Team No. R03

Docket No. 20-2106

IN THE

Supreme Court of the United States

VESSEL, INC.

Petitioner,

v.

LOS ANGELES MUNICIPAL WORKERS PENSION FUND

Respondent

On Writ of Certiorari to the
Supreme Court of California

BRIEF FOR RESPONDENT

TABLE OF CONTENTS

QUESTIONS PRESENTED

1. Whether claims challenging certain statements describing a company's environmental commitments, practices, and risks are inactionable under 15 U.S.C. § 77k(a) as a matter of law.

2. Whether the Private Securities Litigation Reform Act's discovery stay provision applies to a private action under the Securities Act of 1933 in state or federal court, or solely to an action in federal court.

TABLE OF AUTHORITIES

UNITED STATES SUPREME COURT CASES

UNITED STATES COURT OF APPEAL CASES

UNITED STATES DISTRICT COURT CASES

STATE COURT CASES

STATUTES

OTHER AUTHORITIES

STATEMENT OF THE CASE

I. Statement of Facts

Vessel's investors seek liquidity. Philip Knowles ("Knowles"), a graduate of the University of Chicago graduate business school, founded Vessel in 2013 with $10 million of angel funding, initially focused only on manufacturing plastic bottles. R. at 2-3. Over five years Vessel expanded aggressively and **raised over $1.3 billion** to fund its rapid growth. R at 4-5. As a result, by 2018, Vessel had grown into a significant producer of polymers and resins used in the production of plastics, and a manufacturer of plastic components for a wide range of industrial applications. R. at 6.

Brooks, Knowles' financial advisor for Vessel's seven rounds of capital raises, emphasized "these days, you gotta be green to get any green out of investors' pockets." R. at 4. As a result, Vessel included language in its offering memorandums describing the company's commitment to environmental compliance. R. at 5.

Facing continued capital needs and investors anxious for a liquidity event, Knowles met at the University Club in Chicago with Brooks. R. at 6. Brooks suggested a sale of the company, thereby satisfying the venture capitalists' need for liquidity. R at 6. Knowles declined because he was not yet near his goal of becoming the largest integrated producer of chemical stock for the manufacture of plastic products. R at 6.

While Knowles acknowledged that he also could use liquidity, he preferred to sell some of the Vessel common shares he owned than the entire company. R at 6. Brooks suggested an underwritten public offering of a portion of Knowles' stock, a substantial portion of the venture investors' position, and enough new shares to meet Vessel's capital requirements. R at 6.

Vessel emphasizes ESG in order to achieve an optimally priced IPO.

Knowles agreed and shortly thereafter, Squire & Thorne, Knowles' legal counsel in the previous fundraising rounds, held an organizational meeting regarding the public offering. The discussions primarily focused on the company's commitment to Environmental, Sustainability, and Governance principles ("ESG") principles, in particular the impact of its products and manufacturing on the environment and how to present this topic to investors. R. at 6-7.

Tabor, Squire & Thorne's senior partner, insisted on including language relating to maintaining the highest environmental standards and assembling an experienced team tasked with compliance. A slide Tabor projected during the meeting titled "We go green or go home," suggested passionate but vague language about Vessel's biodegradability in design. R. at 7.

Brooks, speaking on behalf of the venture investors, argued that language alone was unacceptable and would **adversely affect the pricing of the offering**. The underwriters agreed with Brooks and **insisted that an optimally priced offering** would require language relating specifically to the company's products, including **the biodegradability of its main product lines**. R. at 7.

The underwriters, their counsel, and Squire & Thorne met with the company's environmental team and operations group—including Vessel's senior chemists—to pin down what products had been thoroughly tested to ensure that the toxic nature of certain resins and polymers was disclosed to customers, the steps taken to verify that none of its products were carcinogenic, and the biodegradability of various product lines. Their conclusion was that it was more likely than not that over 70% of its products by sales volume were biodegradable within 400 days of disposal, **but only with respect to two of its four largest product lines**. Those four products lines make up the vast majority of Vessel's total sales. R. at 7-8.

Tabor **again argued that the language for which he had previously advocated was satisfactory** for pricing the offering, but the underwriters and Brooks insisted a **fact-based narrative was necessary**. The prospectus retained the vague language used in previous funding rounds, that "The Company pays rigorous attention to environmental standards and best practices and keeps a strong environmental team in place to ensure continued compliance with this undertaking." The prospectus also including a more particular statement, "Vessel's goal is to ensure that **at least 70% of its products by sales volume** are biodegradable **within 400 days** of disposal." The prospectus, however, did not include the last clause of the statement noting that the findings with respect to biodegradability **only applied to "two of its four largest product lines."** R. at 8.

Vessel's IPO and subsequent challenges to the registration's environmental claims. Vessel's common shares were registered with the Securities Exchange Commission ("SEC") and the offering was consummated on January 16, 2019. The initial offering price was $17 per share. The shares immediately traded up at $32 per share before settling at $30. The Los Angeles Municipal Workers' Pension Fund ("LAMWPF") purchased 6 million shares of common stock in the offering, at $31 per share. R. at 8.

