No. 24-1151

In the Supreme Court of the United States

BDO USA, LLP,

Petitioner,

v.

NEW ENGLAND CARPENTERS GUARANTEED ANNUITY AND PENSION FUNDS, ET AL.,

Respondents.

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

BRIEF OF PROFESSOR JOSEPH A. GRUNDFEST AND PROFESSOR COLLEEN HONIGSBERG AS AMICI CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF AMICI CURIAE[1]

Joseph A. Grundfest is the William A. Franke Professor of Law and Business (Emeritus) at Stanford Law School and a senior faculty member at the Rock Center for Corporate Governance. He was a Commissioner of the Securities and Exchange Commission from 1985 to 1990. Professor Grundfest has taught securities law for decades, published extensively on the subject in leading law reviews (including the Harvard, Yale, and Stanford Law Reviews), and submitted amicus briefs to this Court in significant securities cases.

Colleen Honigsberg is Associate Dean of Curriculum and Professor of Law at Stanford Law School. Her research focuses on the empirical study of corporate and securities law, and has been published in leading academic journals, including the Journal of Financial Economics, the Journal of Law & Economics, the Stanford Law Review, and the Journal of Accounting Research. She currently serves on the Executive Committee of the Securities and Exchange Commission's Investor Advisory Committee and on the Standards and Emerging Issues Advisory Group at the Public Company Accounting Oversight Board. Professor Honigsberg has been licensed as a Certified Public Accountant and thus has particular expertise in the accounting matters implicated by the pending petition.

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1 No counsel for any party authored this brief in whole or in part, and no party, counsel for a party, or person or entity other than amici curiae and their counsel made a monetary contribution intended to fund the brief's preparation or submission. Consistent with Rule 37.2, counsel of record for the parties received timely notice of amici's intent to file this brief.

Amici have a longstanding interest in the proper and consistent interpretation and enforcement of the federal securities laws. That interest includes ensuring that securities law liability is limited to matters that are, in both law and reality, properly deemed material to the investing public. Because the Second Circuit's decision in this case undermines that limitation, amici respectfully submit that the petition should be granted.

INTRODUCTION AND SUMMARY OF ARGUMENT

For more than 50 years, this Court has recognized that materiality is an important limitation on federal securities law liability. *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 444-45 (1976) (citing *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 385 (1970)). During that half-century, this Court has repeatedly rebuffed bright-line definitions of materiality, instead requiring a context-specific inquiry into whether an alleged misstatement or omission "significantly altered the 'total mix' of information made available" to investors. *Id.* at 449; *see Basic Inc. v. Levinson*, 485 U.S. 224, 236 (1988); *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 39 (2011).

The Second Circuit's decision in this case, however, threatens to erode that longstanding precedent. As BDO's petition shows, the decision below will be used by plaintiffs' attorneys to argue that an auditor's misstatement of compliance with the auditing standards established by the Public Company Accounting Oversight Board (PCAOB) is always material to investors, even if there is no link between the alleged misstatement of compliance and any errors in the audited financials. Pet. App. 36a.

That is a prohibited *per se* rule of materiality and warrants this Court's review.

First, a *per se* materiality rule built on violations of PCAOB auditing standards creates a circuit split with the Sixth Circuit and generates serious tension with decisions from several other circuits. The need for uniformity in federal securities regulation is sufficient cause to warrant this Court's review.

Second, a *per se* materiality rule is legally and factually misguided. A *per se* rule conflicts with this Court's consistent admonition against bright-line materiality rules. It also rests on the flawed factual assumption that an auditor's alleged technical noncompliance with a PCAOB standard is *necessarily* value-relevant to investors, even if the alleged noncompliance has no impact on the financial statements of the company in which the investor is actually investing. Substantial research, however, shows the absence of such a uniform investor reaction.

