defendants under Sections 11 and 12(a)(2) of the Securities Act stemming from the two securities offerings made pursuant to AmTrust's 2015 Registration Statement. The first is AmTrust's November 2015 Offering, underwritten by Citigroup and Morgan Stanley, of 5 million shares of common stock pursuant to a preliminary prospectus supplement and a prospectus supplement. This preliminary prospectus supplement and prospectus supplement, together with the 2015 Registration Statement, incorporated by reference AmTrust's annual financial report for 2014 and quarterly financial reports for the first three fiscal quarters of 2015. The second offering is AmTrust's September 2016 Offering, underwritten by Morgan Stanley, RBC, UBS, and KBW, of 10 million depositary shares pursuant to a preliminary prospectus supplement and a prospectus supplement that, together with the 2015 Registration Statement, incorporated by reference AmTrust's annual financial report for 2015 and quarterly financial reports for the first two quarters of 2016. Each of the relevant financial reports contained overstated income numbers arising from the time-of-sale approach for the warranty contracts and the improper expensing of bonuses.

As a threshold matter, three of the Underwriter Defendants—Morgan Stanley, UBS, and KBW—contend that the Appellants lack standing to even assert Section 12 claims against them in connection with the September 2016 Offering because the Complaint does not specifically allege that the Appellants purchased securities from those underwriters.[17] Under Section 12(a)(2), a plaintiff has standing to bring an action against the seller of a security only if the plaintiff is "the person purchasing such security from them." *Akerman v. Oryx Commc'ns, Inc.*, 810 F.2d 336, 344 (2d Cir. 1987) (quotation marks omitted); *see also Freidus v. Barclays Bank PLC*, 734 F.3d 132, 141 (2d Cir. 2013) ("In order to have standing under § 12(a)(2), . . . plaintiffs must have purchased securities directly from the defendants."); 15 U.S.C. § 77l(a). A "statutory seller" may include an underwriter who successfully solicited the transfer of title from issuer to purchaser in exchange for some financial gain.[18] Morgan Stanley, UBS, and KBW assert that in a case involving multiple underwriters of a single offering, the purchaser of a security must in its pleadings specifically identify which underwriter sold the security at issue in order to have standing to sue that underwriter. We have not yet addressed this question.

We conclude that the Appellants have adequately established standing under Section 12(a)(2) by alleging that they purchased securities pursuant to the "pertinent offering documents" or in the relevant offerings underwritten by the defendants. *In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258, 311 (S.D.N.Y. 2011) (Kaplan, J.). Here, according to the Complaint, the Appellants bring their Section 12(a)(2) claims on their own

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[17] The Underwriter Defendants do not challenge Appellants' standing to sue the underwriters of the November 2015 Offering—Citigroup and Morgan Stanley—or their standing to sue RBC for the September 2016 Offering.

[18] In a similar vein, a purchaser of a security has standing to bring an action under Rule 10b–5a against underwriters (and brokers, dealers, and non-issuer sellers) for material misstatements about the security "if those entities made material misstatements about the security, as long as the plaintiff[] purchased or sold the securities about which the misstatements were made." *Menora Mivtachim Ins. Ltd. v. Frutarom Indus. Ltd.*, 54 F.4th 82, 88 (2d Cir. 2022); *see In re NYSE Specialists Sec. Litig.*, 503 F.3d 89, 102 (2d Cir. 2007).

behalf and on behalf of "other members of the Securities Act Class who purchased AmTrust common stock or [shares sold in connection with the September 2016 Offering] *pursuant to the Prospectuses*." Joint App'x 132 (emphasis added). We can reasonably infer from these allegations that the Appellants acquired securities from the Underwriter Defendants in connection with the September 2016 Offering. We are therefore satisfied that the allegations suffice to establish the Appellants' standing in this case. *See, e.g.*, *John v. Whole Foods Mkt. Grp., Inc.*, 858 F.3d 732, 736–38 (2d Cir. 2017) (noting that "general factual allegations of injury may suffice" to establish standing, "for on a motion to dismiss we presume that general allegations embrace those specific facts that are necessary to support the claim" (cleaned up)).

Turning to the merits, the District Court dismissed the Appellants' Section 11 and Section 12 claims against the Underwriter Defendants, concluding that the Appellants had "fail[ed] to allege any untrue or misleading statements of material fact or opinion with respect to those claims." Spec. App'x 73. In other words, the District Court dismissed these claims, which it described as "identical to those of the Securities Act claims asserted against the AmTrust [D]efendants," for effectively the same reasons it dismissed the claims against the AmTrust Defendants. Spec. App'x 73. For reasons we have already provided, we disagree with the District Court's conclusion that the reported income statements related to AmTrust's warranty contracts and its employee bonuses were non-actionable opinions. Insofar as the District Court dismissed the Appellants' claims under Section 11 and Section 12(a)(2) against the Underwriter Defendants arising from those two categories of statements, we vacate the dismissal and remand for further proceedings consistent with this opinion. As to any remaining claims against the

Underwriter Defendants, we affirm the District Court's dismissal.

IV. THE CLAIMS AGAINST BDO, AMTRUST'S OUTSIDE AUDITOR

Finally, we address the Appellants' claims against AmTrust's outside auditor, BDO, under Section 11 of the Securities Act in connection with BDO's audit reports on AmTrust's financial statements and its system of internal controls over financial reporting for each of the years ending December 31, 2013– 15, and under Section 10(b) of the Exchange Act and Rule 10b-5 in connection with its audit report for the year ending December 31, 2013 ("2013 Audit Opinion"), which was included in AmTrust's 2013 Form 10-K.

We begin with the Securities Act claims. Section 11 provides in relevant part that if "any part of the registration statement . . . contained an untrue statement of material fact," anyone acquiring the associated security may sue "every accountant . . . who has with his consent been named as having prepared or certified any part of the registration statement or . . . any report or valuation which is used in connection with the registration statement." 15 U.S.C. § 77k(a)(4). BDO is thus responsible under Section 11 for any material inaccuracy in the AmTrust registration statements that it certified, or in financial reports incorporated in those statements. *Id.*; *see Miyahira v. Vitacost.com, Inc.*, 715 F.3d 1257, 1265 (11th Cir. 2013); *Belizan v. Hershon*, 495 F.3d 686, 692 (D.C. Cir. 2007); *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 n.11 (1983).

As BDO observes, the Appellants have not developed the argument in their opening brief challenging the District Court's dismissal of the Section 11 claim against BDO. The challenge, if it can be called that, appears in a footnote. *See Norton v. Sam's Club*, 145 F.3d 114, 117 (2d Cir. 1998) ("[A]n argument made only in a footnote [i]s inadequately raised for appellate review."). Although the Appellants develop the argument somewhat in their reply brief, that is too little too late. *See JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V.*, 412 F.3d 418, 428 (2d Cir. 2005) ("[A]rguments not made in an appellant's opening brief are waived even if the appellant . . . raised them in a reply brief."). We thus conclude that the Appellants' challenge to the dismissal of the Section 11 claim against BDO is abandoned, we affirm the District Court's dismissal of that claim, and we proceed to examine the Exchange Act claims against BDO.

The Appellants contend that BDO is liable under Section 10(b) of the Exchange Act for the 2013 Audit Opinion, which stated that BDO had conducted its audit in accordance with standards promulgated by the Public Company Accounting Oversight Board ("PCAOB"), and that the audit provided a reasonable basis for BDO to determine that AmTrust's financial statements were fairly presented. Joint App'x 246–47.

On its face, the 2013 Audit Opinion appears in the same guise as the SOX certifications that we have already concluded are non-actionable opinions. But the Complaint alleges some key facts that differentiate the audit opinion from those certifications. The Appellants allege that the BDO engagement partner on the audit, Richard J. Bertuglia, and another BDO partner, John W. Green, in fact failed to complete the necessary checks and audit work papers before issuing the audit opinion; that they signed several audit work papers without reviewing them; and that they failed to verify that all the necessary audit work was performed before issuing the opinion. The Appellants also allege that the SEC later found that (1) Bertuglia had violated the PCAOB standards by failing to supervise and exercise due professional care, properly examine journal entries for evidence of possible material misstatement due to fraud, or perform sufficient tests of internal controls and substantive audit procedures to support their final opinion, and (2) Green violated PCAOB standards by failing to perform the appropriate engagement quality review.

We agree with the District Court that the Appellants have adequately alleged that BDO's audit opinion contained potentially actionable misstatements of opinion because the Complaint "render[s] it plausible that Bertuglia," who signed the audit opinion, "disbelieved the statement that the audit was conducted in accordance with the relevant PCAOB standards." Spec. App'x 78. The Appellants have also adequately alleged that BDO's statement that it "believe[d] [its] audits provide a reasonable basis for [its] opinion," Joint App'x 246–47, would lead a reasonable investor to conclude that BDO had conducted "some meaningful . . . inquiry," *Omnicare*, 575 U.S. at 188, when in fact, according to the Complaint, BDO never conducted such an inquiry.

We part ways with the District Court, however, insofar as it concluded that the alleged misstatements were not material.

> To state a claim under § 10(b) and the corresponding Rule 10b–5, a plaintiff must plead that the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that the plaintiff's reliance on the defendant's action caused injury to the plaintiff.

Ganino v. Citizens Utils. Co., 228 F.3d 154, 161 (2d Cir. 2000). "At the pleading stage, a plaintiff satisfies the materiality requirement . . . by alleging a statement or omission that a reasonable investor would have considered significant in making investment decisions." *Id.* at 161–62; *see Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988). "[A] complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Ganino*, 228 F.3d at 162 (quotation marks omitted); *see Litwin*, 634 F.3d at 717.

With these basic principles in mind, we conclude that the Appellants adequately alleged that the misstatements in BDO's 2013 Audit Opinion were material. Although the challenged audit certification reflects standardized language, it is not "so general that a reasonable investor would not depend on it as a guarantee." *ECA*, 553 F.3d at 206. Instead, BDO's certification that the audit was conducted in accordance with PCAOB standards succinctly conveyed to investors that AmTrust's audited financial statements were reliable. The absence of BDO's certification would have been significant, for without it, BDO could not have issued an unqualified opinion, AU 508.07, which then would have alerted investors to potential problems in the company's financial reports, *see United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984). The false certification thus subjected unknowing investors to the risk that AmTrust's financial statements were unreliable. For that reason, contrary to the District Court's conclusion, the Appellants were not required to allege a link between BDO's false certification and specific errors in AmTrust's financial statements to establish that BDO's false audit certification was material.

We also respectfully disagree with the District Court's conclusion that the Appellants failed to allege loss causation. Because the Appellants rely on a corrective disclosure theory, they must show that "the loss caused by the alleged fraud results from the relevant truth leaking out." *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223, 261 (2d Cir. 2016) (cleaned up). More specifically, the Appellants "must plausibly allege a disclosure of" BDO's misstatements by which "the available public information regarding" BDO's audit opinion "was corrected."

Carpenters Pension Tr. Fund of St. Louis v. Barclays PLC, 750 F.3d 227, 233 (2d Cir. 2014) (cleaned up).

The Complaint alleges that BDO's misleading representations regarding the 2013 Audit Opinion caused investor losses because the unqualified audit opinion artificially inflated the price of AmTrust securities. As noted, at the time BDO issued its audit opinion, it had not completed the necessary audit work. Its auditors completed the work after BDO issued the unqualified opinion and concluded that they did not need to revise the opinion. Even then, the audit partners failed to note their assessment of omitted procedures or to revise the audit documentation to show that the work was completed only *after* the opinion had been issued.

An April 2017 article in the Wall Street Journal disclosed the debacle. The article reported that BDO auditors failed to complete the necessary checks before signing off on the audit paperwork. The article also described how BDO auditors covered up their incomplete work by "loading unfinished documents into an internal software system to show the right time stamp, then returned later to complete some of the work." Joint App'x 262 (quotation marks omitted). After the article was published, the price of AmTrust's securities dropped.

Relying on the three-year gap between BDO's completion of the audit work and the disclosure in the Wall Street Journal, the District Court concluded that the Appellants failed to allege loss causation. In the District Court's view, the Appellants needed to allege a disclosure and corresponding decline in the price of AmTrust's securities between the time BDO issued its misleading audit opinion and the time that BDO retroactively completed the work. *See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 175 n.4 (2d Cir. 2005) (explaining that the plaintiffs could not establish loss causation based on a disclosure that did not "reveal to the market the falsity of the prior" statements).

We disagree with this view for two reasons. First, the Wall Street Journal article was the first time that the problems with BDO's audit were publicly disclosed. Prior to the disclosure, the misleading nature of BDO's audit certification remained uncorrected, "continu[ing] to taint the total mix of available public information." *Carpenters Pension Tr. Fund*, 750 F.3d at 234 (cleaned up). Because the article revealed the specific deficiencies that rendered the audit opinion misleading, there is a "clean match" between the misleading audit opinion and the subsequent disclosure. *Ark. Tchr. Ret. Sys. v. Goldman Sachs Grp., Inc.*, 77 F.4th 74, 80 (2d Cir. 2023). Second, even after cleaning up their auditing paperwork, BDO's auditors still failed to correct that paperwork to reflect the dates the work was actually completed or to document their assessment of the omitted procedures. So BDO's statement that it "conducted [its] audits in accordance with the standards of the Public Company Accounting Oversight Board," Joint App'x 246, remained at the very least misleading. *See, e.g.*, AS 3.6 (requiring the auditor to document "the procedures performed" with "sufficient information to enable an experienced auditor" to determine "the date such work was completed as well as the person who reviewed the work and the date of such review"). Accordingly, despite BDO's belated completion of the audit work, the Wall Street Journal article's disclosure of the deficiencies in BDO's audit revealed the continuing falsity of its audit certification.

Because the District Court dismissed the Appellants' Section 10(b) and Rule 10b-5 claims against BDO on materiality and loss causation grounds, it did not address scienter. Addressing that issue in the first instance on appeal, we conclude that the Appellants adequately alleged that BDO acted recklessly in conducting the audit and issuing the audit opinion. In particular, the Appellants alleged that BDO senior partners and managers—Bertuglia, Green, and Lev Nagdimov—knew that the audit did not comply with PCAOB standards and consciously concealed their noncompliance. These allegations support a strong inference of fraudulent intent. *See Emps.' Ret. Sys. of Gov't of the Virgin Islands v. Blanford*, 794 F.3d 297, 308 (2d Cir. 2015) (holding that allegations describing the defendants' efforts to conceal information demonstrate fraudulent intent).[19]

BDO argues that the Appellants failed to establish scienter because they did not allege that BDO's conduct "approximate[d] an actual intent to aid in the fraud being perpetrated by" AmTrust. *In re Advanced Battery*, 781 F.3d at 644; *accord Novak*, 216 F.3d at 309 (holding that accounting irregularities "do[] not constitute reckless conduct sufficient for § 10(b) liability"). But the Appellants do not rely on mere accounting irregularities or BDO's failure to identify problems with AmTrust's accounting practices. Rather, they allege that BDO consciously covered up its *own* misrepresentation that its audit complied with PCAOB standards. For these reasons, we vacate the District Court's dismissal of the Appellants'

[19] BDO argues that the Appellants failed to allege that any individual whose intent could be imputed to BDO acted with the requisite scienter. *See Teamsters Loc. 445 Freight Div. Pension Fund v. Dynex Cap. Inc.*, 531 F.3d 190, 195 (2d Cir. 2008). We disagree. BDO concedes that Bertuglia, the engagement partner for the AmTrust audit, was the "maker" of the misleading audit certification. BDO Br. 45. And the Appellants alleged that Bertuglia did not review all of the audit paperwork or confirm that the auditors had obtained sufficient evidence to support their opinion, but he released the unqualified audit certification anyway. These allegations support a strong inference that Bertuglia knew that BDO's audit opinion was misleading insofar as the opinion falsely asserted that BDO conducted its audit in accordance with PCAOB standards.

Exchange Act claims under Section 10(b) and Rule 10b-5 against BDO.

CONCLUSION

To summarize:

1. We vacate the dismissal of the Appellants' Section 11 claims against the AmTrust Defendants and the Director Defendants, the Section 12(a)(2) claims against AmTrust, and the Section 15 claims against the Officer Defendants and Director Defendants (Zyskind, Pipoly, DeCarlo, Fisch, Gulkowitz, Karfunkel, and Miller) relating to AmTrust's accounting for certain warranty contracts and bonuses.

2. We vacate the dismissal of the Appellants' claims under Section 11 and Section 12(a)(2) against the Underwriter Defendants relating to AmTrust's accounting for certain warranty contracts and bonuses.

3. We vacate the dismissal of the Appellants' claims under Section 10(b) and Rule 10b-5 against BDO.[20]

4. We otherwise affirm the judgment of the District Court.

We have considered the Appellants' remaining arguments and conclude that they are without merit. Accordingly, for the reasons set forth above, the judgment of the District Court is AFFIRMED in part and VACATED in part, and the case is REMANDED for proceedings consistent with this opinion.

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[20] After due consideration of the Appellants' petition for rehearing, we grant the petition only insofar as it concerns the Appellants' claims against BDO under Section 10(b) and Rule 10b-5—claims addressed by the revisions in this amended opinion. We deny the remainder of the Appellants' petition.

APPENDIX B

United States Court of Appeals
For the Second Circuit

August Term, 2020

Argued: June 4, 2021
Decided: August 23, 2023

Docket No. 20-1643-cv

NEW ENGLAND CARPENTERS GUARANTEED ANNUITY AND PENSION FUNDS,

Lead Plaintiff-Appellant,

STANLEY NEWMARK, IRVING LICHTMAN REVOCABLE LIVING TRUST, JUPITER CAPITAL MANAGEMENT,

Plaintiff-Movant-Appellants,

SHARON ALBANO, Individually and On Behalf of All Others Similarly Situated,

Consolidated-Plaintiff-Movant-Appellant,

JOHN SACHETTI, Individually and On Behalf of All Others Similarly Situated,

Consolidated-Plaintiff,

JOEL RUBEL, Individually and On Behalf of All Others Similarly Situated,

Plaintiff,

v.

DONALD T. DECARLO, SUSAN C. FISCH, ABRAHAM GULKOWITZ, GEORGE KARFUNKEL, JAY J. MILLER,

Consolidated-Defendants-Appellees,

AMTRUST FINANCIAL SERVICES, INC., BARRY D. ZYSKIND, RONALD E. PIPOLY, JR., BDO USA, LLP, RBC CAPITAL MARKETS, LLC, UBS SECURITIES LLC,

CITIGROUP GLOBAL MARKETS INC., KEEFE, BRUYETTE & WOODS, INC., MORGAN STANLEY & CO. LLC,
Defendants-Appellees.

Before:

LOHIER, NARDINI, *Circuit Judges*

KOVNER, *Judge*.[*]

The Appellants, investors in the securities of AmTrust Financial Services, Inc., appeal from a judgment of the United States District Court for the Southern District of New York (Kaplan, J.) dismissing their complaint for failure to state a claim under Sections 11, 12, and 15 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 against AmTrust, various AmTrust corporate officers and board members, AmTrust's outside auditor, and multiple underwriters of AmTrust's sale of securities. The District Court determined that certain public misstatements relating to AmTrust's recognition of revenue generated by its extended warranty contracts and the expenses associated with its payment of discretionary employee bonuses were non-actionable statements of opinion. We conclude that these misstatements of opinions were actionable under the circumstances alleged in the Appellants' complaint. We identify no error in the District Court's dismissal of the Appellants' remaining claims. We therefore **AFFIRM** in substantial part, **VACATE** in part, and **REMAND** the case for further proceedings.

ANDREW S. LOVE (Susan K. Alexander, Robbins Geller Rudman & Dowd LLP, San Francisco, CA; Samuel H. Rudman, David A. Rosenfeld, Mark T. Millkey, William J. Geddish, Avital O. Malina, Robert D. Gerson, Vincent M. Serra, Robbins Geller Rudman & Dowd LLP, Melville, NY; Jeremy A. Lieberman,

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[*] Judge Rachel P. Kovner, of the United States District Court for the Eastern District of New York, sitting by designation.

Pomerantz LLP, New York, NY; Thomas J. McKenna, Gainey McKenna & Egleston, New York, NY; Kim E. Miller, Kahn Swick & Foti, LLC, New York, NY, *on the brief*), Robbins Geller Rudman & Dowd LLP, San Francisco, CA, *for* Plaintiffs-Appellants.

STEVEN M. FARINA (John S. Williams, Matthew J. Greer, *on the brief*), Williams & Connolly LLP, Washington, D.C., *for* Defendants-Appellees AmTrust Financial Services, Inc., Barry D. Zyskind, Ronald E. Pipoly, Jr., Donald T. DeCarlo, Susan C. Fisch, Abraham Gulkowitz, George Karfunkel, and Jay J. Miller.

TIMOTHY E. HOEFFNER (Jason D. Gerstein, Ludwig von Rigal, *on the brief*), McDermott Will & Emery LLP, New York, NY, *for* Defendant-Appellee BDO USA, LLP.

GREGG L. WEINER (Christopher Thomas Brown, Ropes & Gray LLP, New York, NY; William T. Davison, Ropes & Gray LLP, Boston, MA), Ropes & Gray LLP, New York, NY, *for* Defendants-Appellees Morgan Stanley & Co. LLC, Citigroup Global Markets Inc., UBS Securities LLC, RBC Capital Markets, LLC, and Keefe, Bruyette & Woods, Inc.

LOHIER, *Circuit Judge*:

When is a statement of opinion that reflects some subjective judgment nevertheless actionable under the federal securities laws?

On April 4, 2017, AmTrust Financial Services, Inc., one of the country's largest publicly traded property and casualty insurers, restated five years of its financial results to correct what it acknowledged were significant errors in its annual and quarterly reports filed with the Securities and Exchange Commission ("SEC"). Among other things, AmTrust disclosed that it had improperly recognized most of the expected revenue from certain extended warranty contracts at the start rather than over the life of the contracts. AmTrust also reported that it had improperly accounted for certain discretionary employee bonuses by treating the bonuses as expenses in the year they were paid rather than the year they were earned by employees.

AmTrust's restatement spurred the Appellants in this case, all investors in AmTrust securities,[1] to sue AmTrust, its officers (the "Officer Defendants," and, together with AmTrust, the "AmTrust Defendants"), members of its board of directors (the "Director Defendants"),[2] its former auditor,[3] and certain underwriters of AmTrust securities (the "Underwriter Defendants"), [4] for misstating the company's financial condition and results in violation of Sections 11, 12 and 15 of the Securities Act of 1933 (the "Securities Act"), and Section 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and the corresponding Rule 10b-5.

The United States District Court for the Southern District of New York (Kaplan, J.) dismissed the third amended complaint (the "Complaint") under Federal Rule of Civil Procedure 12(b)(6), holding that none of the misstatements were actionable under the securities laws. We agree with the District Court's dismissal of the claims relating to most of the misstatements, and we therefore

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[1] The named plaintiffs are New England Carpenters Guaranteed Annuity and Pension Funds, Stanley Newmark, Irving Lichtman Revocable Living Trust, Jupiter Capital Management, Sharon Albano, John Sachetti, and Joel Rubel.

[2] The Officer Defendants are Barry D. Zyskind (at all relevant times AmTrust's President and Chief Executive Officer ("CEO")) and Ronald E. Pipoly Jr. (at all relevant times AmTrust's Executive Vice President and Chief Financial Officer ("CFO")). The Director Defendants are Donald T. DeCarlo, Susan C. Fisch, Abraham Gulkowitz, George Karfunkel, and Jay J. Miller.

[3] BDO USA, LLP ("BDO").

[4] RBC Capital Markets, LLC, UBS Securities LLC, Citigroup Global Markets Inc., Keefe, Bruyette & Woods, Inc., and Morgan Stanley & Co. LLC.

AFFIRM in substantial part. But as we explain below, we disagree with the District Court's dismissal of the Appellants' claims under Sections 11, 12(a)(2), and 15 of the Securities Act against AmTrust, its officers and directors, and the Underwriter Defendants related to AmTrust's accounting for revenue generated by its extended warranty contracts and the expenses associated with discretionary employee bonuses. We therefore VACATE the judgment insofar as it dismisses those claims and REMAND to the District Court for further proceedings consistent with this opinion.

BACKGROUND

I. FACTUAL BACKGROUND

The following facts, which we assume to be true for purposes of this appeal, are drawn from the Complaint and the documents it incorporates by reference. *See Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 708 (2d Cir. 2011).

