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SECURITIES LAW — MATERIALITY REQUIREMENT — SECOND  
CIRCUIT FINDS ISSUER’S FAILURE TO DISCLOSE LOAN IMPAIR-  
MENTS IMMATERIAL AS A MATTER OF LAW. — *Hutchison v.*  
*Deutsche Bank Securities Inc.*, 647 F.3d 479 (2d Cir. 2011).

Investors generally may sue issuers of securities for material misstatements or omissions of fact in public disclosure documents.<sup>1</sup> Over thirty-five years ago, in *TSC Industries, Inc. v. Northway, Inc.*,<sup>2</sup> the Supreme Court articulated the canonical materiality standard — “there must be 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”<sup>3</sup> — but courts, litigants, and commentators have struggled to apply this standard.<sup>4</sup> Recently, in *Hutchison v. Deutsche Bank Securities Inc.*,<sup>5</sup> the Second Circuit held that a firm’s failure to disclose the impairment of loans amounting to less than five percent of its total assets was immaterial as a matter of law.<sup>6</sup> In reaching this holding, however, the Second Circuit focused its quantitative analysis on the size of the alleged omission relative to the issuer’s entire asset portfolio rather than to the issuer’s equity value or net income — measures that would likely have been more relevant to the plaintiffs, who were shareholders. Because the court relied on a standard that insufficiently took into account the specific type of securities the plaintiffs owned, its decision to affirm dismissal frustrated the purposes of the federal securities laws.

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<sup>1</sup> Sections 11 and 12 of the Securities Act of 1933 (Securities Act), 15 U.S.C. §§ 77a–77aa (2006 & Supp. IV 2011), create liability for material misstatements or omissions in an issuer’s registration statement and prospectus, respectively. *Id.* §§ 77k–77l (2006). Rule 10b-5, promulgated under section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), *id.* §§ 78a–78pp (2006 & Supp. IV 2011), applies the same materiality standard in prohibiting material misstatements or omissions in connection with secondary market securities transactions. 17 C.F.R. § 240.10b-5(b) (2011).

<sup>2</sup> 426 U.S. 438 (1976).

<sup>3</sup> *Id.* at 449. The Supreme Court has repeatedly affirmed that the *TSC Industries* materiality standard is the definitive formulation. *See, e.g.*, *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318 (2011); *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988); *see also* Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 BUS. LAW. 317, 320 (2007) (“*TSC Industries* is the authority to which all subsequent judicial materiality determinations relate.”).

<sup>4</sup> *See* Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1152 (2003). Critiques of “reasonable investor” standards predate *TSC Industries*. *See, e.g.*, *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 682 (S.D.N.Y. 1968) (“Since no one knows what moves or does not move the mythical ‘average prudent investor,’ it comes down to a question of judgment, to be exercised by the trier of fact as best he can in light of all the circumstances.”). In a similar vein, a then-director of the Securities and Exchange Commission’s Division of Corporate Finance admitted that “[m]ateriality is hard for all of us to get our arms around.” Phyllis Diamond, *More Reg FD Cases in the Pipeline*, *Beller Says at Lawyers’ Gathering*, 37 SEC. REG. & L. REP. 1878, 1878 (2005).

<sup>5</sup> 647 F.3d 479 (2d Cir. 2011).

<sup>6</sup> *Id.* at 485–90.

CBRE Realty Finance (CBRE) was a commercial real estate specialty finance company organized in 2005 that “focuse[d] on originating, acquiring, investing in, financing and managing a diversified portfolio of commercial real estate-related loans and securities” in North America.<sup>7</sup> CBRE launched an initial public offering (IPO) of shares in September 2006,<sup>8</sup> having filed a registration statement and prospectus with the Securities and Exchange Commission (SEC) pursuant to the Securities Act of 1933<sup>9</sup> (Securities Act).<sup>10</sup> In its registration statement, CBRE disclosed that as of August 31, 2006, it had an approximately \$1.1 billion investment portfolio that included \$186 million in mezzanine loans.<sup>11</sup> CBRE also disclosed that it intended to finance future investments “primarily by borrowing against or ‘leveraging’ [its] existing portfolio”; it predicted that its “overall leverage [would] be between 70% and 80% of the total value of [its] assets.”<sup>12</sup> In mid-2006, CBRE’s leverage was at the low end of this target range; its pre-IPO balance sheet disclosed equity of \$290 million supporting assets of \$979 million, a leverage ratio of roughly 70%.<sup>13</sup>

At the time of the IPO, CBRE had two mezzanine loans totaling \$51.5 million outstanding to real estate developer Triton Estate Partners, LLC.<sup>14</sup> According to the plaintiffs, these loans, which were collateralized by condominium conversion projects in Maryland, were “impaired”<sup>15</sup> at the time of the IPO<sup>16</sup>: Triton had missed tax payments

<sup>7</sup> CBRE Realty Fin., Inc., Amendment No. 6 to Form S-11 (Form S-11/A), at 76 (Sept. 26, 2006) [hereinafter CBRE Registration Statement]. In late 2008, CBRE was renamed Realty Finance Corp. CBRE Realty Fin., Inc., Current Report (Form 8-K) (Dec. 15, 2008).

