No. 15-88

IN THE
Supreme Court of the United States

BOCA RATON FIREFIGHTERS & POLICE PENSION FUND,
Petitioner,

v.

ROBERT J. BAHASH, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF SENATOR RICHARD BLUMENTHAL AS *AMICUS CURIAE* SUPPORTING PETITIONER

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INTEREST OF *AMICUS CURIAE*[1]

Amicus Senator Richard Blumenthal is a United States Senator representing the State of Connecticut. As a Member of Congress, Senator Blumenthal has an interest in ensuring that the federal securities laws are correctly interpreted in accordance with their remedial purpose. As he explains below, Senator Blumenthal believes that the Second Circuit's unduly broad understanding of "puffery" weakens the protections afforded by those laws and flouts Congress's purpose in enacting them.

Senator Blumenthal has served consistently as a voice of accountability for the ratings agencies and for truthful disclosures to American investors. As Connecticut's Attorney General, he led the first state lawsuit against the ratings agencies for their deceptive statements in the run-up to the financial crisis. As a Senator, he has continued to advocate for greater accountability from ratings agencies and issuers. And, as a sitting Senator in a State located in the Second Circuit, Senator Blumenthal has a particularly strong interest in ensuring that the decision below is overturned.

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[1] Pursuant to Rule 37.6, counsel for *amicus* represent that they authored this brief in its entirety and that no person other than *amicus* or his counsel made a monetary contribution intended to fund its preparation or submission. Pursuant to Rule 37.2(a), all parties were provided timely notice of *amicus*'s intention to file this brief and have consented to its filing. Petitioner filed a letter with the Court granting blanket consent to the filing of *amicus* briefs, and written consent from respondents to the filing of this brief is being submitted contemporaneously with the brief.

INTRODUCTION

This case arises from one of the most important series of events in the Nation's economic history. It concerns one critical cause of the 2008 financial crisis: ratings agencies' false and public insistence that they used objective and independent ratings methodologies to evaluate mortgage-backed securities. The agencies' false statements misled investors who purchased the toxic securities they rated, the analysts who relied on those ratings, and the agencies' own shareholders. The resulting collapse of the financial markets led to one of the worst recessions in U.S. economic history. In short, the misconduct at issue in this case resulted in just the sort of calamity that the federal securities laws were designed to prevent.

Petitioner brought suit on behalf of shareholders who owned respondent's common stock, alleging that Standard & Poor's ("S&P") falsely represented the independence and objectivity of its ratings process. The Second Circuit upheld the dismissal of those allegations, reasoning that S&P's verifiably false statements about its ratings process were insufficiently specific to be material to reasonable investors.

Amicus, as a Senator with a particular interest in the effective operation of the federal securities laws, believes that the Second Circuit committed an error of grave consequence for the national economy. Indeed, the Second Circuit's unduly expansive view of inactionable "puffery" not only creates a circuit conflict destructive to the uniformity that the federal securities laws are supposed to promote, but also weakens protections available to investors in the country's most important financial market. The facts of this very case – and the historic crisis from which it arose

– demonstrate the national importance of that error. Accordingly, the Court should grant certiorari and make clear that issuers cannot use the doctrine of "puffery" to evade responsibility for statements whose falsity is objectively verifiable.

ARGUMENT

I. CERTIORARI IS WARRANTED TO RESOLVE LOWER-COURT CONFUSION OVER THE DEFINITION OF PUFFERY UNDER THE FEDERAL SECURITIES LAWS

A. The Courts Of Appeals Have Adopted Conflicting Definitions Of Puffery

As petitioner demonstrates (at 14-24), the circuits are divided over the proper legal standard for determining when a misleading statement qualifies as inactionable puffery. Courts generally agree that some statements are so abstract – and thus incapable of misleading a reasonable investor – that they constitute immaterial puffery as a matter of law. But the Second Circuit holds a significantly broader view of puffery than other circuits. According to the Second Circuit, statements that are merely "general" in nature – even if "knowingly and verifiably false" – can still constitute inactionable puffery. *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 183 (2d Cir. 2014).