AmTrust provides workers' compensation, commercial automobile insurance, general liability, and extended service and warranty coverage. As relevant to this appeal, AmTrust promotes and markets extended service plans ("ESPs")—essentially extended warranties. AmTrust receives two types of revenue from its ESP business. First, AmTrust and its subsidiaries sell contractual liability insurance to various retailers, covering the obligations that the retailers assume as part of the ESPs. Second, retailers pay AmTrust "for marketing and administrative services," including "call center services," related to the ESPs. Joint App'x 67, 82. During the relevant time, AmTrust "recognize[d] revenue related to promotion, marketing and administration services at the time of the sale of ESP[s]" but "defer[red] a portion of service revenue based upon an estimate of administrative services to be provided in future periods." Joint App'x at 82.

Starting in 2010, AmTrust made a number of acquisitions that fueled much of its corporate growth. The acquisition most relevant to this appeal closed in 2010, when AmTrust bought Warrantech, a publicly traded company focused on providing ESPs and warranty programs for retailers, dealers, distributors, and manufacturers that became, after the acquisition, a core part of AmTrust's business. Prior to the acquisition, the SEC had investigated Warrantech's practice of recognizing the full amount of the revenue it received from its ESPs and other service contracts at the time the contract was entered and the initial sale of services commenced (we will at times refer to this as the "time-of-sale" approach). The SEC had instructed Warrantech instead to recognize the revenue generated by those contracts on a straight-line basis over the life of the contracts. Warrantech publicly announced that it would comply with the SEC's guidance, abandoned its time-of-sale approach, and revised its method of recognizing revenue relating to the ESPs. For reasons that are unclear, AmTrust, though aware of the SEC's prior guidance to the contrary, reverted back to the original time-of-sale approach after it acquired Warrantech.

From 2012 to 2016 the price of AmTrust stock, which traded on the NASDAQ Global Market, skyrocketed. The company's gross written premiums, a central measure of its financial condition, grew from $2.75 billion to $7.95 billion. Yet as early as 2013, financial commentators and analysts began speculating publicly about AmTrust's actual financial condition. One commentator reported that AmTrust may have used accounting gimmicks to inflate its earnings and net equity. A financial journal, Barron's, questioned AmTrust's accounting practices.

The bad press failed to slow AmTrust's growth. In November 2015 AmTrust filed a preliminary prospectus supplement and prospectus supplement with the SEC announcing an offer of 5 million shares of common stock (the “November 2015 Offering”) pursuant to a registration statement filed on June 11, 2015 (the “2015 Registration Statement”). The transaction, underwritten by Defendants Citigroup Global Markets Inc. (“Citigroup”) and Morgan Stanley & Co. LLC (“Morgan Stanley”), occurred on November 11, 2015 and raised $320 million. In September 2016 AmTrust filed another preliminary prospectus supplement and prospectus supplement under the 2015 Registration Statement, this time announcing that the company planned to offer American depositary shares in a transaction (the “September 2016 Offering”) underwritten by Morgan Stanley, UBS Securities LLC (“UBS”), RBC Capital Markets, LLC (“RBC”), and Keefe, Bruyette & Woods, Inc. (“KBW”). The prospectus supplement accompanying the September 2016 Offering incorporated by reference AmTrust’s annual financial report on Form 10-K for the year ending December 31, 2015, its 10-Q report for the quarter ending March 31, 2015, and various other reports the company had previously filed with the SEC. The September 2016 Offering raised $278.2 million.

AmTrust’s prospects took a turn for the worse in 2017. In February and March 2017 AmTrust announced that accounting errors had prompted it to delay the filing of its 10-K for the year ending December 31, 2016 and that it needed more time to complete its consolidated financial statements. On April 4, 2017, AmTrust finally filed its Form 10-K for 2016. The 2016 10-K included restated financial results for the years ending December 31, 2012, 2013, 2014, 2015, and 2016, as well as each interim period during 2015 and 2016. The restatement revealed that the company’s income and earnings had been significantly overstated since 2012.[5]

[5] To use the annual financial results for 2015 as an example, the errors meant that income before other income, income taxes, equity in

The restatement identified two material accounting errors. First, according to a press release that AmTrust issued describing the errors, AmTrust had mistakenly relied on the "upfront recognition of a portion of warranty contract revenue associated with administration services, . . . instead of deferring recognition of the revenue over the life of the contract." Joint App'x 208. In other words, AmTrust had "historically recognized the majority of revenue related to administrative services at the time of sale of ESP," but had "revised its application of the revenue recognition guidance to record revenue related to administration services on a straight-line basis over the term of the ESP contracts." Joint App'x 80. The second accounting error was that discretionary employee "bonuses . . . were expensed in the year paid but . . . should have been accrued [as an expense] in the year earned based on" accepted accounting standards. Joint App'x 208. The restatement also identified other "miscellaneous adjustments" to AmTrust's financial statements that the company concluded were not material.[6] Joint App'x 208.

II. PROCEDURAL BACKGROUND

The Appellants commenced this putative class action in March 2017, after AmTrust first publicly disclosed the accounting errors at issue in this case. Although there are two slightly different class periods during which the

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earnings of unconsolidated subsidiaries and non-controlling interest was overstated by 16.79 percent; income before income taxes, equity in earnings of unconsolidated subsidiaries and non-controlling interest was overstated by 17.04 percent; net income was overstated by 11.56 percent; net income attributable to AmTrust common stockholders was overstated by 12.62 percent; diluted earnings per share was overstated by 12.45 percent; comprehensive income was overstated by 22.94 percent; and comprehensive income attributable to AmTrust Financial Services, Inc. was overstated by 23.55 percent. *See* Joint App'x 213–14.

[6] Although the Appellants challenged other statements below, they do not press those arguments on appeal and, as a result, we do not consider them.

Appellants purchased AmTrust securities—the first between February 14, 2013 and April 10, 2017 (the "AmTrust Class Period") and the second between March 3, 2014 and April 10, 2017, during which BDO served as AmTrust's outside auditor (the "BDO Class Period")—for our purposes, the distinction is immaterial. The Appellants eventually filed a second amended complaint asserting claims under Sections 11, 12(a)(2), and 15 of the Securities Act, 15 U.S.C. §§ 77k, 77l(a)(2), 77o, Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a), and Rule 10b–5, 17 C.F.R. § 240.10b–5. The District Court dismissed the second amended complaint without prejudice, concluding for the most part that the alleged misstatements were nonactionable statements of opinion. The Appellants filed a third amended complaint (the operative complaint here), which the District Court also dismissed, largely for the same reasons, this time with prejudice.

This appeal followed.

DISCUSSION

We review the District Court's dismissal under Rule 12(b)(6) *de novo*, accepting all factual allegations as true and drawing all reasonable inferences in favor of the Appellants. *Olagues v. Icahn*, 866 F.3d 70, 74 (2d Cir. 2017).

I. THE SECURITIES ACT CLAIMS AGAINST THE AMTRUST DEFENDANTS AND THE DIRECTOR DEFENDANTS

We begin with the Appellants' claims against the AmTrust Defendants and the Director Defendants under Sections 11 and 15 of the Securities Act, as well as their claims against AmTrust under Section 12(a)(2) of the Securities Act. The Act requires that companies issuing securities make a "full and fair disclosure of information" in connection with a public offering. *Pinter v. Dahl*, 486 U.S. 622, 646 (1988); *see Fed. Hous. Fin. Agency for Fed. Nat'l*

Mortg. Ass'n v. Nomura Holding Am., Inc., 873 F.3d 85, 98 (2d Cir. 2017). The Act aims to protect investors and to "achieve a high standard of business ethics in the securities industry." *Lorenzo v. SEC*, 139 S. Ct. 1094, 1103 (2019) (quotation marks omitted); *see also SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1466 (2d Cir. 1996). It thus permits purchasers of a public company's securities to sue the company and certain corporate officers for any material misstatements or for the omission of material information in the company's registration statements filed with the SEC.

Section 11 of the Act, for example, provides:

> In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . [may] sue.

15 U.S.C. § 77k(a); *see Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175, 179 (2015). So "[i]n the event of such a misdeed, the statute provides for a cause of action by the purchaser of the registered security against the security's issuer, its underwriter, and certain other statutorily enumerated parties." *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 358 (2d Cir. 2010). "Section 15, in turn, creates liability for individuals or entities that 'control[ ] any person liable' under section 11." *Id.* (quoting 15 U.S.C. § 77o). And as relevant to this appeal, Section 12(a)(2) similarly imposes liability on any person who offers or sells a security by means of a prospectus containing material misrepresentations or omissions.[7]

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[7] Section 12(a)(2) provides, in relevant part:

Appellants' principal challenge under the Securities Act relates to the two accounting errors described above that AmTrust identified in its restatement as materially affecting its reported income during the relevant time: (1) its recognition of revenue from administration services based on the time-of-sale approach; and (2) its decision to record discretionary bonus payments as expenses the year in which they were paid rather than the year in which the bonuses were actually earned.

Relying largely on the Supreme Court's decision in *Omnicare* and our decision in *Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011), the District Court determined that AmTrust's financial statements reflected the exercise of subjective judgment and were thus non-actionable statements of opinion. *Cf. Omnicare*, 575 U.S. at 184 (noting that an executive who expressed "a view, not a certainty" "could not be liable for a false statement of fact"). We respectfully disagree with this particular conclusion of the very able and experienced District Judge, who did not have the benefit of our latest guidance in this area. *See Abramson v. Newlink Genetics Corp.*, 965 F.3d 165 (2d Cir. 2020).

In *Fait*, we explained that "when a plaintiff asserts a claim under section 11 or 12 based upon a [defendant's

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> Any person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable . . . to the person purchasing such security from him . . . .

15 U.S.C. § 77l(a)(2).

alleged] belief or opinion . . . liability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed." *Fait*, 655 F.3d at 110. But we have since recognized that the Supreme Court in *Omnicare*, which was decided after *Fait*, unequivocally "rejected the proposition that there can be no liability based on a statement of opinion unless the speaker disbelieved the opinion at the time it was made." *Abramson*, 965 F.3d at 175. By pointing out that a statement of opinion, even if believed, may nonetheless be actionable if it contains a factual misstatement or is rendered misleading by the omission of material facts, *Omnicare* expanded the scope of issuer liability for statements of opinion. Nevertheless, *Fait* continues to guide us in distinguishing between a statement of fact and a statement of opinion in the first place.

So what distinguishes a fact from an opinion under the federal securities laws? In general, a fact is "a thing done or existing or an actual happening," while an opinion is "a belief, a view, or a sentiment which the mind forms of persons or things." *Omnicare*, 575 U.S. at 183 (quotation marks omitted). A statement of fact "expresses certainty about a thing," while a statement of opinion does not. *Id.* Statements of opinion often include qualifying language (like "I believe" or "I think") that conveys a lack of certainty about the thing being expressed, marks the statement as reflecting the speaker's impression or point of view rather than an objective truth, and makes it easier to identify the statement as one of opinion rather than fact. *See id.* at 183–84.

But not all statements of opinion include such qualifying language. In *Fait*, for example, we held that unqualified estimates of goodwill and loan loss reserves were statements of opinion because the estimates were clearly "subjective . . . rather than objective factual matters." *Fait*, 655 F.3d at 111 (quotation marks omitted).

Certain statements address issues so plainly subjective, we reasoned, that the statement is one of opinion not just by virtue of the words used but also because of the nature of the information conveyed. In *Fait*, we characterized the inquiry as turning on whether the relevant statement reflects the speaker's determination of "a matter of objective fact" or instead expresses the speaker's judgment about a matter that lacks "any objective standard." *Id.* at 109–10 (quotation marks omitted). The latter statement, we said, is "inherently subjective." *Id.* at 113.

The rule we articulated in *Fait* was narrowly invoked in the context of estimates of goodwill and loan loss reserves, both of which we characterized as inherently requiring a substantial exercise of judgment. Estimates of goodwill "depend on management's determination of the 'fair value' of the assets acquired and liabilities assumed." *Id.* at 110. Absent "any objective standard such as market price that" the company "should have but failed to use in determining" the value of its assets, "an estimate of the fair value of those assets will vary depending on the particular methodology and assumptions used." *Id.* at 110–11. Likewise, in *Omnicare*, the Supreme Court described an opinion variously as a statement that "in ordinary usage . . . does not imply . . . definiteness . . . or certainty," or as a statement that "rest[s] on grounds insufficient for complete demonstration." 575 U.S. at 183 (quotation marks omitted).

If a statement turns on the exercise of subjective judgment, a plaintiff will be unable to establish that it is false merely by showing that other reasonable alternative views exist. Where those alternatives exist, the speaker making the statement (expressing an opinion) can choose among them without running afoul of the federal securities provisions at issue here. *See Omnicare*, 575 U.S. at 189–90 ("Reasonable investors understand that opinions sometimes rest on a weighing of competing facts.") This is true even if most of the existing facts cut against the statement.

But opinions lead double lives. Most obviously, as the Supreme Court clarified in *Omnicare* and our Court more recently observed in *Abramson*, an opinion may implicitly convey "facts about how the speaker has formed the opinion—or, otherwise put, about the speaker's basis for holding that view." *Omnicare*, 575 U.S. at 188. In the context of a securities transaction, a reasonable investor expects that opinion statements "rest on some meaningful . . . inquiry," "fairly align[] with the information in the issuer's possession at the time," and do not "reflect baseless, off-the-cuff judgments," *id.* at 188–90; *see Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1093 (1991) (noting that even "conclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading"). If, for example, "a registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself," then the issuer may be liable under Section 11's omissions clause even though the statements convey an opinion. *Omnicare*, 575 U.S. at 189. "By increasing the ability of plaintiffs to plead material omissions with respect to statements of opinion. . . , *Omnicare* reduced the significance of district courts' classification of statements as those of fact or opinion." *Abramson*, 965 F.3d at 176.

Opinions are thus actionable under Section 11 of the Securities Act not only when "the speaker did not hold the belief she professed," *Omnicare*, 575 U.S. at 185–86, but also if the statement of opinion contains embedded statements of fact that are untrue, or the statement omits information whose omission conveys false facts about the speaker's basis for holding that view and makes the opinion statement misleading to a reasonable investor, *id.* at 186–88; *see Abramson*, 965 F.3d at 175; *Fait*, 655 F.3d at 111 (noting that opinion "statements may be actionable if they misstate the opinions or belief held, or, in the case of statements of reasons, the actual motivation for the speaker's actions, and are false or misleading with respect to the underlying subject matter they address" (emphasis omitted)). The standard for opinion liability presents "no small task for an investor" seeking to plead that an opinion is misleading. *Omnicare*, 575 U.S. at 194.

So one of the more straightforward ways a statement of opinion may be actionable is if it contains an embedded statement of fact that is not true. In other words, the opinion may be false or misleading if the embedded fact is not one as to which reasonable minds can differ. This occurs where, for example, there is an accepted method for assessing whether the statement is true, but the statement is not justified by the accepted method and clearly contradicts the facts on which it purports to rest. Consider the following example from *Abramson*:

> A statement structured, 'I believe that x is so because y has occurred,' contains the factual and falsifiable statement, 'y has occurred.' If y has in fact not occurred, the statement of opinion is actionable because an embedded but complete 'statement of a material fact' . . . can be proven false.

Abramson, 965 F.3d at 175.

Statements of opinion are also actionable as false or misleading under Section 11's omission clause if the opinion "omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement[of opinion] itself." *Omnicare*, 575 U.S. at 188; *see Abramson*, 965 F.3d at 175 ("[P]laintiffs can allege that a statement of opinion, without providing critical context, implied facts that can be proven false.").

"With respect to this [alternative] basis for challenging a statement of opinion, *Omnicare* held that the appropriate perspective for identifying whether a statement of opinion implies facts is that of the reasonable investor." *Abramson*, 965 F.3d at 175.

Mindful of these background principles, we conclude that the Appellants have stated a claim under Section 11 of the Securities Act against the AmTrust Defendants and the Director Defendants based on AmTrust's past recognition of revenue for extended warranty contracts using the time of sale approach, as well as its practice of recording discretionary bonuses as expenses when they were paid rather than earned.[8] For the same reasons, we vacate the District Court's dismissal of the Appellants' Section 12(a)(2) claims against AmTrust arising from the same misstatements. *See In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d at 359.

The Appellants claimed that the Defendants were also liable for improper reporting of acquisition costs, foreign exchange gains and losses, software costs, interest expenses, intercompany transactions, and other accounting-related statements. They do not challenge the District Court's dismissal of those claims on appeal, and we therefore affirm the judgment insofar as it dismissed the claims. We focus instead, as do the Appellants, on the

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[8] The District Court dismissed the Appellants' control-person liability claim under Section 15 of the Securities Act against AmTrust's officers and directors because it found no primary liability under Section 11. Because we conclude that the Appellants have stated a claim for primary liability for the statements about the accounting treatment of warranty contracts and bonuses, we vacate the District Court's dismissal of the corresponding Section 15 claims against Zyskind, Pipoly, DeCarlo, Fisch, Gulkowitz, Karfunkel, and Miller and remand for further proceedings consistent with this opinion. *See In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d at 358 (noting that "the success of a claim under section 15 relies, in part, on a plaintiff's ability to demonstrate primary liability under section[] 11").

claims relating to the extended warranty contracts and the bonuses.

A. THE EXTENDED WARRANTIES

We turn first to AmTrust's practice of recognizing "upfront" most of the revenue generated from its extended warranty contracts during the relevant time. In a March 2017 media release, AmTrust clarified that this revenue recognition practice was "based on the interpretation of ASC [Accounting Standards Codification] 605, Revenue Recognition, used in the previously filed financial statements related to multiple-element revenue recognition." Joint App'x 670. The company conceded, however, that it should have instead "deferr[ed] recognition of the revenue over the life of the contract."[9] Joint App'x 670. The restatement acknowledged that the time-of-sale approach resulted in material misstatements regarding AmTrust's income and revenue associated with the warranty contracts. Specifically, it explained:

> The Company has historically recognized the majority of revenue related to administration services at the time of the sale of ESP. However, the Company revised its application of the revenue recognition guidance to record revenue related to administration services on a straight-line basis over the term of the ESP contracts. This correction of an error, *which created an overstatement of service and fee income and an overstatement of*

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[9] The Accounting Standards Codification ("ASC") is the "source of authoritative generally accepted accounting principles," commonly referred to as "GAAP," published by the Financial Accounting Standards Board ("FASB") "to be applied by nongovernmental entities" such as AmTrust. Financial Accounting Standards Board, *Accounting Standards Codification: Overview and Background* 105-10-05-1 (2020), https://asc.fasb.org/1943274/2147479442; *see also Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 93 (2d Cir. 2016) (relying on FASB standards as a source of GAAP).

> *other expenses that were also recognized upfront in current periods*, required a restatement of the Company's previously issued financial statements.

Joint App'x 568 (emphasis added).

On appeal, AmTrust describes its initial representations about the revenue related to administrative services for ESPs as statements of opinion, not fact, because its determination of when to recognize the revenue associated with ESPs was a subjective judgment call. In particular, AmTrust explains that its pre-restatement decision to recognize this revenue upfront was "based on its interpretation of the accounting guidance regarding 'multiple-element revenue recognition,'" including ASC 605-25-25-5. AmTrust Br. 31. ASC 605-25-25-5 governs when a "delivered item or items shall be considered a separate unit of accounting." Under that accounting standard, revenue from these multi-element arrangements (also known as bundled contracts or sales) can be recognized upon delivery only if the contracts or services "have value to the customer on a standalone basis." ASC 605-25-25-5(a), superseded by Accounting Standard Update No. 2014-09 (May 28, 2014). Lastly, AmTrust observes that a contract or service has "value on a standalone basis if [it is] sold separately by any vendor or the customer could resell [it] on a standalone basis." *Id.*

The company suggests that assessing value to the customer on a standalone basis — that is, determining whether the administrative services revenue received from vendors who administer the warranty programs is separable from revenue generated by the warranty coverage provided to customers — is an inherently subjective enterprise. The problem with this argument is that AmTrust has never actually contended that its customers can resell the administrative services associated with the warranty contracts at issue here on a standalone basis or that vendors are able to sell them separately.

Nothing in the Complaint suggests that doing so is even possible, and although AmTrust maintains that there are other ways to determine a contract's "value on a standalone basis" under the services section of ASC 605 that require judgment calls, nothing in the text of ASC 605, including ASC 605-25-55-1, on which AmTrust also relies, refers to other methods for determining value.

In further support of their respective arguments, both the Appellants and AmTrust turn to ASC 605-20-25-3, which provides:

> [R]evenue from separately priced extended warranty or product maintenance contracts shall be deferred and recognized in income on a straight-line basis over the contract period except in those circumstances in which *sufficient historical evidence indicates* that the costs of performing services under the contract are incurred on other than a straight-line basis.

ASC 605-20-25-3 (emphasis added), superseded by Accounting Standards Update No. 2014-09 (May 28, 2014). On one hand, the Appellants suggest that ASC 605-20-25-3 establishes an objective standard that generally requires the recognition of this revenue on a straight-line basis. On the other hand, AmTrust defends the District Court's decision by relying on the exception contained in ASC 605-20-25-3, claiming that the determination of whether historical evidence is sufficient to permit non-straight-line treatment is "a quintessential question of judgment" and that the standard is thus inherently subjective. AmTrust Br. 30–31.

For its part, the District Court concluded that the restated financial statements were non-actionable opinions because determining the sufficiency of historical evidence that would support incurring costs on a non-straight-line basis "inherently requires a subjective judgment as to whether the exception applies." Spec. App'x 89. As the

District Court itself recognized, however, the determination that AmTrust's statements are opinion, not fact, is not necessarily the end of the analysis. Spec. App'x 42 ("The claim will survive . . . if plaintiffs have alleged adequately that the statement was an untrue or misleading statement of opinion."); *see Abramson*, 965 F.3d at 176.

The Appellants respond that they have alleged the objectively determinable *absence* of historical evidence necessary to support the non-straight-line accounting approach that AmTrust applied. *See* Joint App'x 152 ("ASC Topic No. 605 . . . does not permit the method of recognition employed by AmTrust without historical evidence demonstrating the appropriateness of such method, historical evidence AmTrust acknowledges it never possessed."). AmTrust's reliance on the sufficiency of historical evidence to justify its accounting treatment, the Appellants contend, runs headlong into the Complaint's allegation, which at this stage we accept as true, that there was in fact *no* historical evidence to support its approach.

We agree with the Appellants that subjective judgments about the sufficiency of historical evidence to support a particular accounting treatment presuppose the existence of *some* historical evidence. Indeed, AmTrust now acknowledges that it should have recorded revenue for its warranty contracts on a straight-line basis in reliance on ASC 605-20-25-3. And no one disputes that GAAP permits time-of-sale recognition only if *some* historical evidence justified doing so. At the pleading stage, we think the alleged absence of such evidence, if accepted as true, means that AmTrust's representations about the warranty contract revenue reported in its historical consolidated financial statements misled investors to conclude that the company was aware of some historical evidence in support of recognizing the revenue on a non-straight-line basis, when in (alleged) fact it was not. In other words, AmTrust is plausibly alleged to have "sa[id] one thing and [held] back another." *Omnicare*, 575 U.S. at 192.

We therefore conclude that AmTrust's financial statements relating to the warranty contract revenue reported in its historical consolidated financial statements were actionable statements of opinion under Section 11, and we vacate the District Court's dismissal of the Appellants' Section 11 claims against the AmTrust Defendants and the Director Defendants arising from those statements.

B. THE DISCRETIONARY BONUSES

We turn next to AmTrust's practice of expensing certain discretionary employee bonuses in the year the bonuses were paid rather than the year the bonuses were earned.

According to the Complaint, in its restatement AmTrust "admitted that the financial statements it issued to investors during the relevant period were presented in violation of GAAP by failing to timely accrue compensation related expenses." Joint App'x 83. Specifically, AmTrust explained that:

> In prior years, the Company had expensed discretionary bonuses paid to its employees in the year the bonuses were paid because the Company did not consider the discretionary bonuses to be "probable," which is the standard required for accrual. Upon review of ASC 270, *Interim Reporting*, and ASC 450, *Contingencies*, management determined that its application was incorrect because, even though the bonuses were discretionary, the bonuses should have been estimated and expenses assigned to interim periods so that the interim periods bear a reasonable portion of the anticipated annual amount.

Joint App'x 83.

The parties agree that ASC 450 applies to determine how to account for these bonuses. Under ASC 450-20-25-2, companies should expense costs when it is "probable" that a liability has been incurred and when "[t]he amount of loss can be reasonably estimated" within a range.[10] AmTrust asserts that its decision to expense bonuses in the period they were paid rather than earned in its previously issued consolidated financial statements is a classic exercise of subjective judgment. Suggesting to investors that it is not "probable" that the company would pay bonuses at a future time is, the company asserts, merely stating a non-actionable opinion. Even assuming without deciding that these are statements of opinion, we are not persuaded.

