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 THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AND THE CENTER FOR AUDIT QUALITY AS *AMICI CURIAE* IN SUPPORT OF CERTIORARI

MICHAEL J. SCANLON
LUCAS C. TOWNSEND
*Counsel of Record*
JOHN N. REED
GIBSON, DUNN & CRUTCHER LLP
1700 M Street, N.W.
Washington, D.C. 20036
(202) 955-8500
LTownsend@gibsondunn.com

JAMES J. FARRELL
GIBSON, DUNN & CRUTCHER LLP
200 Park Avenue
New York, NY 10166
(212) 351-4000

*Counsel for Amici Curiae*

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## INTEREST OF *AMICI CURIAE* *

The American Institute of Certified Public Accountants ("AICPA") is the national organization of the certified public accounting profession. Its membership includes hundreds of thousands of CPAs who work in every sector of the business and financial services profession, including public accounting, business and industry, government, education, and consulting. Among the AICPA's most important roles is promoting and maintaining high professional standards among its members. To this end, the AICPA has been a principal force in developing accounting and auditing standards, drafting model legislation, sponsoring educational programs, and issuing professional publications to improve the quality of the services provided by CPAs, including audit quality.

The Center for Audit Quality ("CAQ") is a nonpartisan public policy organization that promotes high-quality performance by U.S. public-company auditors; convenes capital-market stakeholders to advance the discussion of critical issues affecting the capital markets; and, using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public-company auditors and audits to dynamic market conditions. Its membership consists of U.S. public-company audit firms of all sizes, and such firms collectively audit at least 99% of public companies (by market capitalization).

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* No party's counsel authored this brief in whole or in part, and no person or entity other than *amici* or their counsel made a monetary contribution to fund the brief's preparation or submission. Pursuant to Rule 37.2, *amici* provided timely notice of their intent to file this brief to counsel of record for all parties.

This case presents an important opportunity for this Court to reaffirm its longstanding precedents concerning materiality in the securities-fraud context and dispel confusion concerning their application to audit firms and other market participants. For decades, those precedents have established that the materiality of an alleged misstatement or omission must be evaluated in the context of the "total mix" of information provided to the market. *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). That contextual approach has shaped the way audit firms and other market participants consider disclosure issues under the federal securities laws. The decision below, however, could be read to conflict with this Court's precedents by creating a rule that an auditor's alleged noncompliance with PCAOB auditing standards is *always* material to investors.

Although *amici* agree that audit opinions matter to investors and strongly believe that they play a critical role in the health of the capital markets, the decision below could be read to misapprehend key aspects of audits and auditing standards. It also could be read to upend the settled law of materiality as applied to other market participants by paving the way for courts to create other rules of materiality for different speakers. *Amici* therefore submit this brief to provide necessary context regarding audits and auditing standards based on their expertise and respectfully urge this Court to grant certiorari.

## INTRODUCTION AND SUMMARY OF ARGUMENT

For nearly fifty years, this Court has held that information is material under the federal securities laws only if there is a "substantial likelihood" that the information would be "viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). That contextual approach to materiality has long influenced the ways that companies disclose information and auditors evaluate financial statements and perform audits. As a result, the equal and consistent application of that standard is essential to the stability and efficiency of our capital markets.

The decision below, however, could be read to conflict with this Court's longstanding approach to materiality by suggesting that auditors should be subject to a different rule. Specifically, in concluding that respondents "were not required to allege a link between [petitioner's] false certification and specific errors in AmTrust's financial statements," Pet. App. 36a, the Second Circuit's decision could be read to have created a new rule that *any* alleged noncompliance with PCAOB auditing standards ("Auditing Standards") is material to investors. Such a rule would contradict this Court's contextual approach to materiality by creating a "bright-line rule" that "designates a single fact . . . as always determinative of" materiality—something this Court has repeatedly rejected. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 236 (1988); *see also Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 43–44 (2011). And it would subject auditors to potential securities-fraud liability for technical instances of noncompliance that, in the context of a particular case, do not matter to reasonable investors. That never has been, and should not be, the law.