Third, the Second Circuit's decision warrants prompt review because it comes from the Second Circuit. That court wields outsized influence in securities litigation, largely attributable to the volume of securities matters it resolves. If the Second Circuit's *per se* materiality rule survives, even more securities class actions will be filed in the Second Circuit, even more will survive dismissal, and the Second Circuit will become an even more powerful magnet for questionable claims and "extort[ionate] settlements." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 163 (2008). Moreover, because of incentives to settle securities claims, cases presenting this question will often not lead to appeals. The time for this Court to intervene is now.

That common-sense conclusion is reinforced by quantitative metrics developed by Professor Grundfest that help inform whether an asserted circuit split warrants this Court's review. First, the Court can examine the aggregate share of the overall market implicated by the conflict; a split between circuits accounting for only 5% of the total market may be less important than a split between circuits accounting for 50%. Second, the Court can examine the relative share of the market on each side of the conflict. A split may be worthier of review if the circuits on each side account for roughly equal shares, as opposed to lopsided shares in which one side could be dismissed as a relatively insignificant outlier. Applying those metrics here shows that the question presented involves a total market share of 85%, with the Second Circuit accounting for 37% on one side and six other circuits accounting for 48% on the other. These metrics underscore the importance of the circuit split and the need for prompt resolution.

ARGUMENT

I. The Second Circuit's Decision Creates A Circuit Split

"[R]esolv[ing] conflicts among the United States courts of appeals" on questions of "federal law" is "a principal purpose for which [this Court] use[s] [its] certiorari jurisdiction." *Braxton v. United States*, 500 U.S. 344, 347 (1991); *see, e.g.*, *City & Cnty. of San Francisco v. Sheehan*, 575 U.S. 600, 610 (2015) (explaining that the Court's "certiorari jurisdiction exists to clarify the law"); *see also* Sup. Ct. R. 10(a) (certiorari review is appropriate when "a United

States court of appeals has entered a decision in conflict with the decision of another United States court of appeals on the same important matter").

The need for consistent application of the law is particularly acute in the context of "federal securities regulation," because it "is inherently national in scope and in need of uniform rules." *Ceres Partners v. GEL Assocs.*, 918 F.2d 349, 354 (2d Cir. 1990). Indeed, as this Court has repeatedly recognized, ensuring fair and effective operation of federal securities law through nationally uniform rules is a matter of critical national importance. *See, e.g.*, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 161 (2008) ("[A] dynamic, free economy presupposes a high degree of integrity in all of its parts, an integrity that must be underwritten by rules enforceable in fair, independent, accessible courts."); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 78 (2006) ("The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated.").

The petition explains (at 12-19) that the Second Circuit's decision below creates a stark circuit split. The Second Circuit reasoned that, as a legal matter, auditors' misstatements of PCAOB compliance are always material, even if the statement has no effect on the information available to investors about a company's finances. Pet. App. 36a.

That *per se* rule conflicts directly with Sixth Circuit precedent rejecting the theory that an auditor's failure to comply with professional auditing standards is *per se* material. *See Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 432-34 (6th Cir. 1980). Instead, such compliance certifications are material in the Sixth Circuit only insofar as they affect the substance of information available to investors regarding a company's finances. *Id.* at 432. As the Sixth Circuit correctly explained, "[t]he question of materiality in this context is whether, given all the financial information, there was a substantial risk that the actual value of assets or profits were significantly less than [the accounting firm] stated them to be." *Id.* Thus, when an auditor's technical noncompliance does not "produce[] financial statements materially at odds with the real facts," as was true with respect to BDO's audit of AmTrust, the certification statement is not *per se* material. *Id.*; *see* Pet. App. 36a (acknowledging no alleged "link between BDO's false certification and specific errors in AmTrust's financial statements").