Other circuits take a much narrower view. The Ninth Circuit, for example, has held that "[s]tatements by a company that are capable of objective verification are not 'puffery' and can constitute material misrepresentations." *Oregon Pub. Emps. Ret. Fund v. Apollo Grp. Inc.*, 774 F.3d 598, 606 (9th Cir. 2014) (citing *SEC v. Todd*, 642 F.3d 1207, 1216-17 (9th Cir. 2011)). Multiple other circuits have held similarly, concluding that a statement is not puffery if it is

verifiably false. *See City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 674 (6th Cir. 2005); *In re Level 3 Commc'ns, Inc. Sec. Litig.*, 667 F.3d 1331, 1339-41 (10th Cir. 2012); *In re Harman Int'l Indus., Inc. Sec. Litig.*, 791 F.3d 90, 108-09 (D.C. Cir. 2015). In those circuits, unlike in the Second, a statement's mere generality is not enough to shield it from scrutiny under the federal securities laws. Rather, "[t]he key is whether the proposition at issue can be proven or disproven using standard tools of evidence." *City of Monroe*, 399 F.3d at 674.

The conflict between those competing legal standards is not merely theoretical; it has led courts to treat the same statements differently. In this case, the Second Circuit's unduly expansive view of puffery shielded S&P from liability for verifiably false statements, merely because of those statements' "generic, indefinite nature." App. 5a. By contrast, the United States District Court for the Central District of California, when confronted with the very same statements, applied the Ninth Circuit rule and held those statements actionable because they were "verifiable representations" capable of "objectiv[e]" evaluation. *See United States v. McGraw-Hill Cos.*, No. CV 13-0779 DOC (JCGx), 2013 WL 3762259, at *7 (C.D. Cal. July 16, 2013). Had petitioner brought this case in the Ninth Circuit, it likely would have obtained a similar ruling and survived dismissal.

B. The Conflict Over When Statements Qualify As Puffery Merits Certiorari

The circuit split over the proper standard for evaluating puffery warrants the Court's review. As the law stands currently, investors' ability to recover for injuries stemming from general-yet-verifiably-false statements depends on the forum in which they bring

suit. Such geographical variation thwarts a core goal of the federal securities laws. Indeed, one important purpose of the Securities Exchange Act of 1934 ("Exchange Act" or "1934 Act") is "to achieve greater uniformity of construction" regarding claims for securities fraud. *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 383 (1996) (internal quotations omitted); *see Will v. Calvert Fire Ins. Co.*, 437 U.S. 655, 675-76 (1978) (Brennan, J., dissenting) (criticizing rules that undermine "the policy of uniform and effective federal administration and interpretation of the 1934 Act"); *cf.* 15 U.S.C. § 78q-1(f)(2)(A)(ii) (finding that the "safe and efficient operation of the national system" for securities transactions would be "substantially impeded" "in the absence of a uniform rule"). Such uniformity is impossible where different courts apply different rules for determining when a false statement is actionable.

The circuit conflict created by the decision below is particularly troubling. The Second Circuit presides over the Nation's most vital financial center, and a large number of important issuers and institutional investors reside in the States within its jurisdiction. For that reason, securities lawsuits are traditionally concentrated in the Second Circuit, and that court's rulings have assumed outsized importance to the development of national securities-law jurisprudence.[2] The Second Circuit's departure from the definition of puffery employed in the rest of the country therefore deserves this Court's immediate review.

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[2] *See* NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2014 Full-Year Review* 10 (Jan. 20, 2015) (surveying securities class-action filings), *available at* http://www.nera.com/content/dam/nera/publications/2015/Full_Year_Trends_2014_0115.pdf.

In resolving that conflict, the Court should take a narrow view of puffery, particularly at the motion-to-dismiss stage. If allowed to stand, the decision below would leave investors in the Nation's most important financial market without a remedy for verifiable misstatements that – though objectively false – are too "general" to avoid the Second Circuit's capacious standard for puffery. And because that standard operates at the pleading stage to snuff out cases before discovery, it improperly *assumes* the immateriality of such statements while depriving investors of the opportunity to build a factual record showing otherwise. *See Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2413 (2014) (statement is material if it "significantly alter[s] the total mix of information" about a security) (internal quotations omitted); *Basic Inc. v. Levinson*, 485 U.S. 224, 236 (1988) (materiality inquiry is "inherently fact-specific").

