No. 20-____

IN THE

Supreme Court of the United States

BOFI HOLDING, INC., *et al.*,

Petitioners,

v.

HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM,

Respondent.

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

PETITION FOR WRIT OF *CERTIORARI*

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March 26, 2021

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTIONS PRESENTED

In *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), this Court recognized the fraud-on-the-market presumption of reliance for private rights of action brought by investors under Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5. The fraud-on-the-market presumption is predicated upon the "efficient capital markets hypothesis" (ECMH). The ECMH posits that the market price of a security trading in an efficient stock market reflects all publicly available information, including any misrepresentation, about the issuer of the securities and its business. In *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), this Court held that in such fraud-on-the-market cases the element of loss causation requires more than a showing that the alleged misrepresentation inflated a security's market price at the time of the investor's purchase. An investor-plaintiff also must show that the misrepresentation caused the investor's economic loss when the "truth beg[an] to leak out" publicly into the efficient market.

The questions presented here are:

1. Whether disputed public allegations about an issuer or its business, without any additional corroborating disclosure or event, reveal to an efficient market the "truth" for purposes of establishing loss causation under *Dura* (as held by the Sixth and Ninth Circuits, in direct conflict with the Eleventh Circuit).

2. Whether allowing a plaintiff to show that a disclosure or event revealed the "truth" about the issuer or its business by pointing to the magnitude of the decline in the price of the issuer's stock conflicts with *Dura* and misapplies *Basic*.

3. Whether the Court should overrule *Basic* to the extent it recognizes the ECMH, as that economic theory sows confusion in the lower courts with respect to the proper analysis of loss causation.

PARTIES TO THE PROCEEDING

Petitioners are BofI Holding, Inc. (now named Axos Financial, Inc.), Gregory Garrabrants, Andrew J. Micheletti, Paul H. Grinberg, Nicholas A. Mosich and James S. Argalas.

Respondent is Houston Municipal Employees Pension System.

CORPORATE DISCLOSURE STATEMENT

BofI Holding, Inc. (now named Axos Financial, Inc.) has no parent corporation. BlackRock Inc. (a publicly held company) holds 10% or more of its stock.

PROCEEDINGS BELOW

United States District Court (S.D. Cal.):

Golden v. BofI Holding, Inc., Civ. No. 3:15-cv-02324-GPC-KSC, Civ. No. 3:15-cv-02486-GPC-KSC (S.D. Cal. Feb. 1, 2016)

In re BofI Holding, Inc. Securities Litigation, Civ. Nos. 3:15-cv-02324-GPC-KSC, 2016 U.S. Dist. LEXIS 132574 (S.D. Cal. Sept. 27, 2016)

In re BofI Holding, Inc. Securities Litigation, Civ. Nos. 3:15-cv-02324-GPC-KSC, 2017 U.S. Dist. LEXIS 79062 (S.D. Cal. May 23, 2017)

In re BofI Holding, Inc. Securities Litigation, Civ. Nos. 3:15-cv-02324-GPC-KSC, 2017 U.S. Dist. LEXIS 198153 (S.D. Cal. Dec. 1, 2017)

In re BofI Holding, Inc. Securities Litigation, Civ. Nos. 3:15-cv-02324-GPC-KSC, 2018 U.S. Dist. LEXIS 46694 (S.D. Cal. Mar. 21, 2018)

United States Court of Appeals (9th Cir.):

Houston Municipal Employees Pension System v. BofI Holding, Inc. (In re BofI Holding, Inc. Securities Litigation), No. 18-55415, 977 F.3d 781 (9th Cir. 2020)

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PETITION FOR WRIT OF *CERTIORARI*

Petitioners respectfully petition for a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-35a) is reported at 977 F.3d 781 (9th Cir. 2020). The court of appeals' denial of rehearing and rehearing *en banc* (App., *infra*, 73a) and the opinion of the district court granting petitioners' motion to dismiss with prejudice (App., *infra*, 36a-72a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on October 8, 2020. A timely petition for rehearing was denied on November 16, 2020 (App., *infra*, 73a). The jurisdiction of the Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

The Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.) (PSLRA), provides in pertinent part:

> In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.

15 U.S.C. § 78u–4(b)(4).

PRELIMINARY STATEMENT

This case lies at the intersection of two of the Court's most important decisions regarding private securities class action litigation: *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), and *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005). In *Basic*, the Court endorsed the "fraud-on-the-market" presumption of reliance in cases exercising the private rights of action under Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission (SEC) Rule 10b-5. That presumption rests upon the "efficient capital markets hypothesis" (ECMH), an economic theory that the market price of a security trading in an efficient market reflects all publicly available information (including any misrepresentations) about the issuer and its business. In *Dura*, the Court held that in "fraud-on-the-market" cases, satisfying the element of loss causation requires more than a showing that a misrepresentation inflated a security's market price at the time of the investor-plaintiff's purchase. A securities class action plaintiff also must show that the misrepresentation caused an economic loss "after the truth makes its way into the market."

Here, a panel majority of the Ninth Circuit held that the filing of a self-styled civil "whistleblower" employment lawsuit by a disgruntled junior former employee of the issuer, laden with speculative, vigorously contested and never-proven allegations of internal misconduct, was a "corrective disclosure" that revealed the "truth" about the issuer's banking business to the efficient market. The court held that, whether or not actually true, the contested allegations revealed the "truth" because, in the majority's view, it was plausible an efficient market "perceived [the] allegations as credible and acted upon them on the assumption that they were true." The court held that a substantial factor supporting this conclusion was the magnitude of the price drop (30%) of the issuer's stock following the filing of the former employee's lawsuit.

In the five-and-a-half years since the former employee's lawsuit was filed, despite numerous internal investigations, governmental investigations and external audits, not one of the former employee's allegations has been independently corroborated or had any actual impact on the issuer's heavily regulated (and very successful) banking business. BofI never suffered loan losses in excess of reported reserves, issued a restatement of its financials, disclosed a material weakness in its systems of internal controls, received a qualification from its independent auditors, was the subject of a formal enforcement action commenced by a government agency, paid any regulatory fines or suffered any governmental-imposed restriction on the bank or its ability to conduct its business.

The questions presented are three-fold. The first question seeks to resolve a circuit split in the application of *Dura*'s holding that a misrepresentation causes an economic loss "after the truth makes its way into the [efficient] market." The Ninth Circuit here joined the Sixth Circuit in holding that complaint allegations may be treated as revealing the "truth" within the meaning of *Dura*, even absent any corroboration that the allegations are true. This deepened a pre-existing split between those circuits and the Eleventh Circuit, which holds that complaint allegations do not reveal the "truth" to an efficient market without some additional corroborating disclosure, such as a finding by a regulator or an admission by the issuer. On this point, Ninth Circuit Judge Kenneth Lee dissented from the majority, describing its decision as incompatible with "case law and common sense." Judge Lee recognized that permitting an inference of loss causation to be predicated upon "unsubstantiated allegations that may turn out to be nothing more than wisps of innuendo and speculation" risks "impos[ing] an exorbitant cost on companies." The Court should resolve this circuit conflict to restore certainty for issuers in our national securities markets and deter securities class action "strike suits" that piggy-back on or coordinate with uncorroborated, self-interested complaint allegations by adversaries of an issuer.

The second question addresses a conflict between the Ninth Circuit's decision and *Dura*. In a fraud-on-the-market case, an issuer's stock price is presumed to react to (and thereafter reflect) all newly available material information about the issuer, even if that information is false. The presumption, though, does not work in reverse. Not every stock price reaction is presumed to be caused by newly available material information, let alone newly available information correcting an earlier misstatement. Yet that is precisely what the majority presumed here. It concluded that the former employee's allegations revealed the "truth" about the issuer in large part because the issuer's stock price declined after the filing of the employee's lawsuit. Every securities class action is triggered by a stock price drop; hence the moniker "stock drop cases." The Ninth Circuit's misapplication of *Dura* thus effectively presumes loss causation in all fraud-on-the-market securities class actions. It renders pleading and proving the essential element of loss causation a mere perfunctory exercise. The Court should correct this legal error.

The third question asks the Court to consider overruling *Basic* due to its reliance upon on the ECMH

— the theoretical foundation for all loss causation showings in fraud-on-the-market cases. When the Court was last urged to do so in *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 258 (2014) (*Halliburton II*), Justice Thomas (in a concurring opinion joined by Justices Scalia and Alito) laid out the compelling legal and policy reasons for overruling *Basic*. In the six-and-a-half years since, academic literature and legal commentary have reconfirmed Justice Thomas' reasoning. Securities class actions continue to be a costly drag on the effective functioning of the U.S. capital markets, while providing no meaningful compensation to victims or effective deterrence.

The Ninth Circuit's decision will have severe practical consequences for publicly traded companies. Not only does it facilitate the filing of meritless securities claims, it provides a potent new weapon that adversaries of public companies may now wield with reckless abandon. Competitors, prospective acquirers, disgruntled employees and short-sellers can publicize unsubstantiated allegations of insider wrongdoing, trigger a stock price drop and lie in wait for a potentially devastating "bet the company" securities class action. A hostile acquirer can use this new leverage to facilitate extortion in merger talks with a publicly traded company: "drop the price or we will tell the market we think you were cooking the books." The target's management would be faced with a conundrum: agree to sell the company "on the cheap" or risk years of costly, distracting and reputation-killing securities class action litigation. Either way, innocent investors and issuers would lose. Requiring a plaintiff to identify independent corroboration or objective manifestation of the corporate adversary's allegations in order to establish loss causation would avoid this problem without any derogation of the rights of true victims of securities fraud.

The questions presented are of significant legal and practical importance and this case is an optimal vehicle for addressing them. The Court should grant this petition for a writ of *certiorari*.

STATEMENT OF THE CASE

I. Background

1. Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) prohibits the "use or employ[ment]" of any "deceptive device" "in connection with the purchase or sale of any security" in contravention of rules prescribed by the Securities and Exchange Commission (SEC). 15 U.S.C. § 78j(b). SEC Rule 10b-5(b) forbids entities subject to the Exchange Act from "mak[ing] any untrue statement of a material fact" or "omit[ting] to state a material fact necessary in order to make the statements made . . . not misleading." 17 C.F.R. § 240.10b-5(b). The Court has inferred from those sources of law a private right of action permitting the recovery of damages for securities fraud. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975). The elements of a Rule 10b-5 claim are (1) a material misstatement or omission; (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation (*i.e.*, that the misrepresentation caused the asserted loss). *See Dura*, 544 U.S. at 341-342.

2. In *Basic*, the Court created a "rebuttable presumption" of investor reliance. *Basic*, 485 U.S. at 242. That presumption was based upon the "fraud on the market" theory, which in turn was predicated in part upon the ECMH, a hypothesis that the price of a company's stock, when it trades in an efficient market,

reflects all publicly available material information about the company.

3. In *Dura*, the Court addressed the element of loss causation in "fraud-on-the-market" cases. The Court held that a securities plaintiff must plead and prove that a defendant's misrepresentations or other fraudulent conduct (as opposed to other events) proximately caused the investors' loss. *See Dura*, 544 U.S. at 342-343, 345-346. The Court rejected the notion that an allegation of "price inflation" alone was sufficient, observing that if "the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss." *Id.* at 342. The Court criticized "[t]he complaint's failure to claim that [the company's] share price fell significantly after the truth became known." *Id.* at 347. Under *Dura*, a securities class action plaintiff must plead and prove that the misrepresentation caused an economic loss "after the truth makes its way into the market." *Id.* at 342.

II. Facts and Procedural History

1. Petitioners are BofI Holding, Inc. ("BofI")[1] and five of its officers or directors. Founded in 1999, BofI offers consumer and business checking, savings and time-deposit accounts, and financing for residential and commercial real estate, businesses and vehicles. During the alleged class period, BofI's common stock publicly traded on NASDAQ.

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[1] On October 1, 2018, BofI Holding, Inc. changed its name to Axos Financial, Inc. For ease of reference, we will continue to refer to the corporate petitioner (along with its subsidiary, previously known as BofI Federal Bank) as "BofI."

BofI derives operational efficiencies by distributing its loan and deposit products through a variety of marketing channels rather than through an expensive branch network. BofI has a history of low loan losses because of its adherence to strong underwriting standards and maintenance of a low weighted average loan-to-value ratio of around 60% across its loan portfolio.

As a federally chartered financial institution, BofI is subject to extensive regulation by its principal regulator, the United States Office of the Comptroller of the Currency (OCC), as well as by the Federal Deposit Insurance Corporation, the Federal Reserve Board, the SEC and others. OCC bank examiners perform frequent, on-site examinations to review BofI's performance, management, financial condition and compliance with banking regulations. BofI's financial statements are reviewed and audited by an independent public accounting firm, BDO USA LLP.

At no time since the start of the putative class period in this case (September 4, 2013) has BofI reported loan losses in excess of reserves, issued a restatement, disclosed a material weakness in its systems of internal controls, received a qualified opinion from its auditors, been the subject of a formal governmental enforcement action, paid any regulatory fine or suffered any government-imposed restriction on the bank's ability to conduct its business.

2. Respondent Houston Municipal Employees Pension System allegedly purchased BofI common stock between September 4, 2013 and February 3, 2016 (the putative class period). Pursuant to the PSLRA, 15 U.S.C. § 78u-4(a)(3), the United States District Court for the Southern District of California (Curiel, J.) appointed respondent as the lead plaintiff in this action.

3. This action has its genesis in the allegations of Charles Matthew Erhart, a former junior internal auditor at BofI. In March 2015, Erhart left BofI and never returned. On October 13, 2015, Erhart filed a lawsuit against BofI accusing it of wrongful termination. *See Erhart v. BofI Holding, Inc.*, Case No. 3:15-cv-02287-BAS-NLS (S.D. Cal. filed Oct. 13, 2015) (*Erhart* Action). Erhart alleged he was constructively terminated in retribution for purportedly reporting to the OCC, SEC and his supervisors a litany of alleged internal misconduct and potential compliance violations. All were investigated, both internally by BofI's Audit Committee and independent counsel, and externally by government regulators and outside auditors. None of the investigations found any merit in Erhart's speculative, immaterial and/or ill-informed allegations.[2]

4. At the same time Erhart filed his complaint, *The New York Times* published an article summarizing his allegations. The next day, BofI's stock declined by 30.2%.[3] The day after that, the first of several class action complaints was filed.

5. The gravamen of this securities case is that petitioners allegedly "misrepresented the risks of investing in BofI" that were purportedly "revealed" by Erhart's allegations. Respondent alleged that BofI represented itself as a "careful, prudent institution,"

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[2] The district court in the *Erhart* action later granted summary judgment dismissing nearly all aspects of Erhart's federal claims. *See Erhart v. BofI Holding, Inc.*, 2020 U.S. Dist. LEXIS 57137 (S.D. Cal. Mar. 31, 2020). No trial date has been set on the remaining claims.

[3] Subsequent investigation indicated coordination between Erhart's counsel and short-sellers of BofI stock seeking to profit from the decline in BofI's stock price. To their chagrin, BofI's stock price has since recovered fully.

yet secretly "disregard[ed] internal controls" attendant to regulatory compliance and made risky loans in order to increase loan volume and earnings. Respondent did not allege that the supposedly concealed "risks" to BofI's business from these alleged activities ever materialized. It did not (and could not) allege, for example, that BofI ever reported losses in excess of reserves, a spike in reserves due to supposedly risky loans, a material weakness in its internal controls or a formal enforcement action stemming from governmental reviews and investigations into these alleged activities.

Respondent's operative Third Amended Class Action Complaint ("TAC") focuses on alleged misstatements in three categories: (1) internal controls, compliance infrastructure and risk management; (2) underwriting standards and credit quality; and (3) governmental investigations. To support its information and belief that the challenged statements were deliberately false or misleading, respondent relied upon (i) anecdotal complaints of nine unnamed former employees (referred to as confidential witnesses or CWs);[4] (ii) blog posts by anonymous short-sellers on the *Seeking Alpha* crowd-sourced financial blog; and (iii) allegations of misconduct and potential compliance violations in the complaint in the *Erhart* Action. Respondent alleged that the complaint in the *Erhart* Action and the anonymous

[4] None of the CWs was employed at BofI during the entire putative class period, and some left BofI before the class period even started. One pled guilty to 24 felonies, including to embezzling more than $476,000 from BofI. All were manifestly disgruntled, and expressed only anecdotes, opinions and/or hyperbole. None identified a single unpaid loan, material weakness in BofI's systems of internal controls or actual (as opposed to potential) compliance violation at BofI at any point before, during or after the putative class period.

Seeking Alpha blog posts were "corrective disclosures" of the "truth" for purposes of pleading loss causation. Petitioners moved to dismiss the TAC for failure to plead loss causation and failure to satisfy the PSLRA's heightened pleading requirements.

6. On March 21, 2018, the district court granted petitioners' motion to dismiss for failure to plead loss causation. Addressing the *Erhart* Action allegations, the district court applied then-prevailing Ninth Circuit authority which held that publicly announced investigations (*see Loos v. Immersion Corp.*, 762 F.3d 880 (9th Cir. 2014)) and third-party complaint allegations (*see Curry v. Yelp Inc.*, 875 F.3d 1219 (9th Cir. 2017)) do not reveal the "truth" about a fraud, but rather only the potential or risk that a fraud occurred.

7. On *de novo* review, a majority of the Ninth Circuit panel reversed in part. App., *infra*. It held that the *Erhart* Action complaint, even without a subsequent fraud-confirming disclosure, was a "corrective disclosure." *Id.* at 17a. The court devised and analyzed a series of factors, including the extent to which BofI's stock price dropped after the filing of the *Erhart* Action, to conclude that the TAC plausibly showed that "the market reasonably perceived Erhart's allegations as true and acted upon them." *Id.* at 16a.[5]

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[5] The Ninth Circuit also held (in a single passing sentence) that the TAC met the heightened pleading standards of the PSLRA. *Id.* at 14a. The decision below is the first by any court of appeals to hold that a securities class action plaintiff satisfied the PSLRA pleading standards based *solely* upon the say-so of former employees without the occurrence of an actual adverse business event (such as an earnings miss, product recall or enforcement action) caused by or even relating to the allegedly concealed "true" facts.

8. Judge Lee dissented in part. He seized on the anomaly of a securities fraud case proceeding in the absence of any adverse business event purportedly caused by the alleged false statements:

> Philosophers have long debated the question, "If a tree falls in the forest but no one is around to hear it, does it make a sound?" This case perhaps presents the converse of that conundrum: If there is no fraud, can a securities fraud lawsuit still proceed?

Id. at 30a (Lee, J., dissenting in part). According to Judge Lee, allowing securities plaintiffs to premise corrective disclosures of the "truth" on a former employee's "unsubstantiated assertions" in a lawsuit without any additional external disclosures confirming the allegations did not "comport[] with our case law or common sense." *Id.* at 30a. He noted that at the time BofI's stock price declined, the market could not possibly have known whether the *Erhart* allegations were credible, and nothing in the five years since has even remotely corroborated "Erhart's self-interested allegations." *Id*. at 32a. "[A]t this time, the drop in BofI's share price 'can only be attributed to market speculation about whether fraud has occurred.'" *Id.* at 34a (quoting *Loos*). Consistent with *Curry*, *Loos* and *Lloyd v. CVB Fin. Corp.*, 811 F.3d 1200 (9th Cir. 2017), Judge Lee would have required "additional external confirmation of fraud allegations in a whistleblower lawsuit for them to count as 'corrective disclosures.'" App., *infra*, 30a.

