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

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

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INTEREST OF *AMICUS CURIAE*[1]

Washington Legal Foundation (WLF) is a nonprofit, public-interest law and policy center with supporters nationwide. Founded in 1977, WLF promotes free enterprise, individual rights, limited government, and the rule of law. To that end, WLF often appears as *amicus curiae* in key cases presenting questions about the proper scope of the federal securities laws. See, e.g., *Slack Techs., LLC v. Pirani*, 598 U.S. 759 (2023) (No. 22-200); *Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.*, 594 U.S. 113 (2021) (No. 20-222). And WLF's Legal Studies Division routinely publishes papers by outside experts on federal securities law. See, e.g., Zachary Taylor et al., Pirani v. Slack Techs., Inc., et al.: *Ninth Circuit Cuts Securities Plaintiffs Slack on Standing*, WLF Legal Backgrounder (Mar. 25, 2022).

INTRODUCTION AND SUMMARY OF ARGUMENT

To hold a defendant liable under numerous federal securities laws, including Section 10(b) of the Exchange Act, a plaintiff must show that the alleged false statement on which it bases its claim is material. That materiality determination has typically been a fact-specific inquiry without bright-line rules—until now. The Second Circuit's decision below adopted, for

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

the first time, a *per se* materiality standard applicable to auditors' statements certifying compliance with the PCAOB's prescribed accounting practices. Reasoning that a noncompliant audit could not support an unqualified opinion of reliability, and that withholding an unqualified opinion "would have alerted investors to potential problems in the company's financial reports," the court concluded that an inaccurate certification necessarily "subjected unknowing investors to the risk that [the audited] financial statements were unreliable." Pet. App. 36a. The court therefore held that plaintiffs "were not required to allege a link between [the auditor's] false certifications and specific errors in [the] financial statements." *Id.*

That standard directly conflicts with at least one circuit and is in tension with several others. Beyond the circuit split engendered by the Second Circuit's decision, the ruling also (i) undermines the heightened pleading standard that Congress enacted in the Private Securities Litigation Reform Act (PSLRA), (ii) incentivizes over-disclosure of nonmaterial information, and (iii) disturbs the materiality standard across numerous federal securities laws.

(i) Congress enacted the PSLRA to prevent abusive litigation that may otherwise be triggered by any unfavorable change in a company's stock price. Congress effectuated that policy by imposing a heightened pleading standard, augmenting the requirement to plead the elements of fraud with particularity. The Second Circuit's *per se* materiality rule provides an end run around these heightened pleading standards. Under the *per se* approach, materiality will be assumed in virtually every case with even minor certification errors, undermining Congress's efforts to protect market participants from abusive litigation.

(ii) As this Court has warned, a low materiality standard incentivizes businesses to over-disclose non-material information in an effort to avoid litigation and potential liability. Recognizing that such over-disclosures do not serve the public, the SEC has sought to cabin such disclosure. Splitting from its sister circuits, however, the Second Circuit's decision announces a low materiality standard with broad application. If allowed to stand, the uncertainty the decision promotes will undermine the SEC's regulatory efforts to rein in over-disclosure.

(iii) Finally, materiality is a requirement for liability across federal securities law and carries the same interpretations across those statutes. Accordingly, the Second Circuit's *per se* materiality standard has implications not only for Section 10(b) but all federal securities laws that require materiality.

For these reasons and those stated in the Petition, this Court should grant certiorari and reverse.

ARGUMENT

I. The Second Circuit's *Per Se* Rule Substantially Dilutes The PSLRA's Heightened Pleading Standard.

A. Congress enacted the PSLRA to stem the tide of baseless securities litigation.

Congress enacted the PSLRA in response to "significant evidence of abuse in private securities lawsuits," H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), including "nuisance filings, targeting of deep-pocket-defendants, vexatious discovery requests, and 'manipulation by class action lawyers,'" *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (quoting *id.*). Before the PSLRA, abusive litigation "routine[ly]" followed any "significant change in an issuer's stock price," and "often forced [companies] to pay exorbitant 'settlements'" or to "expend management and employee resources" and legal fees even where there was "only faint hope that the discovery process might lead eventually to some plausible cause of action." H.R. Rep. No. 104-369, at 31-32.

