No. 15-88

IN THE

Supreme Court of the United States

BOCA RATON FIREFIGHTERS AND POLICE PENSION FUND,

Petitioner,

v.

ROBERT J. BAHASH, THE MCGRAW-HILL COMPANIES, INC. AND HAROLD MCGRAW, III,

Respondents.

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

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Respondents and their employees loudly touted Standard & Poor's debt securities rating criteria as non-negotiable, predetermined, and publicly available. In fact S&P applied secret criteria negotiated with the issuers who paid it in order to rate those issuers' offerings favorably. For years, respondents assured us—expressly, emphatically, and utterly falsely—that they had addressed this very conflict of interest by adhering to specific policies and employing specific methodologies that insulated rating decisions from issuer influence. When the global financial crisis revealed the breathtaking scope of respondents' deceit, S&P's credibility was shattered and McGraw-Hill's stock price tumbled.

The lower courts nevertheless deemed these false statements to be immaterial "puffery" *at the motion-to-dismiss stage*. Respondents scarcely defend the merits of that decision, because it is indefensible. Respondents instead attempt to defeat the petition by disputing the existence of a circuit split—even though the very same statements were deemed actionable under Ninth Circuit precedent—and they hang their hats on the procedural posture of the case. Their objections lack merit, and the fact that a sitting U.S. Senator and the dean of one of America's leading business schools have filed separate *amicus* briefs confirming the importance of the question presented sends a powerful signal in favor of review.

This Court should grant certiorari to determine whether and when the puffery defense can shield statements as obviously important as the ones at issue in this case. At a minimum, this Court should grant, vacate, and remand so that the Second Circuit can

determine whether its puffery standard is consistent with this Court's decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015).

I. The Second Circuit Applies A Different Standard For Puffery Than Other Circuits.

1. Respondents attack a straw man, arguing that there is no circuit split because the courts of appeals generally agree that "statements which are too indefinite, vague, or general for a reasonable investor to rely upon are immaterial as a matter of law." BIO 18. They cite cases from other circuits finding puffery in distinguishable circumstances. *Id*. 22-23, 25. But the split does not concern whether some puffery defense exists. Instead, the split is over whether that defense applies to verifiably false factual statements that relate to matters of importance. Pet. i. And on that question, the Second Circuit's approach is uniquely favorable to defendants, because it is the only court that ever holds that the answer is "yes" as a matter of law.

While other circuits emphasize the need to ""tread lightly at the motion-to-dismiss stage" in order to avoid "prematurely dismissing suits on the basis of our intuition," *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d 455, 472 (6th Cir. 2014), and have therefore limited "puffery" to only those "terms that are 'too squishy, too untethered to anything measurable, to communicate anything that a reasonable person would deem important to a securities investment decision," *In re Harman Int'l Indus., Inc. Sec. Litig.*, 791 F.3d 90, 109 (D.C. Cir. 2015), the Second Circuit and the district

courts there have dismissed a much broader range of claims. *See* Pet. 15-16. Indeed, only the Second Circuit has made statements such as this: "Plaintiffs' claim that these statements were knowingly and verifiably false when made does not cure their generality, which is what prevents them from rising to the level of materiality required to form the basis for assessing a potential investment." *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 183 (2d Cir. 2014).

Respondents never defend this statement. Instead, they protest that *City of Pontiac* was decided after this case and was therefore not cited in the opinions below, and they contend that other Second Circuit cases have articulated the standards differently. BIO 19-21 & n.13. These disclaimers miss the mark. First, petitioner's argument is not that every Second Circuit case on this question has been wrongly decided. However, in a number of cases, including this one, the Second Circuit has applied a rule that is broader than any other court. The fact that the Second Circuit continued to do so after this case, using language that not even respondents defend, highlights the ongoing circuit conflict and the need for this Court's intervention.