To be clear, *amici* agree with the Second Circuit that audit opinions matter to investors and strongly believe that an auditor's statement of compliance with the Auditing Standards conveys important information to the marketplace. *Amici* also take no position on the merits of the underlying allegations in this case. But *amici* are concerned that the Second Circuit's decision could be read to suggest that incorrect statements of compliance with the Auditing Standards *always* "subjec[t] unknowing investors to the risk that [an issuer's] financial statements were unreliable." Pet. App. 36a. Such a definitive proclamation is not universally true. The Auditing Standards, which govern every aspect of an audit, involve an array of substantive and analytical procedures, call for the application of significant professional judgment, and require thousands of hours of work. Consequently, an auditor may commit a technical violation of the Auditing Standards that is not material to investors because it does not threaten the overall quality of the audit or whether the financial statements subject to the audit were fairly presented.

But if other courts apply the decision below beyond the facts of this case, *any* noncompliance with the Auditing Standards could be deemed material under the federal securities laws as a matter of law. Not only would that result increase the likelihood that auditors are subjected to strike suits, but it could also set a precedent for creating exceptions to this Court's longstanding approach to materiality and thereby threaten the well-established law of materiality as applied to issuers and other market participants. And because state law often follows federal law, adopting a new rule of materiality here could increase the risk of liability for even those auditors who do not perform work for public companies.

A new, expanded definition of materiality also would conflict with sound public policy against expanding the private right of action under federal securities laws. Congress has recognized the dangers of vexatious securities litigation and sought to address them by passing the Private Securities Litigation Reform Act of 1995. These dangers are especially grave for auditors, who opine on the financial statements of every publicly listed company in the United States and therefore face the threat of litigation whenever a company reveals negative news or suffers a stock-price drop. An auditor-specific exception to this Court's materiality precedents would be a step in the wrong direction that threatens to undermine well-established congressional policy concerning the capital markets.

Thus, while *amici* agree that audit opinions are important to investors and the capital markets, they respectfully urge this Court to reaffirm that materiality must always be determined in context, with the key question being whether the alleged misstatement or omission by the auditor would have been viewed by a reasonable investor as having altered the total mix of information. This Court should grant the petition to avoid the unwarranted erosion of the materiality element and expansion of the private right of action under the federal securities laws.

## ARGUMENT

### I. THE DECISION BELOW COULD BE READ TO DEVIATE FROM THIS COURT'S PRECEDENTS ON MATERIALITY

The decision below could be read to conflict with the two pillars of this Court's materiality jurisprudence: Materiality must be evaluated in the context of the "total mix" of information provided to the market, and there are no "bright-line rules" that allow courts and litigants to bypass that inquiry.

Nearly fifty years ago, this Court established that the materiality of an alleged misstatement is a contextual and fact-specific inquiry. In *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), the Court held that facts are material only when there is a "substantial likelihood" that "reasonable investor[s]" would view them "as having significantly altered the 'total mix' of information" provided to the market, *id*. at 449. The Court specifically rejected the notion that "material facts include all facts which a reasonable shareholder *might* consider important." *Id*. at 445 (quotation marks omitted). That formulation, the Court explained, set an "unnecessarily low" materiality standard that would harm issuers and investors alike by implicating information of "dubious significance." *Id*. at 448. That minimal standard also would expose companies and their management to "liability for insignificant omissions or misstatements," which "can be great indeed" in the securities-fraud context. *Id*. at 448–49. In turn, companies' "fear" of that "substantial liability" might lead them to "bury the shareholders in an avalanche of trivial information"—helping no one. *Ibid*.

A decade later, *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), preserved and elaborated on this Court's contextual approach to materiality. In that case, a company asked this Court to create a "bright-line rule" simplifying the materiality inquiry for misstatements or omissions related to "preliminary merger discussions." *Id*. at 233. This Court soundly rejected that request to create an exception to its contextual materiality standard. Although a "bright-line rule" might "indeed [be] easier to follow," such a rule would "*necessarily*" oversimplify the "inherently fact-specific" materiality inquiry: "Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive." *Id*. at 236 (emphasis added). Instead, *TSC* requires "delicate assessments" of the facts and circumstances to determine materiality. *Ibid*. (quoting *TSC*, 426 U.S. at 450).