9. On November 16, 2020, the court of appeals denied petitioners' petition for rehearing and rehearing *en banc*.

REASONS FOR GRANTING THE PETITION

I. The Courts of Appeals are Divided Over Whether Public Allegations May, Without More, Reveal the "Truth" For Purposes of Establishing Loss Causation Under *Dura*

1. Loss causation requires proof that an artificially inflated purchase price declined after "the truth became known" to the market. *Dura*, 544 U.S. at 342-343, 347. It is generally recognized that this showing requires a public disclosure or event that revealed a fact previously misrepresented or wrongfully omitted. *See, e.g.*, *In re Vivendi, S.A. Sec. Litig.*, 838 F.3d 223 (2d Cir. 2016) (describing loss causation as generally requiring proof a "misstatement or omission concealed *something* from the market that, when *disclosed*, negatively affected the value of the security"); *In re Williams Sec. Litig.-WCG Subclass*, 558 F.3d 1130, 1138 (10th Cir. 2009) ("Plaintiff must establish that his losses were attributable to some form of revelation to the market of the wrongfully concealed information.") (citation omitted).

The first question presented in this petition is whether unsubstantiated public allegations of issuer misconduct, without any additional verifying disclosure or business event that objectively manifests the correctness of the disputed allegations, reveal the "truth." The three Circuits that have addressed this question — the Sixth, Ninth and Eleventh — split into two distinct camps.

2. The Eleventh Circuit holds that public allegations of misconduct made in a separate lawsuit against the issuer cannot, standing alone, reveal the "truth" for purposes of establishing loss causation. *Sapssov v. Health Mgmt. Assoc.*, 608 Fed. Appx. 855, 863 (11th

Cir. 2015). In *Sapssov*, a hospital system publicly represented that its inpatient admissions policy complied with regulations and accounted for its financial success. *Id.* at 861. Thereafter, a former employee filed a whistleblower complaint alleging the admissions policy was non-compliant, and a securities analyst published a report summarizing the allegations. In a subsequent securities fraud lawsuit, the plaintiffs alleged that this summary, alone, and together with an earlier publicly announced regulatory investigation of the hospital system, revealed the falsity of its statements. *Id.* at 858, 863.

The court held the whistleblower's allegations of wrongdoing to be incapable of revealing anything beyond the allegations themselves. *Id.* at 863. Treating them as unsubstantiated, untested and subject to challenge, the court of appeals observed that the "whistleblower case, the basis of the [analyst's report], was not proof of liability." It concluded that, whether "[t]aken independently or combined," the investigation and the employee's allegations were "inadequate to establish the falsity of [the hospital system's] disclosures." *Id.* at 864.

Sapssov rests squarely on the Eleventh Circuit's earlier decision in *Meyer v. Greene*, 710 F.3d 1189 (11th Cir. 2013). There, the court of appeals held that the commencement of an SEC investigation did not "reveal[] to the market the pertinent truth of anything." *Id.* at 1201 n.13 (alteration in original) (internal quotation marks omitted). *Meyer* suggested that such investigation could at some point in time "qualify as a partial corrective disclosure" if, for example, it led to a finding or admission of fraud or culminated in a financial restatement. *See id.* As the court explained, only upon such later disclosure or event would the actual "truth" enter the market, making it possible to causally link any loss resulting from the investigation to a misstatement. *Id.* ("It is, after all, impossible to say that an SEC investigation was the moment when the 'relevant truth beg[an] to leak out' if the truth never actually leaked out.") (quoting *Dura*, 544 U.S. at 342) (alteration in original). These same principles logically apply to disputed complaint allegations.

3. In contrast to the Eleventh Circuit, the Sixth Circuit holds that a separate lawsuit's public allegations can reveal the "truth." In *Norfolk County Retirement Systems v. Community Health Systems*, 877 F.3d 687, 697 (6th Cir. 2017), as in *Sapssov*, the defendant was a hospital system that attributed its financial results to superior operating performance rather than improper admissions procedures. *Id.* at 691.

Even though the Sixth Circuit confronted essentially the same loss causation theory advanced in *Sapssov*, it reached the opposite result. It held that each putative disclosure of truth, including mere allegations of misconduct, must be examined "individually (and in the context of other disclosures) to determine whether the market *could have* perceived it *as* true." *Id.* (emphasis added). It applied this test to the public allegations of misconduct in a separate lawsuit by a competitor against the issuer that described the results of expert data analyses showing the admissions practices' effects on defendant's financial performance. The Sixth Circuit determined that there was no basis "other than the analyses' placement in a complaint" to find the market did not regard the analyses "as anything other than credible" and so "revealed a truth that [the hospital system] . . . had until then fraudulently concealed." *Id.* at 697.

4. In its decision below, the Ninth Circuit declared expressly that it was joining the Sixth Circuit in treating allegations as capable of revealing the "truth." App., *infra*, 17a. Describing the district court below as having "held that allegations in a lawsuit, standing alone, can never qualify as a corrective disclosure because they are just that—allegations, as opposed to 'truth'" the Ninth Circuit, like the Sixth Circuit, "reject[ed] any such categorical rule." *Id.* Applying several factors, it concluded that the TAC set forth facts showing the market reasonably perceived Erhart's allegations as "worthy of belief" and therefore "true." *Id.*[6]

A well-defined circuit split now exists as the decisions of the Sixth and Ninth Circuits are wholly irreconcilable with that of the Eleventh Circuit. Notably, the Ninth Circuit not only adopted the Sixth Circuit's approach but elaborated upon it, identifying and applying specific factors. As a result of this amplification, the circuit divide has sharpened, and no further development in the courts of appeals is needed before this Court resolves the question presented.

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[6] The Ninth Circuit panel majority strained to distinguish its own precedents. App., *infra*, 18a-19a (purporting to distinguish *Loos* and *Curry*). In *Loos*, the Ninth Circuit adopted the Eleventh Circuit's decision in *Meyer* to hold that an announced internal investigation of potential fraud, standing alone, cannot reveal the truth. *Loos*, 762 F.3d at 889. In *Curry*, the Ninth Circuit applied *Loos* (and, hence, *Meyer*) to hold that consumer complaints that were filed with the Federal Trade Commission, when they became public, revealed only the risk or potential that an issuer's prior statements were false and so did not establish loss causation. *Curry*, 875 F.3d at 1225-27. Judge Lee, in his dissent, argued that *Loos* and *Curry* mandated a different result. App., *infra*, 34a. He also voted in favor of *en banc* review. App., *infra*, 73a. The Ninth Circuit chose instead to leave its own precedents unreconciled.

5. The Ninth and Sixth Circuits have come down on the wrong side of the circuit split. Treating unsubstantiated allegations of company misconduct as capable of revealing the "truth" whenever the court divines that market participants "perceived [them] as true" incorrectly equates proof of *perceived* "truth" with proof that the actual "truth became *known*." *Dura*, 544 U.S. at 347 (emphasis added). Nothing in *Dura* suggests the market's perception of allegations as credible can substitute for the actual revelation of "truth." As noted by Judge Lee, a separate lawsuit's allegations do not reveal any "truth" but rather only "disclos[e] . . . 'an added *risk* of future corrective action.'" *See* App., *infra*, 33a-34a (Lee, J., dissenting in part) (quoting *Meyer*, 710 F.3d at 1201).

As *Basic* makes clear, the market's perception of a statement as "true" cannot be a determinant of, or a proxy for, the actual "truth" having entered the market. *See Basic*, 485 U.S. at 246 (noting studies showing "market price of shares . . . reflects all publicly available information, *and*, hence, any material *misrepresentations*") (emphasis added). In this case, the Ninth Circuit nevertheless held that because the market could have reasonably perceived unsubstantiated and vigorously disputed allegations by a former BofI employee as "credible," the allegations alone must be treated as the "truth" entering the market. This artifice ignores the undisputed reality that after more than five full years not a single one of the "risks" purportedly "revealed" by the *Erhart* complaint has materialized, and not a single one of his allegations of wrongdoing has been confirmed, corroborated or objectively manifested by an adverse business event. Indeed, BofI's subsequent financial performance and record of regulatory compliance more strongly suggest that Erhart's allegations revealed not "truth" under

Dura but self-interested speculation. The danger that a supposedly corrective allegation of internal misconduct might in fact be fictional (a risk heightened when public allegations of corporate misconduct are made by disgruntled employees or other corporate adversaries in litigation seeking millions of dollars from the issuer) is precisely what led Judge Lee to insist that some external confirmation be required:

> It need not be a *mea culpa* from the company, but perhaps a surprise restatement of earnings, an unexplained announcement about an increase in reserves, or some other information that confirms those allegations and thus acts as a corrective disclosure.

See App., *infra*, 35a.

6. The Eleventh Circuit's approach is the correct one. It recognizes that stock price drops following misconduct allegations do play a role in a loss causation analysis, but their relevancy must await some additional confirmatory event or disclosure. *Meyer*, 710 F.3d at 1201 n.13. Only then can it be inferred that the market's reaction stemmed from its having anticipated (correctly) that the potential "truth" would in fact become "known." *Ibid.* Until then, any loss causation showing based on mere allegations alone is "premature." App., *infra*, 32a (Lee, J., dissenting in part).

The Court should resolve this circuit split by establishing a rule of loss causation that comports with the express language of *Dura*.

II. The Ninth Circuit's Decision Conflicts With *Dura* and Misapplies *Basic*

The second question addresses a related conflict between the decision below and *Dura* and a misapplication of *Basic*. The Ninth Circuit's test to determine whether "the truth became known" includes as a leading factor the degree to which the market price for the security allegedly reacted to the public allegations. App., *infra*, 17a (noting "BofI's stock price plunged by more than 30% on extremely high trading volume" and stating that "[a] price drop of that magnitude would not be expected in response to whistleblower allegations perceived as unworthy of belief"). Use of this factor to determine loss causation has no merit, for it confounds the distinct concepts of loss and loss causation. A securities fraud claim requires a "loss the purchaser sustains when the [concealed] facts . . . become generally known and *as a result* share value depreciate[s]." *Dura*, 544 U.S. at 344 (second and third alterations in original) (emphasis added) (internal quotation marks omitted). Hence, the "truth" must first become known, and then any loss sustained must result from the market's reaction to that "truth." The Ninth's Circuit's test works in reverse. It uses the market's reaction — the fact and extent of the stock price drop — to infer that the "truth" became known and caused the drop. *See* App., *infra*, 17a.[7]

[7] A more recent decision from the Ninth Circuit exacerbates this problem. In *Wochos v. Tesla, Inc.*, 985 F.3d 1180 (9th Cir. 2021), the Ninth Circuit affirmed the denial of leave to amend, holding that amendment would be futile because the plaintiffs would be unable to establish loss causation. The court noted that although the issuer's stock price dropped in the immediate aftermath of a *Wall Street Journal* article supposedly disclosing the "truth," "the stock price immediately rebounded, . . . over the

Dura precludes this inference. *Dura*'s holding rests on the principle that a later lower price does not necessarily indicate a loss resulting from the "truth" having entered the market. *See Dura*, 544 U.S. at 342 (noting, for example, the absence of loss causation when the purchaser resells "before the relevant truth begins to leak out"). As *Dura* further observes, even when the "truth" does enter the market, a "lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price." *Id.* at 343. Whether a disclosure or event revealed the "truth" and, if it did, whether any "lower price" reflected it, are questions that must be answered independent of the fact, and extent of, the "lower price" itself.

The Ninth Circuit's use of the magnitude of the stock price decline to determine loss causation is further flawed because a price reaction is not any determinant of actual "truth" having entered the market under *Basic*. To the contrary, *Basic* holds that all material statements, *including false ones*, are presumed to affect stock prices. *See Basic*, 485 U.S. at 246. Hence, supposedly "corrective" false or mistaken disclosure can, just like an issuer's misrepresentation, cause a stock price reaction. In neither instance is the reaction indicative of any actual "truth" having entered the market.

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next week." The panel held that this "quick and sustained" stock price recovery refuted "the inference that the alleged concealment of this particular fact caused any material drop in the stock price" and "Plaintiffs have thus failed to show that they can adequately plead loss causation." *Id.* at 1198.

The decision below adopted and applied a loss causation test that conflicts with controlling decisions of this Court. Review is required to correct these errors.

III. The Court Should Consider Overruling *Basic*

1. Respondent's loss causation theory in this fraud-on-the-market case necessarily rests upon the ECMH endorsed in *Basic*. It is upon that hypothesis that respondent purported to establish the first link in the causation chain between the alleged misstatements and its claimed economic loss: an artificially inflated purchase price. Although "an inflated purchase price will not itself constitute or proximately cause the relevant economic loss," *Dura*, 544 U.S. 342, under the loss causation theory advanced here, it is a necessary condition. The Ninth Circuit's decision acknowledged this. App., *infra*, 11a (noting "the plaintiff's theory of loss causation begins with the allegation that the defendant's misstatements (or other fraudulent conduct) artificially inflated the price").

As discussed above, the Ninth Circuit's decision rests upon flawed factual inferences the court drew from market fluctuations. Those inferences, mistaken as they were, all flow from the *Basic* presumption and ECMH. Those errors illustrate how lower courts misunderstand and misapply *Basic* and the ECMH, with serious ramifications to publicly traded companies and investors alike.

The discussion above in points I and II explains why this Court should clarify how lower courts should properly apply *Basic* and *Dura* when considering allegations of loss causation. This raises a critical threshold issue: Given the confusion exhibited by the

Ninth Circuit and other courts on this point, the Court should consider in the alternative whether *Basic* should be overruled in whole or in part.[8]

2. In 2014, three Justices of this Court indicated their willingness to reconsider the ECMH endorsed in *Basic*. Echoing the key insight from the dissent in *Abrams v. United States*, 250 U.S. 616 (1919) (Holmes, J.), Justice Thomas' concurring opinion in *Halliburton II*, joined by Justices Scalia and Alito, recognized that time, scholarship and experience had combined to undermine the foundation of the *Basic* presumption. *See Halliburton II*, 573 U.S. at 285 (Thomas, J., concurring). Justice Thomas' concurrence built upon *Amgen Inc. v. Connecticut Ret. Plans & Trust Funds*, 568 U.S. 455 (2013), in which four Justices expressed a need for the Court "to revisit *Basic*'s fraud-on-the-market presumption" because the ECMH underlying "[t]he *Basic* decision itself is questionable." *Id.* at 489 n.4 (Thomas, J., joined by Scalia and Kennedy, JJ., dissenting); *see also id.* at 482-483 (Alito, J., concurring). Scholarship, empirical evidence and recent

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[8] The Court may consider overruling *Basic* even though this argument was only implicit in the lower courts. Overruling or substantially modifying *Basic* is "not a new claim . . . but a new argument to support what has been [petitioners'] consistent claim," namely that the Ninth Circuit should have affirmed the district court's dismissal of the action for failing to plead loss causation. *Lebron v. National R.R. Passenger Corp.*, 513 U.S. 374, 379 (1995); *accord Citizens United* v. *FEC,* 558 U.S. 310, 330-331 (2010) (allowing direct challenge to the Court's precedents that petitioner had disclaimed below because it was a "new argument" in support of petitioner's consistent First Amendment "claim"). The Court retains the authority to overrule a precedent that underlies a claim rather than "assuming a premise . . . that is itself in doubt." *Id.* at 331.

trends in investor behavior since *Halliburton II* have made the case for overruling *Basic* even stronger.

3. In endorsing the ECMH, *Basic* invoked "considerations of fairness, public policy, and probability, as well as judicial economy," 485 U.S. at 245, and "common sense." *Id.* at 246. It trusted in the accuracy of then-"[r]ecent empirical studies," *id.* at 246 & n.24, to engraft the ECMH into federal securities law. But as Justice White pointed out in his prescient dissent (joined by Justice O'Connor):

> [T]he fraud-on-the-market theory is a mere babe. Yet today, the Court embraces this theory with the sweeping confidence usually reserved for more mature legal doctrines. In so doing, I fear that the Court's decision may have many adverse, unintended effects as it is applied and interpreted in the years to come.
>
> * * *
>
> For while the economists' theories which underpin the fraud-on-the-market presumption may have the appeal of mathematical exactitude and scientific certainty, they are—in the end—nothing more than theories which may or may not prove accurate upon further consideration.

Basic, 485 U.S. at 250-251, 254 (White, J., dissenting).

4. The majority in *Halliburton II* recognized that the ECMH "may have garnered substantial criticism since *Basic*," but declined the invitation to overrule *Basic* because, in the majority's view, petitioners "ha[d] not identified the kind of fundamental shift in economic theory that could justify overruling a precedent on the ground that it misunderstood, or has since

been overtaken by, economic realities." *Halliburton II*, 573 U.S. at 272. Justice Thomas disagreed, explaining in detail that the ECMH endorsed by *Basic* is inconsistent with the considerations of probability, common sense and judicial economy that motivated it. *Halliburton II*, 573 U.S. at 292 (Thomas, J., concurring). When a decision proves "unworkable or . . . badly reasoned, 'this Court has never felt constrained to follow precedent." *Payne v. Tennessee*, 501 U.S. 808, 827 (1991).

5. Post-*Halliburton II* shifts in investor behavior have only further undermined the ECMH. *Basic*'s efficient-market theory depends heavily upon "market professionals" who "generally consider most publicly announced material statements about companies, thereby affecting stock prices." *Basic*, 485 U.S. at 247 n.24. To an increasing extent, however, valuations for individual stocks are influenced by inclusion in indices and exchange traded funds. The key attribute of indexes and ETFs is that they are vehicles for "informationless" passive investing. *See* Eric Belasco, *et al.*, *The Impact of Passive Investing on Corporate Valuations*, Managerial Finance, Vol. 38, No. 11, at 1067-1084 (2012) ("[T]he preference shift towards index fund investing is reducing the informational efficiency of stock prices . . . . By their nature, index fund investors are inattentive to asset valuations . . . ."). This rise in passive investing may both (i) "reduce the amount of information embedded in prices"; and (ii) "magnify any pricing differences with securities not included in the index." Vladyslav Sushko, *et al.*, *The implications of passive investing for securities*, BIS Quarterly Review at 119 (Mar. 2018). More recently, hordes of social-media-driven day traders have pushed the stocks of companies (such as GameStop and AMC) to valuations wholly disconnected from the real or

expected economic performance of the underlying businesses. This emergent investor behavior further undermines presumed market efficiency and the validity of the ECMH. *See*, *e.g.*, J.B. Heaton, *GameStop Hype Exposes Securities Litigation Theory's Flaws*, https://www.law360.com/corporate/articles/1363958/gamestop-hype-exposes-securities-litigation-theory-s-flaws?nl_pk=c38fa7a2-7809-4c06-97cd-17de08224057&utm_source=newsletter&utm_medium=email&utm_campaign=corporate (last visited Mar. 14, 2021); Annie Nova, *More bubbles, less shorting. What the GameStop craziness could mean for the future of investing*, CNBC Personal Finance, https://www.cnbc.com/2021/02/06/what-the-gamestop-craziness-could-mean-for-the-stock-markets-future.html (last visited Feb. 7, 2021).

6. Pernicious trading strategies by short-sellers now more than ever seek to exploit how misinformation can (at least temporarily) affect price. In "short and distort" schemes, traders pseudonymously author scurrilous articles creating an impression of wrongdoing for the very purpose of deflating the stock price (if only momentarily) to profit from their short position in a particular security. Joshua Mitts, *Short and Distort*, Columbia Law and Economics, Working Paper No. 592, at 2 (2018) (examining 2,900 pseudonymous attack articles against mid- and large-cap firms published on *Seeking Alpha*, and showing that many were followed by stock-price declines and sharp reversals, leading to over $20.1 billion in mispricing); *see also* Joshua Mitts, "Short Sellers and Plaintiffs' Firms: A Symbiotic Ecosystem," The CLS Blue Sky Blog, Oct. 14, 2020, https://clsbluesky.law.columbia.edu/2020/10/14/short-sellers-and-plaintiffs-firms-a-symbiotic-ecosystem/ (critiquing the majority opinion here and describing the instant case as one "in which short sellers and plaintiffs' firms enjoy a kind of *de facto*

symbiosis"). As trading in modern securities markets has become largely insensitive to value-influencing information, and as share prices have become more susceptible to distortions from third-party misinformation, the ECMH has become anachronistic.