Second, respondents' efforts to distance this case from the Second Circuit's articulation of its rule in *City of Pontiac* fail. In this case, as in *City of Pontiac*, the lower courts held that respondents' statements were "too general to cause a reasonable investor to rely upon them." Pet. App. 5a. And here, as in *City of Pontiac*, it did not matter that the key statements were knowingly and verifiably false. For instance, when respondent McGraw stated that S&P calculates

ratings by applying "predetermined, nonnegotiable, and publicly available criteria," Pet. App. 12a, he made verifiable claims: if S&P in fact negotiated over its criteria, or used criteria that were not publicly available, then all three of those adjectives would be knowingly and verifiably false—but the Second Circuit held that these statements were nevertheless "generic" and "indefinite," and therefore puffery. *Id*. 5a.

2. The clearest illustration of a circuit conflict is that a district court in the Ninth Circuit rejected the defendants' (including respondent McGraw's) argument that these very same statements were puffery. *See* Pet. 18 (citing *United States v. McGraw-Hill Cos.*, No. CV 13-0779 DOC JCGx, 2013 WL 3762259 (C.D. Cal. July 16, 2013)). The court described McGraw's argument as "deeply and unavoidably troubling," and explained that because S&P stated that it had "established policies and procedures to address [it's] conflicts of interest through a combination of internal controls and disclosure," it had not engaged in mere puffery, but had instead made "specific assertions of current and ongoing policies that stand in stark contrast to the behavior alleged." *McGraw-Hill Cos*., 2013 WL 3762259, at *5-*6. As the *amicus* brief of Dean Richard Lyons explained, "a firm's representation that it has identified and addressed a conflict of interest is critical information for investors," and "courts should look with skepticism on any effort to label statements about conflicts—especially conflicts that relate to a business's key products—as mere 'puffery.'" Lyons Br. 9-10.

Respondents suggest a distinction: the complaint in the California case alleged that the end users of the ratings were defrauded, while the complaint in this

case alleges that McGraw-Hill's shareholders were defrauded. BIO 24. Respondents argue that statements which are material to one set of investors might not be material to another. That argument is unpersuasive for two reasons. First, even if respondents' speculation is accurate, it has nothing to do with whether the statements constitute "puffery." Statements are either "capable of objective verification," or they are not; the identity of the listener is irrelevant. *See Ore. Pub. Emps. Ret. Fund v. Apollo Grp., Inc.*, 774 F.3d 598, 606 (9th Cir. 2014) (setting forth the Ninth Circuit's standard for puffery).

Second, as the petition explained (at 19 n.4), to the extent this distinction matters, it only makes the dismissal in this case more inflammatory: investors evaluating the quality of rated securities had an incentive to take respondents' statements with a grain of salt, and to further research the quality of those securities. Petitioner, on the other hand, had every reason to take respondents at their word, and had no access to contrary information. *See* Lyons Br. 9 (explaining that a company executive's statements about conflicts of interest are material to investors because investors do "not have access to most internal decisions, processes, or communications—many of which may be regarded as trade secrets"). Thus, if anything, respondents' misstatements were more likely to be material to petitioner. If respondents wish to dispute the point and argue that the statements in this case were not material to petitioner, those factual contentions should be presented at the appropriate time to a jury—instead of being embraced as a matter of law by judges applying mere intuition.

II. This Case Presents A Strong Vehicle To Address The Question Presented.

1. Respondents emphasize that the petition arises from the lower courts' denial of a motion under Federal Rule of Civil Procedure 60(b), and not from the lower courts' original orders dismissing petitioner's complaint. BIO 12-15. They therefore argue that "this Court's review is limited to the Rule 60(b) motion, under an abuse of discretion standard." *Id*. 13. But when the issue is whether the lower courts applied the correct legal standard, that fact changes nothing because on review of the denial of a Rule 60(b) motion, appellate courts do not defer to erroneous legal reasoning. Here, the lower courts evaluated petitioner's motion against an incorrect legal standard, and they are required to evaluate it again under the correct one. *See, e.g.*, Pet. App. 5a (the Second Circuit acknowledges that a district court abuses its discretion by denying the Rule 60(b) motion based "on an error of law"); *Venture Indus. Corp. v. Autoliv ASP, Inc.*, 457 F.3d 1322, 1327 (Fed. Cir. 2006) (explaining that on review of the denial of a Rule 60(b) motion, "[a]n abuse of discretion will be found if the district court relies on clearly erroneous findings of fact, improperly applies the law or uses an erroneous legal standard.").