On April 12, 2019, a prominent plastic industry trade journal, *Resin Quarterly*, published an article on **Vessel's largest by sales volume product, Thoroxin, that called into question its biodegradable characteristics**. In the article, several plastics experts cast doubt on the achievability of the biodegradability goal set out in the prospectus, citing several factors that could contribute to Vessel's products taking much longer to degrade. Within forty-eight hours, Vessel's share price declined **thirty percent**. When follow-up articles in other respectable trade journals cast similar doubts on Thoroxin, the price declined **another fifteen percent**, finally stabilizing at $20.15 per share. On April 17, 2019, the Pension Fund sold its entire position at $23 per share, suffering a loss of over $48 million. R. at 8-9.

II. Procedural History

The District Court. On August 22, 2019, the LAMWPF ("Plaintiff" or "Respondent") filed a '33 Act putative class action in the San Francisco County Superior Court, representing all claimants who bought shares of common stock issued by Vessel in its public offering on January 16, 2019. R. at 10. The complaint asserted a violation of Section 11 of the '33 Act, 15 U.S.C. § 77(k)(a), on the basis that Vessel included misleading and inaccurate statements in its S-1 registration statement. R. at 10.

Soon after, Vessel filed a demurrer, arguing that the statements the complaint alleged were misleading were (1) not actually misleading, and (2) even if they were, not materially so. R. at 10. On January 15, 2020, the parties filed a Joint Case Management Conference Statement in which Vessel requested that the court stay discovery pursuant to 15 U.S.C. § 77z-1(b)(1) of the Reform Act, which LAMWPF opposed. R. at 10. The trial court granted Vessel's request for a stay of discovery. R. at 10.

LAMWPF then filed a motion to lift the discovery stay, but the trial court never issued a decision on this motion as it granted Vessel's demurrer on June 8, 2020. R. at 10. LAMWPF filed a timely appeal of both holdings in the California Court of Appeals, and the Appellate Court summarily denied their request for review without a written opinion. R. at 11.

Appellate Review. On appeal, the court reversed the opinion of the lower court on both issues, holding that LAMWPF stated a viable claim against Vessel under Section 11 of the '33 Act, and that the discovery stay provision of the Reform Act does not apply to '33 Act claims brought in state court.

SUMMARY OF THE ARGUMENT

This Court should find that the LAMWPF's claims challenging the two statements made by Vessel in their S-1 registration statement describing the company's environmental commitments, practices, and risks are actionable under 15 U.S.C § 77k(a). Recognizing the importance of ESG factors to institutional investors such as the LAMWPF, Vessel included statements purporting to represent a reasonable target of biodegradability for their entire product line, despite that Vessel knew that it had only a preponderance of data to support this claim for half of its largest product lines. Furthermore, the decision to pursue an optimally priced offering by providing inadequate disclosure of its products' biodegradability renders misleading the Company's statement that it was rigorously committed to environmental best practices. This omission misled LAMWPF as to a material aspect of its investment in Vessel: the company's environmental sustainability.

Further, this Court should find that the discovery stay provision in 15 U.S.C. § 77z-1(b)(1) does not apply to actions brought in state court. To do otherwise would be to act counter to Congressional intent in passing the Private Securities Litigation Reform Act ("PSLRA") and the Securities Litigation Uniform Standards Act ("SLUSA"). The Reform Act has numerous procedural provisions which only apply in federal court, and Congress did not indicate any reason why the discovery stay provision should be construed more broadly than the other procedural provisions in the Reform Act. Additionally, when Congress amended the Reform Act, it could have made it clear that the discovery stay provision was to apply in both state and federal courts, but instead chose to make federal court the exclusive forum for most securities class actions. Furthermore, if this Court finds that the provision applies in state court, it will upset the balance between state and federal courts, placing the constitutionality of the provision in peril.

ARGUMENT

I. VESSEL'S STATEMENTS ARE RENDERED MATERIALLY MISLEADING BY ITS OMISIONS AND ARE THEREFORE ACTIONABLE UNDER SECTION 11, AS THIS COURT REAFFIRMED MOST RECENTLY IN *Omnicare*.

Congress enacted the Securities Act of 1933 ("The '33 Act") to protect investors by ensuring that issuers would make a "full and fair disclosure of information" relevant to a public offering. *Pinter v. Dahl*, 486 U.S. 622, 646 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988). To successfully bring a Section 11 claim, an investor must show "(1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material." *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009). Here, Vessel's omission of the basis of the biodegradability goal in its S1 registration rendered materially misleading both 1) its statement describing its goal for biodegradability across its product lines and 2) its statement regarding its commitment to environment sustainability.

Disclosing that the biodegradability target was based on findings which only applied to two of its four largest product lines would have significantly altered a reasonable investor's view of the achievability of that goal. Furthermore, the firm's decision to cherry-pick its findings to achieve an "optimally-priced offering" renders Vessel's commitment to rigorously follow environmental best practices misleading.

"Section 11 places a relatively minimal burden on a plaintiff" and this is especially true at the pleadings stage. *Herman & MacLean v. Huddleston,* 459

U.S. 375, 382 (1983). It is improper to dismiss Respondent's complaints as a matter of law under a motion to dismiss unless "reasonable minds [could] not differ." *S.E.C. v. Todd*, 642 F.3d 1207, 1220-21 (9th Cir. 2011)

In determining whether Respondent's claims are actionable and can thus survive a motion to dismiss, this case implicates whether Section 11 will remain a tool for investors to enforce the '33 Act's registration requirement by allowing investors to hold issuers accountable for materially misleading statements. *15 U.S.C. § 77k(a).* This Court should continue its historical recognition of the importance that full and honest disclosure has in supporting the ability of investors to rely on registration statements, and affirm the decision by the California Supreme Court that Vessel's statements are actionable under Section 11 of the '33 Act.