Congress did not intend the federal securities laws to place investors in such an untenable litigating position. The securities laws reflect "Congress' remedial purpose . . . to protect investors by compelling full and fair disclosure." *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 687 (1985) (internal quotations omitted). That remedial purpose extends not just to large sophisticated investors with the resources to parse the Second Circuit's puffery standard, but also to less sophisticated investors who are likely to rely on statements like the ones S&P made here. The decision below leaves such investors without a remedy when they rely on verifiably false statements that courts later (with the benefit of expertise and hindsight) regard as too "general" to be material. App. 5a. This Court should grant review and make clear that the Second Circuit's harsh rule is incompatible with the federal securities laws.

II. THE FACTS OF THIS CASE VIVIDLY ILLUSTRATE THE IMPORTANCE OF THE QUESTION PRESENTED

The question this case presents is of more than academic interest. Its facts exemplify why Congress enacted the Exchange Act and why the proper interpretation of that Act remains of vital national importance. This case thus provides a compelling opportunity for the Court to vindicate the pro-investor policies at the heart of the federal securities laws.

A. S&P Made Statements That Concealed Its Central Participation In The Financial Crisis

S&P played a pivotal role in the inflation of the credit market that led to the recent financial crisis. The imprimatur conferred by S&P's "AAA" ratings made residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs") – which in reality were unconscionably risky due to lax due-diligence practices by securities underwriters and loan originators – "seem like safe investments." Staff of Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs, 112th Cong., *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse* 243 (2011) ("Senate Report").[3] S&P continued to give those securities AAA ratings despite intensifying warnings about the impending crisis in the mortgage system on which they were based. *See id.* S&P disregarded those warnings due in large part to the structural conflict of interest that underpinned its business model, under which "[c]redit rating agencies were paid by the Wall Street firms that sought their ratings and

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[3] *Available at* http://www.hsgac.senate.gov/imo/media/doc/Financial_Crisis/FinancialCrisisReport.pdf?attempt=2.

profited from the financial products being rated." *Id.* at 244. S&P thus competed with other ratings agencies by lowering its standards for risky investments – and thereby attracting additional business from issuers who wanted the legitimacy that high ratings conferred. *See id.*

S&P's fraudulent scheme worked as follows: In order successfully to market RMBS and CDOs, issuers require a credit rating from S&P or another credit rating agency recognized by the Securities and Exchange Commission. As a result, S&P and the other credit rating agencies were necessary cogs in the RMBS and CDO market. Due to the complexity of many mortgage-backed securities, "investors often relied heavily on credit ratings to determine whether they could or should buy the products." Senate Report at 250. S&P itself understood the importance of its ratings: the "investor perception that S&P's ratings accurately reflected credit risk was crucial to S&P's business." Compl. ¶ 50, *United States v. McGraw-Hill Cos.*, No. CV 13-0779 (C.D. Cal. filed Feb. 4, 2013) ("DOJ Compl.").[4]

Moreover, various institutional investors are required by law to invest only in securities that receive an investment-grade rating from S&P or one of its competitors. *See* Senate Report at 248. For those investors, S&P's role in financial markets is particularly vital. Restrictions on investments in non-investment-grade securities increased demand for S&P's generous ratings, which in turn "created pressure on [S&P] to issue top ratings in order to make the rated products eligible for purchase by regulated financial institutions." *Id.*

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[4] *Available at* http://www.justice.gov/iso/opa/resources/849201325104924250796.PDF.

S&P exploited that demand by emphasizing repeatedly that its ratings process was impartial. *See* DOJ Compl. ¶¶ 110-124 (collecting statements). As petitioner explains in a proposed third amended complaint in this case, S&P emphasized that its rating process was "objective" and "independent"; that ratings were unaffected "by the existence of, or potential for, a business relationship" with the issuer; and that its ratings process was premised on "independent benchmarks." Proposed Third Am. Compl. ¶¶ 407, 409, 420, *Reese v. McGraw-Hill Cos.*, No. 1:08-cv-07202-SHS (S.D.N.Y. filed Mar. 28, 2013) ("Investor Compl."). Still worse, after the mid-2007 mass downgrading of structured finance products, S&P reiterated that it did "not engage in . . . behavior" such as "weaken[ing] [ratings] criteria" to attract revenue from issuers of toxic securities. *Id.* ¶ 484. Those statements were material to investors, and they made an important contribution to the 2008 collapse of the country's financial markets.