This Court reaffirmed these core principles less than fifteen years ago in *Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27 (2011). In *Matrixx*, another company "urge[d]" this Court to adopt a "bright-line rule" concerning adverse-event reporting for pharmaceutical trials. *Id*. at 39. Once again, the Court rejected the company's request. Because adverse-event reports "appear in many forms," their "mere existence . . . will not satisfy [the materiality] standard" or be "dispositive of every case." *Id*. at 43–44 (quotation marks omitted). Instead, materiality involves a "fact-specific inquiry" and depends on the "total mix" of information available to the market. *Ibid*. (quotation marks omitted).

The lower courts have consistently applied this unbroken line of precedents to determine materiality, shaping the behavior and expectations of market participants from issuers to investors. *See*, *e.g.*, David A. Katz & Laura A. McIntosh, *Corporate Governance Update: "Materiality" in America and Abroad*, Harvard Law School Forum on Corporate Governance (May 1, 2021), https://corpgov.law.harvard.edu/2021/05/01/corporate-governance-update-materiality-in-america-and-abroad ("The concept of materiality is a bedrock feature of American securities law" that "informs the way investors think, talk, and transact" and "the way lawyers advise their clients"). Cases against auditors are subject to the same standard, and auditors have likewise relied on it. That contextual approach to materiality forms an important backdrop for auditors to scope, plan, and perform their audits and assess any deficiencies they identify. *See*, *e.g.*, PCAOB Auditing Standard ("AS") 2105 (providing guidance on considering materiality under the "total mix" standard in planning and performing an audit).

The decision below, however, could be read to diverge from this Court's longstanding approach to materiality. The Second Circuit determined that respondents had adequately alleged that petitioner made a material misstatement by falsely stating that its audit complied with the Auditing Standards. Pet. App. 36a. Based on the nature of the alleged deficiencies in petitioner's audit, the Second Circuit also concluded that petitioner's allegedly false statement of compliance "subjected unknowing investors to the risk that [the issuer's] financial statements were unreliable" and, therefore, that respondents "were not required to allege a [specific] link" between that misstatement and errors in the issuer's financial statements. *Ibid*.

Although the Second Circuit's conclusion was specific to that case and that audit, it could be misinterpreted to establish a new rule that *any* alleged noncompliance with the Auditing Standards is *always* material to investors. That erroneous reading would conflict with this Court's decisions twice over by establishing a "bright-line rule" for materiality, *Basic*, 485 U.S. at 236, that excuses investors from ever needing to establish that an alleged misstatement altered the "total mix" of information available to investors, *TSC*, 426 U.S. at 449. But a bright-line approach is no more appropriate for the Auditing Standards than merger negotiations or adverse-event reports. For auditors' opinions as much as any other topic, materiality requires "delicate assessments" of the facts and circumstances surrounding the opinion. *Basic Inc.*, 485 U.S. at 236 (quoting *TSC*, 426 U.S. at 450).

## II. THE DECISION BELOW COULD BE READ TO MISAPPREHEND IMPORTANT ASPECTS OF AUDITS AND THE AUDITING STANDARDS

Audits play an important role in the U.S. securities markets because they provide reasonable assurance that an issuer's financial information has not been materially misstated. *Amici* also agree that an audit's compliance with the Auditing Standards provides important information to investors. Pet. App. 36a. But *amici* disagree with the Second Circuit to the extent that its decision is read to establish that incorrect statements of compliance with the Auditing Standards *always* "subjec[t] unknowing investors to the risk that [an issuer's] financial statements were unreliable." *Ibid.* That statement is not universally true. Instead, any bright-line rule that treats noncompliance with the Auditing Standards as determinative of materiality would fail to acknowledge important facts about the nature of audits and those standards.