A. VESSEL'S OMISSION IS MISLEADING BECAUSE IT WOULD HAVE SIGNIFICANTLY ALTERED A REASONABLE INVESTOR'S "TOTAL MIX" OF INFORMATION REGARDING VESSEL AS AN INVESTMENT.

As this Court has noted, "whether a statement is 'misleading' depends on the perspective of a reasonable investor." *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175, 186-87 (2015). Vessel specifically tailored its language to be appealing to investors focused on Environmental, Sustainability, and Governance ("ESG") factors. This tailoring included the omission of the extent to which their biodegradability data was applicable to their product lines. This omission would have misled a reasonable investor to overvalue the biodegradability of Vessel's products and its commitment as a company to environmental sustainability.

Since its first venture funding round in 2014, Vessel has been aware of the growing number of investors focused on ESG factors and targeted them with a full awareness that "you gotta *be* green to *get* any green." R. at 4. Vessel's decision to include language regarding its products' biodegradability was driven by this awareness, and a desire on the part of shareholders to achieve "optimal pricing" in the offering by crafting a "fact-based narrative." R. at 7-8.

While a reasonable investor understands the difference between a statement alleging specific facts and a goal or target, investors may reasonably understand that such a statement "conveys facts about how the speaker has formed that opinion—or, otherwise put, about the speaker's basis for holding that view." *Omnicare*, 575 U.S. at 188. Given the specificity and framing of the biodegradability target, an investor would be justified in assuming that there was a meaningful basis for this goal. Furthermore, the company's "rigorous" commitment to "environmental standards and best practices" is at odds with Vessel's decision to prioritize an "optimally priced" IPO over fulsome accuracy over its products' biodegradability, thereby rendering it misleading. R. at 7-8.

1. <u>The omitted biodegradability findings do not align with the basis of supporting fact which reasonable investors infer from the specificity and framing of Vessel's biodegradability target.</u>

The specificity of Vessel's biodegradability target ("70%; 400 days") and the framing of it as a lower bound ("at least 70%") rather than a long-term, aspirational goal, would justify an investor inference of some degree of confidence in this goal. At the very least an investor would rationally read this statement as reflecting an opinion supported by adequate due diligence and not reflecting "baseless, off-the-cuff-judgements." *Omnicare,* 575 U.S. at 189.

Investors in Vessel could have reasonably expected that when Vessel signaled the achievability of this biodegradability target that it "fairly align[ed] with the information in the issuer's possession." *Ibid.* The issue is that Vessel was in possession of information that presented a much more conservative view of the likelihood that it could achieve "<u>at least</u> 70%." R. at 8. (emphasis added). Circuit courts have recognized that a failure to fully disclose relevant information can be misleading when it could cause "a reasonable investor to make an overly optimistic assessment." *Meyer v. Jinkosolar Holdings Co., Ltd.*, 761 F.3d 251 (2d. Cir. 2014).

When Vessel provided a specific target of 70% and framed it as the "least" it hoped to achieve, a reasonable investor would likely infer that Vessel had a strong factual basis underlying this statement. While Vessel did not have a duty to disclose "all information a potential investor might take into account when making [their] decision," *Rubke*, 551 F.3d at 1163, the findings that Vessel possessed were significantly less conclusive than a reasonable investor might assume. At the time Vessel made this statement, it knew that two of its four largest product lines, all of which were assessed, more likely than not could not meet the 400-day, 70% biodegradability target.

While this may not amount to a wholesale repudiation of the possibility that the Vessel could achieve its stated goal, the fact that after a fulsome review of its product lines Vessel only had data to support the claim for half of its largest product lines casts serious doubt on the achievability of their biodegradability target. This serious doubt stands in significant contrast to the confidence implied by Vessel's unqualified, highly specific biodegradability target. This presents "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). Therefore, the omission rendered Vessel's biodegradability target misleading.

2. Vessel's decision to "cherry-pick" its internal findings to position itself to achieve an "optimally priced" IPO is inconsistent with what a reasonable investor would expect from the firm's commitment to environmental standards and best practices.

Rigorous is defined as "manifesting, exercising, or favoring rigor: very strict" and "scrupulously accurate: precise." See *Rigorous*, MERRIAM-WEBSTER'S DICTIONARY AND THESAURUS (11th ed. 2014). Vessel committed to paying "rigorous attention to environmental standards and best practices and [keeping] a strong environmental team in place to ensure continued compliance with this undertaking." R. at 8. In other words, Vessel committed to pay strict attention to maintaining compliance with these standards and best practices, including investing in personnel to ensure compliance. The decision to release a potentially misleading statement regarding biodegradability to the investing public in order to "optimally price" its IPO would not fall within any reasonable investor's understanding of an environmentally sustainable best practice.

Even without the aid of a dictionary, an investor could reasonably understand this commitment to be more than a vague statement of corporate values. The statement indicates a high quality of environmental safeguards in place at the company. While Vessel may technically have had an environmental compliance team in place and been generally committed to environmental sustainability, statements are "evaluated not only by literal truth, but by context and manner of presentation." *Singh v. Cigna Corp.*, 918 F.3d 63 (S.D.N.Y. 2019) (internal quotation marks omitted). The decision by Vessel's management to prioritize the pricing of its securities offering over honest disclosure of its products' environmental sustainability casts serious doubt on the sincerity of Vessel's commitment to environmental standards and best practices.