<sup>8</sup> *Hutchison*, 647 F.3d at 481.

<sup>9</sup> 15 U.S.C. §§ 77a–77aa (2006 & Supp. IV 2011).

<sup>10</sup> Section 5 of the Securities Act requires issuers of public securities to file a registration statement with the SEC. *Id.* § 77e. Various SEC rules promulgated under the Securities Act set out the precise requirements for such registrations. *See, e.g.*, Regulation S-K, 17 C.F.R. §§ 229.10–.1208 (2011); Regulation C, 17 C.F.R. §§ 230.400–.498.

<sup>11</sup> CBRE Registration Statement, *supra* note 7, at 3. In real estate projects, mezzanine debt refers to a loan collateralized by a lien on the equity interest in the property-owning entity, as opposed to a mortgage, in which the loan is collateralized by an interest in the property itself. *See generally* Kate Lewis, *Mezzanine Debt: A Primer for Distressed Asset Buyers*, NAT’L REAL EST. INVESTOR (Jan. 26, 2010, 12:41 PM), [http://nreionline.com/distressedinventory/mezzanine\\_debt\\_0126](http://nreionline.com/distressedinventory/mezzanine_debt_0126).

<sup>12</sup> CBRE Registration Statement, *supra* note 7, at 7.

<sup>13</sup> *Id.* at F-2. CBRE’s pre-IPO full balance sheet was reported as of June 30, 2006, *see id.*, at which point CBRE’s total assets of \$979 million were slightly less than the \$1.1 billion investment portfolio as of August 31, 2006.

<sup>14</sup> *Hutchison*, 647 F.3d at 481–82.

<sup>15</sup> *Id.* at 482 (internal quotation marks omitted). For additional background on the impairment accounting concept, see FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 114 (1993), *available at* <http://www.fasb.org/pdf/fas114.pdf>, which states that “[a] loan is impaired when . . . it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement.” *Id.* at 4.

<sup>16</sup> *Hutchison*, 647 F.3d at 481–82.

on the underlying properties and exceeded its construction budget on one of the projects by \$3 to \$5 million, and the senior lender to the project had stopped funding its commitments as a result of these conditions.<sup>17</sup> Moreover, CBRE was allegedly aware of this fact.<sup>18</sup> Despite the SEC's requirement that issuers "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact" on financial performance,<sup>19</sup> CBRE did not disclose anywhere in its registration statement that the Triton loans were potentially impaired.<sup>20</sup>

Several months after the IPO, on February 26, 2007, CBRE announced that the Triton loans were not performing.<sup>21</sup> On May 7, 2007, CBRE announced that it was foreclosing on both properties securing the Triton loans.<sup>22</sup> CBRE also announced on August 6, 2007, that it would recognize a \$7.8 million impairment charge for one of the loans. Combined with a \$22.6 million judgment CBRE subsequently won against the guarantors of the Triton loans,<sup>23</sup> this charge suggested that the economic losses on the loans exceeded \$30 million,<sup>24</sup> a significant sum compared to CBRE's post-IPO market capitalization of \$445.1 million<sup>25</sup> and annual net income of \$13.7 million in 2006 and negative \$11.3 million in 2007, respectively.<sup>26</sup> Following the February and August announcements, CBRE's stock price dropped 18% and 32%, respectively, on heavy trading volume.<sup>27</sup>

<sup>17</sup> *Id.* at 482.

<sup>18</sup> See Plaintiffs-Appellants' Opening Brief at 6-11, *Hutchison*, 647 F.3d 479 (No. 10-1535), 2010 WL 3690791, at \*6-11 (detailing factors supporting the plaintiffs' allegation that CBRE knew the Triton loans were impaired before it filed its registration statement).

<sup>19</sup> 17 C.F.R. § 229.303(a)(3)(ii) (2011).

<sup>20</sup> *Hutchison*, 647 F.3d at 482. To the contrary, CBRE represented in its Registration Statement that it "had reviewed its portfolio of loans and did not 'identify any loans that exhibited] characteristics indicating that impairment ha[d] occurred.'" *Id.* at 482 (alterations in original) (quoting CBRE Registration Statement, *supra* note 7, at F-7).

<sup>21</sup> See Plaintiffs-Appellants' Opening Brief, *supra* note 18, at 14, 2010 WL 3690791, at \*14. CBRE announced "that the loan on [one of the two condominium properties] was 'non-performing' and that the loan on [the other property] was 'on its watch list.'" *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> See *CBRE Fin. TRS, LLC v. McCormick*, No. 1:08-cv-1964, 2009 WL 4782124, at \*1, \*10 (D. Md. Dec. 8, 2009), *aff'd*, 414 F. App'x 547 (4th Cir. 2011).

<sup>24</sup> See Plaintiffs-Appellants' Opening Brief, *supra* note 18, at 15, 2010 WL 3690791, at \*15.