In our view, there is some reason to conclude that the Appellants have plausibly alleged that AmTrust's method of deferring the recognition of expenses related to bonuses until the bonuses were paid (thus delaying the charge to income) was objectively improper rather than an exercise of subjective judgment. In particular, the Appellants allege that AmTrust had a practice of paying bonuses. The Complaint thus plausibly alleges that there was no basis to conclude that the continued payment of earned bonuses was not "probable" and that such bonuses therefore could not be expensed when earned. There is no dispute that the bonuses at issue on appeal were earned during the relevant periods and, as AmTrust's restatement eventually acknowledged, that they should have been expensed during those periods. Although multiple accounting standards may have been relevant to determining when to expense a bonus, all of the standards in play here support the position that the bonuses should have been expensed in the year

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[10] *See also* ASC 450-10-55-3 ("Amounts owed for services received. . . are not contingencies even though the accrued amounts may have been estimated; there is nothing uncertain about the fact that those obligations have been incurred.")

they were earned, not the year they were paid.[11] We are not aware of a GAAP provision on which AmTrust relied that suggests otherwise. And the fact that these GAAP standards, together or alone, are subject to misreading, misinterpretation, or misapplication, as happened here, does not necessarily mean that they entail an exercise of subjective judgment.

But we do not need to decide whether these financial statements are statements of fact or, as AmTrust asserts, statements of opinion. *See Abramson*, 965 F.3d at 176. Even if they are statements of opinion (because, say, determining whether it is "probable" that the corporate officers would exercise their discretion to pay the bonuses at a future time is a matter of subjective judgment), we conclude that the statements are nonetheless actionable because the Complaint adequately alleges that it was improbable that the earned bonuses would not be paid. Accepting that allegation as true makes it quite plausible that the AmTrust Defendants did not base the company's statements of probability on a "meaningful . . . inquiry," that their statements did not "fairly align[] with the information in the issuer's possession at the time," and that there was no basis for AmTrust to state that the bonuses should be expensed in the year they were paid rather than earned. *Omnicare*, 575 U.S. at 188-89.

For these reasons, we conclude that the Complaint states a claim under Section 11 against the AmTrust Defendants and the Director Defendants arising from AmTrust's misrepresentation of reported income in its historical consolidated financial statements based on the

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[11] Under ASC 450-10-55, bonuses should have been expensed as incurred during the relevant period. ASC 710-10-25 likewise required AmTrust to expense an employee's right to be compensated when earned. And ASC 270 required the bonuses to be expensed as incurred in interim periods.

erroneous accounting treatment relating to bonus payments.

C. SOX CERTIFICATIONS BY AMTRUST EXECUTIVES

The remaining Section 11 claims against the AmTrust Defendants are a different matter. They rest on certifications by company executives regarding, among other things, the accuracy of AmTrust's financial reporting, its conformity with GAAP, and the effectiveness of AmTrust's disclosure controls and procedures. The District Court concluded that these certifications were non-actionable statements of opinion. We agree.

First, the Officer Defendants, Zyskind (the CEO) and Pipoly (the CFO), attested to (1) the accuracy of AmTrust's financial reporting, (2) the effectiveness of the company's disclosure controls and procedures, and (3) their disclosure of any weaknesses in internal controls over the company's financial reporting in certifications mandated by Section 302 of the Sarbanes Oxley Act ("SOX"), 15 U.S.C. § 7241(a); *see also* 17 C.F.R. §§ 240.13a-14, 240.13a-15, 240.15d-15. Their certifications about the accuracy of AmTrust's financial reporting, including that financial statements were prepared in conformity with GAAP, signal that they are opinions by stating that they are "based on [the] knowledge" of the officer. *See* Joint App'x 103–04, 153. There is no allegation that the opinion is actionable on the ground that it was *not* based on the officer's knowledge.[12] Similarly, we conclude that the two other challenged SOX certifications relating to (1) disclosure controls and procedures, and (2) internal control over financial reporting contain language that conveys management's

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[12] For the reasons discussed below, we disagree with the Appellants that the existence of the Warrantech SEC guidance letter demonstrates that the officers *knew* the financial reports were false or misleading or did not comply with GAAP, even with all reasonable inferences drawn in the Appellants' favor.

subjective judgments about the company's internal controls and thus constitute statements of opinion.

The Appellants point to allegations that AmTrust later reversed course and that its restatement acknowledged a failure of internal controls. The Appellants insist that the reversal compels the inference that the SOX certifications were not believed when made. But AmTrust's change of opinion, standing alone, does not mean that the original certified opinions were disingenuous.[13] Nor is a genuinely held opinion that "turned out to be wrong" necessarily actionable. *Omnicare*, 575 U.S. at 186. In any event, as noted, the Complaint fails to adequately allege that the AmTrust executives who signed the certifications did not believe what they certified.

Finally, Appellants contend that the certifications were misleading because they falsely conveyed the existence of "'some meaningful . . . inquiry'" conducted by the certifying executives. Appellants' Br. 42 (quoting *Omnicare*, 575 U.S. at 188). But here too, the Complaint fails to allege any facts that establish a lack of meaningful inquiry, other than the fact that the certification turned out to be wrong.

For these reasons, we affirm the District Court's dismissal of the Appellants' Section 11 claims relating to the SOX certifications.

II. THE EXCHANGE ACT CLAIMS AGAINST THE AMTRUST DEFENDANTS

The District Court also dismissed the Appellants' claims against the AmTrust Defendants under Section 10(b) of the Exchange Act and Rule 10b-5. To survive a motion to dismiss under these provisions, "a plaintiff must

[13] The Appellants reference in passing on appeal that the SOX certifications contained embedded statements of fact. *See* Appellants' Br. 41. We conclude that the argument is abandoned because the Appellants have failed to develop it. *See Zhang v. Gonzales*, 426 F.3d 540, 545 n.7 (2d Cir. 2005).

allege that [each] defendant (1) made misstatements or omissions of material fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that the plaintiff's reliance was the proximate cause of its injury." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,* 493 F.3d 87, 105 (2d Cir. 2007); *see also Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 93 (2d Cir. 2016). Under the Private Securities Litigation Reform Act of 1995, moreover, a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with [scienter]." 15 U.S.C. § 78u–4(b)(2)(A).

In contrast to the Securities Act claims under Section 11, which do not require a showing of scienter,[14] the central question with respect to the Appellants' claims under the Exchange Act is whether the Complaint adequately "pleaded facts giving rise to a strong inference that the . . . Defendants acted with 'scienter, a mental state embracing intent to deceive, manipulate, or defraud.'" *In re Advanced Battery Techs., Inc.*, 781 F.3d 638, 644 (2d Cir. 2015) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007)). Scienter may be established by alleging facts "(1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI Commc'ns*, 493 F.3d at 99; *see Set Cap. LLC v. Credit Suisse Grp. AG*, 996 F.3d 64, 78 (2d Cir. 2021). Any allegation of conscious misbehavior or recklessness should be "viewed holistically and together

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[14] As we explained in *Fait*, "[w]hile issuers are subject to virtually absolute liability under section 11, the remaining potential defendants under sections 11 and 12(a)(2) [of the Securities Act] may be held liable for mere negligence." *Fait*, 655 F.3d at 109 (cleaned up). And "in contrast to claims brought pursuant to section 10(b) of the [Exchange Act], claims under sections 11 and 12 do not require allegations of scienter." *Id.*

with the allegations of motive and opportunity" to determine whether the complaint supports a strong inference of scienter. *Set Cap. LLC*, 996 F.3d at 78. Although "the requisite intent of the alleged speaker of the fraud need not be alleged with great specificity," *Chill v. Gen. Elec. Co.*, 101 F.3d 263, 267 (2d Cir. 1996), the "inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Tellabs*, 551 U.S. at 314; *see also In re Advanced Battery*, 781 F.3d at 644; *ECA & Loc. 134 IBEW Joint Pension Tr. of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009).

Keeping that standard in mind, we agree with the District Court that the Complaint does not adequately allege that the AmTrust Defendants acted with scienter.

First, the Complaint does not adequately plead scienter based on the AmTrust Defendants' motive and opportunity to commit fraud. Urging otherwise, the Appellants rely on the AmTrust Defendants' financial incentives to keep share prices high and to fuel the company's acquisition strategy. But the desire to sustain "the appearance of corporate profitability" is not itself the kind of incentive or motivation that raises an inference of scienter. *Chill*, 101 F.3d at 268. The Appellants also direct us to allegations that Pipoly and other top executive officers (but, notably, not Zyskind or the Board Defendants) sold a significant number of shares of AmTrust stock during the AmTrust Class Period. In doing so, however, the Appellants acknowledge that Pipoly's significant selloff began several months before the AmTrust Class Period, a fact that renders his stock sales during this class period less unusual. *See Ark. Pub. Emps. Ret. Sys. v. Bristol-Myers Squibb Co.*, 28 F.4th 343, 355 (2d Cir. 2022).

Nor does the Complaint allege facts that provide "strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI Commc'ns*, 493 F.3d at 99. We have explained that "[s]cienter based on conscious misbehavior . . . requires a showing of deliberate illegal behavior, a standard met when it is clear that a scheme, viewed broadly, is necessarily going to injure." *Gould v. Winstar Commc'ns, Inc.*, 692 F.3d 148, 158 (2d Cir. 2012) (quotation marks omitted). Recklessness, meanwhile, entails "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *ECA*, 553 F.3d at 198 (quotation marks omitted). None of the facts alleged in the Complaint—including the "magnitude" of the restatement and the duration of the period it covered—satisfy these requirements. Joint App'x 213. In determining whether the AmTrust Defendants acted with scienter, it is not enough that it took a period of years for AmTrust to acknowledge its significant accounting errors.

Finally, the Appellants argue that the AmTrust Defendants did not believe their accounting judgments regarding the early recognition of revenue on the administration-service fees connected to AmTrust's warranty program. The Appellants allege that AmTrust knew its accounting treatment was wrong because Warrantech, the company AmTrust acquired in 2010, announced in its Form 10-K for the year ended March 31, 2006, that it had changed its revenue-recognition practices regarding its warranty contracts in response to SEC guidance. In particular, the Complaint alleges that AmTrust must have known, or recklessly disregarded, that the SEC earlier had advised Warrantech that its time-of-sale approach was improper and that its warranty business compelled a straight-line revenue recognition approach. But we think that AmTrust's subsequent resort to a time-of-sale approach for the contracts, though wrong, is more plausibly explained by the changes to the guiding accounting principles since 2006 to which AmTrust points us, or to AmTrust's negligence.[15] *See* AmTrust Br. 42–44. Negligence, even in a "heightened form," is not sufficient to allege scienter. *Novak*, 216 F.3d at 312.

For these reasons, we conclude that the Complaint fails to raise a strong inference of scienter, and we affirm the dismissal of the Appellants' claims against the AmTrust Defendants under Section 10(b) and Rule 10b–5.[16] We also affirm the District Court's corresponding dismissal of the Appellants' 'control person' claim under Section 20(a) of the Exchange Act because such a claim is "necessarily predicated on a primary violation of securities law." *Rombach v. Chang*, 455 F.3d 164, 177–78 (2d Cir. 2004).

III. THE SECURITIES ACT CLAIMS AGAINST THE UNDERWRITER DEFENDANTS

The Appellants also assert claims against the Underwriter Defendants under Sections 11 and 12(a)(2) of the Securities Act stemming from the two securities offerings made pursuant to AmTrust's 2015 Registration Statement. The first is AmTrust's November 2015 Offering, underwritten by Citigroup and Morgan Stanley, of 5

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[15] The Appellants also call our attention to purported "red flags" in the form of press coverage criticizing AmTrust's accounting practices generally, although none of the press articles mentions the two central accounting issues that led to AmTrust's restatement. Given the generality of these media reports, we are not persuaded that they support an inference of scienter that is at least as compelling as any opposing inference of nonfraudulent intent.

[16] We have applied the holding in *Omnicare* to claims brought under Section 10(b) of the Exchange Act. *See Tongue v. Sanofi*, 816 F.3d 199, 209–10 (2d Cir. 2016). Because, as we previously concluded, the Officer Defendants' certifications are non-actionable statements of opinion, we also affirm the dismissal of the Appellants' Section 10(b) claims based on these certifications. *See City of Omaha, Neb. Civilian Emps.' Ret. Sys. v. CBS Corp.*, 679 F.3d 64, 67–68 (2d Cir. 2012) (noting that Section 10(b) and Section 11 claims "share a material misstatement or omission element").

million shares of common stock pursuant to a preliminary prospectus supplement and a prospectus supplement. This preliminary prospectus supplement and prospectus supplement, together with the 2015 Registration Statement, incorporated by reference AmTrust's annual financial report for 2014 and quarterly financial reports for the first three fiscal quarters of 2015. The second offering is AmTrust's September 2016 Offering, underwritten by Morgan Stanley, RBC, UBS, and KBW, of 10 million depository shares pursuant to a preliminary prospectus supplement and a prospectus supplement that, together with the 2015 Registration Statement, incorporated by reference AmTrust's annual financial report for 2015 and quarterly financial reports for the first two quarters of 2016. Each of the relevant financial reports contained overstated income numbers arising from the time-of sale approach for the warranty contracts and the improper expensing of bonuses.

As a threshold matter, three of the Underwriter Defendants—Morgan Stanley, UBS, and KBW—contend that the Appellants lack standing to even assert Section 12 claims against them in connection with the September 2016 Offering because the Complaint does not specifically allege that the Appellants purchased securities from those underwriters. [17] Under Section 12(a)(2), a plaintiff has standing to bring an action against the seller of a security only if the plaintiff is "the person purchasing such security from them." *Akerman v. Oryx Commc'ns, Inc.*, 810 F.2d 336, 344 (2d Cir. 1987) (quotation marks omitted); *see also Freidus v. Barclays Bank PLC*, 734 F.3d 132, 141 (2d Cir. 2013) ("In order to have standing under § 12(a)(2), . . . plaintiffs must have purchased securities directly from the

[17] The Underwriter Defendants do not challenge Appellants' standing to sue the underwriters of the November 2015 Offering—Citigroup and Morgan Stanley—or their standing to sue RBC for the September 2016 Offering.

defendants."); 15 U.S.C. § 77l(a). A "statutory seller" may include an underwriter who successfully solicited the transfer of title from issuer to purchaser in exchange for some financial gain.[18] Morgan Stanley, UBS, and KBW assert that in a case involving multiple underwriters of a single offering, the purchaser of a security must in its pleadings specifically identify which underwriter sold the security at issue in order to have standing to sue that underwriter. We have not yet addressed this question.

We conclude that the Appellants have adequately established standing under Section 12(a)(2) by alleging that they purchased securities pursuant to the "pertinent offering documents" or in the relevant offerings underwritten by the defendants. *In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258, 311 (S.D.N.Y. 2011) (Kaplan, J.). Here, according to the Complaint, the Appellants bring their Section 12(a)(2) claims on their own behalf and on behalf of "other members of the Securities Act Class who purchased AmTrust common stock or [shares sold in connection with the September 2016 Offering] *pursuant to the Prospectuses*." Joint App'x 132 (emphasis added). We can reasonably infer from these allegations that the Appellants acquired securities from the Underwriter Defendants in connection with the September 2016 Offering. We are therefore satisfied that the allegations suffice to establish the Appellants' standing in this case. *See, e.g.*, *John v. Whole Foods Mkt. Grp., Inc.*, 858 F.3d 732, 736–38 (2d Cir. 2017) (noting that "general

[18] In a similar vein, a purchaser of a security has standing to bring an action under Rule 10b–5a against underwriters (and brokers, dealers, and non-issuer sellers) for material misstatements about the security "if those entities made material misstatements about the security, as long as the plaintiff[] purchased or sold the securities about which the misstatements were made." *Menora Mivtachim Ins. Ltd. v. Frutarom Indus. Ltd.*, 54 F.4th 82, 88 (2d Cir. 2022); *see In re NYSE Specialists Sec. Litig.*, 503 F.3d 89, 102 (2d Cir. 2007).

factual allegations of injury may suffice" to establish standing, "for on a motion to dismiss we presume that general allegations embrace those specific facts that are necessary to support the claim" (cleaned up)).

Turning to the merits, the District Court dismissed the Appellants' Section 11 and Section 12 claims against the Underwriter Defendants, concluding that the Appellants had "fail[ed] to allege any untrue or misleading statements of material fact or opinion with respect to those claims." Spec. App'x 73. In other words, the District Court dismissed these claims, which it described as "identical to those of the Securities Act claims asserted against the AmTrust [D]efendants," for effectively the same reasons it dismissed the claims against the AmTrust Defendants. Spec. App'x 73. For reasons we have already provided, we disagree with the District Court's conclusion that the reported income statements related to AmTrust's warranty contracts and its employee bonuses were non-actionable opinions. Insofar as the District Court dismissed the Appellants' claims under Section 11 and Section 12(a)(2) against the Underwriter Defendants arising from those two categories of statements, we vacate the dismissal and remand for further proceedings consistent with this opinion. As to any remaining claims against the Underwriter Defendants, we affirm the District Court's dismissal.

IV. THE CLAIMS AGAINST BDO, AMTRUST'S OUTSIDE AUDITOR

Finally, we address the Appellants' claims against AmTrust's outside auditor, BDO, under Section 11 of the Securities Act in connection with BDO's audit reports on AmTrust's financial statements and its system of internal controls over financial reporting for each of the years ended December 31, 2013–15, and under Section 10(b) of the Exchange Act and Rule 10b-5 in connection with its audit report for the year ending December 31, 2013 ("2013 Audit

Opinion”), which was included in AmTrust’s 2013 Form 10-K.

We begin with the Securities Act claims. Section 11 provides in relevant part that if “any part of the registration statement . . . contained an untrue statement of material fact,” anyone acquiring the associated security may sue “every accountant . . . who has with his consent been named as having prepared or certified any part of the registration statement or . . . any report or valuation which is used in connection with the registration statement.” 15 U.S.C. § 77k(a)(4). BDO is thus responsible under Section 11 for any material inaccuracy in the AmTrust registration statements that it certified, or in financial reports incorporated in those statements. *Id.*; *see Miyahira v. Vitacost.com, Inc.*, 715 F.3d 1257, 1265 (11th Cir. 2013); *Belizan v. Hershon*, 495 F.3d 686, 692 (D.C. Cir. 2007); *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 n.11 (1983).

As BDO observes, the Appellants have not developed the argument in their opening brief challenging the District Court’s dismissal of the Section 11 claim against BDO. The challenge, if it can be called that, appears in a footnote. *See Norton v. Sam’s Club*, 145 F.3d 114, 117 (2d Cir. 1998) (“[A]n argument made only in a footnote [i]s inadequately raised for appellate review.”). Although the Appellants develop the argument somewhat in their reply brief, that is too little too late. *See JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V.*, 412 F.3d 418, 428 (2d Cir. 2005) (“[A]rguments not made in an appellant’s opening brief are waived even if the appellant . . . raised them in a reply brief.”). We thus conclude that the Appellants’ challenge to the dismissal of the Section 11 claim against BDO is abandoned, we affirm the District Court’s dismissal of that claim, and we proceed to examine the Exchange Act claims against BDO.

The Appellants contend that BDO is liable under Section 10(b) of the Exchange Act for the 2013 Audit Opinion, which stated that BDO had conducted its audit in accordance with standards promulgated by the Public Company Accounting Oversight Board ("PCAOB"), and that the audit provided a reasonable basis for BDO to determine that AmTrust's financial statements were fairly presented. Joint App'x 246–47.

On its face, the 2013 Audit Opinion appears in the same guise as the SOX certifications that we have already concluded are non-actionable opinions. But the Complaint alleges some key facts that differentiate the audit opinion from those certifications. The Appellants allege that the BDO engagement partner on the audit, Richard J. Bertuglia, and another BDO partner, John W. Green, in fact failed to complete the necessary checks and audit work papers before issuing the audit opinion; that they signed several audit work papers without reviewing them; and that they failed to verify that all the necessary audit work was performed before issuing the opinion. The Appellants also allege that the SEC later found that (1) Bertuglia had violated the PCAOB standards by failing to supervise and exercise due professional care, properly examine journal entries for evidence of possible material misstatement due to fraud, or perform sufficient tests of internal controls and substantive audit procedures to support their final opinion, and (2) Green violated PCAOB standards by failing to perform the appropriate engagement quality review.

We agree with the District Court that the Appellants have adequately alleged that BDO's audit opinion contained potentially actionable misstatements of opinion because the Complaint "render[s] it plausible that Bertuglia," who signed the audit opinion, "disbelieved the statement that the audit was conducted in accordance with the relevant PCAOB standards." Spec. App'x 78. The Appellants have also adequately alleged that BDO's statement that it "believe[d] [its] audits provide a reasonable basis for [its] opinion," Joint App'x 246–47, would lead a reasonable investor to conclude that BDO had conducted "some meaningful . . . inquiry," *Omnicare*, 575 U.S. at 188, when in fact, according to the Complaint, BDO never conducted such an inquiry.

But we also agree with the District Court that the Appellants' Section 10(b) and Rule 10b-5 claim against BDO must be dismissed because the Complaint does not adequately allege that the misstatement in BDO's 2013 Audit Opinion was material.

> To state a claim under § 10(b) and the corresponding Rule 10b–5, a plaintiff must plead that the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that the plaintiff's reliance on the defendant's action caused injury to the plaintiff.

Ganino v. Citizens Utils. Co., 228 F.3d 154, 161 (2d Cir. 2000). "At the pleading stage, a plaintiff satisfies the materiality requirement . . . by alleging a statement or omission that a reasonable investor would have considered significant in making investment decisions." *Id.* at 161–62; *see Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988). "[A] complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Ganino*, 228 F.3d at 162 (quotation marks omitted); *see Litwin*, 634 F.3d at 717.

As the District Court concluded, the Complaint fails to allege any link between BDO's misstatements in the 2013 Auditor Opinion and the material errors contained in AmTrust's 2013 Form 10-K. The audit statements to which the Appellants point were "so general" in this case "that a reasonable investor would not depend on [them] as a guarantee." *ECA*, 553 F.3d at 206. Appellants' "claim that these statements were knowingly and verifiably false when made does not cure their generality, which is what prevents them from rising to the level of materiality required to form the basis for assessing a potential investment." *SAIC*, 818 F.3d at 97–98 (quotation marks omitted). We do not mean to suggest that audit opinions will always fail the materiality test because the statements they contain are too general for investors to rely on. Rather, *in this case*, as the District Court held, Appellants have failed "to allege any facts relevant to the way or ways in which BDO's failure to supervise, review, document, and perform in good faith the 2013 audit would have been significant to a reasonable investor in making investment decisions." Spec. App'x 79. We might have come to a different conclusion had such facts been alleged.

For these reasons, we affirm the District Court's dismissal of the Appellants' Exchange Act claims under Section 10(b) and Rule 10b-5 against BDO.

CONCLUSION

To summarize:

1. We vacate the dismissal of the Appellants' Section 11 claims against the AmTrust Defendants and the Director Defendants, the Section 12(a)(2) claims against AmTrust, and the Section 15 claims against the Officer Defendants and Director Defendants (Zyskind, Pipoly, DeCarlo, Fisch, Gulkowitz, Karfunkel, and Miller) relating to AmTrust's accounting for certain warranty contracts and bonuses.

2. We vacate the dismissal of the Appellants' claims under Section 11 and Section 12(a)(2) against the Underwriter Defendants relating to AmTrust's accounting for certain warranty contracts and bonuses.

3. We otherwise affirm the judgment of the District Court.

We have considered the Appellants' remaining arguments and conclude that they are without merit. Accordingly, for the reasons set forth above, the judgment of the District Court is AFFIRMED in part and VACATED in part, and the case is REMANDED for proceedings consistent with this opinion.

APPENDIX C

United States District Court
Southern District of New York

In re AMTRUST FINANCIAL SERVICES, INC. Securities Litigation

17-cv-1545 (LAX)

This document applies to: All Cases

MEMORANDUM OPINION

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LEWIS A. KAPLAN, *District Judge.*

Plaintiffs bring this putative securities class action against AmTrust Financial Services, Inc. ("AmTrust"), current and former officers and directors, its former auditor, and certain underwriters of its securities. They claim that certain public filings and statements made by defendants contain misstatements of material facts in violation of Sections 11, 12(a), and 15 of the Securities Act of 1933, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. This matter is before the Court on defendants' motions to dismiss the Consolidated Second Amended Complaint (the "SAC" or "Complaint") pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6), and the Private Securities Litigation Reform Act ("PSLRA").