Perhaps even more concerning, the fact that the disclosure decision was made by Vessel's management raises a question of whether the environmental safeguards in place are truly sufficient and whether Vessel's management considers them important. A reasonable investor would surely be interested in understanding whether these safeguards are applicable to management decisions and to what extent sustainability concerns are weighed against profitability. California's Supreme Court correctly found that "false or misleading statements or omissions concerning material facts about management or internal operations" are actionable when the defendant knows the operations to be deficient. *In re Equifax Inc. Sec. Litig.*, 357 F. Supp. 3d 1189 (N.D. Ga. 2019); R. at 15. A reasonable investor could conclude that management's decision not to more fully disclose data in its possession demonstrated that management did not consider the Company's environmental safeguards to be as important as indicated in the registration statement. Furthermore, the fact that the decision to include this "fact-based narrative" was made in the face of contrary advice from the company's counsel on the IPO, Tabor, is significantly likely to alter a reasonable investor's view of the environmental safeguards in place at Vessel. R. at 8.

As the Second Circuit has held, the "veracity of a statement or omission **is measured not by its literal truth, but by its ability to accurately inform rather than mislead prospective buyers**." *Operating Loc. 649 Annuity Tr. Fund v Smith Barney Fund Mgmt. LLC*, 595 F.3d 92 (2d Cir. 2010). When Vessel prioritized its stock price over accountability for environmental sustainability, a statement touting the company's rigorous commitment to the environment is highly capable of misleading investors.

Furthermore, LAMWPF's complaint against Vessel's statements is distinguishable from the prohibition against liability for corporate mismanagement set out in *Santa Fe* because this case involves an instance of nondisclosure. In *Santa Fe*, this Court noted that corporate mismanagement "without any deception, misrepresentation, or nondisclosure" did not violate the statute at issue. *Santa Fe Indus., Inc. v. Green, 476 U.S. 462 (1977)*. In contrast, Vessel's management elected not to disclose material information in its possession to achieve optimal pricing.

B. VESSEL'S STATEMENTS ARE MISLEADING AS TO A MATERIAL FACTOR: ITS ENVIRONMENTAL SUSTAINABILITY.

When Vessel made its general commitment to environmental standards and specifically undertook to supplement this with a "fact-based" narrative regarding the biodegradability for its products, it did so in the hope that investors would reward it with an "optimally priced offering." R. at 7. Vessel correctly recognized that investors would weigh these statements heavily in their "total mix of information," *Basic* 485 U.S. at 231-32, demonstrating an explicit understanding of the materiality of these statements to investors.

The plastics industry faces increased regulatory risk associated with climate change and changing customer preferences for "green" products. A reasonable investor is likely to find statements regarding the biodegradability of a plastic manufacturer's products useful in helping them assess commercial risk, and therefore material to their purchasing decision. Furthermore, for a growing segment of the investing population, such ESG factors are inherently material, oftentimes restricting what securities asset managers can invest in. NICHOLAS G. TERRIS, SOME LIABILITY CONSIDERATIONS RELATING TO ESG DISCLOSURES, K&L GATES HUB (May 2017). The demonstrated importance of these factors to investors renders inapplicable the doctrine of "puffery," which generally holds that statements which are so vague, nonspecific, or indefinite that no reasonable investor could consider them important to the "total mix" of information, are inactionable as a matter of law. (See, e.g., *In re Advanta Corp. Securities Litig.*, 180 F.3d 525, 538–39 (3d Cir. 1999); *Shaw v. Digital Equip.*

Corp., 82 F.3d 1194, 1217 (1st Cir. 1996)).

This Court should affirm the California Supreme Court's finding that Vessel's statements were material. In doing so, this Court will uphold the longheld view that what is material depends on the view of the "reasonable investor." *Basic*, 485 U.S. at 231-232.

1. A reasonable investor (and especially an "ESG" investor) would consider a representation about environmental sustainability to be material for any company in the plastics industry.

Whether something is material requires a court to engage in "delicate assessments of the inferences a 'reasonable shareholder' would draw…and the significance of those inference[s] to him". *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976). This fact-specific inquiry requires assessment within the context of the industry a company operates in. See *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27 (2011) (the Court found that since statistical significance was not a requirement for decision making in the pharmaceutical industry, it was not necessary to find adverse reports material).

An increasing number of investors are interested in ESG issues, with some surveys showing that 80% of institutional investors integrate ESG factors into their investment decisions. MORGAN STANLEY, MORGAN STANLEY SUSTAINABLE SIGNALS: ASSET OWNERS SEE SUSTAINABILITY AS CORE TO FUTURE OF INVESTING (May 2020). "Over 2,300 investment managers, asset managers, and service providers representing over $80 trillion in assets under management (AUM) are signatories to the UN-sponsored Principles for Responsible Investment (PRI), which commit these institutions to incorporating ESG factors into their investment decisions."

Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social, and Governance Disclosures: Hearing on H.R. 4329 and H.R. 3088 Before the H. Subcom. on Investor Protection, Entrepreneurship, and Capital Markets, 116th Cong. 39-40 (2019) (Memorandum of Rep. Maxine Waters, Chairwoman).