B. S&P's Public Statements About The Independence And Objectivity Of Its Ratings Were Verifiably False

Contrary to S&P's public statements, its ratings process was neither independent nor objective. For example, S&P used a model called LEVELS to calculate the credit risk of proposed RMBS. As of 1999, LEVELS relied on a database of 166,000 loans that were almost exclusively investment grade. *See* Investor Compl. ¶ 140; DOJ Compl. ¶ 135. In 2000, the mortgage market began creating riskier, nonprime mortgage loans. Although S&P by 2002 had compiled a new dataset that included many of those riskier loans, it never incorporated the new data into its existing model – then called "LEVELS 5.6." *See*

Investor Compl. ¶ 141; DOJ Compl. ¶ 139. Rather, it developed a new provisional model called "LEVELS 6.0." *See* Investor Compl. ¶ 142; DOJ Compl. ¶ 140.

S&P failed to implement that new model – or update its old one – until 2006. *See* Investor Compl. ¶ 153; DOJ Compl. ¶ 152. Instead, it adhered to its old, outdated ratings model based on obsolete data even as its analysts learned of "increasing risks in the mortgage market." Senate Report at 268-72. In early 2004, S&P announced LEVELS 6.0 in a post on its website, but subsequently deleted the post. *See* Investor Compl. ¶ 144; DOJ Compl. ¶ 142. LEVELS 6.0 would have required issuers of subprime RMBS to provide higher loss coverage to obtain higher S&P grades. But because those mortgages would have been less profitable for issuers, LEVELS 6.0 was never released. *See* Investor Compl. ¶¶ 145-147; DOJ Compl. ¶¶ 143-146.

The evidence uncovered by the DOJ in its case against S&P reveals that S&P withheld its new model in an attempt to preserve market share. On or about May 25, 2004, after the website announcement of LEVELS 6.0, an RMBS analyst emailed S&P executives and advised that S&P was losing a deal because of its conservative ratings models. The email stated that "[w]e just lost a huge Mizuho RMBS deal to Moody's due to a huge difference in the required credit support level," and "[w]hat we found from the arranger was that our support level was at least 10% higher than Moody's." DOJ Compl. ¶ 144; *see* Investor Compl. ¶ 118 (same).

Concerns over losing more deals caused S&P to drag its feet on further efforts to improve its outdated ratings model. When an executive pleaded with colleagues to use the updated model, others

at S&P responded: "we already had 94, 95 percent [market share], and it would just be a better model," asking "if we're not going to gain more revenue why should we spend the money to do that?" Investor Compl. ¶ 165 (alteration in original). In another email exchange, a senior analyst stated that LEVELS 6.0 "could have been released months ago and resources assigned elsewhere if we didn't have to massage the sub-prime and Alt-A numbers to preserve market share." *Id.* ¶ 166.

Unsurprisingly, the Senate investigation into the causes of the financial market found that S&P's self-described efforts to "massage the sub-prime . . . numbers," *id.*, resulted in a structurally "flawed" ratings process, Senate Report at 288. Not only was LEVELS 5.6 based on obsolete data, but S&P's trickle of belated revisions were "never enough to produce accurate forecasts of the coming wave of mortgage delinquencies and defaults." *Id.* The ratings process remained "unclear and subjective," and, even after changes were made, S&P failed to use its updated models to retest securities that had been inaccurately rated under the old models. *Id.* at 294, 297.