Audits are complex evaluations that consist of a wide array of standards and procedures. The nature of the Auditing Standards also varies widely. Some impose detailed, prescriptive requirements, such as provisions governing audit documentation, AS 1215, engagement letters, AS 1301.06, or management representation letters, AS 2805. But others are principles-based and leave significant room for interpretation. For example, the Auditing Standards include principles-based approaches for provisions addressing competence and state of mind, *see* AS 1000.07–.08 (competence), .09–.11 (skepticism), while also providing conceptual approaches for audit topics related to risk assessments, audit evidence, and the exercise of professional judgment, *see* AS 1101 (audit risk); AS 1105 (audit evidence); AS 1000.12 (professional judgment).

As a result, applying the Auditing Standards requires the exercise of professional judgment. For example, auditors exercise due professional care when they perform a variety of audit procedures to reduce the risk of failing to detect a material misstatement to an appropriately low level and obtain sufficient and appropriate audit evidence. Determining what procedures are required to achieve "reasonable assurance" (but not "absolute assurance"), AS 1000.14, involves the exercise of the auditor's professional judgment about the nature and scope of the testing procedures, *see*, *e.g.*, AS 2315.07 ("Some degree of uncertainty is implicit in the concept of 'a reasonable basis for an opinion.'"); AS 2315.12 ("The auditor should apply professional judgment in assessing sampling risk.").

Like the adverse-event reports in *Matrixx*, audit deficiencies thus "appear in many forms" and "will not satisfy [the materiality] standard" through their "mere existence." 563 U.S. at 43–44. Notably, even the PCAOB itself recognizes that an auditor's noncompliance with the Auditing Standards does not necessarily mean that a company's financial statements have been materially misstated. The PCAOB conducts "routine inspections of all accounting firms," *Free Enter. Fund* v. *PCAOB*, 561 U.S. 477, 485 (2010), and those inspections sometimes uncover audit deficiencies. But the PCAOB has taken pains to make clear that the "[i]nclusion of a deficiency in an inspection report . . . does not necessarily mean that the issuer's financial statements are materially misstated." *PCAOB Inspection Procedures: What Does the PCAOB Inspect and How Are Inspections Conducted?*, PCAOB, https://pcaobus.org/oversight/inspections/inspection-procedures.

In accordance with the PCAOB's understanding, not every technical violation of an Auditing Standard would be viewed by "reasonable investor[s] as having significantly altered the 'total mix' of information" provided to the market. *TSC*, 426 U.S. at 449.

For example, under AS 1301, Communications with Audit Committees, an auditor must provide the audit committee with the "names, locations, and planned responsibilities" of other accounting firms that "perform audit procedures in the current audit period." AS 1301.10(d). The profession takes this requirement seriously, and it serves the valuable purpose of keeping the audit committee informed about the accountants who are providing services to the company. But standing alone, an auditor's failure to disclose the "location" of another participating accounting firm to the auditing committee should not support a conclusion that the company's financial statements are unreliable and should not state a claim under the federal securities laws.

Another example concerns AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion. That standard requires the "auditor's report" to include a "statement containing the year the auditor began serving consecutively as the company's auditor." AS 3101.10(b). This is another requirement that the profession takes seriously and that serves important purposes, such as helping the market understand an auditor's familiarity with a client and its business. But a typographical error in the transcription of that date—such as stating that a firm began performing audits in 1997 instead of 1998—simply has no bearing on the accuracy of the company's financial statements and would not be viewed by reasonable investors as changing the "total mix" of available information.

Finally, the ultimate purpose of an audit underscores that the materiality of alleged noncompliance with the Auditing Standards must be evaluated on a case-by-case basis. Although audits subject important information about an issuer's financial statements to audit procedures, auditors do not "'certify' a company's financial statements in the sense that they 'guarantee' or 'insure' them." *Deephaven Private Placement Trading, Ltd.* v. *Grant Thornton & Co.*, 454 F.3d 1168, 1174 (10th Cir. 2006) (footnote omitted). Instead, auditors express their opinions about whether a company's financial statements are materially consistent with governing accounting principles. *See* AS 1000.03, .13; *see also United States* v. *Arthur*

*Young & Co.*, 465 U.S. 805, 810–11 (1984) ("The auditor . . . issues an opinion as to whether the financial statements, taken as a whole, fairly present the financial position and operations of the corporation for the relevant period."). Such statements of belief matter to investors and are valuable because they reflect auditors' professional expertise and examinations of their clients' businesses. But an auditor's opinion ultimately rests on the auditor's belief that he has obtained "reasonable assurance"—not "absolute assurance"—that the company's financial statements have not been materially misstated. AS 1000.14. As a result, a standard of materiality that does not account for an alleged misstatement's context would deviate from precedent and be especially inappropriate for securities-fraud claims against auditors.