BACKGROUND

I. THE PARTIES

The plaintiffs purchased AmTrust securities: (i) through a public offering on November 11, 2015 (the "November 2015 Offering"), (ii) through a public offering on September 27, 2016 of Non-Cumulative Preferred Stock, Series F (the "September 2016 Series F Offering"), or (iii) on the secondary market (A) between and including February 14, 2013 and April 10, 2017 (the "AmTrust Class Period"), or (B) between and including March 3, 2014 and April 10, 2017 (the "BDO Class Period").[1] The lead plaintiff, New England Carpenters Guaranteed Annuity and Pension Funds, purchased AmTrust securities during both the AmTrust and BDO Class Periods.[2] Plaintiffs Albano and Jupiter Capital purchased shares in or "traceable to"

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[1] Consolidated Second Amended Complaint [hereinafter "SAC"] [DI 140] ¶ 1.

[2] *Id.* ¶ 19.

the November 2015 Offering.[3] Plaintiffs ILRT and Stanley Newmark purchased shares in or "traceable to" the September 2016 Series F Offering.[4]

Defendant AmTrust is a publicly traded, multinational specialty property and casualty insurer headquartered in New York.[5] Its products include workers' compensation, commercial automobile insurance, general liability and extended service and warranty coverage.[6]

Defendant Barry D. Zyskind has been the president and chief executive officer of AmTrust since 2000.[7] Defendant Ronald E. Pipoly Jr. served as the executive vice president and chief financial officer of AmTrust from 2005 until June 5, 2017.[8] Together, Zyskind and Pipoly are referred to as the "Officer Defendants."

In addition to the Officer Defendants, plaintiffs assert claims against current and former directors of the board (the "Director Defendants").[9] Each was a director at all times relevant to the allegations in the Complaint.[10]

Plaintiffs separately assert claims against certain underwriters of AmTrust securities (the "Underwriter Defendants"). Plaintiffs name Citigroup Global Markets Inc. ("Citigroup") and Morgan Stanley & Co. LLC ("Morgan Stanley") as Underwriter Defendants in connection with the November 2015 Offering, and Keefe, Bruyette & Woods ("KBW"), Morgan Stanley, RBC Capital Markets, LLC ("RBC"), and UBS Securities LLC ("UBS") as Underwriter

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[3] *Id.* ¶¶ 20-21.
[4] *Id.* ¶¶ 22-23.
[5] *Id.* ¶ 24.
[6] *Id.*
[7] SAC [DI 140] ¶ 25.
[8] *Id.* ¶ 26.
[9] The Director Defendants are Donald T. DeCarlo, Susan C. Fisch, Abraham Gulkowitz, George Karfunkel, and Jay J. Miller. *Id.* ¶¶ 30-34.
[10] *Id.* ¶¶ 30-34.

Defendants in connection with the September 2016 Series F Offering.[11]

Finally, plaintiffs assert claims against AmTrust's former auditor, BDO USA, LLP ("BDO"). BDO is an accounting firm headquartered in Chicago, Illinois, that provides clients with advisory, audit, assurance, consulting, and tax services.[12] BDO issued unqualified audit opinions on AmTrust's financial statements for each of the years 2012, 2013, 2014, and 2015.[13]

II. FACTS

A. AMTRUST'S ACQUISITION OF WARRANTECH

At the heart of certain allegations in the Complaint is AmTrust's extended warranty business and its accounting treatment of certain revenue generated by a subsidiary called Warrantech. AmTrust acquired Warrantech in August 2010 through AmTrust's wholly-owned subsidiary, AMT Warranty.[14] Following the acquisition, Warrantech's former chairman and chief executive officer, Joel San Antonio, became the chairman of AMT Warranty.[15]

Warrantech provides extended service plans and warranty programs for retailers, dealers, distributors, and manufacturers in various markets.[16] In or around 2003, Warrantech recognized the majority of revenue from service contracts at the time of sale and deferred only a minor portion of that revenue.[17] That same year, the SEC began a review of Warrantech's periodic reports.[18] Upon conclusion of its review, the SEC provided guidance advising Warrantech to change its revenue recognition

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[11] *Id.* ¶¶ 36-40.
[12] *Id.* ¶ 29.
[13] SAC [DI 140] ¶ 29.
[14] *Id.* ¶ 70.
[15] *Id.* ¶ 265.
[16] *Id.* ¶ 70.
[17] *Id.* ¶¶ 262-63.
[18] *Id.* ¶ 262.

policy to recognize service contract revenue over the life of the contracts.[19] Warrantech implemented the change and announced it in its Form 10-K for the year ending March 31, 2006.[20] The change had "the effect of deferring to later periods the substantial portion of these revenues which the Company [] previously recognized up front."[21]

After AmTrust acquired Warrantech, the policy was changed back to Warrantech's pre-SEC review practice of recognizing the majority of service contract revenue at the time of sale.[22]

B. AMTRUST'S GROWTH

Plaintiffs allege that AmTrust experienced "extraordinary" growth from 2012 to 2016.[23] During that time, the company increased its gross written premiums from $2.75 to $7.95 billion.[24] During the same period, its service and fee income nearly quadrupled, increasing from $138.6 million to $537.9 million.[25] For the year ending December 31, 2016, 40 percent of that service and fee income was generated by Warrantech.[26]

AmTrust acquired an additional three companies from October 2014 to April 2016.[27] Each acquisition was preceded by a positive earnings announcement that beat analysts' expectations and a subsequent capital raise through the sale of preferred stock or subordinated notes.[28] AmTrust then used at least a portion of the funds raised to

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[19] SAC [DI 140] ¶ 263.
[20] *Id.*
[21] *Id.*
[22] *Id.* ¶ 264.
[23] *Id.* ¶ 63.
[24] *Id.*
[25] SAC [DI 140] ¶ 73.
[26] *Id.* ¶ 74.
[27] *Id.* ¶¶ 60-62.
[28] *Id.* ¶¶ 60-62.

finance the acquisitions.[29] As a result of AmTrust's strong performance, its share price rose over the AmTrust and BDO Class Periods, reaching an all-time high on August 5, 2015 of approximately $35 a share.[30]

C. MEDIA SPECULATION REGARDING AMTRUST'S PERFORMANCE

On December 12, 2013, GeoInvesting, LLC ("GeoInvesting"), an AmTrust short-seller[31] and, according to its website, a provider of premium microcap research,[32] published a report titled "AmTrust Financial Services: A House of Cards?"[33] GeoInvesting found it suspicious that AmTrust was able to "beat[] consensus estimates for 14 consecutive quarters," while "tak[ing] on so many different types of risk."[34] The research company took "a deeper look into [AmTrust's] books and accounting."[35] It concluded that AmTrust "appear[ed] to be inflating earnings/net equity" by improperly accounting for intercompany transactions and thereby understating losses on foreign subsidiaries in its consolidated financial statements.[36] GeoInvesting questioned also the effectiveness of AmTrust's internal controls over financial reporting.[37]

Defendants Zyskind and Pipoly responded to the report on the same day it was published on a conference call with investors.[38] They said that the report contained factual inaccuracies and misstatements, and that all AmTrust

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[29] *Id.* ¶¶ 60-62.
[30] *Id* ¶ 65.
[31] Declaration of Lawrence J. Zweifach [hereinafter "Zweifach Decl."] Ex. 20 [DI 149-20] at ECF p. 21.
[32] GeoInvesting, https://geoinvesting.com (last visited July 23, 2019).
[33] SAC [DI 140] ¶ 269.
[34] *Id.*
[35] *Id.*
[36] *Id.* ¶ 270.
[37] *Id.*
[38] *Id.* ¶ 271.

foreign companies report "in our consolidation under US GAAP [Generally Accepted Accounting Prinicples]."[39]

Two months after the GeoInvesting report, on February 8, 2014, Barron's published an article titled "Turning Losses Into Gains," by Bill Alpert.[40] The article raised the same question as the GeoInvesting report with respect to AmTrust's accounting for foreign subsidiary losses.[41] In addition, it questioned AmTrust's accounting practices related to deferred acquisition costs.[42]

On May 31, 2014, the same author published a second article titled "Balance Sheet Risk Makes AmTrust Shares Vulnerable."[43] The article questioned AmTrust's accounting related to intercompany transactions[44] and what the author described as AmTrust's "inconsistent loss reserves that have the effect of flattering earnings and capital."[45] AmTrust responded with a statement that the articles were "replete with significant factual inaccuracies."[46]

D. AMTRUST ANNOUNCES THAT IT WOULD SWITCH AUDITORS

The media were not the only ones scrutinizing AmTrust in 2014. Regulators too were focused on the company, which came to light on September 16, 2014 when AmTrust filed a Form 8-K with the SEC. The filing stated that ACP Re Ltd. ("ACP"), a company affiliated with AmTrust through common ownership, had received approval from the New York Department of Financial Services ("NYDFS") to acquire a piece of Tower Group

[39] SAC [DI 140] ¶ 271.
[40] Zweifach Decl. Ex. 21 [DI 149-21].
[41] SAC [DI 140] ¶ 274.
[42] *Id.*
[43] *Id.* ¶ 278; Zweifach Decl. [DI 149] ¶ 22.
[44] SAC [DI 140] ¶ 281.
[45] *Id.* ¶ 280.
[46] *Id.* ¶ 281.

International, Ltd.[47] The approval letter, dated September 12, 2014, stated:

> "In light of AmTrust's growth and increased geographic footprint, AmTrust will engage an external auditing firm with corresponding global resources and skills beginning with the audit for the annual period ending December 31, 2015. Before the engagement is undertaken, the selection of the auditing firm shall be subject to the review and prior approval of the Department [NYDFS]."[48]

E. AMTRUST AND ALISTAIR CAPITAL MANAGEMENT

From subsequent events, it is apparent that the announcement did not put an end to concerns regarding AmTrust's accounting practices and internal controls.

On December 11, 2014, AmTrust filed in New York state court a summons against Alistair Capital Management, LLC ("Alistair"), which is a registered investment adviser, as well as against Alistair's founder, Casey H. Nelson, GeoInvesting, and a number of individuals.[49] The summons gave notice of AmTrust's claims "arising out of defendants' attempt to damage plaintiff's reputation and business and manipulate its stock price through the dissemination of actionable false and misleading statements concerning plaintiff's business, as well as other conduct, as part of an organized scheme to harm that business."[50]

Seven days later, on December 18, 2014, Alistair issued a public letter to the members of AmTrust's audit committee alerting them to what Alistair believed to be "numerous instances of improper accounting and indications of material weaknesses in internal controls

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[47] Zweifach Decl. Ex. 9 [DI 149-9] at ECF p. 4.

[48] *Id.*

[49] SAC [DI 140] ¶¶ 287.88.

[50] Summons with Notice, NYSCEF Doc. No. 1, Index No. 653816/2014.

over financial reporting."[51] Specifically, the letter questioned AmTrust's practices with respect to: (1) accounting for deferred acquisition costs, (2) its valuation of life settlement contracts, (3) reinsurance assets related to Maiden Holdings, Ltd., (4) the consolidation of Luxembourg reinsurance captives, and (5) accounting for loss and loss adjustment expense reserves assumed in acquisitions.[52] Alistair urged the AmTrust audit committee to initiate an investigation into the company's financial controls and accounting practices.[53]

F. AMTRUST'S NOVEMBER 2015 PUBLIC OFFERING

On June 11, 2015, AmTrust filed with the SEC on Form S-3 a registration statement for the offer and sale of, *inter alia,* common and preferred stock.[54] Pursuant to that registration statement, AmTrust filed a preliminary prospectus on November 10 and a prospectus supplement on November 12, 2015 (the "prospectuses," and together with the registration statement, the "November 2015 Offering Materials").[55] The prospectuses stated that AmTrust was offering 5,000,000 shares of common stock.[56] They incorporated by reference AmTrust's annual report for the year ending December 31, 2014 filed on Form 10-K, and the quarterly report for the quarter ending March 31, 2015 filed on Form 10-Q.[57] The offering was held on or about November 11, 2015 and raised $320,000,000.[58] Citigroup and Morgan Stanley underwrote the transaction.[59]

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[51] SAC [DI 140] ¶ 292.
[52] Zweifach Decl. Ex. 24 [DI 149-24] at ECF p. 3.
[53] *Id.* at ECF p. 2.
[54] SAC [DI 140] ¶ 148.
[55] *Id.* ¶¶ 149-50.
[56] *Id.* ¶¶ 149-50.
[57] *Id.* 150.
[58] *Id.* ¶ 1.
[59] *Id.* ¶ 150.

The November 2015 Offering is the first of two upon which plaintiffs' Securities Act claims are based. Before the Court describes the second offering, a brief discussion of several intervening events is necessary.

G. AMTRUST ANNOUNCES DISMISSAL OF BDO AND HIRING OF KPMG

On April 4, 2016, AmTrust announced in a press release filed on Form 8-K that the audit committee had "approved the dismissal of BDO," which became effective as of the date of its completion of the audit for the first quarter of 2016.[60] The press release announced also that the accounting film, KPMG LLP ("KPMG"), would replace BDO as AmTrust's auditor "beginning with the second fiscal quarter of 2016, and for the fiscal year ending December 31, 2016."[61]

Harkening back to 2014, and in a seemingly repeating pattern, the announcement was followed by an article published in Barron's on April 23, 2016 questioning the valuation of AmTrust shares in light of the same author's concerns over the company's accounting practices.[62] Just as he had done in his May 2014 article, the author discussed the adequacy of AmTrust's reserves and the propriety of its accounting for intercompany transactions.[63]

H. AMTRUST'S SEPTEMBER 2016 SERIES F OFFERING

On September 20, 2016, AmTrust filed another preliminary prospectus pursuant to the 2015 registration statement announcing an offering of depositary shares.[64] The following day, the company filed a prospectus supplement (together with the preliminary prospectus and 2015 registration statement, the "2016 Series F Offering

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[60] SAC [DI 140] ¶ 308.
[61] *Id.* ¶ 309.
[62] *Id.* ¶¶ 302-03; Zweifach Decl. Ex. 23 [DI 149-23].
[63] Zweifach Decl. Ex. 23 [DI 149-23] at ECF pp. 2-3.
[64] SAC [DI 140] ¶ 151.

Materials").[65] The 2016 Series F Offering Materials incorporated by reference the company's annual report filed on Form 10-K for the year ending December 31, 2015,[66] the company's quarterly report filed on Form 10-Q for the quarter ending March 31, 2015, and various reports filed with the SEC on Form 8-K from January through August 2016.[67] The materials provided also historical financial data based on the company's annual financial statements for the years ending December 31, 2011 through 2015.[68] The offering concluded on September 27, 2016 and raised $278.2 million.[69] Morgan Stanley, UBS, RBC, and KBW underwrote the transaction.[70]

The September 2016 transaction is the second public offering upon which plaintiffs' Securities Act claims are based.

I. AMTRUST ANNOUNCES THAT IT WOULD CORRECT FINANCIAL STATEMENTS FOR 2014 AND 2015 AND MAKE CORRECTIONS TO CERTAIN FINANCIAL INFORMATION FOR 2012 AND 2013

Prior to the opening bell on February 27, 2017, AmTrust announced that it was delaying the filing of its annual report on Form 10-K for the year ending December 31, 2016 and that it expected to make certain corrections to its financial statements.[71] The relevant portion of the press release merits quoting in full:

[65] *Id.* ¶ 152.

[66] Though the company had announced on a Form 8-K filed September 16, 2014 and discussed above that it would switch auditors beginning with the annual report for the year ending December 31, 2015, the switch did not occur until after the first quarter of 2016.

[67] SAC [DI 140] ¶ 152.

[68] *Id.*

[69] *Id.* ¶ 153.

[70] *Id.* ¶ 151.

[71] *Id.* ¶ 76.

"On or before March 1, 2017, AmTrust intends to file a Form 12b-25 with the Securities and Exchange Commission providing the Company an automatic 15-day extension to file its Form 10-K for the year ended December 31, 2016. As previously disclosed, the Company appointed a new independent registered public accounting firm on April 1, 2016. Additional time is needed for the Company to complete its consolidated financial statements and assessment of internal controls over financial reporting for the fiscal year ended December 31, 2016, and, as a consequence, for the Company's auditor, KPMG LLP, to complete its audit procedures and audit of the consolidated financial statements included in the Form 10-K. The Company expects to file the Annual Report on Form 10-K within the 15-day extension period provided by Rule 12b-25.

In addition, the Company expects to make immaterial corrections to errors in its financial statements for fiscal years ended December 31, 2015 and 2014 and certain financial information for fiscal years ended December 31, 2013 and 2012 for inclusion in the Form 10-K and these processes have not been completed. The Company is still evaluating corrections to its historical quarterly financial statements within these fiscal years. [Reference to footnote omitted].

In connection with the foregoing, the Company expects to disclose in the Form 10-K that, as part of its evaluation of its internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxely Act of 2002, the Company identified material weaknesses in its internal control over financial reporting that existed as of December 31, 2016, specifically related to

> ineffective assessment of the risks associated with the financial reporting, and an insufficient complement of corporate accounting and corporate financial reporting resources within the organization. As the Company completes the preparation of its financial statements and the related audit process for fiscal year 2016, additional adjustments and/or material weaknesses could be identified. While the company believes that significant progress has been made in enhancing internal controls as of December 31, 2016 and in the period since, the material weaknesses have not been fully remediated due to insufficient time to fully implement and assess the design and operating effectiveness of the related controls. The Company will continue the process to enhance internal controls throughout 2017."[72]

The company held a conference call on the same day it issued the press release. On the call, when asked about the delay in filing the Form 10-K for the year ending December 31, 2016, Zyskind responded that it "simply [was] taking us more time to complete the work required for KPMG to complete its audit."[73] Pipoly then announced that AmTrust was adding several new positions to its financial leadership team.[74]

Following AmTrust's announcement that it would delay the filing of its Form 10-K, its common stock price fell $5.32 per share.[75]

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[72] Zweifach Decl. Ex. 11 [DI 149-11] at ECF p. 7.
[73] SAC [DI 140] ¶ 79.
[74] *Id.* ¶ 81.
[75] *Id.* ¶ 83.

J. AMTRUST ANNOUNCES THAT IT WOULD RESTATE ITS FINANCIAL STATEMENTS

After the close of trading on March 16, 2017, AmTrust issued another press release announcing that:

> "additional time is needed for the Company to complete its consolidated financial statements and assessment of internal controls over financial reporting for the fiscal year ended December 31, 2016, and, as a consequence, for the Company's auditor, KPMG LLP, to complete its audit procedures and audit of the consolidated financial statements included in the Form 10-K. Accordingly, the Company will file its Form 10-K for the year ended December 31, 2016 as soon as practicable."[76]

It continued:

> "the Audit Committee of the AmTrust Board of Directors, in consultation with management and its current and former independent auditors, concluded that the Company's previously issued consolidated financial statements for 2014 and 2015 (including for each of the four quarters of 2015) as well as for the first three quarters of 2016 should be restated and should no longer be relied upon."[77]

The company disclosed that the restatement was necessary primarily due to two errors in its historical consolidated financial statements. Specifically:

> "These errors relate to: (1) upfront recognition of a portion of warranty contract revenue associated with administration services, based on the interpretation of ASC [Accounting Standards Codification] 605, Revenue Recognition, used in the previously filed financial statements related to

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[76] Zweifach Decl. Ex. 12 [DI 149-12] at ECF p. 6.
[77] *Id.*

> multiple-element revenue recognition, instead of deferring recognition of the revenue over the life of the contract; and (2) bonuses that were expensed in the year paid but that should have been accrued in the year earned based on ASC 710, Compensation, and ASC 270, Interim Reporting."[78]

Finally, AmTrust stated that it would "also make other miscellaneous adjustments that had been previously identified but not corrected because they were not material, individually or in the aggregate, to its previously issued consolidated financial statements."[79]

Following the announcements in the press release, AmTrust's common stock price fell $4.03 per share.[80]

K. AMTRUST ISSUES ITS RESTATEMENT

On April 4, 2017, AmTrust filed with the SEC its annual report on Form 10-K for the year ending December 31, 2016. The report included "restated audited [consolidated financial statements] as of and for the years ended December 31, 2015 and 2014, as well as restated unaudited quarterly financial data for fiscal year 2015 and the first three quarters of 2016."[81] These items collectively are referred to as the "restated financial data and results." The issuance of the restated financial data and results is referred to as the "restatement."

In an accompanying note, the company explained that the restatement related primarily to "the correction of two errors reported in our historical consolidated financial statements."[82] It stated:

> "In accordance with accounting guidance presented in ASC 250-10 and SEC Staff Accounting Bulletin

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[78] *Id.* at ECF p. 7.
[79] *Id.*
[80] SAC [DI 140] ¶ 89.
[81] Zweifach Decl. Ex. 4 [DI 149-4] at ECF p. 3.
[82] *Id.*

> No. 99, *Materiality,* management assessed the materiality of these errors and concluded that they were material to the Company's previously issued financial statements. The two primary errors relate to: (1) upfront recognition of the portion of warranty contract revenue associated with administration services, instead of recognizing the revenue over the life of the contract, and (2) bonuses that were expensed in the year paid but that should have been accrued as earned based on ASC 270, *Interim Reporting* and ASC 450, *Contingencies.* We have also identified other adjustments . . . that we have corrected as part of this Restatement."[83]

The additional adjustments identified and corrected as part of the restatement — but not assessed as material by management — were described as follows:

> (1) "Deferred Acquisition Costs — The Company corrected errors in its calculation of deferred acquisition costs related to (a) the over-amortization of certain deferred acquisition costs in 2015, resulting in an overstatement of expenses in 2015, (b) the capitalization of certain salaries and consulting fees that were not eligible for deferral, resulting in an understatement of expenses, (c) the treatment of certain costs in the Company's U.K. operations as both underwriting expense and salary and benefit expenses, resulting in the duplication of the amount capitalized and deferred, and (d) the inclusion of deferred warranty administration fees and obligor liabilities associated with the administration services provided to our ESPs."[84]

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[83] *Id.*

[84] *Id.* at ECF p. 9.

(2) "Foreign exchange gain/(loss) — The Company corrected errors related to the re-measurement of monetary balances denominated in foreign currencies into their functional currencies that were recorded as other comprehensive income. Given the monetary nature of some of these assets, the re-measurement impact should have been recorded as foreign currency transaction gain/(loss) in our income statements."[85]

(3) "Capitalized software — The Company capitalized certain internally developed software costs that did not meet criteria for deferral under ASC 350, *Intangibles -Goodwill and Other*. This error resulted in an over-capitalization of certain software expenses, and an understatement of expenses."[86]

(4) "Imputed interest — The Company corrected an error related to interest imputed on contingent consideration owed as a result of certain business acquisitions, which resulted in an understatement of interest expense in 2015."[87]

(5) "Intercompany eliminations — The Company corrected an error related to internal brokerage commissions paid from one of its subsidiaries to another subsidiary, which should have been eliminated in consolidation, thereby causing an overstatement of commission income in 2015."[88]

(6) "Other items — The Company corrected other errors that impacted the 2014 and 2015 consolidated financial statements, including unaccrued liabilities, uncollectible other

[85] *Id.*
[86] *Id.*
[87] *Id.* at ECF p. 10.
[88] Zweifach Decl. Ex. 4 [DI 149-4] at ECF p. 10.

> receivables, accrued commissions, unrecognized amortization expense, unrealized loss on investments and proper year end cut-off related to premiums and claims."[89]
>
> (7) "Balance Sheet Items — The Company historically recorded certain receivables (premium and other) net of commissions and now records the receivables on a gross basis, with the associated commission payable in other accrued expenses and liabilities. In addition, the Company corrected a classification error involving short term investments and cash/cash equivalents, and fixed assets and other investments in the Consolidated Balance Sheets."[90]

The company identified also certain internal control deficiencies that "contributed to the restatement."[91] In a subsection of the explanatory note devoted to "Internal Control Considerations," the company stated the following:

> "As previously disclosed, in assessing the effectiveness of our internal control over financial reporting as of December 31, 2016, management identified certain material weaknesses. Specifically, management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2016 due to ineffective assessment of the risks of material misstatement in financial reporting and insufficient resources in our corporate accounting and corporate financial reporting groups. . . . As a result of these deficiencies, we now believe our

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[89] *Id.*
[90] *Id.*
[91] *Id.* at ECF p. 4.

> internal control over financial reporting was not effective as of December 31, 2015."[92]

The restatement resulted in "decreased service and fee income, increased acquisition costs and other underwriting expenses, and decreased interest expense, which ultimately resulted in decreases to net income."[93] Plaintiffs do not allege any decrease in AmTrust's share price as a result of the filing of the 10-K for the year ending December 31, 2016.