The motivations for those failures are now clear. It is evident from the information uncovered in the DOJ's case and discussed in the Senate Report that S&P bent its ratings criteria to suit the needs of RMBS and CDO issuers. As it developed LEVELS 6.0, S&P was constantly communicating with issuers to test their comfort with the new models. *See* DOJ Compl. ¶¶ 125-127, 170-173; Investor Compl. ¶¶ 113-115, 179-182. Negative reactions from clients likewise caused S&P continually to weaken its ratings criteria. And, in response to fears over the impact of LEVELS 6.0 on RMBS ratings, S&P execu-

tives developed LEVELS 5.7, which did not increase required loss coverage as high as LEVELS 6.0. *See* DOJ Compl. ¶ 150; Investor Compl. ¶ 151.

In 2006, with no analytical justification, the S&P executive in charge of business relationships with RMBS issuers changed an assumption in LEVELS 5.7 so that its ratings would never be more conservative than Moody's ratings for the same securities. *See* DOJ Compl. ¶ 153; Investor Compl. ¶ 154. Similarly, when LEVELS "6.0" was finally (and belatedly) released in 2007, its assumptions were much more favorable to issuers than they should have been, and emails show that S&P executives and employees carefully monitored the model to make sure that it did not affect S&P's market share. *See* DOJ Compl. ¶¶ 154-157; Investor Compl. ¶¶ 155-158.

All those facts squarely contradict S&P's public statements about the independence of its ratings process, and all of them are capable of objective verification. The securities laws were intended to provide investors with a remedy for objectively false statements that conceal such misconduct.

C. The Second Circuit's Decision Undermines Protections For Investors And Consumers

Despite the host of objectively verifiable statements that S&P made about one of the linchpins of the U.S. financial system, the Second Circuit held the statements at issue too general as a matter of law to support a securities-fraud lawsuit. That holding – and its implications for one of the most important financial events in the history of the U.S. economy – merits further review. Indeed, S&P's series of false statements about its ratings – and the resulting mass downgrades in July 2007 – "perhaps more than any other single event triggered the finan-

cial crisis." Senate Report at 243. This case presents the sole remaining opportunity to hold S&P accountable and make respondent's investors whole.

As the financial crisis demonstrated, S&P's tainted ratings enabled the proliferation of toxic assets, which touched nearly every facet of the financial system. By late 2006 – while its sponsorship of those toxic securities continued unabated – S&P was well aware that the performance of subprime RMBS securities was deteriorating rapidly. *See* DOJ Compl. ¶ 200. In fact, in March 2007, an S&P RMBS analyst literally recorded a song joking about the impending market collapse, which he circulated to other RMBS and CDO analysts over email. *See id.* ¶ 233(j)-(k).

From March 2007 through June 2007, S&P continued to issue investment-grade credit ratings for billions of dollars of RMBS and CDO securities that failed to account for the increasing risks in the underlying assets. *See*, *e.g.*, *id.* ¶¶ 234 (March), 236 (April), 238 (May), 241 (early June), 244 (late June). Especially troubling was the fact that in the first week of July – on the eve of the mass downgrades – S&P issued 1,500 new RMBS ratings, nearly equal the number of ratings it issued in each of the preceding three months. *See* Senate Report at 263.

When S&P's deceit was finally revealed, it dealt a massive blow to the market. S&P was forced suddenly to downgrade thousands of securities it had previously rated at investment grade, which placed the securitization markets in turmoil. Institutional investors, like petitioner, were required by regulation to sell off their downgraded securities. And, as the markets for these securities collapsed, financial firms were left holding billions of dollars of unsellable RMBS and CDOs. *See id.* at 32. Among those

harmed were investors in McGraw-Hill who had relied on S&P's professed independence and objectivity. After S&P's misconduct was revealed, the value of McGraw-Hill's stock tumbled by nearly 70%. *See id.* at 272. The direct result was millions of dollars in losses for its shareholders.

By deeming McGraw-Hill's statements puffery, the decision below effectively blamed *investors* – rather than S&P – for believing in the professed objectivity of its ratings. That gets the issue exactly backward. Rating agencies studiously cultivated their reputations as honest stewards of the financial markets, when in reality they were trading their impartiality for short-term market share. The ratings agencies, not the investors they deceived, should be held to account. Any rule that excuses as mere "puffery" S&P's factual misstatements about the integrity of its ratings methodology is fundamentally inconsistent with the core intent of the federal securities laws. The Second Circuit's misguided adoption of that rule should be corrected by this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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