For these investors, the materiality of ESG factors is inherent to their investing process, with some investors being categorically precluded from investing in shares of companies that fail to meet designated ESG criteria. (See Terris, *supra*) While this context heightens the importance that investors place on ESG factors, simply because a statement touches upon ESG does not make it inherently material. However, Vessel's statements implicated issues relevant to the commercial viability and risk of the business, which this Court has ruled is a basis for satisfying the *Basic* materiality test. See *Matrixx* 563 U.S. at 47. (This Court held that it is substantially likely a reasonable investor will view facts relating to significant risk to commercial viability of a company's products as satisfying the *Basic* "total mix" test for materiality).

Vessel operates in the plastics industry, where environmental sustainability factors are very significant not only to the investing public but commercially. Shifting consumer preferences and sustainability commitments by large corporations present a risk to the demand for plastics companies who are not environmentally sustainable. See MORGAN STANLEY INSTITUTE FOR SUSTAINABLE INVESTING, PLASTIC WASTE: ADDRESSING A GLOBAL ECONOMIC AND

ENVIRONMENTAL CHALLENGE THROUGH THE POWER OF CAPITAL MARKETS, 6 (April 2019). Vessel's statements regarding their business processes to maintain environmental standards and the biodegradability of their products provide the only information in its entire registration statement from which investors could assess the Company's ESG-related risks. An enterprise's legal, regulatory, and commercial risks are significantly likely to be factors which would influence a reasonable investor's view of security and shape their decision to purchase.

2. Because reasonable investors could rely on Vessel's statements regarding its environmental sustainability, the doctrine of "puffery" is inapplicable.

While the courts have rightly applied the doctrine of "puffery" to frivolous lawsuits seeking to establish liability for generic, vague statements which no reasonable investor could rely on, the doctrine is inapplicable in the present case. In contrast to instances of "puffing," Vessel's statements implicate genuine commercial risks: reasonable investors are significantly likely to find their content important in making investment decisions.

Yet even when courts apply a presumption of immateriality to generic opinions which might qualify as puffing, certain "qualitative factors may overcome any presumption of immateriality," including the "significance of the misstatement in relation to the company's operations, and…management's expectation that the misstatement will result in a significant market reaction." See, e.g., *ECA, Loc. 134 IBEW Joint Pension Tr. of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009); SEC Staff Accounting Bulletin No. 99, 64

Fed. Reg. 45150, 45150–52 (1999). Vessel's statements concern both the Company's operations and were made with an express desire to engender a specific reaction from the market, namely an "optimally-priced" IPO. R. at 7. Evidence of the company's success in perceiving the materiality of its ESG statements to investors is found in the sudden, sharp drop in Vessel's share price following several plastics trade journals casting significant doubt on the biodegradability of Vessel's products, and in turn its overall environmental sustainability. R. at 8-9.

Reasonable investors understand that they should not rely on generic, aspirational statements. However, when Vessel made "specific statements that emphasize its reputation…that are clearly designed to distinguish the company from other…companies in the same industry," *Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 97 (2d Cir. 2016) investors can reasonably understand that these statements are intended to provide material information regarding a topic important to investors.

C. RULING THESE STATEMENTS INACTIONABLE AS A MATTER OF LAW WILL IMPAIR INVESTOR PROTECTIONS.

This Court has consistently upheld the purpose of securities regulations to protect investors by mandating full, honest, and fair disclosure by issuers. Holding that the statements challenged by LAMWPF are inactionable as a matter of law would require the Court to significantly narrow the view it has articulated regarding the views of a reasonable investor as the basis of determining whether a statement is materially misleading. This would not only severely limit the ability of investors to hold issuers accountable when they make misleading statements, but would embolden issuers to make attractive, if not plausibly accurate statements, which in turn will damage investors' ability to rely on registration statements to come to accurate assessments of the risks and value of a given security.

To rule that the claims at issue are inactionable would create a precedent which significantly weakens the protection afforded to investors by the "reasonable investor" standard. This protection afforded to investors is rooted in the ability for an investor to have their claims evaluated by a trier of fact on the specific circumstances of a given case. This Court should affirm the Supreme Court of California's decision and uphold this Court's long-held view: that whether a statement is materially misleading requires a delicate, factspecific assessment of the inferences a reasonable shareholder would draw. See *TSC Indus.* 426 U.S. at 450.

1. Finding these statements inactionable as a matter of law will damage the "full, honest, and fair disclosure" that the '33 Act mandates and thereby harm investors whom the '33 Act sought to protect.

Ruling Vessel's statements inactionable as a matter of law would impede the healthy functioning of our securities markets and be contrary to the legislative intent of the '33 Act. Congress passed the '33 Act to "bring into full glare of publicity those elements of real and unreal values which may lie behind a security." H.R. REP. NO. 73-85, at 4 (1933). If this Court finds Vessel's statements inactionable, it will overrule the substantial evidence demonstrating that investors consider such disclosures material, which would be contrary to this Court's history of relying on the views of a "reasonable investor" in determining whether a statement is materially misleading.

As the Supreme Court of California correctly noted, whether a statement or omission is misleading should be decided by a trier of fact and is only appropriately resolved as a matter of law when "reasonable minds **could not differ**". *S.E.C. v. Todd* 642 F.3d at 1220-21. (emphasis added). Ruling that these statements are inactionable as a matter of law requires a finding that no reasonable investor could possibly find these statements materially misleading.