7. The *Basic* presumption has allowed the recent proliferation of "event-driven" securities litigation: cases triggered by the occurrence of an adverse business "event" (such as a building fire or cyberattack) coupled with a hindsight allegation that the company misrepresented the likelihood of the event's occurrence.[9] Lower courts also have construed *Basic* to allow a so-called "price maintenance theory" of fraud-on-the-market, which allows vexatious class actions to proceed in the absence of any front-end "price impact" from the alleged misstatements — essentially allowing securities fraud class actions without alleged misstatements measurably affecting the price of a security when made. Note, *Congress, the Supreme Court, and the Rise of Securities-Fraud Class Actions*, 132 Harv. L. Rev. 1067, 1074-1075 (2019). This and the other abusive litigation trends will persist, and new ones will arise, until *Basic* is jettisoned.

8. *Basic*'s inapt approach to market efficiency poses a very real threat to judicial efficiency. Justice White warned that "[c]onfusion and contradiction in court rulings are inevitable when traditional legal analysis is replaced with economic theorization by the federal courts." *Basic*, 485 U.S. at 252. As illustrated above, the lower courts have struggled to apply *Basic*.

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[9] The instant case resembles an event-driven securities lawsuit — except, ironically, the only "event" was the filing of a lawsuit asserting unsubstantiated allegations. No adverse business "event" actually occurred.

Because *Basic*'s approach to market efficiency is not susceptible to principled application, there has inevitably been a "high level of inconsistency in the courts regarding what makes a market sufficiently efficient to trigger the fraud-on-the-market presumption." Geoffrey Rapp, *Rewiring the DNA of Securities Fraud Litigation:* Amgen*'s Missed Opportunity,* 44 Loy. U. Chi. L.J. 1475, 1484 (2013); *Waggoner v. Barclays PLC*, 875 F.3d 79, 94 (2d Cir. 2017) (noting, nearly thirty years after *Basic*, the Second Circuit has "repeatedly . . . declined to adopt a particular test for market efficiency").

9. Finally, *stare decisis* considerations are weaker here than in other circumstances. "Where a decision has been questioned by Members of the Court in later decisions" — as *Basic* was questioned in *Halliburton II* and *Amgen* — "and [has] defied consistent application by the lower courts, these factors weigh in favor of reconsideration." *Pearson v. Callahan*, 555 U.S. 223, 235 (2009) (citation omitted). Although the principle of *stare decisis* counsels reluctance to revisit errant constructions of statutes, it weighs less heavily against correcting errant economic analysis injected into the *corpus juris* to replace traditional legal principles. Indeed, as noted by Justice Thomas, "when [the Court] err[s] in areas of judge-made law, [the Court] ought to presume that Congress expects [the Court] to correct [its] own mistakes." *Halliburton II*, 573 U.S. at 298. *Basic* grafted a judicially-created presumption upon a judicially-created cause of action. Such innovation is for Congress, not the judiciary, as the Court's more recent precedents explain. See *ibid.* (citing, *e.g.*, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,* 552 U.S. 148, 164 (2008)). This was, in fact, one of Justice White's chief objections to the majority's decision in *Basic*. *See Basic*, 485 U.S. at 254, 256-257 (White, J., dissenting).

The Court should consider, in the alternative, overruling *Basic* in whole or in part.

IV. The Questions Presented Are Important, and Now Is the Time to Decide Them

1. If allowed to stand, the decision below will have severe legal and practical consequences. By endorsing a loss causation theory whereby the "truth" enters the market through unsubstantiated allegations, the Ninth Circuit has further attenuated the causal link a securities fraud plaintiff must establish between any misrepresentation and any economic loss. By not demanding an additional confirming disclosure or adverse business event before allowing a securities fraud claim to proceed, it sanctions the filing of what are essentially premature claims and, hence, likely weak or meritless ones, courting the unique harm such claims inflict. *See* App., *infra*, 30a-32a (Lee, J., dissenting in part).

That harm is well known. As the Court itself has recognized, the cost and burden in defending private securities fraud class actions imposes such enormous pressure to settle that even "plaintiffs with weak claims" are able "to extort settlements from innocent companies." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 162-64 (2008); *see Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975) (noting the danger of permitting a securities plaintiff "with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an in terrorem increment of the settlement value"). The PSLRA was enacted to stem the "routine filing" of securities fraud lawsuits, in part, by expressly imposing on private plaintiffs the burden of pleading and proving loss causation. *Dura*, 544 U.S. at 345-46, 347; *see also* App., *infra*, 33a (Lee, J., dissenting in part) (describing loss causation requirement as a "critical bulwark against frivolous securities fraud lawsuits"). Efforts at reform notwithstanding, the tremendous pressure to settle even weak or meritless securities fraud class actions persists. This is most clearly exposed by the astonishing fact that, since 1996, more than 5,200 securities fraud class actions have been filed in federal court, and yet defendants have taken fewer than 25 — one half of one percent — to trial. *See* Kevin LaCroix, *Rare Securities Class Action Lawsuit Trial Results in Partial Verdict for Plaintiffs*, D&O Diary (Feb. 5, 2019) <tinyurl.com/raresecuritiestrial>. As of 2018, the median cost of a securities class action settlement was $13 million. App., *infra*, 33a (Lee, J., dissenting) (citing Chubb, *From Nuisance to Menace: The Rising Tide of Securities Class Action Litigation* (June 2019), https://bit.ly/3cvbIx4).

The Ninth Circuit's misguided and lax loss causation standard facilitates weak or meritless securities fraud class actions. A plaintiff in the Ninth Circuit can now allege the "truth" entered the market and survive dismissal by pointing to mere allegations of the issuer's misconduct. App., *infra*, 17a-18a. This encourages the filing of claims resembling those that comprise the recently observed trend of "event-driven securities litigation," whereby securities fraud actions are reflexively filed in the wake of an adverse company event (such as oil rig explosion or security data breach) on the theory that, in hindsight, the company underplayed the risk the event would occur. *See* John C. Coffee, Jr., *The Changing Character of Securities Litigation in 2019: It's Time to Draw Some Distinctions*, CLS Blue Sky Blog (Jan. 22, 2019). These actions effectively (and wrongly) presuppose falsity and loss causation from the event's occurrence alone. They are rapidly filed with little or no investigation to force a settlement regardless of the underlying merits. *See* U.S. Chamber Institute for Legal Reform, *A Rising Threat: The New Class Action Racket That Harms Investors and the Economy* 12-13 (2018). This trend harkens back to a pre-PSLRA era. *Id.* at 13.

2. But the decision below heralds an even more troubling development, for it allows unproven public allegation that an "event" occurred (such as, here, possible regulatory violations alleged by Erhart) to alone serve as a revelation of the "truth" for loss causation purposes *even when the alleged event never actually occurred*. In other words, it authorizes "nonevent"-driven securities litigation by which a securities fraud class action advances on what is or may turn out to be nothing. The Ninth Circuit's willingness to treat another lawsuit's allegations as a "truth"-conveying disclosure prompted Judge Lee in his dissent to wonder aloud: "[W]hat if it turns out that Erhart's allegations in his lawsuit are bunk? What if he is mistaken?" App., *infra*, 31a (Lee, J. dissenting in part). The respondent in this case did not wait to find out. The Ninth Circuit's decision thwarts the PSLRA by promoting the very type of rapid, reflexive securities fraud filings the PSLRA was intended to deter. *See* H.R. Conf. Rep. 104-369, at 31, 41, *reprinted in* 1995 U.S.C.C.A.N. 730, 740; *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 320 (2007).

Plaintiffs in "nonevent"-driven securities litigation will work backwards from a stock price drop following disputed allegations of company wrongdoing and assert, just as the respondent does here, that the allegations corrected some earlier generic compliance or policy-related statement. For example, respondent asserts

Erhart's allegations that BofI's conduct violated certain laws corrected the statement "[w]e have made significant investments in our overall compliance infrastructure over the past several quarters, including BSA [Bank Secrecy Act] and AML [anti-money laundering] compliance." App., *infra*, 6a. Because all companies make similar generic statements regarding their legal compliance efforts, securities fraud plaintiffs will almost always manage to find one they can tenuously connect to an allegation that the company failed to comply with law. In this manner, any public corporate controversy coinciding with a stock price decline can be recharacterized as securities fraud. Not only does this "convert rule 10b-5 into a scheme of investor's insurance," *Dura*, 544 U.S. at 345 (citation omitted), it effectively converts allegations of corporate mismanagement into securities fraud, a practice the Court has long rejected. *See Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977).

3. The Ninth Circuit's decision also challenges any normal understanding of what it means for "truth" to enter the market. Under the Ninth Circuit's approach, a securities fraud plaintiff at no stage in the litigation is required to substantiate the public allegations by which the market supposedly learned the "truth." App., *infra*, 16a (stating "the relevant question for loss causation purposes is whether the market reasonably *perceived* Erhart's allegations as true"). Hence, it will be no defense to the loss causation element for a defendant to show that the public misconduct allegations were false, or even fabricated.[10]

[10] The prospect that a defendant might vindicate itself at summary judgment or trial by defeating an element other than loss causation, such as falsity, provides little consolation. "[S]ecurities fraud trials are virtually extinct." App., *infra*, 33a

4. Given the Ninth Circuit's error, and the harmful legal and practical consequences that will certainly flow from it, the resolution of the loss causation question here (which has divided the courts of appeals) is no doubt of critical importance. The Ninth Circuit is an influential circuit in the securities class action arena. In 2020, more securities class action cases were filed in the Ninth Circuit than in any other circuit. *See* Cornerstone Research, *Securities Class Action Filings: 2020 Year in Review* at 33 (2021), *available at* https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2020-Year-in-Review.pdf. In addition, although the Second Circuit has yet to expressly address whether allegations alone can reveal the "truth," it has recently issued opinions in two cases suggesting it would side with the Ninth Circuit. *See Arkansas Teacher Ret. Sys. v. Goldman Sachs Grp., Inc.*, 955 F.3d 254 (2d Cir.) (describing SEC complaint as revealing "hard evidence"), *cert. granted*, No. 20-222, ___ U.S. ___ (Dec. 11, 2020); *Puddu v. 6D Global Techs., Inc.*, 742 Fed. Appx. 553 (2d Cir. Aug. 2, 2018) (treating complaint's allegations, standing alone, as revealing true information). Hence, this case presents an opportunity not only to rectify the Ninth and Sixth Circuits' error, but to forestall a similar erosion of the loss causation element in the Second and other Circuits.

5. By using a security's efficient market price reaction as a factor in determining whether a plaintiff has pleaded loss causation, the Ninth Circuit has further undermined the PSLRA. After all, a significant price decline is a *sine qua non* in just about every securities

(Lee, J., dissenting in part). Most securities class actions never reach summary judgment given discovery costs and inordinate settlement pressure, particularly if a class is certified.

fraud lawsuit. And such a decline following corporate misconduct allegations is particularly unremarkable as such allegations are invariably accompanied by an actual negative event—a lawsuit against the company with its attendant costs, disruption and public relations impact. The Ninth Circuit's stock-price-decline test for loss causation, just like the Ninth Circuit's price-inflation test rejected by *Dura*, renders pleading and proving the essential element of loss causation a mere perfunctory exercise.

Fifteen years have passed since *Dura* with no further guidance from the Court on how to determine if "the truth became known" to the efficient market. *Dura*, 544 U.S. at 347. This case is an optimal vehicle for the Court to provide that guidance, as it cleanly presents outcome-determinative legal questions. No further developments in the courts of appeals on any issue is needed to resolve the questions presented here.

CONCLUSION

Petitioners respectfully request that the Court grant their petition for a writ of *certiorari*.

Respectfully submitted,

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March 26, 2021

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 18-55415

D.C. Nos.
3:15-cv-02324-GPC-KSC
3:15-cv-02486-GPC-KSC

IN RE BOFI HOLDING, INC. SECURITIES LITIGATION,

HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM,

Plaintiff-Appellant,

v.

BOFI HOLDING, INC.; GREGORY GARRABRANTS; ANDREW J. MICHELETTI; PAUL J. GRINBERG; NICHOLAS A. MOSICH; JAMES S. ARGALAS,

Defendants-Appellees.

Appeal from the United States District Court
for the Southern District of California
Gonzalo P. Curiel, District Judge, Presiding

Argued and Submitted January 7, 2020
Pasadena, California

Filed October 8, 2020

OPINION

Before: Paul J. Watford, Mark J. Bennett, and Kenneth K. Lee, Circuit Judges.

Opinion by Judge Watford;

Partial Concurrence and Partial Dissent by Judge Lee

SUMMARY[*]

Securities Fraud

The panel reversed the district court's judgment dismissing a securities fraud class action brought under § 10(b) of the Securities Exchange Act and Rule 10b-5 and remanded for further proceedings.

Shareholders alleged that executives of BofI Holding, Inc., committed securities fraud by falsely portraying the banking company as a safer investment than it actually was. In particular, the shareholders alleged that defendants made false or misleading statements touting the bank's conservative loan underwriting standards, its effective system of internal controls, and its robust compliance structure. The district court concluded that the shareholders adequately pleaded the first five elements of their claim, at least as to some of the challenged misstatements, but failed to adequately plead loss causation, meaning a causal connection between defendants' fraudulent conduct and the shareholders' economic loss.

The panel held that one way to prove loss causation in a fraud-on-the-market case is to show that the defendant's fraud was revealed to the market through

[*] This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

one or more "corrective disclosures" and that the company's stock price declined as a result. In Part III.B., the panel agreed with the district court that a series of blog posts offering negative reports about the company's operations did not qualify as a corrective disclosure. The panel concluded that even if the posts disclosed information that the market was not previously aware of, it was not plausible that the market reasonably perceived the posts as revealing the falsity of BofI's prior misstatements, thereby causing the drops in BofI's stock price on the days the posts appeared. In Part III.A., however, the panel held that a whistleblower lawsuit filed by a former company insider was a potential corrective disclosure. The panel joined the Sixth Circuit in rejecting a categorical rule that allegations in a lawsuit, standing alone, can never qualify as a corrective disclosure.

Finally, the panel agreed with the district court that the shareholders failed to plausibly allege the falsity of statements concerning government and regulatory investigations.

Judge Lee concurred in judgment in Part III.B. and dissented as to Part III.A. Judge Lee wrote that he agreed with much of the analysis in the majority's opinion but would require additional external confirmation of fraud allegations in a whistleblower lawsuit for them to count as a corrective disclosure. Accordingly, he dissented from the majority's holding that plausible insider allegations, standing alone, can qualify as a corrective disclosure.

COUNSEL

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OPINION

WATFORD, Circuit Judge:

To recover damages in a private securities fraud action, the plaintiff must establish a causal connection between the defendant's fraudulent conduct and the plaintiff's economic loss—an element known as loss causation. One way to prove loss causation is to show that the defendant's fraud was revealed to the market through one or more "corrective disclosures" and that the company's stock price declined as a result. In this case, the plaintiff alleged loss causation by relying on two corrective disclosures: a whistleblower lawsuit filed by a former company insider and a series of blog posts offering negative reports about the company's operations. The district court dismissed the case after concluding that neither the whistleblower lawsuit nor the blog posts could qualify as corrective disclosures. We agree as to the blog posts but reach a different conclusion with respect to the whistleblower lawsuit.

I

The company sued in this case, BofI Holding, Inc., is the holding company for BofI Federal Bank, a federally chartered savings association. (We refer to both entities collectively as BofI, although they now operate under a different corporate name.) In the years before this lawsuit was filed, BofI reported strong earnings growth and its stock price rose handsomely. Between August 2015 and February 2016, however, the price of the stock dropped by more than 47%. BofI shareholders filed multiple securities fraud suits against the company and several of its officers and directors. The suits were consolidated into this class action, brought on behalf of all BofI shareholders who purchased publicly traded shares between September 4, 2013, and February 3, 2016. The district court appointed the Houston Municipal Employees Pension System as lead plaintiff to represent the class.

The shareholders allege that BofI executives committed securities fraud by falsely portraying the company as a safer investment than it actually was. In particular, as relevant for this appeal, the shareholders allege that defendants made false or misleading statements touting the bank's conservative loan underwriting standards, its effective system of internal controls, and its robust compliance infrastructure.

The shareholders bring this action under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5. To state a claim, they must adequately plead six elements: (1) a material misrepresentation or omission; (2) made with scienter; (3) in connection with the purchase or sale of a security; (4) reliance on the misrepresentation or omission; (5) economic loss; and (6) loss causation. *Halliburton Co. v. Erica P. John Fund, Inc.,* 573 U.S. 258, 267 (2014). In a series of rulings preceding the order on appeal, the district court held that the shareholders have adequately alleged the first five elements of their claim, at least as to some of the challenged misstatements. In the order challenged on appeal, however, the court ultimately dismissed the operative Third Amended Complaint on the basis that the shareholders failed to adequately plead the last element, loss causation. We summarize the court's rulings below.

As to the first element, falsity, the district court dismissed many of the alleged misstatements as non-actionable. But the court ruled that the shareholders have adequately pleaded falsity with respect to two categories of misstatements, concerning (1) the bank's underwriting standards and (2) its system of internal controls and compliance infrastructure. Representative of the misstatements regarding underwriting standards are the following:

- "We continue to maintain our conservative underwriting criteria and have not loosened credit quality to enhance yields or increase loan volumes."
- "We continue to have an unwavering focus on credit quality of the bank and have not sacrificed credit quality to increase origination."
- "[W]e continue to originate only full documentation, high credit quality, low loan-to-value, jumbo single-family mortgages and have not reduced our loan rates for these products."

The court also found actionable two misstatements regarding internal controls and compliance infrastructure:

- "We have made significant investments in our overall compliance infrastructure over the past several quarters, including BSA [Bank Secrecy Act] and AML [anti-money laundering] compliance."
- "We have spent a significant amount of money on BSA/AML compliance upgrades and new

> systems and new personnel. We have also been beefing up our compliance teams."[1]

The shareholders predicated their showing of falsity on allegations attributed to confidential witnesses who used to work at BofI. The district court concluded that the witnesses' allegations were reliable and based on personal knowledge, as our circuit's case law requires. *See Zucco Partners, LLC v. Digimarc Corp.,* 552 F.3d 981, 995 (9th Cir. 2009). Assuming the witnesses' allegations were true, the court found "ample evidence," with respect to underwriting standards, to suggest that "BofI was not adhering to high credit quality standards and that it had, in fact, begun to 'sacrifice credit quality to increase origination.'" Likewise, with respect to internal controls and compliance infrastructure, the witnesses' allegations plausibly suggested that "BofI had not adequately staffed its BSA and AML compliance along with other internal control departments."