To be sure, the procedural posture of the case may ultimately make petitioner's job harder by creating an additional hurdle on remand. But this Court need not resolve whether relief is ultimately warranted in order to decide this case. It can instead do what it normally does: clarify the legal standard and allow the lower courts to apply the standard to the facts of this case.

2. Respondents are also wrong that independent grounds support the decision below. They argue that in addition to failing to allege that the statements were material, the complaint fails to allege falsity, and also scienter. BIO 16-17.

With regard to falsity, respondents quote portions of the lower courts' opinions addressing statements not at issue in the petition. For example, respondents quote the Second Circuit's first opinion, which chided a previous version of the complaint for failing to plead certain allegations with particularity. BIO 16 (quoting Pet. App. 43a). But that holding related to "the complaint's allegations with respect to McGraw-Hill's oversight and surveillance procedures," and not the statements at issue here, which relate to S&P's independence from conflicts of interest, as pleaded in the Third Amended Complaint. Pet. App. 41a; Pet. 7 n.2 (distinguishing those statements from the statements presently being challenged).

In adjudicating the Rule 60(b) motion, the district court (but not the Second Circuit) held that the new evidence did not show why S&P's statements were false. For example, it concluded that the statement that S&P "appl[ies] its own predetermined, nonnegotiable, and publicly available criteria and assumptions to the facts presented" could not be read as "a guarantee that its ratings were made without regard to profits, market share, or client feedback." Pet. App. 25a-26a. But that ruling is not an alternate ground outside the scope of the question presented; instead, it is plainly included within the scope of the question, which is premised upon the statements being "verifiably false." *See, e.g.*, *Ohio v. Robinette*, 519 U.S. 33, 38 (1996) (holding that any issue that is a

"predicate to an intelligent resolution of the question presented" is "fairly included therein") (quotation marks omitted).

The district court's ruling on the question of falsity is also indefensible because the statements relating to S&P's independence in the rating process *are* verifiably false. In the Third Amended Complaint, each false statement is followed by a paragraph explaining why it is false. For example, after the paragraph citing S&P's statement that it applies "its own predetermined, nonnegotiable, and publicly available criteria and assumptions to the facts presented," (¶ 491) the Third Amended Complaint alleges that this statement "was verifiably false because those criteria were in fact negotiable, since S&P was secretly working with issuers on a deal-by-deal basis to get around its publicly announced 'notching' policy when 'notching' would have interfered with S&P's ability to rate a CDO." (¶ 492) Thus, the district court's analysis—that the statement cannot be false because it cannot be taken as a sweeping guarantee that S&P would never consider market share or profits—hinges on an erroneous legal standard. The Third Amended Complaint explains exactly which publicly announced criteria were disregarded, and exactly how negotiations with issuers impaired the credibility of S&P's ratings.

While the "predetermined, nonnegotiable, and publicly available" statement is the clearest example of an actionable falsehood, it is by no means the only one. The Third Amended Complaint recites a litany of specific statements, made consistently over a period of years, all disclaiming that S&P would allow issuers to influence its rating decisions. For example, S&P's code