Other circuits take a similar approach and explain that materiality necessarily turns on a case-specific connection between an auditor's alleged procedural noncompliance and the company's finances—not a *per se* rule. *See, e.g.*, *Bradford-White Corp. v. Ernst & Whinney*, 872 F.2d 1153, 1159-60 (3d Cir. 1989) (predicating auditor liability for incorrectly certifying compliance with generally accepted auditing standards on the finding that the company's financials were "materially misstated"); *accord Brody v. Stone & Webster, Inc. (In re Stone & Webster, Inc. Sec. Litig.)*, 414 F.3d 187, 214 (1st Cir. 2005); *Sioux, Ltd. Sec. Litig. v. Coopers & Lybrand*, 914 F.2d 61, 66 (5th Cir. 1990); *United States v. Weiner*, 578 F.2d 757, 779 (9th Cir. 1978); *Deephaven Priv. Placement Trading, Ltd. v. Grant Thornton & Co.*, 454 F.3d 1168, 1176 n.9 (10th Cir. 2006).

II. A *Per Se* Materiality Rule Is Legally And Factually Unsound

The adoption of a *per se* rule also warrants review because it conflicts with this Court's precedent and with the reality of PCAOB-inspected audits.

1. Materiality is among the most fundamental elements of liability under the federal securities law. Indeed, while this case involves materiality under Section 10(b) of the Exchange Act, the major privately-enforced liability provisions under both the Securities Act and the Exchange Act—which together "form the backbone of American securities law," *Slack Techs., LLC v. Pirani*, 598 U.S. 759, 762 (2023)—hinge on materiality determinations. "[F]or the securities lawyer 'materiality' is the name of the game." 3 Thomas Lee Hazen, *Law of Securities Regulation* § 10:77 (May 2025 Update) (Hazen) (citation omitted).

Decades ago, this Court "defined a standard of materiality under the securities laws" that still governs today: Affirmative misstatements or omissions are material if there is "a substantial likelihood that [they] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)); *see Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38-39 (2011).

The Court has been "careful not to set too low a standard of materiality," *Basic*, 485 U.S. at 231, ensuring that entities do not face potential liability for benign misstatements and omissions that do not threaten to mislead investors about anything of consequence. The Court has also been careful to reject an approach to materiality that would effectively "designate[] a single fact or occurrence as always determinative" of materiality. *Id.* at 236. The test for materiality is not amenable to categorical, "bright-line" rules. *Matrixx*, 563 U.S. at 39; *Basic*, 485 U.S. at 236.

2. Creating a *per se* rule of materiality in the context of auditor compliance statements is flawed in multiple respects.

First, the court severed the link between alleged noncompliance with PCAOB standards and the underlying financial statements. Pet. App. 36a. A reasonable investor, however, would view an audit's procedural shortcomings as altering the "total mix" of relevant information, *Matrixx*, 563 U.S. at 38, only if the alleged deficiencies affect the *company's* reported financial statements. After all, investors do not invest in audits—they invest in companies. And audit deficiencies often have no impact on the presentation of the company's financials—as was the case here. *See* Pet. App. 36a, 75a.

Thus, while federal regulators may have an interest in scrutinizing auditing compliance for prophylactic reasons unrelated to the existence of actual harm, investors are not necessarily affected by an audit process failure that does not affect the company's financial statements. *See, e.g.*, Ctr. for Audit Quality, *Perspectives on Corporate Reporting, the Audit, and Regulatory Environment: Institutional Investor Research Findings* 10 (Nov. 2023), https://perma.cc/PS8U-BENV ("Although investors acknowledged audit deficiencies are an issue to monitor, for a subgroup of investors, the lack of restatements resulting from inspections signaled to them that the deficiencies were not material and thus alleviated concerns.").

Second, the conclusion that *any* alleged "false certification" *necessarily* "subjected unknowing investors to the risk" that "financial statements were unreliable," regardless of whether the alleged falsity is linked to any substantive difference in financial result, Pet. App. 36a, is legally and factually misguided.