As to the second element, scienter, the district court again ruled partially in the shareholders' favor. The shareholders were required to allege facts giving rise to a strong inference that the defendants acted "either intentionally or with deliberate recklessness." *In re Verifone Holdings, Inc. Securities Litigation,* 704 F.3d 694, 698, 701 (9th Cir. 2012); *see also* 15 U.S.C. § 78u-4(b)(2). The court held that the shareholders failed to

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[1] In light of its ruling on loss causation, the district court declined to address whether certain alleged misstatements are actionable. On remand, the district court will need to determine which of the remaining misstatements are actionable, but it appears that at least some of them are, such as BofI's assertions that its "disclosure controls and procedures were effective," and that "[a]ll significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting" had been disclosed.

satisfy this standard for four of the five individual defendants, but concluded that the allegations of scienter were adequate as to BofI's Chief Executive Officer, Gregory Garrabrants, and thus as to the company as well. The court based this conclusion on the confidential witness allegations mentioned above.

BofI did not contest that the shareholders satisfied the third, fourth, and fifth elements of their Rule 10b-5 claim. The alleged misstatements were plainly made in connection with the purchase or sale of a security, as they were made in BofI's public filings and on earnings calls with investors. To establish reliance, the shareholders invoked the "fraud-on-the-market" presumption, which is premised on the theory that "the price of a security traded in an efficient market will reflect all publicly available information about a company," including materially false or misleading statements. *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds,* 568 U.S. 455, 458, 461-62 (2013). As a result, a plaintiff who purchases shares at an inflated price is presumed to have done so in reliance on any material misstatements reflected in the stock's price. *Id.* at 462. And with respect to economic loss, the shareholders indisputably lost money on their investment when BofI's stock lost nearly half its value by the end of the class period.

That leaves the sixth and final element, loss causation. After the district court issued the rulings described above, BofI filed a motion for judgment on the pleadings, in which it argued for the first time that the shareholders had not adequately alleged loss causation. The district court agreed and dismissed the shareholders' Second Amended Complaint with leave to amend.

The shareholders filed the operative Third Amended Complaint in response to the district court's ruling. To establish loss causation, the complaint relies on two corrective disclosures. The shareholders allege that these disclosures revealed the falsity of the company's statements regarding underwriting standards, internal controls, and compliance infrastructure and that the market reacted by driving down the price of BofI's stock.

The first corrective disclosure is a whistleblower lawsuit filed against BofI by Charles Erhart, a former mid-level auditor at the company, on October 13, 2015. *See Erhart v. BofI Holding lnc.,* No. 15-cv-2287 (S.D. Cal. Oct. 13, 2015). Erhart's suit—the details of which were disclosed in a *New York Times* article published that same day—alleged rampant and egregious wrongdoing at the company, including that BofI had doctored reports submitted to the bank's primary regulator, the Office of the Comptroller of the Currency (OCC), and that BofI had made high-risk and illegal loans to foreign nationals. Erhart also alleged that his attempts to raise these compliance issues within the company led to retaliation and eventually to his termination. By the close of trading the next day, the price of BofI's shares had fallen by 30.2% on extremely high trading volume.

The second corrective disclosure consists of a group of eight blog posts published by anonymous authors on *Seeking Alpha,* a crowd-sourced online resource for investors, between August 2015 and February 2016. The blog posts argued that things at BofI were not as rosy as they seemed. The posts' specific charges varied, ranging from allegations of potential regulatory violations to evidence of risky loan origination partnerships. Each post stated that it was based on information derived from publicly available sources and that the author was “short” BofI. According to the complaint, BofI’s stock price fell on each day that one of the blog posts appeared.

BofI filed a motion to dismiss the Third Amended Complaint, and in the ruling now on appeal, the district court held that the shareholders failed to plausibly allege loss causation. The court reasoned that, because the Erhart lawsuit contained only “unconfirmed accusations of fraud,” it could not have disclosed to the market that BofI’s alleged misstatements were actually false. To qualify as a corrective disclosure, the court held, the Erhart lawsuit had to be followed by “a subsequent confirmation” of the fraud, which the shareholders have not alleged.

As for the *Seeking Alpha* blog posts, the district court concluded that they cannot serve as corrective disclosures because each of them relies entirely on publicly available information. In the court’s view, the blog posts could not have “revealed” anything to the market because the information they disclosed was presumably already known to market participants and thus reflected in BofI’s stock price.

Having identified fatal deficiencies in the shareholders’ loss causation allegations, the district court dismissed the action with prejudice after concluding that yet another opportunity to amend the complaint was unwarranted.

II

We agree with the district court that the shareholders have adequately alleged falsity and scienter with respect to misstatements concerning BofI’s underwriting standards, internal controls, and compliance infrastructure. The dispositive issue on appeal is whether the shareholders have also adequately alleged loss causation. Before tackling that question, we begin with a brief overview of the loss causation requirement, with the aim of illuminating the function this element serves in a private securities fraud action.

Like any other tort plaintiff who seeks to recover damages, a plaintiff in a securities fraud suit must plead and ultimately prove that the defendant's wrongful conduct caused the plaintiff's injury. Congress codified that requirement in the Private Securities Litigation Reform Act. Under the heading "Loss causation," the Act provides: "In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4). Courts have likened this requirement to the showing of proximate causation required in ordinary tort actions. *See, e.g., Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336, 343-46 (2005); *Lloyd v. CVB Financial Corp.,* 811 F.3d 1200, 1210 (9th Cir. 2016).

In fraud-on-the-market cases like this one, the plaintiff's theory of loss causation begins with the allegation that the defendant's misstatements (or other fraudulent conduct) artificially inflated the price at which the plaintiff purchased her shares—meaning the price was higher than it would have been had the false statements not been made. Merely purchasing shares at an inflated price, however, does not cause an investor to suffer economic loss as a result of the fraud. *Dura Pharmaceuticals,* 544 U.S. at 342. If the defendant's fraud remains concealed, the price will usually remain inflated, allowing the plaintiff to sell her shares and recoup the inflationary component she paid. *See id.; Find What Investor Group v. FindWhat.com,* 658 F.3d 1282, 1315 (11th Cir. 2011).

To establish loss causation in a fraud-on-the-market case, the plaintiff must show that after purchasing her shares and before selling, the following occurred: (1) "the truth became known," and (2) the revelation caused the fraud-induced inflation in the stock's price to be reduced or eliminated. *Dura Pharmaceuticals,* 544 U.S. at 347; *see Find What,* 658 F.3d at 1310. At that point, the plaintiff has suffered an economic loss caused by the misstatements because she is no longer able to recoup in the marketplace the inflationary component of the price she originally paid. *Find What,* 658 F.3d at 1311; Madge S. Thorsen et al., *Rediscovering the Economics of Loss Causation,* 6 J. Bus. & Sec. L. 93, 98 (2006).

The most common way for plaintiffs to prove that "the truth became known" is to identify one or more corrective disclosures. *See Mineworkers' Pension Scheme v. First Solar Inc.,* 881 F.3d 750, 753-54 (9th Cir. 2018) (per curiam); *Lloyd,* 811 F.3d at 1209. A corrective disclosure occurs when "information correcting the misstatement or omission that is the basis for the action is disseminated to the market." 15 U.S.C. § 78u-4(e)(1) (using that event to establish a statutory cap on damages).

Although deciding what qualifies as a corrective disclosure has proved more challenging than might have been expected, a few basic ground rules can be sketched out. First, a corrective disclosure need not consist of an admission of fraud by the defendant or a formal finding of fraud by a government agency. *See Metzler Investment GMBH v. Corinthian Colleges, Inc.,* 540 F.3d 1049, 1064 (9th Cir. 2008). A corrective disclosure can instead come from any source, including knowledgeable third parties such as whistleblowers, analysts, or investigative reporters. *Norfolk County Retirement System v. Community Health Systems, Inc.,* 877 F.3d 687, 695 (6th Cir. 2017); *Public Employees' Retirement System of Mississippi v. Amedisys, Inc.,* 769 F.3d 313, 322 (5th Cir. 2014). Second, a corrective disclosure need not reveal the full scope of the defendant's fraud in one fell swoop; the true facts concealed by the defendant's misstatements may be revealed over time through a series of partial disclosures. *Amedisys,* 769 F.3d at 322-24; *In re Williams Securities Litigation—WCG Subclass,* 558 F.3d 1130, 1137-38 (10th Cir. 2009). Third, to be corrective, a disclosure "need not precisely mirror the earlier misrepresentation." *Williams,* 558 F.3d at 1140. It is enough if the disclosure reveals new facts that, taken as true, render some aspect of the defendant's prior statements false or misleading. *Amedisys,* 769 F.3d at 321-22.

Even if the true facts concealed by the fraud are revealed to the market, the plaintiff must still show that the disclosure of the truth caused the company's stock price to decline. For a subsequent decline in price could be attributable to factors unrelated to the fraud, such as a change in economic circumstances or investor expectations. *Dura Pharmaceuticals,* 544 U.S. at 343. The securities laws do not protect against ordinary investment losses of that sort. *See id.* at 345. We have explained that loss causation does not require a showing "that a misrepresentation was the *sole* reason for the investment's decline in value." *In re Daou Systems, Inc.,* 411 F.3d 1006, 1025 (9th Cir. 2005). Rather, "as long as the misrepresentation is one substantial cause of the investment's decline in value, other contributing forces will not bar recovery under the loss causation requirement." *Id.* The determination of whether there is a causal link includes a temporal component—a disclosure followed by an immediate drop in stock price is more likely to have caused the decline—but timing is not dispositive. *See In re Gilead Sciences Securities Litigation,* 536 F.3d 1049, 1058 (9th Cir. 2008) ("A limited temporal gap between the time a misrepresentation is publicly revealed and the subsequent decline in stock value does not render a plaintiff's theory of loss causation per se implausible.").

III

With that background in mind, we turn to the specific corrective disclosures at issue in this case. We address the Erhart lawsuit first, followed by the *Seeking Alpha* blog posts.

A

As discussed above, to prove loss causation by relying on one or more corrective disclosures, a plaintiff must show that: (1) a corrective disclosure revealed, in whole or in part, the truth concealed by the defendant's misstatements; and (2) disclosure of the truth caused the company's stock price to decline and the inflation attributable to the misstatements to dissipate. At the pleading stage, the plaintiff's task is to allege with particularity facts "plausibly suggesting" that both showings can be made. *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 557 (2007); *see Oregon Public Employees Retirement Fund v. Apollo Group, Inc.,* 774 F.3d 598, 605 (9th Cir. 2014) (holding that allegations of loss causation must satisfy Federal Rule of Civil Procedure 9(b)'s heightened "particularity" requirement).

The shareholders pleaded facts with particularity that plausibly suggest they can make the first showing. The allegations of egregious wrongdoing in the Erhart lawsuit, if accepted as true, unquestionably revealed to the market that at least some of BofI's alleged misstatements were false.[2] For example, Erhart recounted an instance in which he relayed to his superiors a third-party vendor's report on BofI's operations. Erhart alleged that he personally prepared a memorandum summarizing the vendor's findings, which identified roughly 30% of BofI's customers as "bad," meaning the customers had red flags such as suspiciously high cash balances, social security numbers that did not match any public records, and, in one instance, the social security number of a dead person. Erhart further alleged that when he gave the list to his superior, Senior Vice President John Tolla, Tolla demanded that the audit committee alter the list and give the altered version to the OCC. Erhart also claims that his thorough work and his attempts to report potential compliance violations earned him retaliation rather than praise. These and other similar allegations, if true, render BofI's prior assertions about the strength of its underwriting standards, internal controls, and compliance infrastructure false or misleading.[3]

As to the second showing, the shareholders allege that BofI's stock price fell by more than 30% on extremely high trading volume immediately after the

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[2] We take judicial notice of the contents of the complaint filed in *Erhart v. BofI Holding Inc.,* No. 15-cv-2287 (S.D. Cal. Oct. 13, 2015), but not of the truth of the allegations asserted therein, which BofI vigorously contests. *See Lee v. City of Los Angeles,* 250 F.3d 668, 689-90 (9th Cir. 2001).

[3] The district court held in its order dismissing the Second Amended Complaint that none of the allegations in the Erhart lawsuit relate back to the subject matter of the specific misstatements the court had found actionable. We disagree with that ruling. As noted above, a corrective disclosure need not be a mirror image of the prior misstatement. See Williams, 558 F.3d at 1140.

market learned of Erhart's allegations. The shareholders have plausibly alleged that this drop constituted a dissipation of the inflation attributable to BofI's misstatements instead of a reaction to some other negative news unrelated to the alleged fraud.

To plead loss causation here, the shareholders did not have to establish that the allegations in Erhart's lawsuit are in fact true. Falsity and loss causation are separate elements of a Rule 10b-5 claim. The shareholders adequately alleged that BofI's misstatements were false through the allegations attributed to confidential witnesses. In analyzing loss causation, we therefore begin with the premise that BofI's misstatements *were* false and ask whether the market at some point learned of their falsity—through whatever means. Viewed through that prism, the relevant question for loss causation purposes is whether the market reasonably *perceived* Erhart's allegations as true and acted upon them accordingly. *See Norfolk County,* 877 F.3d at 696 (inquiry when evaluating an alleged corrective disclosure is "whether the market could have perceived it as true"). If the market recalibrated BofI's stock price on the assumption that Erhart's allegations are true—and thus that BofI's prior misstatements were false—then the drop in BofI's stock price represented dissipation of inflation rather than a reaction to other non-fraud-related news.

The shareholders alleged facts with particularity that plausibly suggest the market perceived Erhart's allegations as credible and acted upon them on the assumption that they were true. Erhart's descriptions of wrongdoing are highly detailed and specific, and they are based on firsthand knowledge that he could reasonably be expected to possess by virtue of his position as a mid-level auditor at the company. True, Erhart's motivations for coming forward may not have been entirely pure, as he lodged his allegations in a lawsuit seeking money from BofI. But that is just one factor among many that market participants would have weighed in deciding how much credence his claims deserved. The fact that BofI's stock price plunged by more than 30% on extremely high trading volume immediately after the market learned of Erhart's allegations bolsters the inference that the market regarded his allegations as credible. A price drop of that magnitude would not be expected in response to whistleblower allegations perceived as unworthy of belief, and the drop is not readily attributable to non-fraud-related factors that might have moved BofI's stock price that day.

The district court nonetheless held that allegations in a lawsuit, standing alone, can never qualify as a corrective disclosure because they are just that—allegations, as opposed to "truth." The court concluded that, to adequately plead loss causation, the shareholders had to identify an additional disclosure that confirmed the truth of Erhart's allegations.

We join the Sixth Circuit in rejecting any such categorical rule. *Norfolk County,* 877 F.3d at 696. To be sure, allegations in a lawsuit do not provide definitive confirmation that fraud occurred. But short of an admission by the defendant or a formal finding of fraud—neither of which is required, *see Amedisys,* 769 F.3d at 324-25; *Metzler,* 540 F.3d at 1064—any corrective disclosure will necessarily take the form of contestable allegations of wrongdoing. As the Sixth Circuit observed, "every representation of fact is in a sense an allegation, whether made in a complaint, newspaper report, press release, or under oath in a courtroom." *Norfolk County,* 877 F.3d at 696. What matters for loss causation purposes "is that some [representations] are more credible than others and thus more likely to be acted upon as truth." *Id.* If the market treats allegations in a lawsuit as sufficiently credible to be acted upon as truth, and the inflation in the stock price attributable to the defendant's misstatements is dissipated as a result, then the allegations can serve as a corrective disclosure. The plaintiff must, of course, prove that the defendant's misstatements *were* false, but that can be done through proof other than the corrective disclosure itself.

The two cases on which the district court relied most heavily are not to the contrary. In *Loos v. Immersion Corp.,* 762 F.3d 880 (9th Cir. 2014), the defendant company announced that it was conducting "an internal investigation into certain previous revenue transactions in its Medical line of business." *Id.* at 885 (quoting the company's press release). We held that the plaintiff could not rest his theory of loss causation on the announcement of this investigation standing alone. Quoting the Eleventh Circuit's decision in *Meyer v. Greene,* 710 F.3d 1189 (11th Cir. 2013), we noted that "[t]he announcement of an investigation reveals just that—an investigation—and nothing more." *Loos,* 762 F.3d at 890. Such an announcement does not reveal to the market any *facts* that could call into question the veracity of the company's prior statements; all the market could react to was "speculation" about "what the investigation will ultimately reveal." *Id.*

Our case presents a different situation. Erhart's lawsuit disclosed facts that, if true, rendered false BofI's prior statements about its underwriting standards, internal controls, and compliance infrastructure. No speculation on that score was required.

The second case on which the district court relied, *Curry v. Yelp Inc.,* 875 F.3d 1219 (9th Cir. 2017), is also distinguishable. There, the plaintiffs accused Yelp of falsely representing that the reviews it posted were authentic and independent. *Id.* at 1222. The plaintiffs alleged that the falsity of this representation was revealed to the market when the Federal Trade Commission disclosed some 2,000 complaints the agency had received "from businesses claiming that Yelp had manipulated reviews of their services" in various ways. *Id.*

We rejected the plaintiffs' loss causation allegations as inadequate. *Id.* at 1225. Critically for our purposes, the customers who filed complaints in *Curry* were outsiders who lacked any firsthand knowledge of Yelp's practices. Thus, they could not attest to whether Yelp was actually engaged in manipulating reviews, nor to whether the reviews the company posted were authentic and independent. *See id.* at 1223. We refused to allow the plaintiffs to allege loss causation "merely by resting on a number of customer complaints and asserting that where there is smoke, there must be fire." *Id.* at 1225.

Here, by contrast, Erhart is a former insider of the company who had personal knowledge of the facts he alleged. Those facts revealed that a number of BofI's alleged misstatements were false. If the market regarded his factual allegations as credible and acted upon them on the assumption that they were true, as the shareholders have plausibly alleged here, Erhart's allegations established fire and not just smoke.[4]

[4] BofI contends that the shareholders cannot plead loss causation because they cannot plausibly allege that the bank ever suffered an adverse fmancial event, such as losses from its loan

One final point bears mentioning. In ruling against the shareholders, the district court emphasized that a plaintiff in a securities fraud action must plead loss causation "with particularity" under Rule 9(b). *See Apollo Group,* 774 F.3d at 605. When applied to allegations of loss causation, however, Rule 9(b)'s particularity requirement usually adds little to the plaintiff's burden. The plaintiff must plausibly allege a causal connection between the defendant's misstatements and the plaintiff's economic loss, and to succeed in doing so the plaintiff will always need to provide enough factual content to give the defendant "some indication of the loss and the causal connection that the plaintiff has in mind." *Dura Pharmaceuticals,* 544 U.S. at 347. That effort "should not prove burdensome," *id.,* for even under Rule 9(b) the plaintiff's allegations will suffice so long as they give the defendant "notice of plaintiffs' loss causation theory" and provide the court "some assurance that the theory has a basis in fact." *Berson v. Applied Signal Technology, Inc.,* 527 F.3d 982, 989-90 (9th Cir. 2008). The shareholders pleaded loss causation here with sufficient particularity to accomplish those twin aims.

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portfolio or a spike in its reserves. But this misconstrues the significance of BofI's alleged misstatements. According to the shareholders, BofI misrepresented itself as a safe investment when in fact it was far riskier. The shareholders contend that, before the corrective disclosures, the price of BofI's stock was inflated by the market's belief that the company's statements were true, and that the price declined when the market learned that BofI's statements were false. On this account, the shareholders suffered an economic loss caused by the misstatements because they purchased their shares at an inflated price and are now unable to recoup the inflationary component in the market. That remains true regardless of whether the risks concealed by BofI's misstatements ever materialized and harmed the bank's bottom line.

B

We turn next to the *Seeking Alpha* blog posts. We agree with the district court that the shareholders failed to plausibly allege that these posts constituted corrective disclosures, although we disagree somewhat with the district court's rationale.