of conduct states that "[r]atings assigned by Ratings Services to an issuer or issue *shall not be affected* by the existence of, or potential for, a business relationship between Ratings Services (or any Non-Ratings Business) and the issuer (or its affiliates) or any other party, or the non-existence of such a relationship." (¶ 155) (emphasis added) It is impossible to read that statement as anything other than an ironclad guarantee that S&P would not consider issuers' interests in the rating process, which it plainly did. Later, after the subprime mortgage market faltered and market participants began to ask questions about S&P's rating process, an S&P executive reassured the market that S&P was applying stringent rating criteria, which might cause some issuers not to seek a rating from S&P. (¶ 479) The executive then stated that loss of market share is "not what we're concerned about. We're concerned about calling it as it is." (*Id*.) And in a publication that S&P posted on its website in 2007, it again explained that "one way to increase revenue would be for us to weaken our criteria to ensure that a transaction that would not have been economically viable can take place. This would, of course, violate our internal rules . . . . *[W]e do not engage in such behavior*." (¶ 484) (emphasis added) The *amicus* brief of Senator Blumenthal, citing facts from the Third Amended Complaint, explains exactly how S&P misled its own investors to their severe detriment and the detriment of the financial system as a whole. *See* Blumenthal Br. 7-12. In sum, the Third Amended Complaint shows exactly how and why S&P's key statements were materially false—and indeed that is precisely what the district court in Northern California found. *See*

McGraw-Hill Cos., 2013 WL 3762259, at *6 ("[T]he Court cannot find that all of these 'shalls' and 'must nots' are the mere aspirational musings of a corporation setting out vague goals for its future. Rather, they are specific assertions of current and ongoing policies that stand in stark contrast to the behavior alleged by the government's complaint.").

Respondents' reliance on the scienter argument is equally misplaced because neither court adjudicating the Rule 60(b) motion ruled on it. In the motion-to-dismiss litigation, the district court and the Second Circuit held, with relatively little analysis, that the second amended complaint failed to plead scienter. *See* Pet. App. 44a-45a, 50a. In the Rule 60(b) motion, however, petitioner challenged these holdings, and proffered a Third Amended Complaint that cures any pleading defect relating to scienter. *See, e.g.*, ¶¶ 25, 401, 404, 410, 505-06 (all describing respondents' scienter). When the district court and the Second Circuit denied Rule 60(b) relief, they did not hold otherwise. *See* Pet. App. 5a (affirming the denial of the Rule 60(b) motion on the ground that "the new evidence does not alter the District Court's and this Court's previous conclusion that defendants' statements regarding the 'independence' and 'integrity' of their ratings constitute 'mere commercial puffery,'" and saying nothing about scienter), 24a-26a (reaffirming findings regarding puffery and falsity only). Thus, scienter is not an independent ground for the decision below, and to the extent that respondents wish to prevail against the Rule 60(b) motion on that ground, they would have to do so on remand—which they will be unable to do because the Third Amended

Complaint documents respondents' knowledge and intent in detail.

III. At A Minimum, This Court Should Grant, Vacate, And Remand For Reconsideration In Light Of *Omnicare*.

As the petition explained (at 13-14), this Court's description of "puffery" in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 135 S. Ct. 1318 (2015), is inconsistent with the Second Circuit's formulation. This Court stated unequivocally that a "determinate, verifiable statement" about a company's products "is not mere puffery." *Id*. at 1326. Thus, an executive who mischaracterizes the technology used in those products may be liable. *Id*. at 1327. The Second Circuit, however, has held that even a statement that is "knowingly and verifiably false when made" can be puffery. *City of Pontiac*, 752 F.3d at 183. And in this case, the Second Circuit held that equally specific statements about the methodology behind S&P's products were too generic to be actionable.

Respondents answer that the holding of *Omnicare* "has no impact on any issue in this case" because *Omnicare* was about when opinions are actionable under Section 11 of the Securities Act. BIO 27. That is true, but irrelevant. While *Omnicare* is not principally a puffery case, it does set forth this Court's most definitive pronouncement of the puffery standard: seven Justices joined an opinion clearly stating the rule. Moreover, there is no other Supreme Court case that either respondents or the Second Circuit can rely on to advance an inconsistent rule—and the Second Circuit's rule is clearly inconsistent with *Omnicare*. In

light of the clear conflict between this Court's most authoritative statement and the Second Circuit's rule, the Court should, at a minimum, grant, vacate, and remand for reconsideration in light of *Omnicare*.

CONCLUSION

For the foregoing reasons, as well as those in the Petition for a Writ of Certiorari, the petition should be granted.

Respectfully submitted,

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