As a legal matter, it conflicts with this Court's admonition against "bright-line" rules for materiality. *Basic*, 485 U.S. at 236. Particularly in the context of auditing certifications, *per se* rules are misplaced. As the SEC has stressed, bright-line rules "cannot appropriately be used as a substitute for a full analysis of all relevant considerations" when considering materiality. SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, 45,151 (Aug. 19, 1999). And in actions brought by private plaintiffs asserting securities fraud, plaintiffs must plead particularized facts demonstrating that those considerations collectively render the auditing deficiency material to reasonable investors. *See* 15 U.S.C. § 78u-4(b)(1); Fed. R. Civ. P. 9(b); 3 Hazen § 12:61 n.23 ("This particularity requirement applies to the materiality element of a fraud claim."). The Second Circuit has no basis to read that element out of the law by adopting a *per se* materiality rule.

The assumption that a sufficient deviation from PCAOB procedure is always material is, moreover, factually unsound. Contrary to the Second Circuit's reasoning, investors do not necessarily find it material that a company's outside auditor followed each and every PCAOB-prescribed procedure—particularly when, as here, noncompliance had no effect on the auditor's ultimate opinion regarding the financial statements.

Indeed, although auditors are required to state that they complied with PCAOB standards while performing their audit, *see* 17 C.F.R. § 210.2-02(b); PCAOB Auditing Standard 3101.09(c), minor audit mistakes and technical noncompliance with the PCAOB's standards are not surprising. In recent years, the PCAOB's rulemaking activity has proliferated, and audits—particularly of the world's largest companies—have become far more complex. *See, e.g.*, PCAOB, Press Release, *PCAOB Revises Standard-Setting, Research, and Rulemaking Agendas Following Record-Setting Action in 2023* (Nov. 1, 2023), https://perma.cc/GB5H-3UD4 ("The PCAOB took more action on standard setting and rulemaking in 2023 than any year in the last 10 years[.]"); PCAOB, *Spotlight: Staff Priorities for 2025 Inspections and Interactions With Audit Committees* 5 (Dec. 2024), https://perma.cc/7MNQ-KGGD (noting various factors that increase audit complexity).

Given these complexities, technical deficiencies are inevitable. For example, in an analysis of randomly selected 2024 public company audit engagements, the PCAOB concluded that 76% of the engagements had at least one "deficiency." PCAOB, *Spotlight: Staff Update on 2024 Inspection Activities* 14 (Mar. 2025), https://perma.cc/2E2K-ACRL. The PCAOB approximated that only 19% of the randomly selected engagements had a Part I.A deficiency, meaning that the auditor lacked sufficient audit evidence to support its audit opinion. The remainder were either Part I.B or I.C deficiencies, meaning that the deficiency was less severe or resulted from potential noncompliance with an applicable SEC rule. *Id.* at 6-7, 14.

Yet, available data demonstrate that the reaction to these deficiencies is context-specific, and not uniform, a reality that rejects the appropriateness of any *per se* materiality rule. This conclusion is supported by a recent analysis of market reaction to the PCAOB's inspection reports where the issuer can be identified. *See* Andrew Acito et al., *Market-Based Incentives for Optimal Audit Quality* (Dec. 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4997362.

PCAOB inspection reports do not explicitly name issuers. Issuer identity can, however, be determined if the accounting firm has a limited number of clients (*e.g.*, an accounting firm with a single issuer client). *Id.* at 4. For these issuers, the market often reacts to audit inspection reports—reacting positively to non-deficient audits and negatively to deficient audits. *See id.* at 4, 16. Critically, however, even for these issuers, the market reactions "are not *always* significantly different from zero," *id.* at 16 (emphasis added), when there is a report of failure to comply with PCAOB standards. Thus, even if there is a trend in terms of market reaction, there are important and frequent exceptions to the rule, thereby establishing a statistical argument that the data do not support a *per se* rule based on a failure to comply with every PCAOB standard.

Moreover, shareholders continue to vote in favor of auditor ratification at high levels even when there is evidence of past audit deficiencies. Sarah Keohane, Audit Analytics, *A Closer Look at Shareholder Votes Against Auditor Ratification* (June 17, 2024), https://perma.cc/M64B-98L6 ("Throughout the last six years, our analysis on shareholder votes reveals that, on average, nearly 98% of total votes are cast in favor of auditor ratification."). If deficiencies in PCAOB inspections were *per se* material, we would not expect such a high percentage of votes to be cast in favor of auditor ratification. This high favorability underscores the flaw in any *per se* rule of materiality for audit deficiencies.