L. BDO'S ROLE

BDO issued unqualified audit opinions on AmTrust's financial statements and internal controls for each of the years ending December 31, 2012 through 2015.[94] BDO's audit opinion dated March 2, 2015 — reflecting BDO's conclusions from its audit of AmTrust's consolidated financial statements for the year ending December 31, 2014 — was included in the November 2015 Offering Materials.[95] Its audit opinion dated February 29, 2016 — reflecting BDO's conclusions from its audit of AmTrust's financial statements for the year ending December 31, 2015 — was included in the September 2016 Series F Offering Materials.[96] These opinions each represented that:

> "[BDO] conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a

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[92] *Id.*

[93] *Id.* at ECF p. 3.

[94] SAC [DI 140] ¶ 200.

[95] *Id.* ¶ 205.

[96] *Id.* ¶ 206.

test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedules. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AmTrust Financial Services, Inc. at December 31, [year audited] and [year prior to that], and the results of its operations and its cash flows for each of the three years in the period ended December 31, [year audited], in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), AmTrust Financial Services, Inc.'s internal control over financial reporting as of December 31, [year audited], based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated [month, day, year] expressed an unqualified opinion thereon."[97]

With respect to BDO's audit of AmTrust's consolidated financial statements for the year ending December 31, 2013 and the audit of AmTrust subsidiaries' financial statements for the same year (the "2013 Consolidated Audit" and "2013 Subsidiary Audit," respectively), the Complaint alleges certain irregularities and misconduct.

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[97] *Id.* ¶ 205.

Richard J. Bertuglia of BDO was staffed as the engagement partner on that audit.[98] He was supported by John W. Green, who served as the engagement quality review partner, and Lev Nagdimov, who served as a senior manager.[99] Bertuglia's responsibilities included supervising the work of the audit team and ensuring that the audit complied with Public Company Accounting Oversight Board standards.[100] Green was responsible for reviewing the bases for the overall conclusion of the audit and preparing the engagement report "to determine whether to provide concurring approval of issuance."[101]

In December 2013, the audit team informed Bertuglia and Nagdimov that the audit was approximately 14 weeks behind schedule.[102] In consequence, Bertuglia instructed the team to focus on the 2013 Consolidated Audit and delay work on the 2013 Subsidiary Audit.[103] The team did as instructed.[104] In doing so, they "departed from their original audit plan" and did not document the change.[105]

On February 21, 2014 — one week before the February 28, 2014[106] audit deadline — Bertuglia met with the audit team and told them to finish incomplete work in three specific areas: journal entry testing, internal controls testing, and material account balances.[107] A few days later, Nagdimov told the team to load and sign all work papers in BDO's electronic system, including blank work papers — or placeholders — so that the signatures would bear an

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[98] *Id.* ¶ 552.
[99] *Id.*
[100] *Id.* ¶ 553.
[101] SAC [DI 1401 ¶ 554.
[102] *Id.* ¶ 556.
[103] *Id.* ¶558.
[104] *Id.* ¶ 559.
[105] *Id.*
[106] *Id.* ¶ 558.
[107] SAC [DI 140] ¶ 561.

electronic time stamp that pre-dated the deadline.[108] The team members did as they were told.[109]

On February 28, 2014, the audit deadline, Bertuglia and Green discovered incomplete work papers while reviewing the audit work.[110] Nagdimov told them that the papers were complete but had not been loaded into the system yet due to technical issues.[111] Bertuglia then authorized the release of an unqualified audit opinion on AmTrust's 2013 consolidated financial statements and internal controls.[112]

Afterward, Bertuglia and Green learned that AmTrust would not file its Form 10-K until March 3, 2014, thereby extending the audit deadline from February 28 to March 3. Bertuglia and Green spent that time signing 2,000 work papers, a number of which they did not review.[113] Bertuglia then "redated BDO's audit report to March 3, 2014.[114] Neither he nor Green checked whether the incomplete work papers they had discovered on February 28 in fact had been completed.[115]

On March 7, 2014, Bertuglia learned that the audit team did not finish work related to the 2013 Consolidated Audit, including testing certain journal entries, internal controls, and material accounts.[116] Bertuglia and Green decided that the team needed to finish the work and "assess their potential impact on BDO's audit report, as required by AU Section 390, Consideration of Omitted Procedures

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[108] *Id* ¶¶ 561-62.
[109] *Id.* ¶ 563.
[110] *Id.* ¶ 564.
[111] *Id.*
[112] *Id.* ¶ 566.
[113] SAC [DI 140] ¶ 567.
[114] *Id.*
[115] *Id.*
[116] *Id.* ¶ 568.

After the Report Date."[117] The team completed the work over the following month but did not amend the dates on those documents that had been loaded into the system prior to the deadline as placeholders or incomplete drafts.[118] When all the work was complete, Bertuglia reviewed it and determined that it did not affect BDO's unqualified audit opinion or require any action pursuant to AU Section 390.[119]

On April 11, 2017, the Wall Street Journal reported that the FBI and SEC had opened investigations into AmTrust's accounting practices based at least in part on information provided by a former BDO auditor who had come forward as a whistleblower.[120] The whistleblower had discussed the AmTrust audit with colleagues in 2014 and had been "directly assigned to AmTrust audits for at least three years."[121] According to the whistleblower, "BDO often was rushed during its audits, partly because AmTrust was late or inconsistent in providing figures, or lacked documentation."[122] And "[a]t least twice, BDO formally signed off on its AmTrust audit before completing some important checks."[123] BDO staff allegedly "covered for their lapse by loading unfinished documents into an internal software system to show the right time stamp, then returned later to complete some of the work."[124]

In October 2018, the SEC sanctioned Bertuglia, Green, and Nagdimov for their conduct in relation to the 2013 Consolidated Audit.[125]

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[117] *Id.* ¶ 570.
[118] *Id.* ¶571.
[119] SAC [DI 140] ¶ 573.
[120] *Id.* ¶ 218; Zweifach Decl. Ex. 25 [DI 149-25].
[121] Zweifach Decl. Ex. 25 [DI 149-25] at ECF pp. 2-3.
[122] *Id.* at ECF p. 6.
[123] *Id.*
[124] *Id.*
[125] SAC [DI 140] ¶¶ 576, 578-79.

III. PLAINTIFFS' CLAIMS

Plaintiffs assert claims under the Securities Act and the Exchange Act against AmTrust, the Officer Defendants, Director Defendants, the Underwriter Defendants, and defendant BDO. Their claims focus on accounting issues and material weaknesses that AmTrust identified in 2016 and 2017, and corrected in the restatement. As against AmTrust, the Officer Defendants, and BDO, plaintiffs assert theories of both negligence and fraud.

Defendants moved to dismiss the claims. For the reasons set forth below, defendants' motions are granted.

DISCUSSION

I. MOTION TO DISMISS STANDARD

To survive a motion to dismiss, a plaintiff must allege sufficient facts to "state a claim to relief that is plausible on its face."[126] The Court accepts as true all well-pleaded factual allegations and "draw[s] all reasonable inferences in the plaintiffs' favor."[127] The Court, however, is not obliged to accept as true legal conclusions.[128] And "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, [will] not suffice" to defeat a motion to dismiss.[129] In deciding a motion to dismiss, the Court considers the complaint, "any written instrument attached to the complaint, statements or documents incorporated into the complaint by reference, legally required public disclosure documents filed with the SEC, and documents possessed by or known to the plaintiff and upon which it relied in bringing the suit."[130]

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[126] *Ashcroft v. lqbal,* 556 U.S. 662, 678 (2009) (internal quotations and citations omitted).

[127] *Rombach v. Chang,* 355 F.3d 164, 169 (2d Cir. 2004).

[128] *Harris v. Mills,* 572 F.3d 66, 72 (2d Cir. 2009).

[129] *Id.* (quoting *Iqbal,* 556 U.S. at 678).

[130] *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,* 493 F.3d 87, 98 (2d Cir. 2007).

A complaint that pleads fraud under the securities laws must satisfy additional, heightened pleading requirements. These are the requirements of Rule 9(b) and the PSLRA.[131] Rule 9(b) requires a plaintiff to plead "with particularity the circumstances constituting fraud."[132] To do so, the complaint must: "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." [133] The PSLRA requires the complaint to "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."[134]

II. THE AMTRUST DEFENDANTS

Plaintiffs assert claims against the AmTrust defendants under Sections 11, 12(a)(2), and 15 of the Securities Act, and Sections 10(b) and 20(a) of the Exchange Act. The Court begins with plaintiffs' Securities Act claims.

A. SECURITIES ACT CLAIMS

Sections 11 and 12(a)(2) of the Securities Act impose liability on issuers and other signatories of a registration statement or prospectus that contains "materially misleading statements or omissions."[135] Section 15 imposes

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[131] *Id.* at 99.
[132] FED. R. CIV. P. 9(b).
[133] *ATSI,* 493 F.3d at 99 (citing *Novak v. Kasaks,* 216 F.3d 300, 306 (2d Cir. 2000)).
[134] 15 U.S.C. § 78u-4(b)(1).
[135] *In re Morgan Stanley Info. Fund Sec. Litig.,* 592 F.3d 347, 358 (2d Cir. 2010); *see also* 15 U.S.C. § 771(a)(2).

liability on any person who controlled an individual liable under Sections 11 or 12(a)(2).[136]

To state a claim under Sections 11 and 12(a)(2), the plaintiff must allege that the registration statement or prospectus contained: "(1) a material misrepresentation; (2) a material omission in contravention of an affirmative legal disclosure obligation; or (3) a material omission of information that is necessary to prevent existing disclosures from being misleading." [137] If a plaintiff establishes one of these three things, then "the general rule is that an issuer's liability is absolute."[138] This general rule is subject to exception, of course.

The exception applies when the Section 11 and 12(a)(2) claims are "premised on allegations of fraud."[139] In these circumstances, a plaintiff must meet the additional pleading requirements of Rule 9(b). This is so because Rule 9(b) "applies to all averments of fraud."[140] And even though fraud is "not an element or a requisite to a claim under Section 11 or Section 12(a)(2) . . . claims under those sections may be — and often are — predicated on fraud."[141] Accordingly, when the same course of conduct supports both a claim of fraud under the Exchange Act and a claim under Section 11 or 12(a)(2) of the Securities Act, the latter claim must satisfy the requirements of Rule 9(b) unless the complaint identifies clearly an alternate basis, i.e., negligence, for the claim. [142] Mere disavowal of any

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[136] 15 U.S.C. § 77o. A controlling person, however, will not be held liable if he or she had "no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." *Id.*

[137] *Litwin v. Blackstone Group, L.P.*, 634 F.3d 706, 715-16 (2d Cir. 2011).

[138] *Id.* at 716 (internal quotations, alterations, and citation omitted).

[139] *Rombach,* 355 F .3 d at 171.

[140] *Id.* (internal quotations omitted).

[141] *Id.*

[142] *Id.* at 171-172.

allegations that would make Rule 9(b) applicable will not suffice.[143]

Plaintiffs assert that the AmTrust defendants violated Sections 11 and 12(a)(2) by offering and selling securities pursuant to a registration statement and prospectuses that included untrue statements of material fact and omitted to state material facts necessary to prevent existing disclosures from being misleading.[144] The alleged untrue or misleading statements of material fact are the following:

(1) Representations that the company "defers a portion of service revenue based upon an estimate of administrative services to be provided in future periods;"[145]

(2) Numbers and certain results, e.g., net income, in the company's consolidated financial statements;

(3) Representations that the consolidated financial statements were prepared in conformity with GAAP;

(4) Signed certifications required under the Sarbanes-Oxley Act ("SOX certifications") attesting to the accuracy of the financial statements; and

(5) Representations that disclosure and internal controls were effective, and SOX certifications attesting that the Officer Defendants disclosed deficiencies and material weaknesses in internal controls.

On this motion, the Court looks first to whether plaintiffs plead adequately an untrue or misleading statement and second to the materiality of the alleged misleading statement.

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[143] *Id.* at 172 (citing *In re Ultrafent Inc. Sec. Litig.,* 91 F. Supp. 2d 678, 690-91 (S.D.N.Y. 2000)).

[144] Plaintiffs allege specifically that these misstatements were located in AmTrust's 2014 Form 10-K, 2015 Form 10-K, and Forms 10-Q for each of the first three quarters of 2015 and the first two quarters of 2016. SAC [DI 140] ¶¶ 154-198.

[145] *Id.* ¶ 163.

1. Alleged Untrue or Misleading Statements

Much of the Court's analysis hinges on whether the alleged untrue or misleading statements are statements of fact or opinion. A plaintiff who challenges a statement of fact under the Securities Act must allege adequately that the fact was untrue at the time the statement was made or that it omitted to state a material fact necessary to make the statement made not misleading.[146] A plaintiff challenging a statement of opinion has a harder task. That plaintiff must do more than simply plead that the opinion was wrong. The plaintiff must plead facts that, if true, would be sufficient to show that: (1) the speaker did not actually hold the stated belief at the time the statement was made,[147] or (2) the opinion did not rest on some meaningful inquiry, or standard process followed to reach such an opinion, thereby rendering it misleading to a reasonable person reading the statement fairly and in context.[148]

Plaintiffs, perhaps unsurprisingly, argue that the alleged untrue or misleading statements are statements of fact. Defendants disagree. If this were a case in which the alleged misstatements contained frequent trappings of opinion statements — qualifiers such as "I believe" or "I think" — then it would be an easy one. But it is not. Nearly all of the alleged misstatements concern at bottom financial data presented in the company's consolidated financial statements and the accounting principles applied to produce or arrive at that data.

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[146] 15 U.S.C. § 77k(a).

[147] *City of Westland Police and Fire Ret, Sys. v. Metlife, Inc.,* 129 F. Stipp. 3d 48, 72 (S.D.N.Y. 2015).

[148] *Id.* at 71-72 (providing the example of a real estate appraiser's assessment of the value of property as an opinion or belief that could be misleading — and therefore a misstatement within the meaning of the Securities Act — if the appraiser failed to apply accepted principles of real estate valuation in reaching his or her opinion).

It is important to underscore at the outset that this financial data — e.g., reported income — allegedly was false or misleading because of the accounting treatment applied to certain underlying metrics. It is the accounting treatment that plaintiffs contend was erroneous and thus resulted in a false or misleading number — reported income — on the financial statements.

Deciding which is the proper accounting treatment for a certain metric or transaction requires one to consult a governing set of accounting principles. These principles are referred to as GAAP, or Generally Accepted Accounting Principles ("GAAP"). They are used to report companies' financial results, including financial data such as net income.[149] The SEC has the authority to establish GAAP but historically has delegated the task to a private professional association, the American Institute of Certified Public Accountants, and two successor groups. The present group is called the Financial Accounting Standards Board ("FASB"). It issues a codification of GAAP called the Accounting Standards Codification ("ASC"), which is organized into approximately 90 accounting topics. FASB's ASC is authoritative for purposes of the federal securities laws.[150]

A financial datum in a company's financial statements — for example, a reported dollar figure with an associated description or characterization — may be a pure statement of an objective historical fact or it may reflect a result

[149] Generally Accepted Accounting Principles, Glossary, INVESTOR.GOV, U.S. SECURITIES AND EXCHANGE COMMISSION, (https://www.investor.gov/additional-resources/general-resources/glossary/generally-accepted-accounting-principles-gaap) (last visited Aug. 7, 2019).

[150] Financial Accounting Standards Board, Glossary, INVESTOR.GOV, U.S. SECURITIES AND EXCHANGE COMMISSION, (https://www.investor.gov/additional-resources/general-resources/glossary/financial-accounting-standards-board-fasb) (last visited Aug. 7, 2019).

achieved by applying judgments to objective historical facts, in which case it is or reflects an opinion. Which is the case can depend upon on a number of different factors. The Court will address these factors in greater depth, in the specific context of this case, in a moment. But for now, suffice it to say that the Court's first task with respect to each alleged untrue or misleading statement is to determine whether it is one of fact or opinion. Based on that determination, the Court proceeds to its second task: determining whether plaintiffs plead adequately the falsity of the challenged statements under the appropriate standard concerning either statements of fact or opinion. Where relevant, the Court addresses too the question of materiality

a. Representations Regarding Service Revenue

The first statement that plaintiffs allege was untrue or misleading is one that appears in AmTrust's 2014 and 2015 Forms 10-K and concerns AmTrust's accounting for warranty fee revenue. It is the following:

> "The Company recognizes revenue related to promotion, marketing and administration services at the time of the sale of ESP [extended service plan]. However, the Company defers a portion of service revenue based upon an estimate of administrative services to be provided in future periods."[151]

Plaintiffs argue, and the Court agrees, that it is a statement of fact. It is not one of the more complicated alleged misstatements based on financial data and the underlying inputs that the Court addresses in a moment. It is a straightforward statement of fact. At the time the statement was made, the company either recognized revenue at the time of sale or it did not. It either deferred a portion of service revenue or it did not. If it deferred some

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[151] SAC [DI 140] ¶¶ 162, 187.

service revenue, it either did so based on an estimate of future administration services or it did not. The practice in place at the time the statement was made was "determinate" and "verifiable."[152]

Plaintiffs allege falsity on the grounds that the statement omitted certain facts necessary to make the statement made not misleading. Specifically, AmTrust allegedly failed to disclose that the company "recognized the majority of revenue related to administration services at the time of the sale of the ESP."[153] Plaintiffs argue that a reasonable investor reading the statement actually made would have concluded the exact opposite. This is so, plaintiffs contend, because the statement explained that the company deferred service revenue to be provided in future periods and "warranty services are, by definition, to be provided in the future."[154] A reasonable investor therefore would conclude that the company *deferred* the majority of revenue related to warranty contracts, or ESPs.[155]

The argument assumes that: (1) revenue related to administrative service provided in the future exceeds revenue related to promotion, marketing, and other administrative service, and (2) the reasonable investor would have known this. Plaintiffs fail to plead any facts in support of these assumptions, and without any support for

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[152] *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund,* 135 S. Ct. 1318, 1326 (2015).

[153] SAC [DI 140] ¶ 112.

[154] Pls. Br. [DI 153] at 26 (stating that a reasonable investor would come to the conclusion that "because the Company defers warranty revenue relating to services to be provided in future periods, and because warranty services are, by definition to be provided in the future, the Company recognizes very little revenue up front and defers the majority").

[155] *Id.*

these necessary assumptions, plaintiffs are left to argue semantics.

Any argument plaintiffs could make based on defendants' language would fail because defendants' use of the term "portion" was accurate and not misleading. Portion is defined variously as: "a part of any whole; a section, a division; a portion, a fraction;"[156] an "allotment, allowance, bite, cut, lot, part, partage, quota, slice;"[157] "a section or quantity within a larger thing; a part of a whole;"[158] and "an often limited part of a whole."[159] These definitions do not connote a "majority." If anything, they connote a minority, as indicated by the last definition cited.

Separately, defendants were under no duty to quantify the size of the minority of service revenue deferred.[160] They were under a duty only to speak accurately,[161] which they did. As a result, their use of the term "portion" — instead of a more descriptive term — is not actionable. Plaintiffs thus cannot state a claim based on this statement.

b. Numbers and Results in the Consolidated Financial Statements

The second statement — or set of statements — that plaintiffs allege were untrue are numbers in AmTrust's consolidated financial statements for the years ending December 31, 2014 and 2015. These numbers, which the

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156 *Portion, n., Definition,* Oxford English Dictionary, https://www.oed.com/view/Entry/148189?rskey=c1ksEZ&result=1#eid (last visited Sept. 5, 2019).

157 WEBSTER'S COLLEGIATE THESAURUS (1976).

158 THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (4th ed. 2000).

159 *Portion, n.,* MERRIAM-WEBSTER DICTIONARY, https://www.merriam-webster.com/dictionary/portion (last visited Sept. 5, 2019).

160 *See In re Bristol Myers Squibb Co. Sec. Litig.,* 586 F. Supp. 2d 148, 159-60 (quoting *Caiola v. Citibank, N.A.,* 295 F.3d 312, 331 (2d Cir. 2002)).

161 *Id.*

Court may refer to alternatively as financial data, are various types of reported income, including service and fee income, net income, net income attributable to AmTrust common stockholders, diluted earnings per share, and other measures of income.[162] The allegations concerning these types of reported income are based on AmTrust's decision to restate its consolidated financial statements for a number of years including 2014 and 2015. AmTrust made the decision after it identified accounting issues in seven different areas, at least two of which affected the reported income.

The parties disagree over whether these reported income numbers are statements of fact or opinion. If the numbers underlying that data consist only of figures that were then presently known, fixed, or definite — e.g., the price of widgets and number of widgets sold in a previous month — then any resulting data would be a statement of fact.[163] Likewise, if the relevant provision of GAAP or ASC topic applied to produce the data called only for the application of or evaluation under objective criteria, then the resulting data would be a statement of fact.[164] If, however, the relevant accounting guidance called for the exercise of judgment, then the resulting data would be a statement of opinion.[165] And, if determining the relevant

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[162] *See* SAC [DI 140] ¶¶ 156-57.

[163] *See Fait v. Regions Fin. Corp.,* 655 F.3d 105, 110-11 (2d Cir. 2011).

[164] *See id.*

[165] *See id.; Fresno Cnty. Employees' Ret. Ass'n v. comScore, Inc.,* 268 F. Supp. 3d 526, 546 (S.D.N.Y. 2017); *In re Sanofi Sec. Litig.,* 87 F. Supp. 3d 510, 531 (S.D.N.Y. 2015), *aff'd sub nom. Tongue v. Sanofi,* 816 F.3d 199 (2d Cir. 2016); *City of Westland,* 129 F. Supp. 3d at 68 ("While these estimates involve some factual inputs, they necessarily require judgment and thus are statements of opinion or belief, not of fact." (internal quotation marks omitted)); *In re Bank of Am. Corp. Sec., Derivative, & Employee Ret. Income Sec. Act (ERISA) Litig.,* 09-md-2058 (PKC), 2013 WL 6504801, at *15 (S.D.N.Y. Dec. 11, 2013)

provision of GAAP to apply in a certain area of accounting or with respect to a certain transaction involved a subjective evaluation, then any data resulting from that application of GAAP would be a statement of opinion.

Plaintiffs argue that the financial data— or reported income numbers are statements of fact because the data are "historical income metrics" that do not involve any "inherently subjective valuations." [166] They reject the proposition that *any* application of GAAP converts a financial metric into a statement of opinion.[167] And they argue that AmTrust's use of the word "error" to describe the accounting issues it identified demonstrates conclusively that any application of GAAP that resulted in said "errors" could have involved only the application of objective criteria and not a subjective evaluation or matter of judgment.[168] How else, plaintiffs argue, could AmTrust have determined that the accounting issues identified in fact were "errors" rather than "difference[s] of opinion between [BDO and KPMG]"?[169]

Defendants respond that their motion is not based on the contention that *any* application of GAAP — and therefore every financial metric in a company's consolidated financial statements — results in a statement of opinion. Rather, the specific provisions of GAAP relevant to the particular accounting issues that AmTrust identified call for subjective judgments.[170] Defendants point out that

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("[P]laintiffs have cited broad generalities that reflect [defendant's] subjective opinions, and not representations of fact.").

[166] Pls. Br. [DI 153] at 21-22 (stating that "this case is not about complex accounting judgments over which reasonable minds can differ" (internal quotations and citation omitted)).

[167] *Id.* at 21.

[168] *Id.* at 22.

[169] *Id.*

[170] Defs. Reply Br. [DI 156] at 1-2.

plaintiffs fail to refute this point.[171] They argue also that plaintiffs' focus on the historical nature of income metrics is misplaced. There is no bright-line rule distinguishing historical income metrics from estimates of future performance. And the term "historical," as plaintiffs use it, is misleading. The metrics are not akin to those in the widgets example above. Instead, they involve inputs that reflect "subjective judgments," rather than those that are "objectively determinable."[172] Finally, defendants explain that AmTrust's use of the word "error" to describe the accounting issues identified and "corrected" by the restatement has no bearing on whether the financial data upon which plaintiffs base their claims were factual statements or statements of opinion.[173] When the "errors" resulted from "management's interpretation of accounting guidance," as defendants assert happened here, they are errors of opinion, not of fact.[174]

Whether the alleged misstatements are statements of fact or opinion depends on the facts and circumstances of the seven accounting issues identified by AmTrust and addressed in its restatement. The Court thus takes each issue in turn. It addresses first whether the data resulting from the particular accounting treatment at issue is as a statement of fact or opinion. It turns then to the question

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Here, defendants' argument concerns only two of the accounting issues identified by defendants and that, according to defendants, drove the restatement. Defendants contend that the remaining accounting issues and the alleged misstatements based on those issues are immaterial.

[171] *Id.*

[172] *Id.* at 2.

[173] *Id.* at 2 n.1 ("[I]t goes without saying that one can hold an erroneous or incorrect opinion. In other words, the mere existence of the Restatement, and AmTrust's reference to 'errors' does not support Plaintiffs' argument that the misstatements were *factual.*" (emphasis in original)).