To curb such abuses, Congress "impose[d] heightened pleading requirements in actions brought pursuant to [15 U.S.C.] § 10(b) and Rule 10b-5," *Dabit*, 547 U.S. at 81, that "allege[] that the defendant … made an untrue statement of a material fact" or "omitted to state a material fact necessary … to make the statements made … not misleading," 15 U.S.C. § 78u-4(b)(1). Plaintiffs making these allegations must "state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007).

"Exacting pleading requirements" are just one of "the control measures Congress included in the PSLRA." *Id.* The Act also defined a loss-causation element that requires plaintiffs to "plead and then … prove that the misstatement or omission alleged in the complaint actually caused the loss incurred by the plaintiff," H.R. Rep. No. 104-369, at 41; see § 78u-4(b)(4). And "during the pendency of any motion to dismiss," Congress required "all discovery and other proceedings [to] be stayed," § 78u-4(b)(3)(B), allowing defendants to challenge the adequacy of the pleadings before facing the enormous burden of discovery, see H.R. Rep. No. 104-369, at 37. Together, these requirements are meant to provide a meaningful restraint, so that a plaintiff may not "transform a private securities action into a partial downside insurance policy" by extracting "'an *in terrorem* increment of the settlement value'" of a case. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 347-48 (2005) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975)).

B. The Second Circuit's *per se* materiality rule provides an improper workaround to the PSLRA's heightened pleading standard.

The Second Circuit's *per se* materiality standard undermines Congress's "effort to deter or at least quickly dispose of those suits whose nuisance value outweighs their merits." *Dabit*, 547 U.S. at 82. Under the Second Circuit's rule, plaintiffs alleging a misstatement in an outside auditor's certificate of compliance automatically establish materiality and are entitled to discovery even when they concede that an underlying audit opinion correctly informed investors that a company's financial position had been fairly presented.

The PSLRA, however, mandates the opposite approach. In enacting the PSLRA, Congress recognized that private securities fraud actions often "target[] deep pocket defendants, including accountants," and threaten "abuse of the discovery process" to extract "exorbitant 'settlements.'" H.R. Rep. No. 104-369, at 31-32. Concluding that threshold limits were necessary to prevent "serious injuries" that ultimately affect "the investing public and the entire U.S. economy," *id.*, Congress instituted the PSLRA's threshold protections to augment the requirement that fraud be pleaded with particularity, Fed. R. Civ. P. 9(b); see, e.g., *In re Atossa Genetics Inc. Sec. Litig.*, 868 F.3d 784, 793-94 (9th Cir. 2017) (complaints brought under Rule 10b-5 "must satisfy the dual pleading requirements of Federal Rule of Civil Procedure 9(b) and the [PSLRA]"); *Thompson v. Relation-Serve Media, Inc.*, 610 F.3d 628, 633 (11th Cir. 2010) ("Because Rule 10b-5 sounds in fraud, the plaintiff must plead the elements of its violation with particularity."). The PSLRA and Rule 9(b) require plaintiffs asserting violations of § 10(b) or Rule 10b-5 to allege specific facts permitting the inference that "a *reasonable* investor would have viewed … nondisclosed information 'as having *significantly* altered the "total mix" of information made available.'" *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44 (2011) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)).

The requirement of such detailed facts showing materiality in the complaint is foundational to the PSLRA's effectiveness. This Court has long recognized that materiality is an "inherently fact-specific finding," and it has repeatedly elevated respect for "the purposes of the Securities Acts and Congress' policy decisions" over the "ease" of a "bright-line rule." *Basic*, 485 U.S. at 236 (discussing materiality of merger discussions); see also, e.g., *TSC Indus., Inc. v.*

Northway, Inc., 426 U.S. 438, 450 (1976) (materiality determination requires "delicate assessments" concerning "a given set of facts"); *Matrixx Initiatives*, 563 U.S. at 39 (rejecting "bright-line rule" regarding "reports of adverse events associated with … pharmaceutical[s]"). This Court has further "emphasi[zed] that § 10(b) and Rule 10b-5 do not create an affirmative duty to disclose any and all material information," but only what is "necessary to make … statements made, in the light of the circumstances under which they were made, not misleading," *Matrixx Initiatives*, 563 U.S. at 44 (citing 17 C.F.R. § 240.10b-5(b)), and plaintiffs alleging a material omission must therefore account for context.

