Ninth Circuit Holds That Allegations in Whistleblower Complaint May Be Corrective Disclosure, but Short-Seller Posts Are Not

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On October 8, 2020, the U.S. Court of Appeals for the Ninth Circuit reversed the dismissal[1] of a putative securities fraud class action in a decision that provides additional guidance concerning the standard for pleading loss causation in the Ninth Circuit.

The plaintiffs, purported BofI Holding, Inc. (BofI) shareholders, alleged that BofI and certain of its executives 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 plaintiffs claimed that the truth was revealed in two supposed corrective disclosures: (i) a whistleblower lawsuit filed by a former midlevel auditor at the company; and (ii) a series of eight blog posts authored by anonymous short-sellers of BofI stock.

The district court dismissed the complaint, holding that neither alleged corrective disclosure could satisfy the loss causation element of the plaintiffs' claim. Regarding the whistleblower complaint, the court held that the allegations were merely "unconfirmed accusations of fraud" and therefore could not have disclosed to the market that BofI's alleged misstatements were actually false. To adequately plead loss causation, the district court explained, the lawsuit had to be followed by "a subsequent confirmation" of the fraud. Regarding the blog posts, the district court held that they could not constitute a corrective disclosure because each of them relied on already publicly available information. As such, they could not have revealed anything new to the market.

On appeal, the Ninth Circuit reversed the dismissal. Regarding the whistleblower complaint, the court rejected a categorical rule that allegations in a lawsuit, standing alone, can never qualify as a corrective disclosure. The court stated that allegations can constitute a corrective disclosure when the complaint alleges that "the market treat[ed] [the allegations] as sufficiently credible to be acted upon as truth." In reaching this conclusion, the court distinguished two prior Ninth Circuit decisions. First, the court distinguished *Loos v. Immersion Corp.*, 762 F.3d 880 (9th Cir. 2014), where the Ninth Circuit held that the announcement of an internal investigation into purported wrongdoing, without more, cannot satisfy the loss causation element. That decision was premised on the rationale that instituting an investigation can only indicate a risk of fraud and "speculation" about "what the investigation will ultimately reveal." Here, in contrast, according to the court, the whistleblower alleged facts that, if true, plausibly revealed the falsity of BofI's prior statements. Second, the court distinguished *Curry v. Yelp Inc.*, 875 F.3d 1219 (9th Cir. 2017), which held that the Federal Trade Commission's disclosure of 2,000 complaints from businesses claiming that their Yelp reviews had been manipulated did not reveal the falsity of Yelp's prior statements that its reviews were authentic. The court reasoned that the complaints in *Curry* came from "outsiders who lacked any firsthand knowledge of Yelp's practices." In contrast, the whistleblower was "a former insider of the company who had personal knowledge of the facts alleged." Following *BofI*, it appears that the law in the Ninth Circuit remains that the announcement of an investigation, without more, cannot constitute a corrective disclosure, but allegations in a lawsuit potentially can suffice if the allegations are credible, particularized and based on firsthand, insider information.

With respect to the short-seller blog posts, the court also rejected a categorical rule that a disclosure based on publicly available information can never constitute a corrective disclosure. Rather, as the court stated: "The ultimate question is again one of plausibility: Based

[1] In re BofI Holding, Inc. Securities Litigation, No. 18-55415 (9th Cir. Oct. 8, 2020).

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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 court went on to reaffirm that whether an alleged disclosure is based only on already public information remains a key factor in this analysis.

In this instance, the court concluded that the short-seller blog posts cannot constitute a corrective disclosure as a matter of law. The court reasoned that, even if the posts disclosed new information, "it is not plausible that the market reasonably perceived these posts as revealing the falsity of BofI's prior misstatements." That is because 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.'" Under those circumstances, a "reasonable investor reading these posts would likely have taken their contents with a healthy grain of salt."

Whether the defendants will seek either *en banc* review in the Ninth Circuit or *certiorari* in the Supreme Court is not yet known.