[174] *Id.*

of whether plaintiffs plead adequately that the data was untrue.

1. Recognition of Warranty Contract Revenue

The first accounting issue that AmTrust identified, and upon which plaintiffs rely, concerns revenue recognition for warranty contract revenue associated with administration services. During the 2014, 2015, and part of the 2016 fiscal years, AmTrust recognized part of administration services revenue at the time of sale. It did so based on its interpretation of ASC Topic 605 titled Revenue Recognition — specifically, the section that addressed multiple-element revenue recognition.[175]

In its press release issued March 16, 2017, AmTrust announced that its practice of recognizing part of the service revenue upfront was in error. The company explained that it henceforth would recognize revenue related to administration services on a straight-line basis over the life of the contracts.[176] AmTrust stated that this change resulted from its "revised application of the revenue recognition guidance."[177]

Plaintiffs claim that the financial data resulting from AmTrust's revenue recognition practice prior to this switch constituted a misstatement of fact. To do so adequately, plaintiffs must put forward sufficient facts to permit a determination that the particular financial data they challenge indeed is *a statement of fact.* This is so because if they have not alleged facts sufficient to support a finding that the data could have resulted properly only from objective determinations, then they have not alleged sufficiently that the data was factually false. A particular datum — e.g., a particular reported dollar figure on a financial statement — is not necessarily false if the

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[175] *See* SAC [DI 140] ¶ 87.
[176] *Id.* 112.
[177] *Id.*

reported result could have been reached by an appropriate method given appropriate historical data and judgments.[178] In this manner, the characterization of the statement as one of fact or opinion and the sufficiency of the pleadings with respect to falsity go hand in hand.

Thus, to establish that reported revenue and income figures resulting from AmTrust's revenue recognition practice prior to the switch, for example, constituted *mis*statements of fact, plaintiffs must plead first that an ASC topic or section of a particular topic objectively was the *only* correct guidance to apply. Second, they must plead that defendants did not apply that guidance and did not disclose either the particular guidance that they were applying, or that they had chosen not to apply the section that a reasonable investor would assume applied to the transactions. Only by doing both of these things could plaintiffs plead successfully that the alleged misstatements resulting from the accounting treatment of warranty contract revenue were statements of fact and that they were untrue when made.

The allegations in the Complaint with respect to the relevant ASC topic are limited to the following statement:

> "since sellers of extended warranty or product maintenance contracts (a/k/a extended service plans, or ESPs) have an obligation to the buyer to perform services throughout the contract period, revenue associated therewith is to be recognized over the period in which the seller is obligated to perform services pursuant thereto."[179]

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[178] *See Fait,* 655 F.3d at 110-11.
[179] SAC [DI 140] ¶ 111.

This is a summary of the section of ASC Topic 605 related to services.[180] Based only on this short summary of revenue recognition guidance, and AmTrust's announcement in 2017 that it would change its practice, plaintiffs allege that financial data in the 2014 and 2015 consolidated financial statements were false due to improper reporting of revenue "in violation of GAAP."

These allegations are wholly insufficient. They ignore an exception in the services section of ASC Topic 605 that allows recognition of revenue on other than a straight line basis.[181] And they fail to address the multiple-element section or the interaction between that section and the services section of ASC Topic 605. Absent facts alleging why the services section controls to the exclusion of any other section,[182] and the reason or reasons why the

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[180] Accounting Standards Codification Topic [hereinafter "ASC"] 605-20-25, FINANCIAL ACCOUNTING STANDARDS BOARD. The section states in relevant part:

"Sellers of extended warranty or product maintenance contracts have an obligation to the buyer to perform services throughout the period of the contract and, therefore, revenue shall be recognized in income over the period in which the seller is obligated to perform. That is, revenue from separately priced extended warranty and product maintenance contracts shall be deferred and recognized in income on a straight-line basis over the contract period except in those circumstances in which sufficient historical evidence indicates that the costs of performing services under the contract are incurred on other than a straight-line basis. 14 those circumstances, revenue shall be recognized over the contract period in proportion to the costs expected to be incurred in performing services under the contract." *Id.*

[181] *Id.* (stating that "revenue from separately priced extended warranty and product maintenance contracts shall be deferred and recognized in income on a straight-Iine basis over the contract period *except in those circumstances in which sufficient historical evidence indicates that the costs of performing services under the contract are incurred on other than a straight-line basis"* (emphasis added)).

[182] For example, the Court is troubled by the following:

exception within the services section did not apply, plaintiffs fail to plead the existence of a factual statement and one that objectively was untrue at the time it was made.

Plaintiffs' failure to allege adequately a false statement of fact, however, does not end the inquiry. The claim will survive the motion if plaintiffs have alleged adequately that the statement was an untrue or misleading statement of opinion. In determining whether plaintiffs have done so, the Court considers all the allegations in the Complaint, including those forming the basis of plaintiffs' securities fraud claims, for two reasons. First, as courts in this district have noted, establishing the misrepresentation element with respect to a statement of opinion essentially establishes the *scienter* element of a fraud claim, and *vice*

The services section of ASC Topic 605 applies to "separately priced extended warranty and product maintenance contracts." ASC 605-20-15. The multiple-element section of ASC Topic 605 applies to "[a]ll deliverables (that is, products, services, or rights to use assets) within contractually binding arrangements (whether written, oral, or implied, and hereinafter referred to as arrangements) in all industries under which a vendor will perform multiple revenue-generating activities." ASC 605-25-15. With respect to the multiple-element section's interaction with other sections within ASC Topic 605 or in different ASC topics, it states: "A multiple-deliverable arrangement *nay* be within the scope of another Codification Topic [including the following]: . . . For revenue recognition, see Topic 605; specifically, Subtopic[] 605-20 [Services]." *Id.* Whether such other Topics apply "is determined by the scope provisions of those Topics." *Id.*

The multiple-element section thus leads right back around to the services section. And in the circumstances, the Court cannot conclude that the services section governed this area of revenue recognition, and objectively so. The Court is unable to do so because the company's descriptions of and disclosures related to its warranty contracts, or ESP, do not reveal whether the contracts included only "separately priced" contracts. In addition, plaintiffs do not plead any facts alleging that the contracts at issue included only separately priced contracts.

versa.[183] Second, allegations of misstatements of opinion are based on knowing (or possibly reckless) conduct, and therefore likely involve the same conduct that underlie claims of fraud. Accordingly, the requirements of Rule 9(b) likely apply, and the Court looks to the allegations that would satisfy the requirements of that rule.

The allegations in the Complaint relevant to whether the financial data was an untrue or misleading statement of opinion focus on Warrantech's historical accounting for warranty contracts and the accounting change that it implemented based on guidance provided by the SEC in 2004. Plaintiffs claim that defendants would have been aware of the so-called SEC-mandated change. Their position, as the Court understands it, is that defendants' decision to recognize revenue in the manner they did either purposefully disregarded the SEC guidance in order to report results that would appear stronger or recklessly disregarded it as a factor in the decision-making process,

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183 *See In re DRDGOLD Ltd. Sec. Litig.,* 472 F. Supp. 2d 562, 569 (S.D.N.Y. 2007) (quoting *Podany v. Robertson Stephens, Inc.,* 318 F. Supp. 2d 146, 154 (S.D.N.Y. 2004)).

The equivalence between falsity of an opinion and *scienter,* however, is not perfect. Establishing *scienter* invariably will establish the falsity of an opinion but the reverse is not always true. To plead falsity of an opinion, a plaintiff must plead only that it is plausible that the defendant did not actually hold the opinion at the time it was expressed. A plaintiff alleging *scienter* must do more. The plaintiff must demonstrate that the inference of *scienter* is "cogent and at least as compelling as any opposing inference." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 324 (2007). Additionally, where *scienter* is shown by alleging facts that constitute circumstantial evidence of intentional misbehavior or recklessness, the showing must be "correspondingly greater." *Kalnit v. Eichler,* 264 F.3 d 131, 142 (2d Cir. 2001). The facts, if true, must demonstrate either deliberate illegal behavior or "conscious recklessness — i.e., a state of mind approximating actual intent, and not merely a heightened form of negligence." *Novak,* 216 F.3d at 312 (2d Cir. 2000) (internal quotations and citation omitted).

thereby rendering their inquiry not a meaningful one. The facts alleged, however, do not support either theory. Moreover, they ignore or fail to allege facts concerning crucial matters including the ways in which the business had or had not changed and any changes to authoritative accounting guidance in the interim. Absent any allegations related to these factors, the Complaint's reliance on events from nearly a decade prior to establish wrongdoing (here, the falsity of an opinion) is insufficient to render it plausible that defendants either did not believe that the multiple-element section was the correct one to apply at the time or failed to conduct a meaningful inquiry before choosing to apply that topic.

Plaintiffs' second argument focuses on the size and importance of the warranty contract revenue to the Company. It too is unavailing. Plaintiffs argue that defendants must have known — or else buried their heads in the sand — about the "impropriety of AmTrust's accounting for service and fee income" due to the "financial significance" of the extended warranty business and amount of revenue it generated.[184] Defendants very well could have paid closer attention to the accounting for revenue generated by this business line, but plaintiffs fail to allege that in doing so, they purposefully chose an incorrect accounting method or failed to conduct a meaningful inquiry into the correct method to use.

Thus, plaintiffs fail to allege adequately that the financial data based on the accounting for warranty contract revenue were misstatements of opinion.

2. Bonus Accrual

The second accounting issue that AmTrust identified and that forms a basis of plaintiffs' claims regarding reported income concerns discretionary bonuses. During the years 2014, 2015, and the first three quarters of 2016,

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[184] SAC [DI 140] ¶¶ 289-91.

AmTrust expensed discretionary bonuses in the year in which they were paid. [185] It is unclear whether this accounting treatment was based on ASC Topic 710 titled Compensation, ASC Topic 450 titled Contingencies, or a combined reading of the two. [186] But when AmTrust disclosed that it would change its treatment of discretionary bonuses, it made clear that the change was based on management's "review of ASC 270, *Interim Reporting*, and ASC 450, *Contingencies."*[187] Following that review, management determined that the prior treatment had been "incorrect because, even though the bonuses were discretionary, the bonuses should have been estimated and expenses assigned to interim periods so that the interim periods bear a reasonable portion of the anticipated annual amount." [188] In essence, AmTrust management had determined that ASC Topic 270 should control.[189]

As with the first accounting issue, to allege sufficiently that any financial data resulting from defendants' accounting treatment of discretionary bonuses prior to the change in treatment constituted a misstatement of fact, plaintiffs must plead that an ASC topic objectively was the correct one to apply. If plaintiffs cannot overcome this hurdle, then they cannot plead falsity of a *fact* based on this area of accounting and the Court will proceed to analyze the claim as one asserting an alleged misstatement of opinion.

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[185] *Id.* ¶ 87.
[186] Defendants note in the March 16, 2017 press release that the accounting treatment considered also to some extent ASC Topic 270 titled Interim Reporting. *Id.* ¶ 87.
[187] *Id.* ¶114.
[188] *Id.*
[189] ASC Topic 270 states that costs and expenses unrelated to revenue are charged against income in interim fiscal periods as incurred based on an estimate of the expenditure to be made at a later date. ASC 270-45-4, 270.45-7.

The Complaint makes no mention of the interaction between ASC Topics 450, 710, and 270, or the application of one over the others with respect to the accounting treatment for discretionary bonuses. The allegations simply cite Topic 450 and the principle that companies generally are required to record expenses in the period in which they are incurred.[190] Plaintiffs therefore do not allege that Topic 450 — or any other objectively was the correct one to apply to the discretionary bonuses.[191] As a result, they fail to allege adequately that any financial data based on this accounting treatment was a misstatement of fact. The Court considers next whether they plead adequately a misstatement of opinion.

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[190] *See* SAC [DI 140] ¶¶ 113-14.

[191] The Court notes but does not decide that the decision of which topic to apply appears to involve a judgment call.

ASC Topic 270 directs companies to make charges to income in each interim period for all costs and expenses unrelated to revenue including: (1) direct expenditures made in the period, e.g., salaries and wages, and (2) accruals for estimated expenditures to be made at a later date, e.g., vacation pay. ASC 270-45-7. The objective of this guidance is "to achieve a fair measure of results of operations for the annual period and to present fairly the financial position at the end of the annual period.

ASC Topic 405, applicable to contingencies, defines a loss contingency as an "existing condition, situation, or set of circumstances involving uncertainty as to a [possible loss] to an entity that will ultimately be resolved when one or more future events occur or fail to occur." ASC 450-20.20. But that topic makes plain that it does not apply to "employment-related costs," which are covered elsewhere, including in ASC Topic 710. ASC 450-20-15.

ASC Topic 710 applies to deferred compensation but it does not explicitly include or exclude discretionary bonuses. It contains a cross reference to the guidance for interim periods but does so in the context of "compensated absences." ASC 710-10-15.

Thus, unless there are objective criteria to determine whether discretionary bonuses are more akin to "vacation pay" or "deferred compensation," and the Court at present is not aware of any, discretionary bonuses do not fit unambiguously under a single topic.

Plaintiffs' allegations related to falsity are based on a report published by GeoInvesting in December 2013, two articles published in Barron's in 2014 and a third published in 2016, and a public letter from Alistair Capital to AmTrust's audit committee in December 2014. The publicity and letter called into question certain of AmTrust's accounting. Plaintiffs' theory is that these published materials put defendants on notice of accounting issues. Defendants, plaintiffs contend, must either subjectively have disbelieved that the accounting for discretionary bonuses was correct at the time AmTrust reported income based in part on that accounting treatment, or recklessly have disregarded the possibility that the accounting treatment was wrong.

There is a gaping hole in plaintiffs' theory. The published materials do not question or draw attention to AmTrust's accounting for discretionary bonuses.

The GeoInvesting report "raised questions about AmTrust's rapid growth and accounting practices" and specifically AmTrust's accounting for intercompany transactions.[192] The report posited that AmTrust could have been boosting earnings by "understating losses on foreign subsidiaries in its consolidated financial statements by improperly accounting for intercompany transactions," including by ceding "$276.9 million in losses [] to Luxembourg subsidiaries."[193] Nothing in the report, however, raised questions related or connected to the accounting for discretionary bonuses such that defendants could have been put on notice of any improprieties.

The first Barron's article questioned AmTrust's "bookkeeping" with respect to foreign subsidiary losses and

[192] SAC [DI 140] ¶¶ 269-70.
[193] *Id.* ¶ 270.

deferred acquisition costs.[194] The second raised concerns regarding AmTrust's "insufficient loss reserves" and suggested that the insufficient reserves were connected to the company's accounting for intercompany transactions.[195] And the third addressed the adequacy of the company's reserves and accounting for intercompany transactions as well.[196]

The only thing mentioned in the Barron's articles that could be read as connected or related to the accounting for discretionary bonuses is the deferred acquisition costs. This is so because AmTrust disclosed that the accounting treatment of discretionary bonuses from 2014 through the third quarter of 2016 "created an error resulting in an overstatement of *acquisition costs."*[197] But there are no allegations that the deferred acquisition costs discussed in the Barron's article and those affected by AmTrust's accounting for discretionary bonuses are the same or even related in any way. And the Court determines from the text of the article that the two are distinct, unrelated issues.

The Alistair letter raised concerns over "numerous instances of improper accounting."[198] The letter groups the

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[194] *Id.* ¶¶ 273-74.

The article explained that:

"Insurers put a portion of their premium revenues into a balance sheet reserve called 'unearned premiums,' while deferring a matching portion of commissions and other premium-generating expenses into an asset called 'deferred policy acquisition costs' —amortizing each over the course of the coverage. The ratio of these line items should be more or less steady across time and comparable businesses . . .." Zweifach Decl. Ex. 21 [DI 149.21] at ECF p. 3.

According to one research firm, AmTrust may have been violating the matching principle and deferring costs more aggressively than revenues. *Id.*

[195] SAC [DI 140] ¶¶ 280-81.

[196] *Id.* ¶ 303.

[197] *Id.* ¶ 114.

[198] Zweifach Decl. Ex. 24 [DI 149-24] at ECF p. 2.

"instances of improper accounting" into five areas: (1) accounting for deferred acquisition costs, (2) valuation of life settlement contracts, (3) reinsurance assets related to Maiden Holdings, Ltd., (4) consolidation of Luxembourg reinsurance captives, and (5) accounting for loss and loss adjustment expense reserves assumed in acquisitions.[199] In the letter, Alistair Capital raised an additional concern related to accrued expenses. It raised this concern in the context of the adequacy of the controls over financial reporting, explaining that AmTrust's "Accrued Expenses and Other Liabilities" balance increased "by more than one would expect" and that this could imply that AmTrust was "failing to recognize expenses, and thus overstating net income."[200]

The first important point to make with respect to the Alistair letter is that the deferred acquisition costs mentioned in it are the same as those mentioned in the Barron's article.[201] The reference to them thus could not have put defendants on notice of any accounting improprieties with respect to the discretionary bonuses.

The second point is that while the "accrued expenses" mentioned in the letter could relate to accounting for discretionary bonuses, there is no indication that was the case here. The Alistair letter was concerned with amounts on AmTrust's financial statements that "appear[ed] to be irreconcilable with one another."[202] In this context, Alistair Capital suggested that "[s]uch discrepancies *could imply* that AmTrust is failing to recognize expenses."[203] This was nothing more than speculation disconnected from any concrete suggestion of any existing issue regarding the

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[199] *Id.* at ECF p. 3. In addition, the letter raised concerns over material weakness in internal controls over financial reporting. *Id.*

[200] *Id.* at ECF p. 6.

[201] *See id.* at ECF p. 8.

[202] *Id.* at ECF p. 6.

[203] *Id.* (emphasis added).

recognition of certain expenses. Contrary to plaintiffs' assertion, it would not have put defendants on notice that their accounting for discretionary bonuses was wrong or required investigation.

Plaintiffs therefore fail to plead falsity with respect to the financial data based on AmTrust's accounting for discretionary bonuses.

3. Remaining Accounting Issues Identified by AmTrust

In addition to the two accounting issues addressed above, AmTrust noted in its March 16, 2017 press release that:

> "The Company will also make other miscellaneous adjustments that had been previously identified but not corrected because they were not material, individually or in the aggregate, to its previously issued consolidated financial statements. In addition, the Company expects to have certain other non-cash corrections related to deferred acquisitions costs and the capitalization of software development costs in 2016."[204]

The Court addresses first the "corrections" related to the deferred acquisition and software development costs before turning to the other miscellaneous adjustments.

i. Deferred Acquisition Costs

AmTrust identified four specific concerns related to deferred acquisition costs:

> "(a) the over-amortization of certain deferred acquisition costs in 2015, resulting in an overstatement of expenses in 2015, (b) the capitalization of certain salaries and consulting fees that were not eligible for deferral, resulting in an understatement of expenses, (c) the treatment

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[204] SAC [DI 140] ¶ 87.

> of certain costs in the Company's U.K. operations as both underwriting expenses and salary and benefit expenses, resulting in the duplication of the amount capitalized and deferred, and (d) the inclusion of deferred warranty administration fees and obligor liabilities associated with the administration services provided to our ESPs."[205]

AmTrust did not identify the specific guidance it had applied, the review it undertook to identify these issues, or the guidance it chose to apply to these areas going forward after having identified them.

Plaintiffs allege that ASC Topic 944 titled Financial Services "establishes specific limitations on the deferral of those costs incurred in acquiring insurance contracts and notes that any such deferred costs are to be expensed over time via amortization."[206] Based on this single allegation, they claim that AmTrust improperly accounted for the four areas identified above, and that any resulting financial data was a misstatement of fact.

Plaintiffs fail to plead that ASC Topic 944 objectively applied to each of the four areas in which AmTrust identified issues and that AmTrust either: (1) did not apply ASC Topic 944, (2) did not disclose that it had selected different guidance to apply, or (3) applied ASC Topic 944 in a manner that was objectively wrong. In consequence, ₹hey fail to plead adequately that financial data derived from each of the four areas was a misstatement of fact. The Court is persuaded with respect to the third area, however, that duplication of numbers is not an act or determination that involves any subjective evaluation. Accordingly, to the extent that plaintiffs' claim is based on the third issue identified by AmTrust, plaintiffs plead adequately that the alleged misstatement is a statement of fact. The Court is

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[205] *Id.* ¶ 116.
[206] *Id.* ¶ 115.

satisfied also that the allegation in this case, AmTrust's admission — of duplication sufficiently alleges falsity.

With respect to the other three areas, plaintiffs' allegations related to falsity again are based on the GeoInvesting report, the Barron's articles, and the Alistair letter, and their theory is the same. Plaintiffs contend that these published materials put defendants on notice of accounting improprieties and that defendants therefore must have either subjectively disbelieved that their accounting for deferred acquisition costs was correct or recklessly disregarded that it was wrong.

The first Barron's article and the Alistair letter both mentioned deferred acquisition costs. The Barron's article noted that AmTrust could have been violating a matching principle by capitalizing costs more aggressively than revenue and thereby boosting profits. The article explained the matching principle as follows:

> "Insurers put a portion of their premium revenues into a balance sheet reserve called 'unearned premiums,' while deferring a matching portion of commissions and other premium-generating expenses into an asset called 'deferred policy acquisition costs' — amortizing each over the course of the coverage. The ratio of these line items should be more or less steady across time and comparable businesses . . . ."[207]

While the Court cannot determine with any certainty whether the "salaries and consulting fees" that AmTrust capitalized then later determined were not eligible for deferral — the second concern related to deferred acquisition costs that AmTrust identified — were subject to this matching, it views the costs as ones that plausibly could have been deferred based on an aggressive or perhaps improper interpretation of "premium-generating

[207] Zweifach Decl. Ex. 21 [DI 149-21] at ECF p. 3.

expenses." Plaintiffs thus allege plausibly that the article could have put defendants on notice of the issue and that they did not believe contemporaneously that their accounting treatment for these costs was correct.

The same is not true for the first concern related to deferred acquisition costs that AmTrust identified. The over-amortization of those costs resulted in an overstatement of expenses. The Barron's article, however, warns of accounting practices that led to an understatement of expenses.[208] So too with the Alistair letter.[209]

The fourth concern is somewhat trickier. AmTrust's disclosure indicates that it deferred improperly "warranty administration fees and obligor liabilities associated with the administration services provided to our ESPs." Viewing the allegations in the Complaint in the light most favorable to plaintiffs, these costs reasonably could be viewed as similar to the salaries and consulting fees, or the second area of concern. It is plausible that these costs were aggressively or improperly deferred in violation of the matching principle, and that the Barron's article and Alistair letter put defendants on notice of that fact. Accordingly, plaintiffs allege adequately a false statement of opinion on this basis.

The Court must determine whether plaintiffs plead adequately the materiality of the misstatements of fact and opinion that plaintiffs have alleged sufficiently. It does so in short order, but first it addresses the remainder of the alleged misstatements based on certain accounting issues.

ii. Capitalization of Software Development Costs

In its 2016 Form 10-K, AmTrust disclosed that:

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[208] *Id.* (stating that "AmTrust's seemingly high level of deferred costs means that the insurer's currently low operating expenses could rise sharply in the future").

[209] *See* Zweifach Decl. Ex. 24 [DI 149-24] at ECF p. 8.

> "The Company capitalized certain internally developed software costs that did not meet criteria for deferral under ASC 350, *Intangibles - Goodwill and Other*. This error resulted in an over-capitalization of certain software expenses, and an understatement of expenses."[210]

It did not disclose whether these software expenses related to upgrades and enhancements or a new software project. The distinction is not trivial.

ASC Topic 350 sets out criteria for deferral of costs related to new projects that contain little if any room for subjective evaluation. Applying the criteria related to upgrades and enhancements, on the other hand, involves the exercise of judgment.[211]

The allegations in the Complaint do not address this distinction. As a result, plaintiffs fail to plead adequately the falsity of a statement of fact. In addition, their allegations are wholly insufficient to plead that the reported data was an untrue or misleading statement of opinion. AmTrust's accounting for software costs were not mentioned in the GeoInvesting report, Barron's articles, or Alistair letter and the Complaint contains no other facts that would indicate that defendants knew at the time that their accounting for these expenses was wrong, recklessly disregarded that possibility, or failed to conduct a meaningful inquiry into the proper way in which to account for these costs. In consequence, plaintiffs fail to allege a misstatement based on the accounting treatment of software expenses.

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[210] SAC [DI 140] ¶ 120.