## III. THE DECISION BELOW COULD BE READ TO UNDERMINE CONGRESSIONAL POLICY

To the extent that the decision below is read to establish a bright-line rule for materiality in the context of the Auditing Standards, it would also conflict with Congress's policy of protecting the integrity of U.S. capital markets by shielding participants from frivolous securities litigation. Congress sought to achieve that goal by enacting the Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (Dec. 22, 1995), "[a]s a check against abusive litigation by private parties" that "impose[d] substantial costs on companies and individuals whose conduct conforms to the law," *Tellabs, Inc.* v. *Makor Issues & Rts., Ltd.*, 551 U.S. 308, 313 (2007). Among the "perceived abuses" were "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);

*see also Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 347 (2005) (stating that before the PSLRA, private securities litigation was marked by "the routine filing of lawsuits" alleging securities fraud "with only [a] faint hope that the discovery process might lead eventually to some plausible cause of action").

The decision below could be read to undermine that policy by creating an exception to this Court's longstanding and well-established approach to materiality—thereby encouraging private parties to file suit over alleged misstatements that are not alleged to have altered the "total mix" of information made available to reasonable investors. Such a reading would elevate *any* alleged noncompliance with the Auditing Standards into a federal lawsuit and thereby expand the risks of frivolous litigation that auditors face as they perform their work.

Reading the decision below to expose auditors to liability for *any* mistake in their compliance with the Auditing Standards—where there is no alleged impact on the "total mix" of information made available to investors—should be especially unwelcome due to the important role that auditors play in the capital markets. *See*, *e.g.*, *United States* v. *Marino*, 654 F.3d 310, 323 (2d Cir. 2011) ("Courts have long recognized the important 'public watch-dog' function of independent financial auditors to the investing public."); *Deephaven*, 454 F.3d at 1174 ("[A]n auditor's independent scrutiny plays a necessary role in ensuring that the integrity of the securities markets will be preserved."). Because most accounting firms are partnerships and a small number of them perform the vast majority of audits for public companies in the United States, *see*, *e.g.*, Sarah Keohane, *Who Audits Public Companies – 2024 Edition*, Ideagen (updated Aug. 14, 2024), https://www.ideagen.com/thought-leadership/blog/who-audits-public-companies-2024-edition, auditors are particularly vulnerable to abuse from vexatious litigation—the very harm that the PSLRA was designed to protect against. In light of those concerns, the Court should clarify and reaffirm that auditors face the same materiality standard as set forth in this Court's longstanding precedents.

* * *

Audits are critical for the health of the capital markets. *Amici* are deeply committed to improving audit quality and the role of the auditor in facilitating confidence in financial reporting; the latter objective is a fundamentally important goal that thousands of the members of *amici* have dedicated their careers to achieving. But the language of the decision below—which could be read to suggest that incorrect statements of compliance with the Auditing Standards *always* "subjec[t] unknowing investors to the risk that [an issuer's] financial statements were unreliable" no matter the context, Pet. App. 36a—creates the risk of escalating even a technical foot-fault of the Auditing Standards into a federal securities lawsuit. Creating a bright-line materiality rule is inconsistent with this Court's well-established precedent and threatens to harm the capital markets.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

MICHAEL J. SCANLON
LUCAS C. TOWNSEND
*Counsel of Record*
JOHN N. REED
GIBSON, DUNN & CRUTCHER LLP
1700 M Street, N.W.
Washington, D.C. 20036
(202) 955-8500
LTownsend@gibsondunn.com

JAMES J. FARRELL
GIBSON, DUNN & CRUTCHER LLP
200 Park Avenue
New York, NY 10166
(212) 351-4000

*Counsel for Amici Curiae*

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