As noted earlier, each of the blog posts asserts that the information it discloses was derived from publicly available sources. Because this is a fraud-on-the-market case, that assertion makes it more difficult for the shareholders to rely on the posts as corrective disclosures. BofI's stock is deemed to trade in an efficient market in which all publicly available information about the company, both positive and negative, is quickly incorporated into the stock price. *See Amgen,* 568 U.S. at 461-62. So its stock price should already reflect whatever public information a blog post might be based upon. A corrective disclosure, though, must by definition reveal new information to the market that has not yet been incorporated into the price.

To rely on a corrective disclosure that is based on publicly available information, a plaintiff must plead with particularity facts plausibly explaining why the information was not yet reflected in the company's stock price. The district court interpreted this requirement to mean that the shareholders had to allege facts explaining why "other market participants *could not* have done the same analysis and reached the same conclusion" as the authors of the blog posts. (Emphasis added.) We think that sets the bar too high. For pleading purposes, the shareholders needed to allege particular facts plausibly suggesting that other market participants *had not* done the same analysis, rather than "could not." If other market participants had not done the same analysis, then it is plausible that the blog posts disclosed new information that the market had not yet incorporated into BofI's stock price.

Prior cases reflect the understanding that some information, although nominally available to the public, can still be "new" if the market has not previously understood its significance. For example, in *In re Gilead Sciences Securities Litigation,* 536 F.3d 1049 (9th Cir. 2008), a pharmaceutical company represented that demand for an HIV drug was strong and that the company complied with federal and state regulations, despite knowing that unlawful off-label marketing was the reason for strong demand. *Id.* at 1051. The company then received a warning letter from the Food and Drug Administration (FDA) about its off-label marketing of the drug. *Id.* at 1052-53. The company's stock price did not incorporate the information disclosed in the letter until three months after the letter had been publicly released, when the company reported a major earnings miss attributable to decreased demand for the HIV drug. *Id.* at 1053-54. We concluded that the plaintiffs plausibly alleged the drop in stock price was caused by the FDA warning letter. *Id.* at 1058. Given the letter's subtle relationship to the company's alleged misstatements—"it did not contain enough information to significantly undermine [the company's] pronouncements concerning demand"—the letter itself "would not necessarily trigger a market reaction." *Id.* Thus, it was "not unreasonable that physicians . . . would respond to the Warning Letter" by issuing fewer prescriptions and lowering demand for the drug, "while the public failed to appreciate its significance" until its impact on revenue was made plain from the earnings release. *Id.* Despite the three-month gap between the FDA letter and the drop in stock price, the plaintiffs' allegations were enough to plead loss causation.

Similarly, in *Public Employees' Retirement System v. Amedisys, Inc.,* 769 F.3d 313 (5th Cir. 2014), a *Wall Street Journal* article analyzed publicly available Medicare records to conclude that Amedisys, a home health services company, was engaging in Medicare fraud. *Id.* at 318. The defendant unsuccessfully pressed the same argument that BofI advances here: "[B]ecause the article proclaims on its face that its analysis was `based on publicly available Medicare records,' . . . [it] does not reveal any new information to the marketplace." *Id.* at 323. The Fifth Circuit rejected such a rule, holding instead that "it is plausible that complex economic data understandable only through expert analysis may not be readily digestible by the marketplace." *Id.* The underlying information, although publicly available, "had little to no probative value in its native state"; someone needed to put the pieces together before the market could appreciate its import. *Id.*

Contrary to the bright-line rule BofI urges us to adopt, these cases endorse a flexible approach to evaluating corrective disclosures. A disclosure based on publicly available information can, in certain circumstances, constitute a corrective disclosure. The ultimate question is again one of plausibility: Based on plaintiffs' particularized allegations, can we plausibly infer that the alleged corrective disclosure provided new information to the market that was not yet reflected in the company's stock price? The fact that the underlying data was publicly available is certainly one factor to consider. But other factors include the complexity of the data and its relationship to the alleged misstatements, as in *Amedisys* and *Gilead,* and the great effort needed to locate and analyze it, as the shareholders allege here. Courts must assess these and other factors on a case-by-case basis. We therefore decline to categorically disqualify the *Seeking Alpha* blog posts as potential corrective disclosures.[5]

Even judged against this more forgiving standard, the shareholders' allegations concerning the eight blog posts do not pass muster. We address each of the eight posts that were followed by a decline in stock price.

The August 28, 2015, blog post. The author of this post claimed to have "analyzed hundreds of BofI's loans," and on the basis of that review the author levied a host of allegations against BofI: that its loan-to-value ratios were often higher than advertised; that the bank faced personnel turnover in the audit department; that it made risky loans to foreign nationals; and that the Securities and Exchange Commission (SEC) was possibly investigating the company.

The October 29, 2015, blog post. This post compared BofI's transcript of an earnings call with the transcripts prepared by news agencies, and it noted potentially important discrepancies. The shareholders claim that the discrepancies show BofI's "lack of internal controls over financial reporting and risk management."

The November 10, 2015, blog post. This post chronicles BofI's alleged relationships with two risky lenders, Quick Bridge and OnDeck Capital. According to the

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[5] We acknowledge that the Eleventh Circuit has adopted the bright-line rule BofI advocates. *See Meyer,* 710 F.3d at 1198 ("[T]he fact that the sources used in the Einhorn Presentation were already public is fatal to the Investors' claim of loss causation."). And it is true that we cited *Meyer* approvingly when we held that the mere announcement of an investigation is insufficient to plead loss causation. *See Loos,* 762 F.3d at 889-90. But the *Loos* court had no occasion to adopt *Meyer's* holding about public information, and its discussion of that portion of *Meyer* is therefore *dicta.* We decline to extend it here.

author, through these relationships, BofI originated bad loans, reaped the origination fees, and then sold the loans to its partner to keep the loans off its books. The author asserts that the loans involved are frequently the subjects of collection actions and bankruptcy proceedings, and points to court filings suggesting that "many borrowers appear to have never been capable of" repaying the loans. This information potentially undermines the veracity of BofI's statements regarding its conservative underwriting standards, particularly the statement that BofI had "not sacrificed credit quality to increase origination."

The November 18, 2015, blog post. This post states that the author's "research suggests that [BofI] has employed a former felon for over 5 years in a very senior and pivotal role," but does not name the individual. The author postulates that BofI "had to have known of the executive's prior criminality" and therefore was probably "in violation of Section 19 of the Federal Deposit Insurance Act." The author concedes he is not "100% certain" that BofI's executive is the former felon, but states his analysis—which included comparing a mugshot photo to a LinkedIn photo, and comparing signatures and birth dates on public documents—was fairly rigorous. The author comments on the regulatory penalties BofI could face if it did not obtain a waiver from the Federal Deposit Insurance Corporation before employing a convicted felon. The post also notes that BofI made loans to the same executive shortly after he filed for bankruptcy.

The November 19, 2015, blog post. In this post, the author claims to have uncovered evidence that BofI provides financing to a "Special Purpose Entity" called Center Street Lending Fund IV, LLC. According to the author, Center Street offers "no doc" and "no FICO" loans and is a named defendant in litigation alleging that it participated in a Ponzi scheme. These alleged facts, documenting BofI's indirect financing of "no doc" loans, potentially contradict the company's claim to "originate only full documentation" loans.

The December 8, 2015, blog post. This post asserts that BofI is financing another Special Purpose Entity, WCL Holdings I, LLC, that was first mentioned in the post of November 10. In the earlier post, the author claimed that BofI assigned the loans it originated with Quick Bridge to WCL, although it was unclear at that point whether BofI was also financing WCL. This post purports to show that BofI is indeed lending to WCL. BofI's alleged financing of an off-book entity to buy back BofI's own risky loans potentially contradicts BofI's statement that it achieved "strong loan growth . . . while maintaining high credit quality standards."

The January 6, 2016, blog post. This post unearths evidence that BofI made a roughly $32 million loan to Encore Capital, a San Diego-based debt collector. Encore's then-Chief Financial Officer, Paul Grinberg, was also the Chair of BofI's Audit Committee. The loans allegedly allowed Encore to make a major acquisition, which led to Grinberg's promotion. According to the author, BofI never disclosed this loan, as the SEC requires for related-party transactions, and indeed omitted the loan from the bank's 2014 disclosures of loans made to board members. These revelations potentially contradict BofI's statements about the robustness of its compliance infrastructure.

The February 3, 2016, blog post. This post details BofI's opening of a new Nevada branch and links it to BofI's acquisition of H&R Block's lending products. The shareholders imply that the post contradicts BofI's statements about its underwriting standards and compliance infrastructure.

The fact that each of these blog posts relied on nominally public information does not, on its own, preclude them from qualifying as corrective disclosures. Some of the posts required extensive and tedious research involving the analysis of far-flung bits and pieces of data. The authors arrived at their conclusions after scouring through hundreds of Uniform Commercial Code filings, bankruptcy court documents, and other companies' registration documents. While other investors undoubtedly could have reviewed registration documents, they likely would not have known to investigate Quick Bridge, On Deck, or Encore precisely because BofI had hidden its relationships with those entities. *Cf. Norfolk County,* 877 F.3d at 697. The time and effort it took to compile this information make it plausible that the posts provided new information to the market, even though all of the underlying data was publicly available. *Cf. Amedisys,* 769 F.3d at 323.

We nonetheless conclude that the shareholders have not plausibly alleged that these posts constituted corrective disclosures. Even if the posts disclosed information that the market was not previously aware of, it is not plausible that the market reasonably perceived these posts as revealing the falsity of BofI's prior misstatements, thereby causing the drops in BofI's stock price on the days the posts appeared. The posts were authored by anonymous short-sellers who had a financial incentive to convince others to sell, and the posts included disclaimers from the authors stating that they made "no representation as to the accuracy or completeness of the information set forth in this article." A reasonable investor reading these posts would likely have taken their contents with a healthy grain of salt.[6]

Therefore, the shareholders have not plausibly alleged that any of the *Seeking Alpha* blog posts constituted a corrective disclosure. The district court did not abuse its discretion in denying further leave to amend, as the court had already pointed out the deficiencies in the shareholders' loss causation allegations concerning the blog posts and had given them an opportunity to correct those deficiencies. *See Loos,* 762 F.3d at 890-91.

IV

Finally, we take up the new category of misstatements that the shareholders alleged for the first time in the Third Amended Complaint, concerning government and regulatory investigations. We agree with the district court that the shareholders failed to plausibly allege the falsity of any of the alleged misstatements in this new category. All but three of the challenged statements are expressions of opinion, not statements of fact "capable of objective verification." *Apollo Group,* 774 F.3d at 606. For example, Garrabrants told investors that regulatory review "is beyond a nonissue" and that "[w]e have great regulatory relations." These vague assurances reflect Garrabrants's opinions and predictions, which are not actionable. *See In re Cutera Securities Litigation,* 610 F.3d 1103, 1111 (9th Cir. 2010).

The shareholders have not plausibly alleged falsity with respect to the three remaining statements. On an

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[6] Some of the posts suffer from other deficiencies. For example, the October 29, 2015, post, comparing transcripts, did not require any special expertise or effort. And most of the misdeeds alleged in the August 28, 2015, and February 3, 2016, posts are not tethered to any actionable misstatements.

earnings call, Garrabrants told investors that: (1) there was "nothing ongoing" with the OCC; (2) there was "no continuity" to any of Erhart's complaints submitted to the OCC; and (3) there were no "regulatory issues of any kind that have arisen from Mr. Erhart's contact with the OCC." These statements were accurate. Although the SEC was investigating BofI at the time, it is unclear whether anyone at BofI was aware of that fact when Garrabrants spoke, and his statements were specifically limited to the OCC in any event. The shareholders do not argue that Garrabrants had an independent duty to disclose the SEC investigation. Without such a duty, Garrabrants was under no obligation to mention it. *See Basic Inc. v. Levinson,* 485 U.S. 224, 239 n.17 (1988); *Retail Wholesale & Department Store Union Local 338 Retirement Fund v. Hewlett-Packard Co.,* 845 F.3d 1268, 1278 (9th Cir. 2017).

* * *

The shareholders have adequately pleaded a viable claim under § 10(b) and Rule 10b-5 for the two categories of misstatements the district court found actionable, with the Erhart lawsuit serving as a potential corrective disclosure. We reverse the district court's judgment dismissing the action with prejudice and remand for further proceedings consistent with this opinion.[7]

Appellant's Motion for Judicial Notice (Dkt. No. 12) is GRANTED.

REVERSED and REMANDED.

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[7] Because the shareholders have alleged a viable claim under § 10(b), the district court on remand should reinstate their claims under § 20(a) against the individual defendants.

LEE, Circuit Judge, concurring in part III.B. in judgment and dissenting in part III.A.:

Philosophers have long debated the question, “If a tree falls in the forest but no one is around to hear it, does it make a sound?” This case perhaps presents the converse of that conundrum: If there is no fraud, can a securities fraud lawsuit still proceed?

The majority holds that a former employee’s allegations of fraud in a whistleblower lawsuit may count as a “corrective disclosure” under Rule 10b-5’s loss causation requirement as long as they are plausible even if there is no additional evidence or disclosure corroborating them. I agree with much of the analysis in the majority’s thoughtful opinion, which attempts to balance carefully competing concerns on a very difficult issue.

But I still fear that the decision will have the unintended effect of giving the greenlight for securities fraud lawsuits based on unsubstantiated assertions that may turn out to be nothing more than wisps of innuendo and speculation. And even meritless securities fraud lawsuits impose an exorbitant cost on companies. I would thus require additional external confirmation of fraud allegations in a whistleblower lawsuit for them to count as a “corrective disclosure.” Doing so comports with our case law and common sense. I thus respectfully dissent from the majority’s holding that plausible insider allegations, standing alone, can qualify as a corrective disclosure (part III.A.).

* * * *

Charles Erhart, a mid-level auditor at BofI, sued his former employer after being terminated, claiming that it was retaliation for whistleblowing. His lawsuit against BofI will go to trial sometime next year.

The majority believes that Erhart's allegations in his separate whistleblower lawsuit against BofI are plausible enough to constitute a "corrective disclosure" under Rule 10b-5's loss causation requirement. The majority opinion thus allows shareholders in this lawsuit to piggyback off of Erhart's whistleblower lawsuit against his former employer. It may well be that Erhart's allegations in his lawsuit are true. His allegations, if true, paint a company rife with corruption and mismanagement. And many corporate schemes of malfeasance have unraveled after a whistleblower exposed the wrongdoing.

But what if it turns out that Erhart's allegations in his lawsuit are bunk? What if he is mistaken? Perhaps he misconstrued certain information because, as a fairly junior-level employee, he did not understand or have access to all the facts. Or what if (as BofI suggests) he is a loose cannon who has a messianic zeal for seeing wrongdoing where none exists? At this point, we simply do not know, especially with no other evidence or disclosure to corroborate Erhart's claims in his lawsuit.

But we do know that BofI has not issued any financial disclosures that would confirm Erhart's allegations that he first aired in 2015. BofI has not done so, even though the U.S. Department of Justice, the Securities and Exchange Commission, and the Treasury Department have reportedly investigated BofI. And apparently at least one SEC investigation that began in 2015 has already closed with no action.

Put another way, five *years* have passed since Erhart first disclosed allegations of misconduct at

BofI, and multiple government agencies commenced investigations into BofI. Yet so far, we have not seen any external evidence corroborating Erhart's allegations. So it may turn out that there may be smoke but no fire. But based solely on a midlevel employee's self-interested allegations in a separate lawsuit, we are allowing a securities fraud lawsuit to move forward. It is premature to do so. Erhart may ultimately be vindicated, and perhaps the government investigations will eventually expose fraud, but we should not let a securities fraud lawsuit proceed when, at this point, there may no there there. We may end up with a scenario in which Erhart loses his whistleblower trial, and the government agencies end their investigations without any action and yet BofI may end up settling a securities fraud case for millions of dollars to avoid litigation costs.

The majority notes that not every insider allegation in a lawsuit will count as a corrective disclosure; only "plausible" ones will survive a dismissal. While the plausibility standard under *Iqbal/Twombly* has rooted out many meritless cases at the pleading stage, such a standard will likely be less useful in a securities fraud lawsuit based on insider allegations in a whistleblower lawsuit. An insider account will almost always have a patina of plausibility because it will likely be based on some non-public allegation that cannot be easily disputed or rebutted at the pleading stage. Indeed, like any good conspiracy theory, an insider's story often has some element of truth to it, even if it is largely mistaken or misguided. In the end, the plausibility standard will likely stave off only lawsuits based on insider accounts that even Mulder and Scully would find unbelievable. In short, the plausibility standard provides little comfort to companies that may face securities fraud lawsuits based on unsubstantiated insider allegations.

What's the harm of letting a securities fraud lawsuit go forward if the company can eventually vindicate itself at trial? Plenty. According to Cornerstone Research, approximately 8.9% of all public companies listed on a U.S. securities exchange were the target of a securities class action in 2019. *See* Cornerstone Research, *Securities Class Action Filings: 2019 Year in Review,* 11 (Jan. 29, 2020), https://bit.ly/2TpajjY. And in 2018, the median cost of a securities class-action settlement was $13 million, according to one estimate. *See* Chubb, *From Nuisance to Menace: The Rising Tide of Securities Class Action Litigation* (June 2019), https://bit.ly/3cvbIx4. If a securities fraud lawsuit survives a motion to dismiss, it likely will lead to a settlement to the tune of millions of dollars. In the past quarter-century or so, only *six* securities fraud cases apparently have been tried to verdict. *See* Jeffrey A. Barrack, *A Primer on Taking A Securities Fraud Class Action to Trial,* 31 Am. J. Trial Advoc. 471, 476 (2008). In a time when trials are rare, securities fraud trials are virtually extinct. That is why the loss causation requirement acts as a critical bulwark against frivolous securities fraud lawsuits. It guards against lawsuits being used as an *"in terrorem* device" to bludgeon companies into settling claims to "avoid the cost and burden of litigation." *Meyer v. Greene,* 710 F.3d 1189, 1196 (11th Cir. 2013) (citing *Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 347-48 (2005)).

It is true that BofI's shares plummeted 30% after Erhart publicly accused his former employer of fraud. But that does not necessarily mean Erhart's allegations revealed the "truth" and acted as a corrective disclosure. Rather, it is better construed as a disclosure of "an added *risk* of future corrective action." *Meyer,* 710 F.3d at 1201 (ruling that an announcement of an SEC investigation by itself is not a corrective disclosure but signals an added risk of it).

Our decision in *Loos v. Immersion Corp.* is instructive. There, Immersion announced an internal investigation into revenue recognition practices of its medical line of business. *Loos,* 762 F.3d 880, 885 (9th Cir. 2014). The company's stock price plummeted 23% after this disclosure. *Id.* A shareholder lawsuit inevitably followed. We affirmed the district court's dismissal of the securities fraud lawsuit, ruling that the company's announcement of potential problems with revenue recognition was not a corrective disclosure. While the disclosure was "ominous," it "simply put[] investors on notice of a *potential* future disclosure of fraudulent conduct." *Id.* at 890.

Similarly, in *Curry v. Yelp Inc.,* Yelp's stock price dropped after the FTC disclosed more than 2,000 complaints from businesses alleging that Yelp had manipulated reviews. 875 F.3d 1219, 1222 (9th Cir. 2017). We acknowledged that a plaintiff "need not allege an outright admission of fraud," but we affirmed the dismissal of the lawsuit because the "mere `risk' or `potential' for fraud is insufficient to establish loss causation." *Id.* at 1225 (quoting *Loos,* 762 F.3d at 889).