This Court has recognized that the inquiry into materiality is objective. *Omnicare*, 575 U.S. at 186-87. For this Court to find that no reasonable investor could find these statements material would require disregarding the significance which ESG factors have to many investors and specifically the investors Vessel targeted. Ruling immaterial a factor which investors have expressly noted as material would involve a subjective assessment of what reasonable investors *should* find material, rather than an objective assessment of what they already do.

Ruling these statements inactionable as a matter of law would upend nearly fifty years of precedent utilizing the "reasonable investor" test as a basis for materiality. This deterioration of the concept of materiality will significantly impair the ability of investors to survive motions to dismiss, and therefore make it difficult to hold accountable issuers who make technically correct but facially misleading statements.

2. Finding these statements not inactionable would aid Congress' and the SEC's advocacy for considering ESG factors as explicitly material.

The rise of ESG investing in the last [two decades] has strained the investor protection which the '33 Act sought to provide. Many investors consider a company's environmental sustainability as a key factor guiding their investment decisions. Issuers have responded by offering disclosures of ESG factors in financial statements, or even as stand-alone sustainability reports.

Congress has recognized the importance of ESG statements to investors and the particular challenge they face in meeting a materiality standard based on a traditional financial and accounting view of disclosures and materiality. See *Caitlin M. Ajax and Diane Strauss, Corporate Sustainability Disclosures in American Case Law: Purposeful or Mere "Puffery"?*, 45 ECOL. LAW Q. 703 (2018). In response, Congress has considered expressly mandating that such statements are considered material. See *ESG Disclosure Simplification Act of 2019*, H.R. 4329, 116th Cong., § 2(b)(3) (2019–2020). The SEC has similarly indicated it finds the current treatment of ESG factors to be insufficiently aligned with investors' views and is rumored to be considering approval of a regulation mandating broad ESG disclosures. See Javier El-Hage, *Fixing ESG: Are Mandatory ESG Disclosures the Solution to Misleading Ratings?*, 26 Fordham J. Corp. & Fin. L. 359.

By finding that Vessel's statements are not inactionable as a matter of law, this Court would avoid further exacerbating an issue already recognized by the political branches of our government: the limited protections afforded to the growing class of ESG investors.

II. THE DISCOVERY STAY PROVISION OF THE PRIVATE SECURITIES LITIGATION REFORM ACT, WHICH PROHIBITS THE COMMENCEMENT OF DISCOVERY DURING THE PENDENCY OF A MOTION TO DISMISS, SHOULD APPLY ONLY TO PRIVATE ACTIONS BROUGHT UNDER THE SECURITIES ACT OF 1933 IN FEDERAL COURT.

The Private Securities Litigation Reform Act ("Reform Act") was passed in 1995 in response to evidence of abuse in private securities lawsuits. The broad purpose of the Reform Act is to protect investors and maintain confidence in capital markets. H.R. Rep. No. 104-369, at 31 (1995). The Reform Act provides for the protection of both investors and issuers from abusive securities litigation by way of procedural provisions which govern the selection of lead plaintiffs and counsel, improve the process by which class members are notified of a proposed or final settlement agreement, and stay all discovery during the pendency of a motion to dismiss. *Id.* at 33-37.

Since its passage in 1995, courts have disagreed over how to interpret the scope of the application of several provisions of the Reform Act, including the subject of this case: the discovery stay. Some courts have found that the stay does not apply in state court actions under the '33 Act, while other courts have found that it does. Private Securities Litigation Reform Act, 15 U.S.C. § 77z-1(b) (1995); *Switzer v. Hambrecht & Co., L.L.C.*, No. CGC-18-564904, 2018 WL 4704776 (Cal. Super. Ct. 2018) (holding that the Reform Act's provision for a discovery stay is procedural and thus only applies to actions filed in federal court). *But see City of Livonia Retiree Health and Disability Benefits Plan v. Pitney Bowes Inc.*, No. X08FSTCV186038160S, 2019 WL 2293924 (Conn. Super. Ct. 2019) (holding that the plain meaning of the discovery stay compels the conclusion that it applies to actions commenced in state court under the Securities Act). Principles of statutory interpretation, combined with the Reform Act's legislative history, legislative intent, and the principle of constitutional avoidance compel the conclusion that the discovery stay provision in 15 U.S.C. § 77z-1(b)(1) only applies in federal courts.

A. The legislative history, purpose, and text of both the Private Securities Litigation Reform Act and Securities Litigation Uniform Standards Act support a finding that Congress did not intend for the discovery stay provision to apply in state courts.

While the phrase, "any private action" in the discovery stay provision in 15 U.S.C. § 77z-1(b)(1) may appear facially unambiguous, this Court has maintained that the word "any" can take on a meaning different from its literal definition, depending upon the context in which it is used. *Small v. United States*, 544 U.S. 385, 387 (2005). This Court has frequently looked to surrounding provisions of a statute as well as legislative intent to aid in determining whether a statute is ambiguous. *Id.* at 388-394. *Huddleston v. United States*, 415 U.S.

814, 820-826 (1974). Upon looking to the surrounding provisions of the Reform Act and legislative history, it is clear that the phrase "any private action" in the discovery stay provision is ambiguous.