An identical conclusion holds with respect to the analogous context of internal control deficiencies. In general, reported financial statements include a certification by the issuer regarding the sufficiency of the company's "internal controls" over financial reporting—*i.e.*, the internal systems designed "to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles." 17 C.F.R. § 240.13a-15(f); *see* 15 U.S.C. § 7241(a). Later events may reveal that such a certification was false, and that the issuer in fact had weaknesses or deficiencies in its internal controls.

Although these deficiencies can increase the risk that the financial statements themselves may be misstated, a false internal-control certification is not itself *per se* material. That is true as a legal matter, and particularly when the internal control deficiency does not result in any materially misstated financials. *See, e.g.*, *Tabak v. Canadian Solar Inc.*, 549 F. App'x 24, 27 n.2 (2d Cir. 2013) ("Because the misstatements regarding 3Q2009 are immaterial, so too is the defendant's alleged failure to disclose CSI's departure from internal controls in generating the 3Q2009 financial statements.").

That conclusion is also true as an empirical matter because investors do not have uniform reactions to disclosed internal control deficiencies. To the contrary, market reactions are context-dependent. *See, e.g.*, Jacqueline S. Hammersley et al., *Market Reactions to the Disclosure of Internal Control Weaknesses and to the Characteristics of Those Weaknesses Under Section 302 of the Sarbanes Oxley Act of 2002*, 13 Rev. Acct. Stud. 141 (2007) (examining market reaction to the disclosure of internal control weaknesses and finding no significant mean or median market response in the full sample); Subash Adhikari et al., *Market Response to Audited Internal Control Weakness Disclosures*, 5 J. Forensic Acct. Rsch. 2 (2020) (finding that the market reaction to disclosures of internal control weaknesses is context-specific). Thus, while internal control deficiencies can sometimes be material to investors, they are clearly not always material. The research thus rejects the proposition that a *per se* rule is appropriate.

III. The Circuit Split Created By The Second Circuit's Decision Is Particularly Consequential

The existence of a circuit split created by an erroneous circuit decision is sufficient to justify this Court's review. But review is especially important in this case because of the Second Circuit's outsized influence in securities class actions.

1. The Second Circuit is the "'Mother Court' of securities law," *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 276 (2010) (Stevens, J., concurring in the judgment) (citation omitted), because of its "'preeminence in the field'" to which other courts routinely "defer[]," *id.* at 260 (majority opinion)

(citation omitted). Because of New York's centrality to the nation's stock markets and financial system, the Second Circuit has historically been the preeminent forum for private securities litigation. *See, e.g.*, Karen Patton Seymour, *Securities and Financial Regulation in the Second Circuit*, 85 Fordham L. Rev. 225, 226 (2016). Most securities class actions are today filed in the Second and Ninth Circuits. *See* Edward Flores & Svetlana Starykh, NERA, *Recent Trends in Securities Class Action Litigation: 2024 Full-Year Review* 5 (Jan. 22, 2025), https://perma.cc/STL2-AWWD.

The Second Circuit is a particular magnet for accounting-related cases like this one. More accounting-related securities cases are filed in the Second Circuit than any other circuit. *See* Cornerstone Research, *Accounting Class Action Filings and Settlements* 23 (2024), https://perma.cc/77T9-FA3Z. And all of the major accounting firms are either based in New York or have a significant presence there. Because of the liberal venue rules under the Exchange Act—which allows suit in any district "wherein the defendant is found or is an inhabitant or transacts business," 15 U.S.C. § 78aa(a)—few firms auditing publicly traded companies are not subject to suit within the Second Circuit under the Exchange Act.