Likewise here, Erhart's allegations are certainly "ominous," and may in fact be true. But at this time, the drop in BofI's share price "can only be attributed to market speculation about whether fraud has occurred." *Loos,* 762 F.3d at 890. And this "type of speculation cannot form the basis of a viable loss causation theory." *Id.* Before plaintiffs can establish loss causation based on an unsubstantiated whistleblower complaint, another shoe has to drop. It has not yet.

In short, if a securities fraud lawsuit turns on insider allegations of wrongdoing in a whistleblower lawsuit, I would prefer a bright-line rule that requires an external disclosure or evidence that confirms those allegations. It need not be a *mea culpa* from the company, but perhaps a surprise restatement of earnings, an unexplained announcement about an increase in reserves, or some other information that confirms those allegations and thus acts as a corrective disclosure.[1]

Finally, I agree with the majority that the anonymous *Seeking Alpha* posts are not corrective disclosures. I would, however, base our decision on the grounds that the *Seeking Alpha* posts contain public information only, and that we should not credit anonymous posts on a website notorious for self-interested short-sellers trafficking in rumors for their own pecuniary gain. *See, e.g.,* Jeff Katz & Annie Hancock, *Short Activism: The Rise of Anonymous Online Short Attacks,* Harvard Law School Forum on Corporate Governance (Nov. 27, 2017), https://bit.ly/3kqF3fi (noting the rise of short shellers engaging in anonymous attacks and explaining that a "short seller need only prove that a fraction of the allegations is true, while the company must disprove each and every allegation").

I thus concur in judgment in part III.B. and respectfully dissent as to part III.A.

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[1] Some may argue that such a requirement may create perverse incentives for a company not to make a corrective disclosure. Perhaps it might in the short run, but a wrongdoer can balance its house of cards for only so long until it ultimately collapses. Insider allegations of wrongdoing almost always lead to governmental investigations, and the truth ultimately comes out under scrutiny.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

[Filed: March 21, 2018]

Case No.: 3:15-cv-02324-GPC-KSC

IN RE BOFI HOLDING, INC. SECURITIES LITIGATION

ORDER GRANTING MOTION TO
DISMISS WITH PREJUDICE
[ECF No. 144]

Before the Court is a motion to dismiss the Third Amended Class Action Complaint (the "TAC") filed by Defendants BofI Holding, Inc. ("BofI"), Gregory Garrabrants, Andrew J. Micheletti, Paul J. Grinberg, Nicholas A. Mosich, and James S. Argalas. (ECF No. 144.) The motion is fully briefed. For the reasons explained below, Lead Plaintiff has failed to allege with particularity essential elements of its securities fraud claims. The Court therefore GRANTS the motion to dismiss with prejudice.

I. Background

In this consolidated putative securities fraud class action, purchasers of BofI's[1] stock assert claims against BofI and several corporate officers for violations of Sections 10(b) and 20(a) of the Securities Exchange

[1] "BofI is the holding company for BofI Federal Bank, a federally chartered savings association that purportedly operates from its single location in San Diego." (TAC, ECF No. 136 at ¶ 28.) In this ruling, "BofI" will refer to both the holding company and its subsidiary BofI Federal Bank.

Act of 1934. On February 1, 2016, the Court appointed Houston Municipal Employees Pension System as the Lead Plaintiff (ECF No. 23), and on April 11, 2016, Lead Plaintiff filed a First Amended Complaint (the "FAC") (ECF No. 26). Defendants filed a motion to dismiss the FAC on the grounds that the FAC (1) failed to identify false or misleading statements and (2) did not plead sufficient facts giving rise to a strong inference of scienter. (ECF No. 37.) The Court granted in part and denied in part. (ECF No. 64.) The Court noted that many of the misrepresentations alleged in the FAC fell "short of the PSLRA's [Private Securities Litigation Reform Act] heightened standards," but because a securities plaintiff "need only plead a single materially false misrepresentation to survive a motion to dismiss," the Court's conclusion that the FAC alleged at least some material misrepresentations meant that the Court did not need to "dwell on those aspects of the Complaint" that did not meet the PSLRA's standards. (*Id.* at 15.) The Court found, however, that the FAC's allegations were insufficient to create a "strong inference of scienter on the parts of Defendants Micheletti, Grinberg, Mosich, and Argalas," and dismissed the claims against those defendants without prejudice. (*Id.* at 25-27.)

On November 25, 2016, Lead Plaintiff filed a Second Amended Complaint (the "SAC"). (ECF No. 79.) Defendants again moved to dismiss. (ECF No. 88.) Again, the Court granted in part and denied in part. (ECF No. 113.) The Court first addressed Defendants' reassertion that Lead Plaintiff's pleadings failed to identify any material misrepresentations. Noting that the SAC—like the FAC—was excessive in length, the Court found it helpful to delineate which of the alleged misrepresentations were actionable, and which were not. The Court explained that the SAC alleged "actionable fraudulent or misleading statements as to BofI's loan underwriting practices and as to its internal controls and compliance infrastructure, but [did] not sufficiently demonstrate[] that Defendants' statements about its Allowance for Loan Losses (ALL), Net income/diluted price per share, Loan-to-Value Ratio (LTV), or undisclosed lending partnerships are actionable under the securities laws." (*Id.* at 9.) Noting that the SAC added no new allegations of scienter on the parts of Micheletti, Grinberg, Mosich, and Argalas, the Court again granted the motion to dismiss the Section 10(b) claims against them. (*Id.* at 3.) The Court nonetheless found the new "control person" allegations sufficient to state plausible Section 20(a) claims against all Defendants. (*Id.* at 58.)

On September 29, 2017, Defendants filed a motion for judgment on the pleadings in which they argued Lead Plaintiff had not pled with sufficient particularity that a disclosure of the falsity of Defendants' misrepresentations caused Lead Plaintiff loss. (ECF No. 123.) The Court agreed and granted the motion. (ECF No. 134.) The Court explained that the corrective disclosures identified in the SAC—a complaint filed in federal court against BofI and a series of articles posted on the website *Seeking Alpha*—either were irrelevant to the alleged misrepresentation or did not actually reveal any fraud to the market. Because that was the first time Defendants argued that Lead Plaintiff failed to plead loss causation adequately, the Court granted Lead Plaintiff leave to amend. (*Id.* at 21.)

On December 22, 2017, Lead Plaintiff filed the now-operative TAC. (ECF No. 136.) As Lead Plaintiff explains in its memorandum in opposition to the instant motion, the TAC is intended to be responsive not only to the Court's judgment on the pleadings ruling, but also to the Court's earlier ruling on Defendants' motion to dismiss the SAC. (*See* ECF No. 148 at 1-2 n.2.) Defendants filed the instant motion to dismiss on January 19, 2018. (ECF No. 144.) Defendants argue that the new alleged misrepresentations in the TAC are not actionable and that the TAC again fails to plead loss causation adequately. Defendants also argue that because Section 20(a) claims require a violation of the securities laws, the TAC's failure to state a claim of violation of Section 10(b) requires dismissal of Lead Plaintiff's Section 20(a) claims. (*Id.* at 25.)

II. Legal Standard

A Rule 12(b)(6) motion attacks the complaint as not containing sufficient factual allegations to state a claim for relief. "To survive a motion to dismiss [under Rule 12(b)(6)], a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). While "detailed factual allegations" are unnecessary, the complaint must allege more than "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements." *Iqbal*, 556 U.S. at 678. "In sum, for a complaint to survive a motion to dismiss, the non-conclusory 'factual content,' and reasonable inferences from that content, must be plausibly suggestive of a claim entitling the plaintiff to relief." *Moss v. U.S. Secret Serv.*, 572 F.3d 962, 969 (9th Cir. 2009).

A claim of fraud must comply with Rule 9(b), which requires the complaint to state with particularity the circumstances constituting fraud. *See* Fed. R. Civ. P. 9(b). Satisfaction of this heightened standard requires delineating "the time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation." *Odom v. Microsoft Corp.*, 486 F.3d 541, 553 (9th Cir. 2007) (quoting *Schreiber Distrib. Co. v. Serv-Well Furniture Co.*, 806 F.2d 1393, 1400 (9th Cir. 1986)). The complaint must also indicate "what is false or misleading about a statement, and why it is false," and "be specific enough to give defendants notice of the particular misconduct that they can defend against the charge and not just deny that they have done nothing wrong." *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1106 (9th Cir. 2003) (quoting *Bly-Magee v. California*, 236 F.3d 1014, 1019 (9th Cir. 2001)). In the Ninth Circuit, Rule 9(b)'s heightened pleading standard applies to all element of a securities fraud claim, including loss causation. *Or. Pub. Empls. Ret. Fund v. Apollo Grp. Inc.*, 774 F.3d 598, 605 (9th Cir. 2014).

III. Discussion

The elements of Lead Plaintiff's Section 10(b) claims, which assert a violation of Rule 10b-5 (*see* TAC ¶ 274), are (1) a material misrepresentation or omission, (2) scienter, (3) in connection with the purchase or sale of a security, (4) reliance, (5) economic loss, and (6) loss causation. *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005). In addition to Rule 9(b)'s application to such claims, the Private Securities Litigation Reform Act ("PSLRA") imposes heightened pleading requirements for the elements of falsity and scienter. With respect to each alleged misrepresentation, the PSLRA mandates that the complaint "(1) 'specify each statement alleged to have been misleading [and] the reason or reasons why the statements is misleading,' 15 U.S.C. § 78u-4(b)(1); and (2) 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,' § 78u-4(b)(2)." *Tellabs*, *Inc. v. Makor Issues & Rights*, *Ltd.*, 551 U.S. 308, 321 (2007). "Absent a duty to disclose, an omission does not give rise to a cause of action under § 10(b) and Rule 10b-5 . . . . An actionable omissions claim arises only when disclosure is 'necessary . . . to make the statements made, in light of the circumstances under which they were made, not misleading.' *Retail Wholesale & Dep't Store Union Local 338 Ret. Fund v. Hewlett-Packard Co.*, 845 F.3d 1268, 1278 (9th Cir. 2017) (quoting 17 C.F.R. § 240.10b-5(b)).

As discussed in Lead Plaintiff's memorandum in opposition, the TAC retains the misrepresentations deemed actionable by the Court in its earlier ruling, but it also adds new instances of alleged material misrepresentations. The TAC groups the alleged misrepresentations into three categories: (1) statements regarding BofI's internal controls, compliance infrastructure, and risk management; (2) statements regarding BofI's underwriting standards and credit quality requirements; and (3) statements regarding regulatory investigations. (ECF No. 148 at 2.) In the analysis that follows, the Court describes the misrepresentations alleged,[2] and then assesses whether the

[2] In its prior ruling, the Court cautioned Lead Plaintiff that the excessive length of its pleadings was contrary to Federal Rule of Civil Procedure 8. (ECF No. 134 at 21.) It appears that Lead Plaintiff has chosen not to heed the Court's warning. Like its earlier iterations, the TAC spans more than one hundred pages and includes numerous allegations of misrepresentations that are patently non-actionable under Ninth Circuit case law. The line between exhaustiveness and excessiveness may be thin, but the TAC clearly falls on the latter side of that divide. Nonetheless, the Court has made an exhaustive review of the TAC and its attached chart organizing Lead Plaintiff's allegations.

corresponding alleged corrective disclosures satisfy Rule 9(b)'s heightened pleading standard. With respect to the first two categories—statements regarding internal controls and underwriting standards—the Court concludes that the allegations of loss causation are inadequate to satisfy Rule 9(b). As for the third category—statements and omissions regarding regulatory investigations—the Court concludes that (1) the alleged statements and omissions are not actionable and (2) the allegations of loss causation are inadequate to satisfy Rule 9(b).

Before engaging in this analysis, however, the Court finds it helpful to review its previous discussion of the definition of "corrective disclosure" in this context.

A. Definition of "Corrective Disclosure"

To establish the element of loss causation, a plaintiff "must plausibly allege that the defendant's fraud was *revealed* to the market and *caused* the resulting losses." *Loos v. Immersion Corp.*, 762 F.3d 880, 887 (9th Cir. 2014) (internal quotation marks omitted). "The misrepresentation need not be the sole reason for the decline in value of the securities, but it must be a substantial cause." *In re Gilead Scis. Secs. Litig.*, 536 F.3d 1049, 1055 (9th Cir. 2008) (internal quotation marks omitted). "This inquiry requires no more than the familiar test for proximate cause"; the ultimate issue "is whether the defendant's misstatement, as opposed to some other fact, foreseeably caused the plaintiff's loss." *Mineworkers' Pension Scheme v. First Solar Inc.*, 881 F.3d 750, 753-54 (9th Cir. 2018) (quoting *Lloyd v. CBV Fin. Corp.*, 811 F.3d 1200, 1210 (9th Cir. 2016)). As stated above, however, loss causation must be pleaded with particularity under Rule 9(b). *Apollo Grp.*, 774 F.3d at 605.

To prove loss causation, Lead Plaintiff points to what it asserts are "corrective disclosures" of BofI's misrepresentations and notes that a drop in BofI's stock price occurred soon after. A corrective disclosure must be relevant to the alleged misrepresentation at issue; it must "relate back to the misrepresentation and not to some other negative information about the company." *Bonanno v. Cellular Biomedicine Grp., Inc.*, No. 15-cv-01795-WHO, 2016 WL 4585753, at *3 (N.D. Cal. Sept. 2, 2016) (internal quotation marks omitted). In other words, a corrective disclosure "is a disclosure that reveals the fraud, or at least some aspect of the fraud, to the market." *In re REMEC Inc. Secs. Litig.*, 702 F. Supp. 2d 1202, 1266-67 (S.D. Cal. 2010) (quoting *Teamsters Local 617 Pension & Funds v. Apollo Grp, Inc.*, 633 F. Supp. 2d 763, 818 (D. Ariz. 2009)).

While a corrective disclosure need not be "an outright admission of fraud to survive a motion to dismiss," the disclosure of "a mere `risk' or `potential' for fraud . . . is insufficient to establish loss causation." *Loos*, 762 F.3d at 888-89 (citing *Metzler Inv. GMBH v. Corinthian Colls., Inc.*, 540 F.3d 1049, 1064 (9th Cir. 2008)). It also need not be a singular event: a series of disclosures, when "viewed in tandem," may be adequate if "[t]he combined force of the[] statements . . . suggest that the market was alerted to" the relevant misrepresentations. *Metzler*, 540 F.3d at 1063 n.6, 1064 n.8. When a series of partial disclosures are alleged, the Court asks whether a full disclosure of the defendant's misrepresentation has been made by "view[ing each] together with the totality of the other alleged partial disclosures." *Lloyd*, 811 F.3d at 1210 (quoting *Pub. Empls. Ret. Sys. of Miss. v. Amedisys, Inc.*, 769 F.3d 313, 324 (5th Cir. 2014)).

As the term suggests, a corrective disclosure normally must reveal some piece of previously undisclosed information showing the falsity of the misrepresentation. *See In re Novatel Wireless Secs. Litig.*, 830 F. Supp. 2d 996, 1019 (S.D. Cal. 2011) ("It stands to reason then that [a] disclosure that does not reveal anything new to the market is, by definition, not corrective." (internal quotation marks omitted)); *In re Maxim Integrated Prods., Inc. Secs. Litig.*, 639 F. Supp. 2d 1038, 1048 (N.D. Cal. 2009) ("[A] disclosure that does not reveal anything new to the market is, by definition, not corrective." (internal quotation marks omitted)). If the alleged disclosure is duplicative of public information, the market will already have incorporated that information into the stock price; thus, the repeated discussion of the same information normally will not cause any later stock price decrease. *See Bonnano*, 2016 WL 4585753, at *5 (aggregation of publicly-available information "cannot constitute new information because an efficient market would easily digest all public information without the need for [the aggregation] to regurgitate it first" (internal quotation mark omitted)). Repeated discussion of already public information *may* serve as a corrective disclosure, however, when it brings to light an implication of which the market was not aware because understanding that implication required some technical or scientific expertise. *See Gilead Scis.*, 536 F.3d at 1053-54. For example, a discussion of public information may be adequate to serve as loss causation if it interprets "complex economic data understandable only through expert analysis [that was not previously] readily digestible by the marketplace." *Amedisys*, 769 F.3d at 323. By bringing to light an implication of these generally non-digestible data, such an "interpretive corrective disclosure" reveals to the public for the first time information that impacts the value of the stock.

Ultimately, "there is no requirement that the corrective disclosure take a particular form or be of a particular quality . . . . It is the exposure of the fraudulent representation that is the critical component of loss causation." *In re Bristol Myers Squibb Co. Secs. Litig.*, 586 F. Supp. 2d 148, 164 (S.D.N.Y. 2008) (internal quotation marks omitted). In essence, the question is: after the disclosures identified by Plaintiff were made, did the market become aware of the falsity of Defendants' misrepresentations to the extent that it devalued BofI's stock? "If yes, Plaintiff has pled with particularity how Defendants' misrepresentations caused Plaintiff harm; if no, Plaintiff's allegations do not meet the pleading requirements." (ECF No. 134 at 8.)

B. Analysis

For the reasons explained below, the *Erhart* Complaint served, at most, only as a partial corrective disclosure of the relevant fraud alleged in the TAC. Moreover, the *Seeking Alpha* articles discussed in the TAC cannot serve as even partial corrective disclosures because they relied on publicly available information, and offered no analysis not generally available to the rest of the market. In response to the Court's previous ruling, the TAC adds allegations for each article stating, conclusively, that the market did not appreciate the implications of the publicly available information relied upon by that article. But those conclusory allegations are not sufficient to meet Rule 9(b)'s pleading standard because they do not suggest any plausible reason *why* market participants would not have understood the implications of the information in front of them. Finally, the motion to seal filed by BofI in a different case raised, at most, speculation that the

Defendants' statements about government investigations were false.

Considering all of the alleged corrective disclosures together, the Court concludes that the TAC does not identify with particularity a corrective disclosure of the misrepresentations alleged.

i. Internal Controls, Compliance Infrastructure, and Risk Management

The TAC alleges that BofI and its corporate officers made numerous misrepresentations about the adequacy and effectiveness of BofI's internal controls, compliance infrastructure, and risk management. These alleged misrepresentations were made in Form 10-Ks (TAC ¶ 39), Form 10-Qs (*id.* ¶ 41), proxy statements (*id.* ¶¶ 43, 45), Sarbanes-Oxley certifications (*id.* ¶¶ 46-47), Form 8-Ks (*id.* ¶ 49), and during investor presentations (*id.* ¶ 50) and earnings conference calls (*id.* ¶ 51). The alleged misrepresentations in this area asserted that BofI's Audit Committee was governed by policies that ensured sound and effective internal controls and that management was responsible for maintaining such effective internal controls. (*Id.* ¶¶ 39, 43, 45, 49.) They also asserted that BofI officers had found the bank's internal controls and disclosure policies to be effective, and they had reviewed bank policies for deficiencies. (*Id.* (¶¶ 41, 46.) Lead Plaintiff also points to statements allegedly made by Garrabrants and Micheletti suggesting that BofI had robust risk management systems and had even recently made significant investments in its compliance staff, including adopting new systems and hiring new staff. (*Id.* ¶¶ 50, 51.) Finally, Lead Plaintiff points to BofI's policy regarding related-party lending, which asserted that such loans were generally made on the same terms as similarly situated borrowers who were not affiliated with BofI. (*Id.* ¶¶ 53-54.) According to the TAC, these statements were false because, in reality, BofI had essentially no internal controls. For example, the TAC cites statements by confidential witnesses who worked at BofI and indicate that management consistently overrode the actions and concerns of internal auditors, altered reports, approved loans to related parties that were significantly more generous than those offered to non-affiliated borrowers, and falsely responded to regulatory subpoenas and requests. (*Id.* ¶¶ 56-122.)