[211] ASC 350-40-25 (stating that to defer costs, the company must conclude that it *is "probable* that [the] expenditures [on upgrades and enhancements] will result in additional functionality" (emphasis added)).

iii. Miscellaneous Adjustments

The allegations in the Complaint concerning the remaining accounting areas all follow the same pattern:

(1) Plaintiffs cite a provision of accounting guidance and a principle or general rule contained therein;

(2) The following paragraph includes an excerpt from AmTrust's 2016 Form 10-K explaining that the company corrected an error related to a certain area of accounting;

(3) The portion quoted contains no reference to any ASC Topic or other guidance that AmTrust previously had relied upon, or relied upon in the review process that led to the change; and

(4) Plaintiffs fail to allege that each accounting area objectively was governed by a single ASC topic.

For the reasons already stated, such allegations fail to plead adequately the falsity of a statement of fact.

In addition, plaintiffs fail to plead adequately that the financial data based in part on any of the miscellaneous issues was an untrue or misleading statement of opinion. None of the published materials referenced or provided any kind of notice that AmTrust's accounting with respect to the miscellaneous issues might have been wrong. And while the materials do reference ceding insurance losses to foreign subsidiaries, that issue is not the same as the one that AmTrust described as "intercompany eliminations." The intercompany eliminations concerned "internal brokerage commissions paid from one of its subsidiaries to another subsidiary, which should have been eliminated in consolidation, thereby causing an overstatement of commission income in 2015."[212] The published materials never mention brokerage commissions or commission

[212] Zweifach Decl. Ex. 4 [DI 149-4] at ECF p. 10.

income. Thus, plaintiffs fail to plead adequately a misstatement based on the miscellaneous adjustments identified by AmTrust.

iv. Materiality

A misstatement is actionable under the securities laws only if it is material. A statement is material if "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to act."[213] If an alleged misstatement is "obviously unimportant" then it will not survive a motion to dismiss.[214]

AmTrust distinguished between the deferred acquisition and software costs, and the other miscellaneous adjustments in the March 16, 2017 press release. It explained that the latter were immaterial, both individually and in the aggregate. It did not describe the former in terms of materiality one way or the other. But notably, the remarks concerning both of these sets of accounting issues followed the company's disclosure that it was restating its financial statements primarily to correct two *material* errors — the accounting for warranty contract administration services revenue and discretionary bonuses. The company did not attribute the restatement to the other accounting issues identified. It stated only that it would make corrections to those areas in the restatement as well. The Court thus rejects plaintiffs' argument that the deferred acquisition and software costs and miscellaneous adjustments were material because they were included in the restatement.

Plaintiffs plead only two other facts in support of materiality: (1) the percentages that reported income numbers were overstated and expenses understated, and

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[213] *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.,* 553 F.3d 187, 197 (2d Cir. 2009) (internal alteration omitted).

[214] *Id.*

(2) the drop in AmTrust stock price after the disclosure that the company had identified accounting errors and issues with internal controls. The allegations in the Complaint and AmTrust's disclosures, read together, indicate that the two facts alleged are attributable to the warranty contract and discretionary bonus issues. AmTrust's disclosures state that the deferred acquisition and software costs and miscellaneous adjustments had a quantitatively immaterial effect on reported income, and plaintiffs fail to plead facts rebutting this statement. Additionally, they fail to allege any ways in which misstatements related to deferred acquisition costs, software costs, and the miscellaneous adjustments would have been qualitatively material.

Thus, the Court concludes with the respect to the majority of plaintiffs' claims based on reported income numbers that plaintiffs fail to plead adequately the falsity of any alleged misrepresentation. In the circumstances where the plaintiffs have pleaded adequately the falsity of an alleged misstatement of fact or opinion, the Court concludes that the plaintiffs fail to plead adequately the materiality of those alleged misrepresentations, both individually and in the aggregate.

c. Representations That Financial Statements Were Prepared in Conformity With GAAP

Plaintiffs contend that statements in AmTrust's Forms 10-K and 10-Q representing that the company's "consolidated financial statements . . . have been prepared in conformity with accounting principles generally accepted in the United States of America" [215] are statements of fact. Financial statements are prepared in conformity with GAAP when they are prepared using the FASB ASC "as the source of authoritative principles and

[215] SAC [DI 140] ¶ 159.

standards," and any relevant "[r]ules and interpretive releases of the [SEC]."[216]

But plaintiffs are not alleging that defendants failed to apply the FASB ASC as the authoritative standards. Instead, they allege that defendants applied the ASC but reached incorrect results. The claim is derivative of the primary allegations regarding warranty contract revenue, bonus accrual, and the other accounting issues identified by AmTrust. Consistent with the Court's conclusion that the Complaint fails to state a claim based on any of these accounting issues, the allegations that defendants violated or failed to conform with GAAP fail too.[217]

d. Signed SOX Certifications Attesting to Financial Statements' Accuracy

Plaintiffs assert that the following statement that appears in various SOX certifications signed by defendants Zyskind and Pipoly is a statement of fact:

> "Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report."[218]

They argue that defendants are strictly liable for this statement because AmTrust's financial statements were inaccurate, as became evident when AmTrust disclosed that its financial statements should no longer be relied upon and would be restated.

Plaintiffs are wrong. The "SOX certifications contain[] an important qualification that the certifying officer's

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[216] ASC 105-10-10-1.

[217] *See Fait*, 655 F.3d at 113.

[218] SAC [DI 140] ¶ 158.

statements are true based on [his or her] knowledge."[219] The attestation is a statement of opinion. Accordingly, plaintiffs must allege more than that the financial statements themselves were inaccurate. They must allege sufficiently that defendants knew that the financial statements were inaccurate.[220]

Plaintiffs fail to do so for the same reasons they fail to plead falsity with respect to the statements of opinion regarding warranty contract revenue, discretionary bonuses, software expenses, and the other miscellaneous accounting issues. They fail too because they did not plead adequately that any misstatements or inaccuracies related to the deferred acquisition costs were material. Absent a sufficient allegation of materiality, the defendants' opinion that the financial statements fairly present in all *material* respects the financial condition of the company was not untrue or misleading when expressed.

e. Representations in the Form 10-K Regarding Sufficiency of Disclosure and Internal Controls and Signed SOX Certifications Attesting to Disclosure of Deficiencies and Weaknesses in Internal Controls

Plaintiffs contend that statements in AmTrust's Forms 10-K and SOX certifications regarding the company's controls are statements of fact.[221] The first statement represents in relevant part that:

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[219] *Das v. Rio Tinto PLC,* 332 F. Supp. 3d 786, 812 (S.D.N.Y. 2018) (internal quotations omitted) (quoting *Menaldi v. Och-Ziff Capital Mont. Group LLC,* 277 F. Supp. 3d, 500, 517 (S.D.N.Y. 2017)).

[220] *See In re Scottish Re Group Sec. Litig.,* 524 F. Supp. 2d 370, 391 (S.D.N.Y. 2007).

[221] The Court disregards the statement included in SAC [DI 140] ¶ 137. The portion excerpted is irrelevant to plaintiffs' claims as it defines and sets out the purpose of internal controls. The only statement of fact contained therein possibly relevant to plaintiffs' claims is that

> "Our management, with participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended []) . . . . Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that . . . our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in the reports we file or submit under the Exchange Act is timely recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regrading required disclosure."[222]

The second states in relevant part:

> "Management has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2014, based on the control criteria established in a report entitled *Internal Control - Integrated Framework (1992),* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such evaluation, we have concluded that our internal control over financial reporting is effective as of December 31, 2014."[223]

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defendants are responsible for establishing and maintaining adequate internal control over financial reporting. The Court doubts that plaintiffs would argue that this statement is untrue.

[222] SAC [DI 140] ¶ 160.

[223] *Id.*

The third states in relevant part:

> "The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
>
> (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
>
> (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting."[224]

All three statements concern the conclusions of management. Accordingly, they are statements of opinion and plaintiffs must do more than simply allege that the conclusions were wrong. They must allege adequately that defendants Zyskind and Pipoly reached a conclusion different from the one stated, or that defendants reached no conclusion at all.

Plaintiffs allege that the statements were false when made because defendants knew or recklessly disregarded the following facts and concealed them from investors: (1) "AmTrust's financial results were the product of fraudulent accounting due to [] violations of GAAP" in the company's accounting for warranty contract revenue, discretionary bonuses, deferred acquisition costs, software costs, and other miscellaneous items, (2) the company's disclosure and internal controls were "ineffective in assessing the risk of material misstatements" in eight areas of accounting

[224] *Id.* ¶ 158.

and financial reporting, and (3) the SOX certifications signed by defendants Zyskind and Pipoly were "materially false and misleading."[225]

The Court takes these fact in reverse order. To begin, the third "fact" is not a fact but a claim. Indeed it is the very claim that plaintiffs try to establish here. Sufficient claims require actual facts alleged in support thereof in order to survive a motion to dismiss. This statement, styled by plaintiffs here as a fact, adds no support to their claim.

The second fact is one that is relevant to the state of things in or around 2017, not in or around 2015 when the challenged statements were made. Thus it adds no support to the argument that the challenged statement of opinion was not sincerely held at the time it was made.

Finally, the Court largely has rejected the first fact already. To the extent it has not, it does so now. While plaintiffs have pleaded adequately a misstatement with respect to the deferred acquisition costs, the Court did not conclude that they have pleaded adequately fraud, or *scienter,* with respect to that issue. *Scienter* requires a greater showing,[226] and it is not one plaintiffs have alleged sufficiently. They barely nudged their claim of a misstatement over the line from possible to plausible. They have not, however, alleged facts sufficient to show that the inference *of scienter* is at least as compelling as any opposing inference.[227] The Court concludes, based on all the facts alleged and materials that the Court may consider on this motion, that the inference of negligence is far stronger. Accordingly, plaintiffs fail to plead that the representations — and in particular the third representation — are misstatements of opinion.

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[225] *Id.* ¶ 323.
[226] *See supra* at n.183.
[227] *See Tellabs,* 551 U.S. at 324.

Plaintiffs thus fail to state a claim under Sections 11 and 12(a)(2) of the Securities Act. Because they fail to allege adequately liability under these sections, their claim under Section 15 fails too.

B. EXCHANGE ACT CLAIMS

Section 10(b) of the Exchange Act makes it unlawful to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may proscribe."[228] Rule 10b-5 is the SEC rule that implements that statute. It prohibits "making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."[229] Section 20(a) of the Act imposes liability on every person who controlled, directly or indirectly, any person liable under the Exchange Act or any rule promulgated thereunder unless the controlling person acted in good faith and did not directly or indirectly induce the violation.[230]

A claim asserted under Section 10(b) and Rule 10b-5 thereunder has six elements: "(1) a material misrepresentation or omission by the defendant; (2) *scienter;* (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[231] In addition to these elements, a plaintiff asserting fraud under the Exchange Act must plead facts sufficient to satisfy the requirements of Rule 9(b) and the PSLRA. To overcome these additional hurdles, the allegations must identify with specificity the

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[228] *ECA, Local 134 IBEW,* 553 F.3d at 197 (quoting 15 U.S.C. § 78j(b)).
[229] *Id.* (alterations omitted) (quoting 17 C.F.R. § 240.10b-5(b)).
[230] 15 U.S.C. § 78t(a).
[231] *City of Westland,* 129 F. Supp. 3d at 65.

statements that the plaintiff contends were fraudulent, the context in which they were made, and the reason or reasons why the statements were fraudulent.[232]

Plaintiffs assert that the AmTrust defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. They assert also a claim under Section 20(a) of the Exchange Act against the Officer Defendants. The statements at the heart of these claims fall into five categories:

> (1) Statements identical to those that form the basis of plaintiffs' Section 11 and 12(a)(2) claims already addressed by the Court;
>
> (2) Statements made on conference calls discussing or touting AmTrust's warranty contract business;
>
> (3) Statements made in response to news reports critical of AmTrust's business;
>
> (4) Statements that address foreign exchange transactions; and
>
> (5) Statements related to the 2016 Form 10-K filing delay, KPMG's work, the "errors" and "corrections" identified, and the restatement.

The Court addresses each in turn. Similar to the Securities Act claims, it must determine first whether the statements are statements of fact or opinion and whether they were false when made.

1. Alleged Misstatements Asserted Under Sections 11 and 12(a)(2)

The alleged misstatements that fall into this group differ from those underlying plaintiffs' Securities Act claims in that they extend back to 2012. They are substantively identical in all other respects.

There are no unique facts related to the years 2012 and 2013 such that the analysis with respect to these alleged

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[232] *ATSI,* 493 F.3d at 99; *see also* 15 U.S.C. § 78u-4(b)(1).

misstatements would differ in any way from the foregoing analysis with respect to the Section 11 and 12(a)(2) claims, Accordingly, the Court's analysis above applies here as well. It concludes that plaintiffs fail to plead adequately that any of the statements in this category were untrue or misleading.

2. Statements Regarding Warranty Contract Business

The second group consists of statements related to the warranty contract business — and health of AmTrust's business generally — that defendants made on ten conference calls and in one press release between February 2013 and November 2016. These statements, in substance, stated that the warranty contract business was strong, growing, stable, performing well, and that the company expected those trends to continue.[233] With two exceptions, which the Court addresses in a moment, the statements communicated the speaker's subjective assessment of the business line and accordingly are statements of opinion.

Plaintiffs contend that these statements of opinion were "materially false and misleading and/or omitted material information"[234] because:

> "they failed to disclose that the Company was inflating its results, including with its Specialty Risk and Extended Warranty business and other of its business segments, which the AmTrust Defendants knew or recklessly disregarded. Specifically, the Company was among other things, recognizing the majority of its warranty contract fee revenue related to administration services at the time of the sale of ESP. Instead, as AmTrust acknowledged in the 2/27/17 Press Release 'its

[233] *See* SAC [DI 140] ¶¶ 317, 328-29, 336, 344-45, 373, 380, 387-88, 415, 432, 455-57.

[234] *Id.* ¶ 330.

> warranty contracts should not be accounted for using the multiple-element guidance, but instead deferred over the life of the contract.' Ultimately, in the 2016 Form 10-K, the Company admitted that although it had 'historically recognized the majority of revenue related to administration services at the time of sale of ESP,' it would need to change its application of the revenue recognition guidance to record revenue related to administrative services on a straight-line basis over the terms of the ESP contract.' Further, AmTrust admitted that the impact of this accounting practice 'created an overstatement of service and fee income' during the Class Period."[235]

These arguments regarding falsity simply repeat those made previously in the context of the Securities Act claims. The Court already has found them to be without merit.

There is a second reason why many, if not all, of these statements of opinion cannot give rise to a securities violation and it is this. They are expressions of puffery and corporate optimism that the company was permitted to make. "People in charge of an enterprise are not required to take a gloomy, fearful or defeatist view of the future; subject to what the data indicates, they can be expected to be confident about their stewardship and the prospects of the business that they manage."[236]

The Court returns now to the two exceptions, which are the following. The first is a set of statements made on a call in November 2014 that clarified, in response to an analyst's question, that the strong revenue numbers for the prior quarter resulted in part from the combination of new warranty business and earnings related to business generated in prior years, and were not the product of any

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[235] *Id.*

[236] *Rombach,* 355 F.3d at 174 (internal quotations and citation omitted).

unusual event.[237] The second is a statement made in a press release issued in November 2016 acknowledging the impact of "the decline in the British pound" on the company's top-line results related to the extended warranty business.[238] These are each statements of fact. But they are statements of fact that plaintiffs ignore completely. They plead no facts that would speak to the falsity of these statements.

Plaintiffs thus fail to allege the falsity of any of these statements of opinion or fact.

3. Statements in Response to Critical Reporting

The third group contains statements made in response to the GeoInvesting report of December 2013 and the Barron's article of February 2014. The statements rejected the reports of improper accounting and described the article as inaccurate.[239] They affirmed that AmTrust's financial reporting and that of its foreign subsidiaries was in conformity with GAAP[240] and highlighted AmTrust's strong position and financial results.[241]

Plaintiffs argue that these statements were materially false and misleading or omitted material information because:

> "AmTrust, Zyskind, and Pipoly concealed from investors the true fact that AmTrust's financial results were materially misstated and should not be relied upon due to the Company's various violations of GAAP . . . including, *inter alia,* the improper reporting of intercompany transactions and deferred acquisition costs, which were known

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[237] SAC [DI 140] ¶¶ 387.88.
[238] *Id.* ¶ 455.
[239] *Id.* ¶¶ 352, 355, 363.
[240] *Id.* ¶¶ 353, 362.
[241] *Id.* ¶ 352.

> by AmTrust, Zyskind, and Pipoly, or recklessly disregarded by them during the Class Period."[242]

They contend also that the statements were false or misleading because AmTrust, Zyskind, and Pipoly knew or recklessly disregarded that "AmTrust's disclosure controls and internal controls were 'ineffective' in assessing the risk of material misstatements relating to eight distinct areas of corporate accounting and financial reporting."[243]

The Court already has addressed whether representations that AmTrust's financial statements were prepared in conformity with GAAP are misstatements of fact or opinion and concluded that they are neither. That conclusion applies here.

The statements regarding the strength of AmTrust's position and results are statements of opinion. These statements, like those made in the context of AmTrust's warranty contract business, are puffery and statements of corporate optimism. They cannot support plaintiffs' claim.

Finally, the rebuttals of various points made in the GeoInvesting report and Barron's article are a mix of statements of fact and opinion. But the Court need not untangle each statement of fact from opinion because all the allegations of falsity already have been rejected by this Court in its discussion of the Securities Act claims. In brief, the Court determined — among other things —that the intercompany transactions and deferred acquisition costs referenced in the two publications were not the same issues as those similarly named and identified by AmTrust around the time of the restatement.

4. Statements Regarding Foreign Exchange Transactions

The fourth group contains a single statement made on a conference call on August 4, 2015. In response to an

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[242] *Id.* ¶ 356.

[243] SAC [DI 140] ¶ 364.

analyst's question regarding "the potential impact of changes in foreign currencies on net income,"[244] Pipoly stated:

> "It's an odd phenomenon in the sense of what we've seen from a currency perspective, the volatility and the inconsistency between a period and currency rate versus an average exchange rate. I mean just to give you an example, at the end, at March 31, the exchange rate with the dollar and the pound was $1.47. Just fast forward to June 30, and that exchange rate was $1.57. That's why you see that that *[sic]* level of volatility and that's what you see flowing through on our income statement from foreign currency, but again it's essentially all a non-cash event . . ."[245]

Plaintiffs argue that the statement was materially false and misleading because the defendants failed to disclose during the AmTrust Class Period that AmTrust "improperly accounted] for foreign currency gains and losses," in "violation of GAAP," and that the defendants "knew or recklessly disregarded" that fact.[246]

The Court already has discarded the premise of plaintiffs' argument in the section of this opinion that addresses the Securities Act claims against the AmTrust defendants. That section and its analysis applies with equal force here. Plaintiffs thus fail to allege a misstatement based on Pipoly's remarks of August 4, 2015.

5. Statements Regarding Events Leading up to and Including the Restatement

The final group contains eight statements. They concern the delay in filing Form 10-Q for the third quarter of 2016 and Form 10-K for the year 2016, the issues

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[244] *Id.* ¶ 413.
[245] *Id.*
[246] *Id.* ¶ 414.

AmTrust identified related to certain controls and areas of accounting, whether the issues were material, and the restatement.

The first statement was made during AmTrust's investor conference held on November 16, 2016. In response to an analyst's question regarding the delay in filing the Form 10-Q, Pipoly stated:

> "[T]his particular issue was resolved. And really, what it was the result of is, is that we needed to have — or KPMG needed to have additional time to evaluate the level of precision around a secondary control. And again, so we were having discussions in terms of whether the level of precision was there necessary in that secondary level of control to make sure that if it wasn't a precise enough control that it'd rise to the level of having a material weakness, which it did not. But it took a few days to evaluate it to make sure that we're both on the same page. . . . [A]s you go through the quarter, you're evaluating controls, and it's a significant part of an overall audit approach. So it was really designed around the precision of a secondary level control."[247]

Plaintiffs contend that the statement was materially false and misleading or omitted material information because the defendants knew or recklessly disregarded that the Company's disclosure and internal controls were "ineffective" in eight areas of accounting and financial reporting.[248] The Court already has found this argument unpersuasive. Moreover, there is no indication whether the control at issue here was one that AmTrust later identified as having a material weakness. Plaintiffs thus fail to allege

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[247] *Id.* ¶ 463.
[248] *Id.* ¶ 464.

that the facts upon which they base their argument even apply to the context in which this statement was made.

The next three statements concern AmTrust's determination in February 2017 that issues it had identified over the course of its review with KPMG were immaterial — a decision it subsequently would reverse.[249] Plaintiffs argue that these statements were materially false and misleading or omitted material facts because defendants knew or recklessly disregarded that the company had engaged in improper accounting practices for several years and that the effects of these improper practices were material.[250] The Court repeats, perhaps unnecessarily, that plaintiffs have failed to establish the premise of their argument and accordingly, the argument fails here.

The same is true of the fifth statement, related to AmTrust's accounting treatment for administration service revenue prior to the fourth quarter of 2016.[251]

The sixth and seventh statements concern the reason AmTrust delayed filing its 2016 Form 10-K. AmTrust explained on a conference call held on February 27, 2017 that the filing was delayed because KPMG needed more time to complete the audit and review the 10-K.[252] Plaintiffs contend that the statements were false, misleading, or omitted material facts because defendants knew or recklessly disregarded that AmTrust allegedly had engaged in improper accounting practices for years, resulting in materially misstated financial statements that would need to be restated once the improprieties were uncovered.[253] The failure to allege adequately any

[249] *See* SAC [DI 140] ¶¶ 470, 474, 478.
[250] *See id.* ¶¶ 471, 475, 479.
[251] *Id.* ¶ 480.
[252] *Id.* ¶¶ 472, 476.
[253] *Id.* ¶¶ 473, 477.

objectively improper accounting practices[254] dooms any claim based on these two statements.

The final statement appears in a March 16, 2017 press release and is a quotation from Pipoly discussing the reason for the restatement. 'He explained that the restatement "largely relate[s] to the timing recognition of revenue . . . in the Company's service and fee business."[255] Plaintiffs claim that the statement was false and misleading or omitted material facts because defendants "failed to disclose the full extent of their accounting improprieties which were so severe that they warranted numerous government investigations."[256] As the Court has noted, the Complaint fails to allege any accounting improprieties that were objectively determinable errors that defendants knew of at the time or recklessly disregarded. As a result, plaintiffs fail to allege a misrepresentation based on this final statement.

Each alleged basis for plaintiffs' 10(b) claims — and thus plaintiffs' 20(a) claims — is insufficient. The Court has concluded also that plaintiffs fail to state a claim under the Securities Act. Accordingly, the Court grants the AmTrust defendants' motion to dismiss.

III. UNDERWRITER DEFENDANTS

The Complaint asserts two claims against the Underwriter Defendants. The first alleges a violation of Section 11 of the Securities Act, and the second alleges a violation of Section 12(a)(2) of the same. The bases for the

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[254] The Court notes that plaintiffs have alleged adequately an objectively improper accounting practice or mistake with respect to duplication of certain numbers, as discussed above, but they have failed to allege the materiality of this mistake or improper practice. Additionally, plaintiffs do not allege that the duplication was known to defendants or recklessly disregarded. Accordingly, it cannot support a claim here.

[255] SAC [DI 140] ¶ 485.

[256] *Id.* ¶ 486.

claims are identical to those of the Securities Act claims asserted against the AmTrust defendants. The Court has concluded that plaintiffs fail to allege any untrue or misleading statements of material fact or opinion with respect to those claims. That conclusion applies here. Accordingly, the Underwriter Defendants' motion to dismiss is granted.

IV. DEFENDANT BDO

BDO audited AmTrust's financial statements for a number of years including 2012 through 2015. Plaintiffs' claims, broadly speaking, allege that BDO failed to conduct its audits in accordance with a set of auditing standards set by the Public Company Accounting Oversight Board ("PCAOB"). PCAOB is a nonprofit corporation established by Congress in 2002 to oversee the audits of public companies in order to protect investors and further the public interest in the preparation of accurate audit reports.

Plaintiffs assert claims against BDO under Section 11 of the Securities Act and Section 10(b) of the Exchange Act. The Court begins with the Securities Act claims.

A. SECURITIES ACT CLAIMS

Plaintiffs claim that BDO violated Section 11 of the Securities Act by making untrue or misleading statements of fact in its unqualified audit opinions that were incorporated into the November 2015 Offering Materials and the 2016 Series F Offering Materials. The alleged misstatements are the following:

(1) Representations that BDO conducted its audits in accordance with PCAOB standards;

(2) Representations that BDO's audit opinions were unqualified; and

(3) Representations that AmTrust's consolidated financial statements conformed with GAAP.