1. <u>The legislative history and Congressional intent of both the discovery stay provision and the Reform Act as a whole support a finding that the discovery stay provision is meant only to apply in federal court.</u>

When interpreting a statute, the court should "always turn first to one, cardinal canon before all others" and must "presume that the legislature says in a statute what it means and means in a statute what it says there." *Conn. Nat'l*

Bank v. Germain, 503 U.S. 249, 253-54 (1992). Furthermore, "when the words of a statute are unambiguous…this first canon is also the last: judicial inquiry is complete." *Ibid.* However, the canons of statutory interpretation can be overcome by "other circumstances evidencing congressional intent." *Chickasaw Nation v. United States*, 534 U.S. 84, 94 (2001). *See also Cir. City Stores, Inc. v. Adams*, 532 U.S. 105, 115 (2001) ("Canons of construction need not be conclusive and are often countered, of course, by some maxim pointing in a different direction."). A full reading of the Reform Act and its legislative history demonstrates of Congress' intent that the discovery stay provision should only apply in federal courts.

The goal of the Reform Act was to discourage frivolous lawsuits and protect both investors and issuers. This goal is reflected in the provisions of 15 U.S.C. § 77z-1(a), which provide additional protections for class members, including restrictions on attorneys' fees, heightened disclosure of settlement terms, and rigorous standards to be used in appointing the lead plaintiff and counsel in a class action. Notably, this subsection only applies to private actions brought pursuant to the Federal Rules of Civil Procedure ("FRCP"), meaning only to private actions brought in federal court. 15 U.S.C. § 77z-1(c), which provides for sanctions for abusive litigation pursuant to FRCP 11, similarly applies only in federal courts as it is not possible to violate FRCP 11 in state court. Both subsections are critical to curbing abusive securities litigation and yet both apply only in federal courts. The legislative history and purpose evince no reason why the discovery stay should be broader in scope than the other procedural subsections in the Reform Act. *See Sibbach v. Wilson & Co.*, 312 U.S. 1, 14 (1941) (holding that discovery rules under the FRCP are procedural and not substantive).

15 U.S.C. § 77z-1(b)(2), part of the discovery stay provision, also references the FRCP, stating that during the pendency of a motion to dismiss, any party to the action is to treat all documents "…as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure." While it is generally assumed to be intentional when Congress includes specific language in one section of a statute but omits it in another, the omission of language from §77z-1(b)(1) specifying that it only applies in federal court can be explained by the general presumption that federal procedure does not apply in state courts. *Clay v. United States*, 537 U.S. 522, 528 (2003). *Howlett v. Rose*, 496 U.S. 356, 372 (1990). The legislative history in no way distinguishes between the discovery stay and other provisions of the Reform Act, treating them all as reforms necessary to curbing abusive securities legislation. H.R. Rep. No. 104-369, at 32 (1995).

2. <u>The SLUSA and its legislative history show that the discovery stay provision is only intended to apply in federal court.</u>

Perhaps most telling of Congressional intent regarding the discovery stay is the Securities Litigation Uniform Standards Act ("SLUSA") and its legislative history. The House Report on the SLUSA indicates the Congress' awareness that plaintiffs, after the passage of the Reform Act, were increasingly filing in state court to avoid the federal procedural provisions of the Reform Act. The SLUSA amended the Reform Act, noting that the solution to the problem of plaintiffs filing in state court to evade Reform Act provisions was to "make Federal court the exclusive venue for securities fraud class action litigation." H.R. REP. 105640, at 10 (1998). That Congress' response to increasing litigation in state courts was to require virtually all securities class actions be brought in federal court, instead of stipulating that the procedural provisions of the Reform Act apply uniformly in federal and state courts, supports the notion that the procedural provisions, including the discovery stay provision, were never intended to apply in state courts.

The SLUSA amended the discovery stay provision by adding 15 U.S.C. § 77z-1(b)(4), which stipulates that "a court may stay discovery proceedings in any private action in a State court as necessary in aid of its jurisdiction, or to protect or effectuate its judgments". While Congress chose to use the general term, "a court," the legislative history indicates that they intended this to mean a federal court. The Committee on Commerce explained that one way it intended to address the migration of securities class actions to state court was by granting power "to Federal judges to quash discovery in State actions if that discovery conflicts with an order of the Federal court." H.R. Rep. 105-640, at 11 (1998). Other courts have similarly interpreted the general term in 15 U.S.C. § 77z1(b)(4), "a court," to mean "a federal court." *See Newby v. Enron Corp.*, 338 F.3d 467, 471 (5th Cir. 2003) (stating that the SLUSA solved the problem of securities class actions being filed in state court "by granting the power to federal court judges to quash discovery in state court actions if discovery in the state case conflicted with an order of the federal court."). *See also In re Everquote, Inc. Sec. Litig.*, 65

Misc.3d 226, 236 (N.Y. Sup. Ct. 2019). Following the canon of statutory interpretation that identical words used in different parts of the same statute are generally perceived to have the same meaning, it would follow that "the court" in the discovery stay provision in 15 U.S.C. § 77z-1(b)(1) was also intended to mean "the federal court." *IBP, Inc. v. Alvarez*, 546 U.S. 21, 22 (2005).