With respect to the disclosure of the falsity of these misrepresentations, the TAC points to two sources: (1) a complaint filed in federal court and (2) several articles published on the website *Seeking Alpha*. The Court addresses these alleged corrective disclosures in turn.

Charles Matthew Erhart, a former BofI internal auditor, filed a complaint against BofI in federal court on October 13, 2015. *Erhart v. BofI Holding*, *Inc.*, No. 3:15-cv-02287-BAS-NLS (S.D. Cal.), ECF No. 1 (the "*Erhart* Complaint"). As recounted in the TAC, the *Erhart* Complaint makes numerous accusations that BofI officials engaged in serious misconduct during Erhart's tenure at the company. (*See* TAC ¶ 124.) In its previous ruling, the Court described the allegations set forth in the *Erhart* Complaint:

> The *Erhart* Complaint alleges that BofI officers did the following while Erhart served as an internal auditor at BofI: instructed him to remove or shield from discovery any discussion of unlawful conduct that Erhart had noted in an audit report; falsified BofI's financial statements; failed to make timely contributions to BofI's employees' 401k accounts without notifying the Internal Revenue Service

or Department of Labor; submitted to the auditing office a strategic plan with forged signatures of the Board of Directors; maintained a too-concentrated deposit source; instructed Erhart never to put evidence of illegal conduct in writing; falsely responded to an SEC subpoena requesting information about a specific account by indicating that BofI had no information about that account; falsely responded to a request by the Office of the Comptroller of the Currency (the "OCC") for information on bank accounts with no tax identification number by stating that BofI had no such accounts; falsely told the OCC that the bank had not received any correspondence or subpoenas from federal and state banking agencies and law enforcement; made undisclosed substantial loans to foreign nationals with serious criminal histories in violation of the Bank Secrecy Act's Anti-Money Laundering Rules; altered auditing reports required by the Bank Secrecy Act's Quality Control requirements; materially miscalculated the bank's allowance for loan and lease losses; created such a "nonexistent culture of compliance" that multiple members of the auditing offices left their jobs; removed negative findings in a Flood Disaster Protection Act audit before submitting it to the OCC; "sanitized" a report later submitted to the OCC describing third party customers who were involved in BofI's Global Cash Card program by removing information suggesting that the customers were fake; and prevented members of the audit department from using email to communicate so as to prevent the

> creation of a "paper trail." The complaint also alleges that BofI's largest consumer account was listed under Garrabrants's brother's name, and that Plaintiff suspected that the money in that account came from Garrabrants's rather than Garrabrants's brother. Finally, the complaint alleges that Erhart's manager, John Ball, abruptly resigned on March 5, 2015, "after refusing an order from CEO Garrabrants to engage in what Ball reasonably viewed to be unlawful conduct to cover up the Bank's wrongdoing," and that after Ball resigned, an officer instructed the auditing department not to inform the OCC of Ball's resignation.

(ECF No. 134 at 9-10 (footnote and citations omitted).)[3] In its previous ruling, the Court concluded that the *Erhart* Complaint's allegations were not relevant to the actionable misrepresentations regarding internal controls and compliance infrastructure because they did not demonstrate that "the compliance office was understaffed or had not been `beefed up' during the relevant period." (*Id.* at 10-11.) Because the *Erhart* allegations were irrelevant, the Court found it did not need to address "the parties' dispute over whether allegations asserted in a whistleblower complaint may serve as a partial disclosure in the first place." (*Id.* at 11 n.3.) The TAC, however, asserts new allegations of misrepresentations that make the *Erhart* Complaint potentially relevant. For example, Erhart's allegations that BofI officers prevented internal auditors from

[3] As the Court noted in its previous ruling, Erhart has since filed a First Amended Complaint. *See Erhart*, No. 3:15-cv-02287-BAS-NLS, ECF No. 32. The relevant allegations in the First Amended Complaint do not differ materially from the original.

discussing illegal conduct in writing and altered audit reports are arguably relevant to Garrabrants and Micheletti's assertion that they confirmed the effectiveness of the Audit Committee's controls and procedures.[4]

a. The *Erhart* Complaint as a Corrective Disclosure

The potential relevance of the *Erhart* Complaint tees up the question this Court avoided in its prior ruling: whether the allegations in the *Erhart* Complaint can serve as a corrective disclosure. The Court concludes that, on their own, Erhart's allegations cannot serve as a corrective disclosure. Rather, allegations in a complaint are analogous to an announcement of internal or regulatory investigations into misconduct, which have been held insufficient, on their own, to serve as corrective disclosures. For example, in *Loos*, the Ninth Circuit held that that a company's announcement that it was initiating an internal review of its accounting practices was insufficient to serve as a corrective disclosure. 762 F.3d at 890. The court explained that an investigation raises merely a "risk" or "potential" of fraud, rather than a disclosure of fraud. *Id.* at 888-89. "While the disclosure of an investigation is certainly an ominous event, it simply puts investors on notice of a *potential* future disclosure of fraudulent conduct." *Id.* at 890. As a result, the court concluded, "any decline in a corporation's share price following the announcement of an investigation can only be attributed to market

[4] This is not to say, however, that the new alleged misrepresentations are actionable. Because the Court concludes that the *Erhart* Complaint and *Seeking Alpha* articles discussed in the TAC cannot serve as a corrective disclosure, the Court need not decide whether these new allegations of misrepresentations are actionable.

speculation about whether fraud has occurred. This type of speculation cannot[, on its own,] form the basis of a viable loss causation theory." *Id.*

Similarly, in *Meyer v. Greene*, the Eleventh Circuit held that the SEC's announcement that it was initiating an inquiry into a company's real estate valuation practices did not, on its own, amount to a corrective disclosure. 710 F.3d 1189 (11th Cir. 2013). As the court explained, while an "investigation can be seen to portend an added *risk* of future corrective action[, t]hat does not mean that the investigations, in and of themselves, reveal to the market that a company's previous statements were false or fraudulent." *Id.* at 1201.

Just like the investigations discussed above, the *Erhart* Complaint offered at most unconfirmed accusations of fraud. To be sure, if the accusations were confirmed to be true through a later disclosure, loss causation would have been established. *See Loos*, 762 F.3d at 890 n.3 ("We do not mean to suggest that the announcement of an investigation can never form the basis of a viable loss causation theory. Like the Eleventh Circuit, we merely hold that the announcement of an investigation, `standing alone and without any subsequent disclosure of actual wrongdoing, does not reveal to the market the pertinent truth of anything, and therefore does not qualify as a corrective disclosure.'" (quoting *Meyer*, 710 F.3d at 1201). Indeed, that is essentially the facts of *Lloyd*. There, the defendant asserted in SEC filings that it did not have serious doubts about its largest borrower's ability to repay debts, despite the defendant's knowing that the borrower was on the brink of declaring bankruptcy. *Lloyd*, 811 F.3d at 1203-04. Soon after, the defendant disclosed that it had recently received a subpoena from the SEC. *Id.* at 1204. Analysts began surmising that these issues related to the defendant's largest borrower. *Id.* at 1204-05. A month later, the defendant announced that the borrower would not be able to pay its debts. *Id.* at 1205. The Ninth Circuit explained that the defendant's announcement about receiving the subpoena was only a *partial* corrective disclosure, which was not completed until the defendant later confirmed the analysts' fears by announcing that the borrower would default on its loans. *Id.* at 1210. The same applies to the *Erhart* Complaint: while it raised a risk perhaps even a serious one—that Defendants had committed fraud, the TAC must identify a subsequent confirmation of that fraud to plead loss causation under Rule 9(b).

The Ninth Circuit's recent decision in *Curry v. Yelp Inc.*, 875 F.3d 1219 (9th Cir. 2017), also supports this view. There, the defendants had "consistently stated that the reviews generated on Yelp's website were 'firsthand' and 'authentic' information from contributors about local business." *Id.* at 1222. After these comments were made, the FTC disclosed that it had received "more than 2,000 complaints from businesses claiming that Yelp had manipulated reviews of their services" by removing and promoting reviews based on a business's relationship with Yelp. *Id.* The Ninth Circuit held that the disclosure of the FTC complaints could not serve as a corrective disclosure because they were only accusations. *Id.* at 1225. According to the court, controlling precedent made clear that "the element of loss causation cannot be adequately made out merely by resting on a number of customer complaints and asserting that where there is smoke, there must be fire." *Id.* The same applies to allegations in Erhart's lawsuit: they draw the market's attention to smoke, but without more, they do not reveal any fire.

Following the reasoning of *Loos*, *Lloyd*, and *Curry*, the Court concludes that the allegations in the *Erhart* Complaint were, at most, a "partial" corrective disclosure of Defendants' misrepresentations about BofI's internal controls. They cannot on their own establish loss causation under the heightened pleading standards of Rule 9(b). If, as in *Lloyd*, a later disclosure occurred that confirmed the risk identified by Erhart's complaint, the totality of those disclosures would be sufficiently corrective to establish loss causation. But for the reasons explained in the next section, the TAC's remaining allegations of corrective disclosures relating to BofI's internal controls (*Seeking Alpha* articles) cannot be considered even another partial corrective disclosure. As a result, in contrast to *Lloyd*, the TAC fails to allege that a later disclosure confirmed any of the allegations asserted in the *Erhart* Complaint.

b. *Seeking Alpha* Articles

The TAC points to two *Seeking Alpha* articles and asserts that they disclosed the falsity of the alleged misrepresentations relating to BofI's internal controls. Lead Plaintiff points first to an article written by an author known as "Real Talk Investments" published on October 29, 2015. (TAC ¶ 131; *see* Real Talk Investments, *Buyer Beware: More Odd Behavior From BOFI*, Seeking Alpha (Oct. 29, 2015), https://seekingalpha.com/article/3620436-buyer-beware-odd-behavior-bofi.[5]) As the Court explained in its previous ruling, this article notes "significant" differences between a transcript of a conference call BofI sent to the SEC and transcripts of the same call prepared by third parties.

[5] The Court takes judicial notice of the *Seeking Alpha* articles referenced in the TAC. *Lee v. City of Los Angeles*, 250 F.3d 668, 688 (9th Cir. 2001).

The differences noted in this article related to whether the OCC was conducting an investigation into BofI; the largest deposit account at BofI; and why BofI switched external auditors "some years ago." (ECF No. 134 at 17-18.) But as the Court explained in its previous ruling, this article did not disclose any new information to the public because the differing transcripts were already publicly available. According to the TAC, "[w]hile the BofI transcript and the webcast were both available prior to October 29, the market did not appreciate the small but significant differences in the two ... until the article compared the discrepancies side-by-side." (TAC ¶ 132.) The TAC fails to identify any reason *why* the market did not appreciate the significance of the difference in the transcript versions, and Lead Plaintiff offers no such explanation in its briefing. As this Court explained in its previous ruling, Lead Plaintiff's failure to offer a plausible reason why the market would not have understood the implications of already public information dooms Lead Plaintiff's use of this article as a corrective disclosure. "Plaintiff does not suggest that, for example, the information discussed in [this article] constitute[d] 'complex economic data understandable only through expert analysis.'" (ECF No. 134 at 15 (quoting *Amedisys*, 769 F.3d at 323, and citing *In re Herbalife*, *Ltd. Secs. Litig.*, No. CV 14-2850 DSF (JCGx), 2015 WL 1245191, at *3 (C.D. Cal. Mar. 16, 2015) (granting motion to dismiss because the complaint "provides no basis to conclude that Pershing's conclusions required expert analysis or that the underlying information was not available to the public"), and *In re Blue Earth*, *Inc. Secs. Class Action Litig.*, No. CV 14-08263-DSF (JEMx), 2015 WL 12001274, at *2 (C.D. Cal. Nov. 3, 2015).)

In its opposition memorandum, Lead Plaintiff contends that the Court was wrong to reject the *Seeking Alpha* articles as corrective disclosures in its previous ruling because "[n]umerous courts in this Circuit ... have held that analyst reports using publicly available information can indeed constitute corrective disclosures." (ECF No. 148 at 5.) The cases Lead Plaintiff cites, however, are not useful in this analysis because they fail to apply Rule 9(b)'s heightened pleading standard to the allegations of corrective disclosure.

See Gilead, 536 F.3d 1049 (predating the Ninth Circuit's holding in *Apollo Group* that Rule 9(b) applied to allegations of loss causation and corrective disclosures); *In re Banc of Cal. Secs. Litig.*, No. SACV 17-00118 AG (DFMx), 2017 WL 3972456, *9 (C.D. Cal. Sept. 6, 2017) ("[T]he Court finds it inappropriate to apply a heightened pleading standard for loss causation."); *Garcia v. Hetong Guo*, No. CV-15-1862-MWF-MRWx, 2016 WL 102213, at *9-11 (C.D. Cal. Jan. 7, 2016) (omitting any discussion of the implications of the heightened pleading standard); *In re Questcor Secs. Litig.*, No. SA CV 12-01623 DMG (FMOx), 2013 WL 5486762, at *21 (C.D. Cal. Oct. 1, 2013) (predating *Apollo Group*). As discussed at length in the Court's prior ruling, one of the consequences of applying Rule 9(b) to allegations of a corrective disclosure based on publicly available information is that the pleading must offer a plausible reason *why* the market would not have understood the implications of that information offered by the article's author. (*See* ECF No. 14-17.)

Next, the TAC cites a January 6, 2016, article written by an author known as "Aurelius." (*See* ECF No. 123-8.) As discussed in the Court's previous ruling, this article "states that BofI's audit committee had been `infected by related party loans to members of the committee,'" "notes that multiple public documents indicate that Grinberg served as a `key executive' in a third party [Propel Tax] that received financing from BofI while Grinberg was serving as BofI's Audit Chairman," "criticizes BofI for not disclosing these deals," "explains how Grinberg's dual roles in BofI and [Propel Tax] creates a conflict of interest," and "suggests that the failure to disclose this information indicates defects in BofI's `internal audit function.'" (ECF No. 134 at 19.) As with the previous article, this article was written based on public information. (ECF No. 123-8 at 19 ("All information for this article was derived from publicly available information.").) Yet the TAC, again, fails to indicate why the market would not have understood the implications of this information. Rather, the TAC repeats the conclusions of the article. (TAC ¶ 134 ("[T]he article identified the relationships between BofI and Propel Tax, as well as Defendant Grinberg's relationship with Propel Tax, which could have compromised the Audit Committee and Company's investigation of the Erhart Complaint and therefore called into question the adequacy of the Company's internal controls and risk management provisions.").) This is not an explanation of why the market would not have understood the implications of the public information, but rather an explanation of the implications themselves. The TAC does not suggest why other market participants could not have done the same analysis and reached the same conclusion. Without more, this article did not reveal anything that demonstrated the falsity of the alleged misrepresentations listed above or confirm for the first time any of the allegations in *Erhart* Complaint.

In sum, the allegations in the *Erhart* Complaint offered, at most, only partial corrective disclosures of the falsity of the alleged misrepresentations discussed above. Because the two *Seeking Alpha* articles cited by the TAC discussed publicly available information, they did not confirm for the first time any of Erhart's allegations. The TAC's allegations of loss causation regarding misrepresentations about BofI's internal controls are insufficient to meet the heightened pleading standards of Rule 9(b).

ii. Underwriting Standards and Credit Quality Requirements

In the second category of allegations, Lead Plaintiff asserts that Defendants made several misrepresentations regarding BofI's underwriting standards and credit quality. The TAC identifies statements by Defendants that every BofI loan must meet the underwriting criteria set forth in BofI's lending policies and applicable regulations and that BofI considered many aspects of a borrower's credit (TAC ¶ 136); that off-balance-sheet loans must meet the same credit policies as on-balance-sheet loans (*id.*); that BofI creates only "full documentation loans" (*id.* ¶ 138); that BofI had no commitments to purchase loans, investment securities, or any other unused lines of credit (*id.* ¶ 139); that BofI did not reduce its "conservative" credit standards while achieving significant portfolio growth (*id.* ¶ 141); and that its partnership with H&R Block would add "strength and diversity" to its "deposit, lending and fee income businesses" and aligned well with BofI's branchless structure (*id.* ¶ 146). According to the TAC, these statements were false because BofI engaged in "unsound lending practices," its off-balance sheet activities "included undisclosed lending partnerships" subjecting BofI to significant credit and regulatory risk, and BofI violated banking regulations by failing to maintain an adequate Customer Identification Program ("CIP"). (*Id.* ¶¶ 149-216.)

According to the TAC, the falsity of these misrepresentations were revealed to the market by way of

Seeking Alpha articles. First, it cites an article published on August 28, 2015 by the author "The Friendly Bear," entitled "The New York Times Has Only Scratched the Surface on BofI Holding . . ." (ECF No. 123-4.) As discussed in the Court's previous ruling, this article states in relevant part "that BofI's preferred loan clients are `home flippers and other speculators — a behavior that resulted in the failure of its "predecessors" Indymac and Thornburg (i.e., allowing borrower to borrow against existing properties, regardless of current lien status, in order to buy additional investment properties),' and that BofI was '[m]aking loans to individuals who are "unsavory" in nature and hardly appear credit-worthy for multi-million dollar loans.' (ECF No. 134 at 12.) The article also "suggests that BofI is lending to individuals who cannot get a loan at their regular bank institution, and that county records demonstrate that BofI's on-balance sheet loans `are sourced through mortgage brokers.' (*Id.*) The article concludes that BofI's five-percent-interest loans are "by definition, economically irrational" and that "BofI must be lending to individuals 'with heaps of existing debt, tax liens, gambling debt, an inability to put more cash at closing, or a history of bankruptcy/foreclosure.'" (*Id.*) The article also describes "that the SEC's recent response to the author's FOIA request suggested that the agency was investigating BofI and that BofI did business with a mortgage company that advertised loans available to borrowers form Russia, a country appearing on OFAC's sanctions list." (TAC ¶ 218.)

The TAC impliedly concedes that all the information relied upon by the author of the August 28, 2015 article was publicly available, but again asserts that the article "relied on information the market had failed to previously appreciate and incorporate into the Company's stock price." (*Id.* ¶ 219.) This time, the TAC suggests a reason that the market might not have understood the implications of this information. It states that the author was only able to reach its conclusions because the author "pored through hundreds of loans that BofI has written over the past several years," and held "conversations with mortgage brokers." (*Id.*) But that is not a plausible reason why the market would not have understood the implications of this publicly available information. The TAC offers no reason to believe that the majority of other actors in the market would not have been able to also "pore over" the information or hold conversations with mortgage brokers. "Under an efficient market theory, it is not necessary for any specific individual to track down every piece of information on every stock. One presumes that all public information is incorporated into the market price no matter how far flung it may be." *Bonanno*, 2016 WL 4585753, at *5; *see also Miller v. PCM, Inc.*, No. LACV 17-3364VAP (KSx), ECF No. 42 (C.D. Cal. Jan. 3, 2018) (rejecting plaintiff's argument that a *Seeking Alpha* article was a corrective disclosure because "much of the information it relayed to the public would be burdensome for the average investor to access"). In other words, the presumption of market efficiency that the TAC relies upon to demonstrate reliance assumes that actors in the market have already "pored over" all publicly available information and drawn all reasonable inferences from that information: "[a]n efficient market for good news is [also] an efficient market for bad news." *In re Merck & Co., Inc. Secs. Litig.*, 432 F.3d 261, 271 (3d Cir. 2005). What is important in this analysis is not that it took the author a lot of time to aggregate the data, but rather that the author was able to engage in some analysis that was not available to other market participants. The TAC offers no plausible reason to believe that was the case here.