The detailed facts mandated by the PSLRA allow a court to weed out complaints at an early stage that fail to meet these necessary criteria. The Second Circuit's *per se* rule, however, allows a plaintiff to circumvent the threshold materiality evaluation whenever there is a certification error, without regard to severity, context, or any other facts. Discovery for opportunistic plaintiffs will become commonplace. There will be a corresponding pressure to settle, even when an auditor's unqualified endorsement of a company's financial statements could not have had any misleading effect. And because technical departures from PCAOB standards are common, see Pet. 21, the *per se* approach will meaningfully impair Congress's effort "to protect investors, issuers, and all who are associated with our capital markets from abusive securities litigation," H.R. Rep. No. 104-369, at 32.

II. The Second Circuit's Split-Creating Decision Invites Uncertainty And Incentivizes Over-Disclosure That This Court And The SEC Have Sought To Prevent.

The Second Circuit's decision cannot be reconciled with decisions of the First, Third, Fifth, Ninth, and Tenth Circuits, and it directly conflicts with the Sixth Circuit's holding in *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422 (6th Cir. 1980). Pet. 12-19. By splitting with these circuits to announce a substantially expanded standard with many apparent applications, see Pet. 23, the Second Circuit's *per se* materiality rule creates uncertainty for entities subject to securities laws as to the proper standard for materiality. Specifically, by making technical noncompliance *per se* material even when there is no underlying impact to an issuer's financial statements, the Second Circuit has opened the door to the possibility that technical noncompliance by issuers and auditors alike will be deemed material regardless of its real-world impact. That uncertainty will inherently incentivize businesses to disclose more information than is necessary or even helpful to investors in an effort to avoid unwarranted liability.

This Court has long recognized the risks of a too-low materiality standard. In *Basic Inc.*, this Court explained that it "was careful not to set too low a standard of materiality" because "it was concerned that a minimal standard might bring an overabundance of information within its reach, and lead management 'simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.'" 485 U.S. at 231 (quoting *TSC Indus.,* 426 U.S. at 448-49).

Nor is preventing unnecessary disclosure a new concern for the SEC. In 2020, the SEC amended Item 105 to "discourage … the disclosure of information that is not material," and sought to "reduce disclosure costs and burdens" by giving companies "flexibility to determine whether certain information is material under the principles-based approach." Modernization of Regulation S-K Items 101, 103, and 105, 85 Fed. Reg. 63,726, 63,727, 63,748 (Oct. 8, 2020). The SEC added that those amendments were designed "to improve disclosures for investors to simplify compliance efforts for registrants" with a "thoughtful mix of prescriptive and principles-based requirements that should result in improved disclosures and the elimination of unnecessary costs and burdens." Press Release, SEC, *SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K* (Aug. 8, 2019), https://www.sec.gov/newsroom/press-releases/2019-148.

The Second Circuit's split-creating *per se* materiality rule threatens to undermine this Court's admonitions against low materiality standards and the SEC's recent regulatory efforts to grant companies flexibility to determine what information is material. Instead, the Second Circuit's rule will result in the same over-disclosure that this Court warned low materiality standards incentivize and that the SEC's regulatory efforts sought to prevent.

III. The Second Circuit's Decision Will Impact The Materiality Standard Across Securities-Related Statutes.

The Second Circuit's *per se* materiality rule risks broadening liability for blameless businesses under provisions beyond § 10(b). This Court recently reiterated, "the common law has long embraced … materiality … as the principled basis for distinguishing everyday misstatements from actionable fraud." *Kousisis v. United States*, 605 U.S. —, 145 S. Ct. 1382, 1396 (2025). Federal statutory law has long done the same, drawing on shared "'common-law antecedents'" in defining fraud and other offenses. *Universal Health Servs., Inc. v. United States*, 579 U.S. 176, 192-93 (2016) (False Claims Act) (quoting *Kungys v. United States*, 485 U.S. 759, 769-70 (1988) (willful misrepresentation in procuring citizenship), and citing *Neder v. United States*, 527 U.S. 1, 25 (1999) (materiality an element of federal mail fraud, wire fraud, and bank fraud statutes)).