Congress choosing the language "the court," when it in fact meant, "the federal court," lends support to a narrower interpretation of "any private action" in 15 U.S.C. § 77z-1(b)(1). Courts have frequently held that general words, such as "any," can take on different meanings depending on the context in which they're used. *Nixon v. Mo. Mun. League*, 541 U.S. 125, 126 (2004). Furthermore, the Supreme Court in *Gregory v. Ashcroft* stated that when Congress intends to pre-empt the historic powers of the states, it should make its intention "clear and manifest." 501 U.S. 452, 460 (1991). If Congress wanted the discovery stay provision to apply in both state and federal courts, thereby preempting the power of the states to administer judicial procedure, all it needed to do was specify that the provision applied in any state or federal action. Indeed, if Congress wanted the federal discovery stay to apply in both state and federal courts, they could have made this exact change when they amended the Reform Act by passing the SLUSA. That they chose not to do so despite being aware that plaintiffs were filing in state court to avoid the discovery stay indicates that it was never their intent for the provision to apply in state court.

The legislative history of the SLUSA further indicates that Congress meant the discovery stay provision to apply only in federal courts, stating that there has been an increase in parallel litigation between state and federal courts to avoid the "federal discovery stay or other provisions of the Act." H.R. Rep. 105640, at 10 (1998). That the Committee report on the SLUSA expressly refers to the "federal discovery stay" of the Reform Act provides further evidence that Congress intended the discovery stay provision to apply only in federal court.

B. Principles of constitutional avoidance support reading the Reform Act discovery stay as applying only in federal court.

The Rules Enabling Act gave the Supreme Court the power to make rules of procedure and evidence for federal courts, which it exercised by adopting the FRCP in 1937. 28 U.S.C. § 2072. The Tenth Amendment to the Constitution provides that the powers not delegated to the U.S. by the Constitution, nor prohibited to it by the states, are reserved for the states. It has long been maintained by the Court that the right to create and apply rules governing "matters of procedure" belongs to the state. *Cent. Vermont R. Co. v. White*, 238 U.S. 507, 511-512 (1915). *Felder v. Casey*, 487 U.S. 131, 138 (1988) (citing the "general and unassailable proposition…that States may establish the rules of procedure governing litigation in their own courts."). *See also Johnson v. Fankell*, 520 U.S. 911, 919 (1997).

The canon of constitutional avoidance "is a tool for choosing between competing plausible interpretations of a statutory text, resting on the reasonable presumption that Congress did not intend the alternative which raises serious constitutional doubts." *Clark v. Martinez*, 543 U.S. 371, 381 (2005). *See also Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 563 (2012) (stating that "every reasonable construction must be resorted to, in order to save a statute from unconstitutionality."). Interpreting the discovery stay provision as applying in both federal and state courts would place the States' rights to establish their own rules of procedure in peril and would thwart the "unassailable proposition…that States may establish the rules of procedure governing litigation in their own courts." *Felder*, 487 U.S. at 138. The Supremacy Clause is "a power that we must assume Congress does not exercise lightly" and the Court should require that Congress make its intent to preempt state procedure explicit instead of reading this intent into an ambiguous provision. *Gregory v. Ashcroft*, 501 U.S. 452, 460 (1991).

The Court has decided several cases involving the applicability of a rule of federal procedure to a federal claim brought in state court. In four of these cases, the Supreme Court held that the application of the state procedural rule imposed an unnecessary burden on a federal right and thus that the federal rule was preemptive. In *Brown v. Western Ry. Of Ala.*, the Supreme Court held that a state pleading standard, which was stricter than the federal standard, could not be used to impose an unnecessary burden upon rights of recovery authorized by federal law. 388 U.S. 294, 298. *See also Felder*, 487 U.S. at 141 (holding that the application of a state notice requirement burdened the exercise of a federal right "by forcing civil rights victims who seek redress in state courts to comply with a requirement that is entirely absent from civil rights litigation in federal courts"); *Dice v. Akron, C. & Y.R. Co.*, 342 U.S. 359 (1951) (holding that the right to a jury trial under the Federal Employers Liability Act was too substantial a part of the rights afforded by the Act to be sacrificed by application of state procedure); *Monessen Sw. Ry. Co. v. Morgan*, 486 U.S. 330 (1988). In deciding these cases, the Court focused on whether the federal procedural rule was a substantial component of a federal cause of action and whether applying state procedure would unnecessarily burden a federal right.

In the most recent case decided by the Court on the topic of federal preemption of state procedure, the court held that, even though defendants would have had the right to an interlocutory appeal in federal court, they were not entitled to such in state court because the application of the state's neutral, procedural rules was "less an interference with federal interests than a judgment about how to best balance the competing state interests…" *Johnson*, 520 U.S. at 920. Like rules governing interlocutory appeals, discovery procedures are neutral: they apply equally in all cases and to all parties in state court. While discovery procedures for '33 Act claims brought in state court may increase the chance plaintiffs' cases will proceed, "it does not expand the defendants' liability beyond that which the facts ultimately support." Wendy Gerwick Couture, *Cyan, Reverse-Erie, and the PSLRA Discovery Stay in State Court*, 47 No. 1 Sec. Regul. L. J. Art. 2. Thus, absent Congress expressly stating their intent for the discovery stay to preempt state procedure, a state's neutral discovery rules should apply to Securities Act claims brought in state court.

CONCLUSION

For the above reasons stated, Respondent respectfully requests that this Court affirm the decision of the California Supreme Court.