The widespread availability of the Second Circuit as a forum for securities cases heightens the need for prompt resolution of the split created by the opinion below. If a *per se* materiality rule survives in the Second Circuit, plaintiffs will naturally bring questionable securities claims in the Second Circuit to take advantage of that favorable legal standard. Allowing the split to persist thus creates an incentive for "forum shopping" that is "of particular concern" in determining whether to grant certiorari. *Yee v. City of Escondido*, 503 U.S. 519, 538 (1992).

2. Thus, simply as a matter of common sense, circuit splits over federal securities issues that involve the Second Circuit are especially consequential. But that common sense can be quantified according to two metrics recently developed by Professor Grundfest. *See* Joseph A. Grundfest, *Quantifying the Significance of Circuit Splits in Petitions for* Certiorari*: The Case of Securities Fraud Litigation* (Mar. 20, 2024) (Rock Center for Corporate Governance, Stanford University, Working Paper No. 254), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4768231.

The first metric is the "aggregate circuit split share." *Id.* at 5-6, 17. It measures the total "market share" of all circuits that have split on either side of the question, based on several statistics quantifying the total number and value of federal class action securities fraud cases in the various circuits. *See id.* at 16-17, 22.

The aggregate circuit split share metric confirms that the Second and Ninth Circuits dominate the market for class action securities fraud litigation. *See id.* at 23 (containing a full table of metrics).[2] Based on an equal-weighted average of all seven metrics, these two circuits alone represent approximately 60% of federal class action securities fraud litigation activity. The aggregate circuit split share of the

[2] Because the metrics are very highly correlated, the use of an equal-weighted average does not bias the result. *See* Grundfest, *supra*, at 17.

remaining circuits is as follows: First Circuit (2%); Third Circuit (12%); Fourth Circuit (3%); Fifth Circuit (4%); Sixth Circuit (4%); Seventh Circuit (5%); Eighth Circuit (2%); Tenth Circuit (3%); Eleventh Circuit (4%); D.C. Circuit (1%). *Id.*

The second metric is the "split ratio," which describes whether a split is caused by outlier circuits with relatively low aggregate circuit split shares, or whether the split instead reflects a disagreement among circuits with comparable circuit shares. *Id.* at 6. Consider a hypothetical split between two circuits in which the decision giving rise to the petition is from a circuit with 10% of the relevant market, while the circuit with an opposing view has a 40% share. The corresponding split ratio can be expressed as 10%–40%. In that circumstance, the decision giving rise to the petition may be seen as an outlier. By contrast, if the two circuits in the hypothetical split each had shares of 25%, the split ratio would be 25%–25%, representing a more even division. *See id.* at 6, 17.[3]

The takeaway from these two metrics is straightforward. All other factors equal, the Court should generally be more inclined to grant petitions that present splits with higher aggregate circuit split shares and relatively even split ratios. Those cases present questions of broader national significance as to which the circuits are more evenly divided.

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[3] This statistic can also be expressed as 20%–80%, where 20 is the percentage of the total market of cases represented by the opinion giving rise to the petition and circuits that agree with that opinion (10 ÷ (10+40) = 0.20) and 80 is the percentage of the total market of cases represented by circuits with the opposing view (40 ÷ (10+40) = 0.80). In the second expression, the values always sum to 100%. See Grundfest, *supra,* at 17, for a detailed discussion of this alternative calculation method.

3. Applying these metrics here powerfully supports the need for certiorari. As the petition explains, the Second Circuit's decision in this case creates a split with the Sixth Circuit, and it is inconsistent with the reasoning in decisions by the First, Third, Fifth, Ninth, and Tenth Circuits. Pet. 12-19; *see supra* at 5-6. Thus, the aggregate circuit split share for this question is 85%, which consists of the Second (37%), Sixth (4%), First (2%), Third (12%), Fifth (4%), Ninth (23%), and Tenth (3%). And the split ratio is expressed as either 37%–48% or 44%–56%. The split here is thus not driven by outlier circuits. This split ratio and the high aggregate circuit split share support the conclusion that the circuit split presented in this case is consequential and worthy of this Court's review.

CONCLUSION

The petition for a writ of certiorari should be granted.

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