Because a materiality element is common to many types of securities fraud actions, the Second Circuit's *per se* rule threatens to have wide-reaching impact. As the Petition notes, the scienter and loss-causation elements that may backstop a diluted materiality standard in private Rule 10b-5 actions do not apply in all contexts. Pet. 22-23. For instance, those requirements do not apply to claims under Section 11 of the Securities Act and Section 18 of the Exchange Act. Lawsuits invoking these provisions are especially likely to proliferate if this Court does not correct the Second Circuit's error.

Section 11 of the Securities Act imposes "virtually absolute" liability "even for innocent misstatements" in a registered security's registration statement. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-82 (1983); see 15 U.S.C. § 77k. Professionals sued under Section 11 have the burden of proving they have been diligent. § 77k(b)(3). Section 11 does not require a showing of scienter or loss causation; rather, "[i]f a plaintiff purchased a security issued pursuant to a registration statement, [a plaintiff] need only show a material misstatement or omission to establish his *prima facie* case." *Herman & MacLean*, 459 U.S. at 382. Thus, in Section 11 suits, plausibly alleging a material misstatement is the *only* threshold plaintiffs must clear before a defendant is faced with "[t]he prospect of extensive deposition of [its] officers and associates and … extensive discovery of business documents." *Blue Chip Stamps*, 421 U.S. at 741 (regarding liability under Rule 10b-5). Section 11 would be "badly strained when construed to provide a cause of action" that could so easily be exploited. *Id.* at 733 n.5.

Materiality is also a critical element of claims invoking Section 18 of the Exchange Act, which concerns misleading statements within securities filings. 15 U.S.C. § 78r(a). It too gives defendants the burden to prove good faith. *Id.* And although Section 18 requires a plaintiff to show reliance on a purported misrepresentation, that does not supplant materiality: The question of "how [the plaintiff] would have acted" is subjective and "speculative," *Basic*, 485 U.S. at 245, whereas "[t]he question of materiality … is an objective one," *TSC Indus.*, 426 U.S. at 445. By making compliance certification errors *per se* material, the

Second Circuit's rule will permit opportunistic plaintiffs to proceed under Section 18 based only on their hindsight, depriving defendants and district courts of the objective reasonableness check the statute and federal pleading rules demand. In that respect, the Second Circuit's decision ignores this Court's admonition that private securities actions exist "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause." *Dura Pharms.*, 544 U.S. at 345.

The Second Circuit's decision also invites federal overreach. In enforcing Rule 10b-5, the Securities and Exchange Commission need not show reliance, *Lorenzo v. SEC*, 587 U.S. 71, 84 (2019), or loss causation, see 15 U.S.C. § 78u-4(b)(4). Although the Commission may not penalize merely negligent misstatements as violations of the Rule, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212-14 (1976), "the Supreme Court has never decided 'whether reckless behavior is sufficient for civil liability under § 10(b),'" *Schueneman v. Arena Pharms., Inc.*, 840 F.3d 698, 705 n.7 (9th Cir. 2016) (quoting *Tellabs*, 551 U.S. at 319 n.3), and the circuit courts have allowed differing degrees of recklessness to satisfy the Rule's scienter requirement, see *Tellabs*, 551 U.S. at 319 n.3. As well, the Commission "has many legal tools at hand to aid in" rooting out fraud, including the power to "subpoena any documents and witnesses it deems relevant … to an investigation" "even without filing suit." *Gabelli v. SEC*, 568 U.S. 442, 451 (2013) (citing 15 U.S.C. §§ 77s(c), 78u(b), 80a-41(b), 80b-9(b) (2006)). In this light, the obligation to pursue only material misstatements is one of few meaningful limits on the Commission's reach. As boilerplate certifications and technical noncompliance are both extraordinarily common, see Pet. 21-23, the Second Circuit's *per se* rule invites the government to investigate and bring suit based on whim, rather than the degree and nature of a target's misconduct.

CONCLUSION

For the foregoing reasons and those stated in the Petition, this Court should grant the petition for a writ of certiorari and reverse the decision below.

Respectfully submitted,

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