Plaintiffs argue that the first representation was untrue because BDO failed to comply with certain auditing standards.[257] With respect to the second representation, plaintiffs claim that it was misleading because BDO did not disclose that it failed to conduct a complete audit at the time it issued its unqualified opinion.[258] And the third representation is untrue, according to the plaintiffs, because BDO ignored AmTrust's "wrongful accounting" and therefore disbelieved the statement at the time it was made.[259]

1. Representations That BDO Conducted its Audits in Accordance With PCAOB Standards

This claim is a mirror image of plaintiffs' claims against the AmTrust defendants alleging misstated financial data based on certain accounting issues. Just as many of the accounting principles at issue — or seemingly at issue — there called for subjective evaluations, so too here. The PCAOB auditing standards to which plaintiffs point are couched in inherently subjective terms. They require, for example, auditors to "obtain reasonable assurance" for their ultimate conclusions including by obtaining "sufficient competent evidential matter to afford a reasonable basis for an opinion."[260] The standards concern "matters as to which reasonable professionals planning or conducting an audit reasonably and frequently could disagree."[261] As a result, the representation that BDO completed an audit in accordance with PCAOB standards is a statement of opinion.

In determining whether plaintiffs allege adequately the falsity of this statement of opinion, the Court considers

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[257] *Id.* ¶¶ 214-28.
[258] *Id.* ¶¶ 230-31.
[259] *Id.* ¶ 232.
[260] SAC [DI 140] ¶¶ 214, 217.
[261] *In re Lehman Bros. Sec. and ERISA Litig.*, 799 F. Supp. 2d 258, 300 (S.D.N.Y. 2011).

all the allegations in the Complaint, including those averring fraud.[262]

a. Alleged Failure to Follow PCAOB Standards Based on AmTrust's Disclosures in 2016 and 2017

The Complaint alleges that defendant BDO failed to conduct its audits in accordance with PCAOB Auditing Standards ("AS") Nos. 5, 12, 14, and 15, and American Institute of Certified Public Accountants Standards ("AU") Sections 326 and 508.[263] These standards require: testing to evaluate the effectiveness of internal controls, risk assessment to identify and assess the risk of material misstatement in financial statements, collection of sufficient evidence to support overall conclusions, evaluation of results and risks to determine whether conclusions are supported adequately, and a determination on whether financial statements are presented in accordance with GAAP. Plaintiffs argue that BDO failed to perform adequately the tasks required because they ignored and/or failed to catch the issues and weaknesses later identified by AmTrust.[264]

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[262] *See supra* at 42-43 & n.183.

[263] Prior to the creation of PCAOB, the American Institute of Certified Public Accountants set standards for financial statement auditing. At the time of the allegations in the Complaint, PCAOB was the controlling body. It had two sets of "equally authoritative auditing standards: (i) standards originally issued by the Auditing Standards Board ('ASB') of the American Institute of Certified Public Accountants ('AICPA') and adopted by the Board on an interim, transitional basis in April 2003 and (ii) standards issued by the Board." PCAOB Release No. 2015-002 at 2, Mar. 31, 2015. When the Board adopted the AICPA auditing standards, it continued to use the "AU section" reference numbers in its codification of standards. *Id.*

[264] *Compare* SAC [DI 140] ¶ 213 (stating that BDO "ignored AmTrust's wrongful accounting," and "[i]n doing so, [] had reason not to believe that the financial statements included in the Offering Materials were fairly presented in conformity with GAAP"), with *Id.* ¶¶ 222-226, 227(b)-(c).

There are a number of factual allegations concerning testing that BDO did not perform prior to issuing its 2013 audit opinion, corners that were cut, and possibly worse.[265] But the Complaint alleges specifically that all audit work was completed after the 2013 opinion was issued, and that BDO determined that its audit opinion was unaffected by any of the results of that work. The audit opinion, as incorporated into both sets of offering materials and at the time "such part[s] became effective,"[266] therefore rested on a complete audit. All plaintiffs' process arguments fall away. The only quarrel plaintiffs could have with BDO regarding its representation at that point is its apparent decision not to amend the date of the audit report and opinion. But there are no claims that the date is a misstatement and even if plaintiffs were to so allege, it is far from certain that they could plead adequately the materiality of any such misstatement in these circumstances.

Consequently, plaintiffs' allegations boil down to an assertion that BDO should be held liable for failing to reach

[265] In addition, there are allegations based on the 2017 Wall Street Journal article. These allegations are duplicative of those based on the 2013 audit to the extent that the facts reported by the Wall Street Journal are identical to those alleged with respect to the 2013 audit. Specifically, the Journal reported that "BDO formally signed off on its AmTrust audit before completing some important checks," and "staffers allegedly covered for their lapse by loading unfinished documents into an internal software system to show the right time stamp, then returned later to complete some of the work." Zweifach Decl. Ex. 25 [DI 149.25] at ECF p. 5. The only key additional fact provided by the Journal is that BDO allegedly signed off on AmTrust audits *twice* before completing the work. The article, however, does not indicate the years in which this allegedly occurred, or whether it occurred in a single year with respect to different components of an AmTrust audit, e.g., the Consolidated Audit and the Subsidiary Audit. Accordingly, any allegations based on the Journal article are too vague and insufficient to support a claim.

[266] 15 U.S.C. § 77k(a).

the same conclusion on subjective matters that AmTrust and KPMG reached in 2016 and 2017, and in so doing, failed to comply with auditing standards. The former does not establish the latter and such a difference of opinion is not actionable under the Securities laws.

b. Alleged Failure to Follow PCAOB Standards Based on BDO's Conduct

Plaintiffs contend that defendant BDO failed to comply with several other auditing standards. These are AS Nos. 3, 5, 7, 8, 10, 13, 14, and 15, and AU Sections 230, 316, 326, and 508. They require: sufficient evidence and testing — or a reasonable basis — to form audit conclusions and documentation thereof; evaluation of certain risks to ensure that the audit results support the conclusion; and audit supervision and quality review to ensure that the work is performed as directed and significant judgments are double-checked. In addition, under AU Section 508, an auditor can issue an unqualified opinion only if the audit was conducted in accordance with PCAOB auditing standards.

According to plaintiffs, BDO failed to comply with these standards due its conduct associated with the 2013 Consolidated Audit and other conduct as reported in the Wall Street Journal in 2017. The allegations concern a failure to complete necessary checks and work papers before the issuance of the audit opinion, a concerted effort to conceal the fact that the work had not been done on time, and a failure of the engagement partner and quality review partner to supervise, review, and verify the results and conclusions of the audit.

As the Court explained above, BDO's eventual completion of its audit work on the 2013 Consolidated Audit renders most of these factual allegations irrelevant except insofar as the plaintiffs may have a legitimate quarrel — though not necessarily an actionable one — with BDO over the date on its 2013 audit report and opinion.

There are four areas, however, that were not "cured" by the completion of the audit work. These are the requirements of good faith and integrity in the exercise of due professional care, supervision of the audit, engagement quality review, and documentation.

Plaintiffs allege that the audit team acted in bad faith by loading incomplete documents into an internal software system so that they would show a time stamp that predated the audit deadline but could be completed later, after that date. They allege that Bertuglia and Green fell short of their duties to supervise and review audit work, including by signing work papers they did not review and failing to verify that all work was performed prior to issuing the audit opinion. And they allege that the change to the work plan was never documented. These allegations render it plausible that Bertuglia disbelieved the statement that the audit was conducted in accordance with the relevant PCAOB standards at the time both sets of offering materials became effective. Plaintiffs thus have alleged adequately a misstatement of opinion.

But that is not all that plaintiffs must do. They must allege also that the misstatement was material. "At the pleading stage, a plaintiff satisfies the materiality requirement [of the securities laws] by alleging a statement or omission that a reasonable investor would have considered significant in making investment decisions,"[267] A plaintiff must do more than allege that an "investor might have considered the misrepresentation or omission important."[268] But it is unnecessary to "assert that the investor would have acted differently if an accurate disclosure was made."[269]

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[267] *Ganino v. Citizens Utils. Co.,* 228 F.3d 154, 161 (2d Cir. 2000).
[268] *Id.*
[269] *Id.*

The Second Circuit has stated often the rule that a complaint may not properly be dismissed on a Rule 12(b)(6) motion "on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance."[270] This rule, however, does not establish a presumption of materiality, nor will it excuse a failure to plead an element of a claim.[271] It simply is a reminder that materiality is a mixed question of law and fact and an instruction that district courts apply when evaluating well-pleaded facts relevant to materiality.

But here, there are no such facts. Plaintiffs fail to allege any facts relevant to the way or ways in which BDO's failure to supervise, review, document, and perform in good faith the 2013 audit would have been significant to a reasonable investor in making investment decisions. This is so particularly because the conduct ultimately had no effect on the 2013 audit opinion.

Plaintiffs thus fail to state a claim based on BDO's representation that it followed PCAOB standards.

2. BDO's Unqualified Audit Opinions

The parties agree that BDO's unqualified audit opinions are statements of opinion. Plaintiffs allege falsity on the basis that the opinion did not rest on a meaningful inquiry — namely, a complete audit conducted in accordance with PCAOB standards. The Court has addressed both the issue of completeness and that of compliance with auditing standards. The arguments are no more persuasive here than they were above. Accordingly, plaintiffs fail to allege a misstatement on this basis.

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[270] *Id.* at 162 (quoting *Goldman v. Belden,* 754 F.2d 1059, 1067 (2d Cir. 1985).

[271] *See Bell Atlantic v. Twombly,* 550 U.S. 544, 555 (2007).

3. Representation That AmTrust's Consolidated Financial Statements Conformed With GAAP

Plaintiffs concede that the representation that AmTrust's financial statements conformed with GAAP is a statement of opinion. They allege that the opinion is false because BDO ignored AmTrust's wrongful accounting and therefore disbelieved the opinion at the time it was expressed. They allege no facts, however, that could support this theory.

The allegations regrading the 2013 Consolidated Audit extend no further than an alleged failure to perform the audit work required coupled with a concerted effort to conceal that fact. The 2017 Wall Street Journal article likewise does not mention any practice or instance of BDO ignoring "wrongful accounting." Crucially, it distinguishes between what the whistleblower claims to have observed with regard to *AmTrust* and what he or she claims to have observed with regard to *BDO*. With respect to the former, the whistleblower claims to have observed "seemingly unsupported adjustments to financial schedules by a senior AmTrust executive," and "reliance on 'plugs,' or undocumented adjustments."[272] With respect to BDO, the whistleblower claims to have observed BDO sign off on AmTrust audits before completing important checks and staffers covering for their lapse by loading unfinished documents into an internal software system to show the right time stamp.[273] There is no bridge between the two. Put differently, the whistleblower does *not* claim that anyone else at BDO saw those accounting improprieties or that any audit team member knew of them and ignored them. In the absence of any facts alleging such a connection, the Complaint fails to allege falsity.

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[272] Zweifach Decl. Ex. 25 [DI 149.25] at ECF p. 6.
[273] *Id.*

Perhaps recognizing this shortcoming, albeit belatedly, plaintiffs change their tune in their opposition brief and argue falsity on the grounds that BDO failed to conduct a complete audit in accordance with PCAOB standards, and therefore, the opinion did not rest on a meaningful inquiry. The Court's analysis on the completeness of the audit and its compliance with auditing standards thus applies here. So too does its conclusion. Plaintiffs fail to allege adequately a misrepresentation on the basis of this statement.

Plaintiffs thus fail to state a claim under the Securities Act against defendant BDO.

B. EXCHANGE ACT CLAIMS

Plaintiffs assert that BDO violated Section 10(b) of the Exchange Act and Rule lob-5 thereunder by making fraudulent statements in its unqualified audit opinion of AmTrust's financial statements for the year ending December 31, 2013. The alleged fraudulent statements are the following:

(1) BDO conducted its audit in accordance with PCAOB standards; and

(2) BDO believed its audit provided a reasonable basis for its opinion.

As an initial matter, an Exchange Act claim differs from a Securities Act claim with respect to the elements that a plaintiff must plead sufficiently in order to state a claim. A claim brought under the Exchange Act that alleges sufficiently a misrepresentation and materiality is actionable only if the plaintiff pleads adequately another element — loss causation. Loss causation is "the proximate causal link" between the alleged material misrepresentation and "the plaintiff s economic harm."[274] To plead this element adequately, a plaintiff must allege

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[274] *ATSI,* 493 F.3d at 106.

that defendant's "misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security."[275]

With respect to the first alleged misstatement, the Court already has concluded that plaintiffs failed to allege adequately a material misstatement based on BDO's compliance with PCAOB standards *after* BDO had completed the audit work and determined that its 2013 audit opinion was unaffected by the results of the completed work. It determines now that the alleged misrepresentation is not actionable under the Exchange Act because plaintiffs fail to allege any disclosure and subsequent negative effect on the value of AmTrust securities in the period from the time the alleged misrepresentation was made to the time BDO completed the work related to 2013 audit.

The same analysis and result applies to the second alleged misstatement. The second statement is the functional equivalent of those addressed in the prior section of this opinion concerning BDO's unqualified audit opinions and the representation that AmTrust's financial statements were presented in accordance with GAAP. The Court already has gone through the analysis and determined that those statements, following completion of the audit work, are not actionable. And while it may be true that prior to that time, AmTrust's stock price was artificially inflated due to the concealment of certain facts, plaintiffs allege no loss causation in that window of time. Thus, plaintiffs fail to state a claim under the Exchange Act against defendant BDO.

The Court holds that plaintiffs fail to state a claim under Section 11 of the Securities Act and Section 10(b) of the Exchange Act against defendant BDO. Accordingly, BDO's motion to dismiss is granted.

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[275] *Lentell v. Merrill Lynch & Co.,* 396 F.3d 161, 173 (2d Cir. 2005).

CONCLUSION

For the foregoing reasons, the Court grants the AmTrust, Underwriters, and BDO defendants' motions to dismiss in their entirety.

SO ORDERED.

Dated: September 9, 2019

Lewis A. Kaplan
United States District Judge

APPENDIX D

United States District Court
Southern District of New York

In re AMTRUST FINANCIAL SERVICES, INC. Securities Litigation

17-cv-1545 (LAK)

This document applies to: ALL ACTIONS.

MEMORANDUM OPINION

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ROPES & GRAY LLP

Attorneys for Defendants Morgan Stanley & Co., LLC, Citigroup Global Markets, Inc., UBS Securities LLC, RBC Capital Markets, LLC, and Keefe, Bruyette & Woods, Inc.

LEWIS A. KAPLAN, *District Judge.*

Plaintiffs in this putative class action were shareholders of AmTrust Financial Services, Inc. ("AmTrust") during the relevant period. Their third amended complaint alleges that AmTrust, its current and former officers and directors, its former auditor, and certain underwriters of its securities violated several provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. In a thorough opinion, familiarity with which is assumed, the Court granted defendants' motions to dismiss the second amended complaint for failure to state a claim. [1] Defendants now move to dismiss the third amended complaint.

In dismissing the second amended complaint, the Court observed that many of plaintiffs' allegations followed the same pattern: (1) defendants made certain assertions about AmTrust's financial results and condition, many of which were or concerned numbers in AmTrust's financial statements; (2) AmTrust later restated its financial statements after changing the accounting treatment of certain aspects of its operations; and (3) the accounting standards employed in preparing the old financial statements therefore must have been impermissible. Accordingly, plaintiffs argue, certain of the figures that

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[1] Dkt. 18 (reported at *In re AmTrust Fin. Servs., Inc. Sec. Litig.*, No. 17-cv-1545 (LAK), 2019 WL 4257110 (S.D.N.Y. Sept. 9, 2019)).

appeared in the earlier financial statements and statements about them had to have been misstatements of fact.

As the Court previously explained, plaintiffs' proposed conclusion does not necessarily follow from their first two propositions. Often, the questions of which accounting principle applies and how it applies call for subjective judgment by the issuer or its auditor. To plead that AmTrust's original numbers were statements of fact, rather than opinions of AmTrust and/or its auditor, plaintiffs would have had to allege plausibly that a given accounting standard objectively was the only correct standard to apply to the topic at issue and that it applied in an objective and singular way. If two or more standards could have applied to a topic, or the applicable standard called for subjective judgments, the accounting output – the figures on a balance sheet or statement of operations – would have been statements of opinion and subject to a different analysis with respect to falsity.

Applying this logic, the Court concluded that plaintiffs' allegations were based primarily on statements of opinion and that plaintiffs had not plausibly alleged that those opinions were false or misleading. In the few instances where plaintiffs plausibly had alleged a misstatement, either of fact or opinion, the Court held that they had failed to allege facts sufficient to permit a conclusion that the misstatement was material. The Court held also that certain statements at issue were inactionable puffery and therefore did not provide a basis for certain Exchange Act Claims.

The third amended complaint does not correct, and largely does not attempt to correct, the defects identified in the Court's prior opinion. It accordingly is dismissed, but a few particular points warrant attention.

1. The first significant addition to the third amended complaint is a catchall theory of liability. The theory is that

Accounting Standards Codification ("ASC") Topic 250 and an SEC regulation establish a certain process for reporting a change in accounting principles. Plaintiffs suggest that AmTrust's alleged decision not to follow this process must mean that it restated its financials because it previously had used impermissible accounting methodologies. Plaintiffs thus would have the Court conclude that all the statements at issue must be statements of fact rather than products of subjective accounting standards and thus essentially opinions.

In effect, plaintiffs are attempting to show that the statements were inaccurate by alleging that defendants believed they were inaccurate. This is no different than arguing that the Earth is flat by alleging that defendants believed it was flat. Perhaps defendants' supposed belief was wrong. Or perhaps they failed for other reasons to take the procedural steps that plaintiffs allege they were required to take. Moreover, even if defendants' beliefs were relevant, the Court explained in its previous opinion that plaintiffs' proposed inference that AmTrust's accounting standards were objectively impermissible simply because the restatements applied different standards is unwarranted.[2]

2. With respect to warranty contract revenue reporting, plaintiffs once again have not alleged adequately that Topic 605's straight-line reporting rule was the only permissible standard and that defendants failed to apply it. They note that Topic 605 requires that "revenue from separately priced extended warranty and product maintenance contracts shall be deferred and recognized in income on a straight-line basis over the contract period." But, as they concede, Topic 605 permits other methods of

[2] AmTrust's supposed admissions that its prior accounting was improper form the basis of many of plaintiffs' arguments in response to the motions to dismiss. The Court rejects these arguments for the same reasons noted here and in its prior opinion.

revenue recognition where "sufficient historical evidence indicates that the costs of performing services under the contract are incurred on [another] basis." The Court noted previously that if this exception could apply, plaintiffs would be unable to show that Topic 605 set forth an objective standard that AmTrust failed to follow. And plaintiffs fail to allege facts sufficient to warrant a conclusion that the straight-line basis, and only the straight-line basis, was required.

Plaintiffs argue that, because AmTrust's restated financials employed the straight-line method, no "sufficient historical evidence" could have existed to permit its previous use of a different method of revenue recognition, and, thus, accounting for this revenue involved no subjective judgments. The Court repeatedly has explained why this argument is unpersuasive. The word "sufficient" inherently requires a subjective judgment as to whether the exception applies. Plaintiffs have not alleged otherwise by pleading that any objective standard informs the determination of whether historical evidence is sufficient.[3]

3. The next issue is AmTrust's accounting for discretionary bonuses. AmTrust initially expensed discretionary bonuses in the year in which they were paid because it did not consider the bonus payments to be "probable" until that time. In its restated statements, however, it chose instead to estimate the bonuses as expenses in periods prior to those in which they were paid.

The Court previously expressed skepticism that any single ASC Topic set an objective standard for accounting for discretionary bonuses and observed that ASC Topics 270, 450, and 710 appear to bear on the issue.[4] However,

[3] In addition, Plaintiffs have failed again to engage with the multiple-element revenue recognition section of Topic 605, which the Court found in the prior opinion leaves also room for discretion on these facts. *See* Dkt. 18 at 41-42 & n.182.

[4] *Id.* at 46 n.191.

the Court ultimately concluded that plaintiffs had failed to state a claim on the simpler ground that they did not discuss the interaction among those three topics or assert that the application of any one standard objectively was required here.

The third amended complaint contains additional descriptions of Topics 270 and 450. Like its predecessor, it says virtually nothing about Topic 710. Rather than explain in any detail how these standards apply or whether any one objective standard governs here, plaintiffs cobble the topics together and suggest merely that they are consistent with each other. Plaintiffs' theory is that because the discretionary bonuses here were "earned" prior to being paid – an assumption that they appear to base entirely on the fact of AmTrust's restatements – AmTrust was required to apply Topics 450-10-55 and 270, as well as what the complaint calls, without additional detail, "the guidance set forth in ASC Topic 710."[5]

Plaintiffs have not corrected the problems that resulted in the dismissal of their prior complaint. But even if the vaguely described trinity of accounting topics that they mention were taken as one standard, plaintiffs have not adequately alleged that defendants misapplied it. ASC Topic 450-10-55, which plaintiffs spend the most time discussing, applies to "amounts owed for services received, such as advertising and utilities." It requires the expensing of payments for such items when they are "earned" because, at that point, "there is nothing uncertain about the fact that those obligations have been incurred." As noted above, AmTrust's original accountants determined that discretionary bonus payments were not "probable" until they were paid. Viewed this way, and assuming as plaintiffs do that Topic 450-10-55 applies here, the accounting for discretionary bonus payments turned on an

[5] Third Amended Complaint ¶ 136.

opinion over whether and when they were "earned." Plaintiffs fail to explain why defendants' opinion was impermissible or how this standard is objective. They simply repeat their conclusory mantra, rejected already, that because AmTrust applied a different standard in its restated filings, the original standard must have been impermissible.

4. Next, plaintiffs have failed to correct the defects in their claim that AmTrust made a material misstatement surrounding its deferred acquisition costs. Previously, the Court concluded that most of these statements were opinions and held that plaintiffs had failed to plead that ASC Topic 944, which they cited, objectively applied to the accounting issues. The Court concluded also that plaintiffs did not allege that AmTrust failed to apply Topic 944, that it did not disclose that it had selected a different guidance, or that it applied Topic 944 incorrectly. The only material addition to the third amended complaint is an allegation that AmTrust's accounting was "consistent with the guidance set forth in GAAP, specifically in ASC Topic No. 944."[6] But this is not the same as alleging that AmTrust actually applied Topic 944 or that any particular topic applies objectively to the issues at hand. Plaintiffs fail to make these allegations once again.

The Court recognized previously that some of the other statements surrounding deferred acquisition costs plausibly were false or misleading. But it found that plaintiffs had failed sufficiently to plead that any of these

[6] *Id.* ¶ 140.

In several places using identical language, the third amended complaint states in conclusory fashion that AmTrust violated GAAP through "the improper reporting of deferred acquisition costs, in violation its own publicly stated policy of accounting and ASC Topic No. 944." *Id.* ¶ 194(c); *see also id.* ¶¶ 350, 360(c), 504. This statement and the "consistent with" language are the only discussion of Topic 944 in the third amended complaint.

alleged misstatements was material, which it suggested they could do by plausibly alleging that the statements meaningfully affected AmTrust's reported income and/or financial condition. Plaintiffs have not pled additional facts in support of materiality.

* * *

Plaintiffs either have not attempted to fix the remaining allegations or have failed to support them with additional factual allegations. These allegations are insufficient for the same reasons outlined in the Court's previous opinion.

Defendants' motions to dismiss [DI 183, 185, 187] are granted. The third amended complaint [DI 172] is dismissed with prejudice.

SO ORDERED.

Dated: April 20, 2020

Lewis A. Kaplan
United States District Judge

APPENDIX E

United States Court of Appeals
for the Second Circuit

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 7th day of January, two thousand twenty-five.

Docket No: 22-1197

NEW ENGLAND CARPENTERS GUARANTEED ANNUITY AND PENSION FUNDS,

Lead Plaintiff - Appellant,

STANLEY NEWMARK, et al.,

Plaintiff - Movant - Appellants,

SHARON ALBANO, Individually and On Behalf of All Others Similarly Situated,

Consolidated-Plaintiff-Movant-Appellant,

JOHN SACHETTI, Individually and On Behalf of All Others Similarly Situated,

Consolidated-Plaintiff,

JOEL RUBEL, individually and on behalf of all others similarly situated,

Plaintiff,

v.

DONALD T. DECARLO, et al.,

Consolidated - Defendants - Appellees,

AMTRUST FINANCIAL SERVICES, INC., et al.,

Defendants - Appellees.

ORDER

Appellee, BDO USA, LLP, filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*. The panel that determined the appeal has considered the request for panel rehearing, and the active members of the Court have considered the request for rehearing *en banc.*

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:

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Catherine O'Hagan
Wolfe, Clerk