Next, the TAC cites an article published November 10, 2015, by Aurelius entitled "Bofl: Boiler Rooms, Bad Loans, and Off-Balance Sheet Maneuvers Underpin Poorly Understood Risks." (ECF No. 123-5.) As discussed in the Court's previous ruling, this article states: "while `the soundness of Bofl's mortgage lending practices have [recently] been questioned, . . . [t]his writing attempts to shed light on an equally important piece of the mosaic. Sourced entirely from publicly available records, this article exposes how a network of boiler rooms, bad loans, and off-balance sheet maneuvers appears to have boosted Bofl's reported operating results while adding greatly to it[s] risk profile." (ECF No. 134 at 12-13.) The article discusses "how Bofl had 'aggressively expanded' into commercial and industrial ("C&I") businesses, but notes that Bofl 'offers only limited disclosures' as to its activities, especially its C&I loans." (*Id.* at 13.) It also states "that despite Bofl's perceived success, "[a] search of public records . . . reveals that the courts has been flooded with collections and/or bankruptcy cases involving loans that Bofl has originated.'" (*Id.*) It explains "this contradiction by stating that 'it appears' that lending partners such as OnDeck purchase loans originated by Bofl," and also discusses "Bofl's relationships with Quick Bridge, and the 'potential existence' of off-balance-sheet SPEs [Special Purpose Entities]." (*Id.*) "The article also indicates that Bofl has partnered with 'Rehab Cash Now,' which advertises loans with no minimum credit score," and "notes that Bofl has also engaged in structured settlement loans, citing recent public court documents, which [Aurelius] notes 'hardly appears sustainable.'" (*Id.*)

The TAC offers no reason why the market would not have drawn the same conclusions from the publicly available information relied upon in the November 10, 2015 article. Rather, it states only that the article "identified the relationships between BofI and the third-party lenders by studying those lender's own SEC filings, rather than BofI's," and "also analyzed how the third party lenders' substandard underwriting standards would increase the risk in BofI loan portfolio." (TAC ¶ 221.) Again, this allegation merely repeats the conclusions reached in the article; it does not suggest why other market participants would not, or could not, have reached those conclusions otherwise. Because the TAC does not identify any such reason (and Lead Plaintiff fails to offer any such reason in its briefing), the November 10 article cannot serve as a corrective disclosure.

Next, the TAC points to an article published on November 18, 2015, by Real Talk Investments entitled "Undisclosed Executive History May Be Final Blow for BofI." Seeking Alpha (Nov. 18, 2015), https://seekingalpha.com/article/3695396-undisclosed-executive-history-may-final-blow-bofi. The article "revealed that BofI had employed a felon convicted of grand theft, forgery of a credit card receipt, burglary, and dealing in stolen property, in violation of Section 19 of the FDIA," and "that BofI issued two loans to the individual even after he filed for bankruptcy." (TAC ¶ 222.) According to the author, the article was "based upon information reasonably available to the author and obtained from public sources that the author believes are reliable." (ECF No. 144-3.) Again, however, the TAC fails to identify (and Lead Plaintiff does not explain in its briefing) why the market would not have drawn this same conclusion based on the same information, other than stating that the author "analyzed loan files" and "conducted background checks" in writing the article. (TAC ¶ 223.) There is no reason to believe that any other market actor could not have done the same thing. As Defendants argue, the article engages in no formal analysis; rather, it "merely compar[es] [the employee's decades old and publicly available] mugshot picture to his Linkedln pictures, [and] compar[es] DOB data from his mugshot with DOB records from public sources that point to an exact match." (ECF No. 144-1 at 20.) In fact, the article "disclaim[ed] any expertise in forensic handwriting analysis, and claims no expertise in photographic or facial analysis." (*Id.* (citation omitted).) As discussed above, the Court must assume that market actors engaged in similar analysis at the time the information became publicly available, unless Lead Plaintiff offers a reason to presume otherwise. Lead Plaintiff's failure to do so requires that the Court conclude this article was not a corrective disclosure.

Next, the TAC cites an article published on November 19, 2015, by Aurelius entitled "Bofl: Risky Loans to Undisclosed, Off-Balance Sheet SPEs Found Disguised Within Mortgage Warehouse Portfolio." (*See* ECF No. 123-6.) According to the TAC, this article "revealed" to the market Bofl's lending relationship with Center Street, "which was known for fix and flip, 'no doc' and 'no FICO,' and `no income verification loans,' and "noted that nearly $300 million in risky single-family lender finance loans Bofl made to Center Street SPEs were disguised as `Warehouse and other' loans on Bofl's financial statements." (TAC ¶ 224.) According to the article, the author reached this conclusion by reviewing "UCC statements obtained from California's public database." (ECF No. 123-6 at 5.) Contrary to the TAC's assertion, the fact that the UCC statements were available to the public demonstrates that the author did not "reveal" to the market the fact of BofI's relationship with Center Street. The TAC does not identify (and Lead Plaintiff does not explain in its briefing) any special analysis conducted by the author of the article. Instead, the TAC asserts in conclusory fashion that the article "provided detailed analysis of how BofI's relationship with Center Street was likely to increase the amount of risk in the portfolio." (TAC ¶ 225.) This is not enough to meet the particularity requirements of Rule 9(b).

The TAC next cites another Aurelius article published on December 8, 2015, entitled "BofI Confirmed to Finance Undisclosed, Off Balance Sheet SPE to which it Transfers Bad Loans." (ECF No. 123-7.) The article "included an image of a UCC Financing Statement showing BLG as the Debtor and BofI" as the secured party. (TAC ¶ 226.) It also described how the UCC Financing Statement referred to a "Master Loan and Security Agreement dated February 12, 2014" between BofI and borrower WCL Holdings I, LLC. (*Id.*) "The article notes that BofI's failure to disclose its relationship with Quick Bridge or WCL may be in violation of applicable accounting standards and that WCL may require consolidation." (*Id.*) "All information for th[e] article was derived from publicly available information." (ECF No. 123-7 at 7.) As with the articles above, the TAC does not identify (and Lead Plaintiff does not include in its briefing) why the market would not have been reasonably able to draw the same conclusions from the same information prior to the article's publication. (*See* TAC ¶ 227 (repeating conclusions of the article, but not suggesting what analysis was done to reach these conclusions).) As Defendants argue, nothing in this article "suggests that the market needed, much less that the [author] was qualified to offer, any legal or accounting judgment about BofI's relationship with Quick Bridge and WCL" to reach the author's conclusions. (ECF No. 144-1 at 21.)

Finally, the TAC points to an article published by Aurelius on February 3, 2016, entitled "Why Bofl Created a Phantom `Full Service Branch' in the Nevada Desert." Seeking Alpha (Feb. 3, 2016), https://seekingalpha.com/article/3859626-bofi-created-phantom-full-service-branch-nevada-desert. This article reported that Bofl was no longer "branchless" because it had opened, according to the FDIC, a "full service" branch in Nevada. (TAC ¶ 228.) The author had visited the branch and discovered that it was "located in shared and tightly compacted office space housing dozens of small businesses and BofI's office was approximately 75 square feet," and that only one person worked in the branch. (*Id.*) The article concluded that, under Bofl's program management agreement with H&R Block, the Nevada branch was "booking" hundreds of millions of dollars as a way to take advantage of Nevada's lax interest-rate laws. (*Id.*) Again, the TAC does not provide (and Lead Plaintiff does not argue in its briefing) why the market would not have reached this conclusion based on the same information other than conclusively asserting "[t]he market did not appreciate that Bofl was opening the Nevada 'branch' for purposes of taking advantage of Nevada's usury laws, and was only made aware of BofI's real motives once an individual from *Seeking Alpha* investigated the branch in person and reported the true purpose behind the opening of this 'branch.'" (*Id.* ¶ 229.) There is no reason to believe, for example, that market participants could not have visited the Nevada branch prior to Aurelius's visit and reached the exact same conclusion. As a result, the TAC fails to allege with particularity that this article was a corrective disclosure.

In sum, none of the *Seeking Alpha* articles cited in the TAC served as corrective disclosures of the alleged misrepresentations relating to BofI's underwriting standards and credit quality requirements.

iii. Regulatory Investigations

Last, the TAC offers allegations that Defendants made materially false and misleading statements relating to government and regulatory investigations. The TAC alleges that none of BofI's SEC filings mentioned any government or regulatory investigation. (TAC ¶ 231.) In particular, the TAC alleges that Defendants failed to disclose an SEC investigation into BofI that was commenced in May 2015. (*Id.* ¶¶ 230-31.) On October 29, 2015, Defendants stated in a Form 10-Q that "from time to time we may be a party to other claims or litigation that arise in the ordinary course of business, such as claims to enforce liens, claims involving the origination and servicing of loans, and other issues related to the business of the Bank," but that "[n]one of such matters are expected to have a material adverse effect on the Company's financial condition, results of operations or business." (*Id.* ¶ 231.) In a *New York Times* article published on August 22, 2015, Garrabrants stated that regulatory concerns over BofI's loans to foreigners were "beyond a nonissue." (*Id.* ¶ 232.) During an earnings call on October 14, 2015, Garrabrants responded to a question regarding the OCC's response to Erhart's accusations of BofI by saying that "[t]here is nothing ongoing" with respect to an OCC investigation, "there is no continuity to this," that "[w]e have great regulatory relations," "[we] are under no regulatory orders, no regulatory restrictions on our business, and we continue to have a great dialogue with our regulators," and "[t]here are no regulatory issues of any kind that have arisen from Mr. Erhart's contact with the OCC." (*Id.* ¶¶ 233-34.)

According to the TAC, these statements were false because the SEC began an investigation into BofI in May of 2015. (*Id.* ¶ 235.) The TAC also alleges that these statements were false in light of Erhart's allegations that when he worked at BofI there were "many [ongoing] subpoenas, including from law enforcement agencies, grand juries, and even from the U.S. Department of Treasury." (*Id.* ¶ 245.) The TAC also alleges that these statements were false or misleading because on October 30, 2015, BofI filed a motion to seal certain filings in litigation against Erhart. Those filings included documents relating to "nonpublic agency investigations," "investigations by the OCC," "confidential government subpoenas," and "records identifying the existence (and, in some cases, the subject matter) of investigations by the OCC." (*Id.* ¶¶ 236-37, 246.) BofI's motion contained a "declaration by a forensic investigator hired by BofI to examine Erhart's computer for confidential information," who found documents containing file names evidencing "communications with regulators," and subpoenas. (*Id.* ¶ 236; *see BofI Fed. Bank v. Erhart*, No. 3:15-cv-02353-BAS-NLS, ECF No. 8-1 (S.D. Cal.).) A chart accompanying the motion indicated that some of the documents would reveal the "existence and nature of confidential regulator communications." (*Id.* ¶ 237.) The TAC also cites an SEC FOIA response that indicated that it had initiated an investigation into BofI on May 28, 2015, and had issued subpoenas after the Class Period on February 22, 2016, and October 19, 2016. (*Id.* ¶¶ 238-39.)

a. Misrepresentations

The Court first considers whether these identified statements are actionable under the heightened pleading standards of Rule 9(b) and the PSLRA. The Court concludes that they are not.

"[A] statement is misleading if it would give a reasonable investor the impression of a state of affairs that differs in a material way from the one that actually exists." *Berson v. Applied Signal Tech., Inc.*, 527 F.3d 982, 985 (9th Cir. 2008). In this context, a misleading statement is distinguished from "puffery," which "concerns expressions of opinion, as opposed to knowingly false statements of fact." *Apollo Grp.*, 774 F.3d at 606. Such "mildly optimistic, subjective assessment hardly amounts to a securities violation." *Id.* (quoting *In re Cutera Secs. Litig.*, 610 F.3d 1103, 111 (9th Cir. 2010)). Rather, in this context, a material misrepresentation is one that is "capable of objective verification." *Id.*

Lead Plaintiff has not identified any duty held by Defendants to disclose the existence of an SEC investigation into BofI. Rather, it argues that the failure to disclose the existence of an SEC investigation rendered the statements listed above false or misleading. The Court disagrees. First, BofI's statements in its SEC filings that it did not "expect" that litigation against it would "have a material adverse effect on the Company's financial condition, results of operations or business" is prototypical opinion-based puffery. *See id.* (rejecting as puffery the statement *"[w]e believe* that our track record for enrollment and revenue growth is attributable to . . ."). The truthfulness of that statement would not have changed in any respect if BofI had also stated that the SEC was investigating BofI's conduct.

Second, Garrabrants statements in the *New York Times* that regulatory inquiries were "beyond a nonissue," and his statement during the conference call that there were no "regulatory issues," are simply too vague to be false or misleading. Neither statement clarified what the definition of an "issue" might be. A reasonable investor hearing these words would have interpreted those statements to mean not that regulators had no interest in BofI's conduct, but rather that regulatory interest in BofI was not, for example, a "big deal." There is no way to objectively verify the truthfulness of these statements because whether regulatory interest into BofI was an "issue" depends on the subjective understanding of the meaning of the term "issue."

Next, the TAC does not indicate any reason to believe that Garrabrants's conference call statements in response to a question about an OCC investigation was false in light of the fact that there was an ongoing SEC investigation at the time. According to the TAC, Garrabrants was asked by an analyst whether the OCC "let [Garrabrants] know that there is nothing ongoing related to these concerns that [Erhart] raised, that they are still investigating at this point?" (TAC ¶ 233.) Garrabrants answered that he had to be "careful" about what "the OCC is doing," but that "there is nothing ongoing," "there is no continuity to this," and that BofI had "great regulatory relations," was under no "regulatory orders" or "regulatory restrictions on our business," and that BofI had "great dialogue with our regulators." (*Id.*) The fact that an SEC investigation might have been ongoing at this time does not render false the statements that there was nothing ongoing, or there was no "continuity," with respect to the OCC. The SEC and OCC are separate regulatory bodies. As for the statements regarding "regulatory orders" or "restrictions," the TAC does not allege that the SEC's investigation at the time of the conference call included any "orders" or "restrictions." And the remaining statements—that BofI had "great regulatory relations" and enjoyed a "great dialogue" with regulators—are too vague to hold any objective meaning. *Cutera*, 610 F.3d at 1111 (rejecting as too vague the statement that "we believe our employee relations are good").

In sum, the TAC does not allege that Defendants made any actionable misrepresentations regarding regulatory investigations into BofI. But even if these statements were actionable, Lead Plaintiff's claims fail because—for the reasons explained immediately below—the corresponding allegations of loss causation do not satisfy Rule 9(b)'s requirements.

b. Loss Causation/Corrective Disclosures

The TAC points to three events as corrective disclosures of the falsity of the statements. First, the TAC cites The Friendly Bear's article, discussed above, published on *Seeking Alpha* on August 28, 2015. (*Id.* ¶ 242.) The author noted in that article that in responding to a recent FOIA request submitted by the author, the SEC invoked FOIA's law enforcement exemption protecting "records compiled for law enforcement purposes, the release of which could reasonably be expected to interfere with enforcement activities." (*Id.*) This response was different from the SEC's responses to the author's previous FOIA requests, which had stated that the SEC possessed no records responsive to the author's inquiry. (*Id.* ¶ 243.) Second, the TAC points to the *Erhart* Complaint, which in relevant part alleged that during Erhart's time at BofI he "saw a BSA spreadsheet that identified many subpoenas, including from law enforcement agencies, grand juries, and even from the U.S. Department of Treasury," and that BofI received many subpoenas. (*Id.* ¶ 245.) Third, the TAC cites BofI's filing of the motion to seal, discussed above. (*Id.* ¶ 246.)

The listed corrective disclosures are insufficient to show loss causation. The Friendly Bear's article cannot serve as a corrective disclosure of the falsity of any of the statements above for two reasons. First, as with the other *Seeking Alpha* articles, the information discussed was publicly available. Lead Plaintiff offers no reason to believe that other market participants could not have also requested information from the SEC about any investigations into BofI and received the same response. Nor did the article's author engage in any specialized analysis. Any other market participant could have made the same inference based on the SEC's response. Second, even if the article revealed new information to the market, it did not *disclose* the SEC investigation referenced in the TAC. Instead, it merely showed that the SEC was considering an investigation into BofI. Because The Friendly Bear's article did not identify the contents of any SEC investigation, the SEC's response suggested at most a risk that Garrabrants's statement that there were no regulatory "issues" resulting from Erhart's contacts with the OCC was false. As discussed above, the disclosure of the possibility of a statement's falsity cannot itself serve as a corrective disclosure. *Loos*, 762 F.3d at 888-89.

Even considering The Friendly Bear's article in conjunction with the other two alleged disclosures, no actual corrective disclosure occurred. The *Erhart* Complaint's assertion that BofI "frequently" received regulatory subpoenas did not disclose the existence of the SEC investigation at issue here. Similarly, the motion to seal filed by Bofl in its action against Erhart suggested, at most, that regulators had issued subpoenas to Bofl at *some point*. The motion did not indicate whether the documents sought to be sealed were relevant to Erhart's interactions with the OCC. Bofl's assertion in the motion to seal that subpoenas had been issued to Bofl at some point while Erhart worked there—therefore did not disclose, or confirm, the falsity of any of the statements listed above. *See Metzler*, 540 F.3d at 1064 (holding a disappointing earnings announcement was not sufficiently tied to specific wrongdoing to produce the inference that the market "realized" the fraud once the earnings announcement was released).

In sum, the TAC's allegations of loss causation with respect to alleged misrepresentations about regulatory investigations do not meet Rule 9(b)'s pleading standard.

IV. Section 20(a) Claims

Lead Plaintiff makes clear that its Section 20(a) claims are derivative of its Section 10(b) claims. (ECF No. 148 at 21.) Because the Court concludes that the TAC fails to state a claim for a violation of Section 10(b), the Section 20(a) claims also fail. *See Curry*, 875 F.3d at 1228.

V. Conclusion

In sum, the Court concludes that the TAC's allegations are insufficient to meet the applicable heightened pleading standards. Because the TAC fails to state a plausible claim for a violation of the securities laws, it also fails to state a violation of Section 20(a).

This was Lead Plaintiff's third iteration of its complaint, and it appears that any further amendment would not survive another motion to dismiss. The Court concludes that another opportunity to amend is not warranted. *See Zucco Partners*, *LLC v. Digimarc Corp.*, 552 F.3d 981, 1007 (9th Cir. 2009) ("The fact that Zucco failed to correct these deficiencies in its Second Amended Complaint is a strong indication that the plaintiffs have no additional facts to plead." (internal quotation marks omitted)). As a result, the Court GRANTS Defendants' motion to dismiss and DISMISSES Lead Plaintiff's claims against Defendants with prejudice.

IT IS SO ORDERED.

Dated: March 21, 2018

/s/ Gonzalo P. Curiel
Hon. Gonzalo P. Curiel
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed: November 16, 2020]

No. 18-55415

D.C. Nos.
3 :15-cv-02324-GPC-KSC
3 :15-cv-02486-GPC-KSC
Southern District of California, San Diego

IN RE: BOFI HOLDING, INC. SECURITIES LITIGATION,

HOUSTON MUNICIPAL EMPLOYEES PENSION SYSTEM,

Plaintiff-Appellant,

v.

BOFI HOLDING, INC., *et al.*,

Defendants-Appellees.

ORDER

Before: WATFORD, BENNETT, and LEE, Circuit Judges.

Judge Watford and Judge Bennett vote to deny the petition for panel rehearing. Judge Lee votes to grant the petition for panel rehearing. The panel unanimously votes to deny the petition for rehearing en banc. The full court has been advised of the petition for rehearing en banc, and no judge requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35. The petition for panel rehearing and rehearing en banc, filed October 22, 2020, is DENIED.