<sup>25</sup> CBRE's IPO priced at \$14.50 per share, Kathy Fung, *CBRE Realty Finance Initial 9.6 Million Common Shares Priced at 14.5*, BLOOMBERG, Sept. 27, 2006, and CBRE had roughly 30.7 million fully diluted shares outstanding after the IPO, CBRE Realty Fin., Inc., Quarterly Report (Form 10-Q), at 1, 18 (Nov. 9, 2006).

<sup>26</sup> CBRE Realty Fin., Inc., Annual Report (Form 10-K), at 93 (Mar. 17, 2008). The \$11.3 million 2007 net loss from continuing operations included the \$7.8 million impairment charge. *Id.*

<sup>27</sup> Plaintiffs-Appellants' Opening Brief, *supra* note 18, at 14-15, 2010 WL 3690791, at \*14-15. The Second Circuit noted, however, that these stock price drops were not necessarily caused by the Triton disclosures because CBRE disclosed other negative information about its business on those days. *Hutchison*, 647 F.3d at 489.

The *Hutchison* plaintiffs, who had purchased shares in the CBRE IPO, brought suit under sections 11, 12(a)(2), and 15 of the Securities Act, alleging that CBRE's registration statement was "materially inaccurate because it failed to disclose that the Triton loans were 'impaired.'"<sup>28</sup> The district court dismissed the complaint for failure to state a claim, holding that the plaintiffs had not plausibly alleged that the omissions in CBRE's registration statement were material.<sup>29</sup> On the district court's reasoning, the fact that the Triton loans were fully collateralized implied that "any Triton default would have made no difference with regard to the merits of investing in CBRE, [so] the risk of potential default could not have been material."<sup>30</sup>

The Second Circuit affirmed the district court's grant of the defendants' motion to dismiss, but on different grounds.<sup>31</sup> Writing for the panel, Chief Judge Jacobs<sup>32</sup> rejected the district court's reliance on the Triton loans' collateralization, emphasizing that the issue of impairment — that is, whether CBRE could collect "*according to the contractual terms of the original agreements*"<sup>33</sup> — was independent of the loans' collateralized status. Because the Triton loans were impaired under this definition, Chief Judge Jacobs reasoned that the "sole remaining issue [was] whether the effect of the 'known' information was 'reasonably likely' to be material"<sup>34</sup> and turned his attention to the "traditional quantitative and qualitative factors used to assess materiality."<sup>35</sup>

In the quantitative prong of its analysis, the court applied the SEC's five percent "rule of thumb" threshold that can "provide the basis for a preliminary assumption that . . . a deviation of less than [five percent] with respect to a particular item on the registrant's financial statements is unlikely to be material."<sup>36</sup> It reasoned that because nei-

<sup>28</sup> *Hutchison*, 647 F.3d at 482.

<sup>29</sup> *Hutchison v. CBRE Realty Fin., Inc.*, 638 F. Supp. 2d 265, 276–77 (D. Conn. 2009).

<sup>30</sup> *Id.* at 275.

<sup>31</sup> *Hutchison*, 647 F.3d at 481.

<sup>32</sup> Chief Judge Jacobs was joined by Judge Livingston and District Judge Rakoff, sitting by designation.

<sup>33</sup> *Hutchison*, 647 F.3d at 486 (quoting CBRE Registration Statement, *supra* note 7, at F-31) (emphasis added).

<sup>34</sup> *Id.* (quoting *Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 716 (2d Cir. 2011), *cert. denied*, 132 S. Ct. 242 (2011)).

<sup>35</sup> *Id.* To analyze materiality, the Second Circuit, following the "persuasive authority" provided in SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 19, 1999) (to be codified at 17 C.F.R. pt. 211), conducts a two-prong analysis under which either quantitative or qualitative considerations can be sufficient to establish materiality. See *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 197–98 (2d Cir. 2009) (citing *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 163 (2d Cir. 2000)).

<sup>36</sup> SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. at 45,151; see also *Hutchison*, 647 F.3d at 487–89.

ther the \$51.5 million of total Triton loan exposure nor the total Triton impairment impact of \$30.4 million exceeded five percent of CBRE's \$1.1 billion investment portfolio, the impairments were quantitatively immaterial as a matter of law.<sup>37</sup> The qualitative prong<sup>38</sup> of the court's analysis yielded a similar result; the court found that CBRE's 2007 stock price declines had only attenuated causal linkages to the alleged omission<sup>39</sup> and that CBRE's mezzanine loan business segment was of insufficient "independent significance" to justify describing a "quantitatively small" omission within it as material for the purposes of the securities laws.<sup>40</sup> Because neither prong of the materiality inquiry was satisfied, the court affirmed that the alleged Triton omissions were immaterial as a matter of law.<sup>41</sup>

Although the Second Circuit's qualitative materiality analysis is debatable,<sup>42</sup> the court need never have reached this qualitative prong because it misapplied the quantitative prong of the test. To be sure, applying the quantitative prong is confusing because there are several different formulations of quantitative materiality. In *Hutchison*, however, the court used an insufficiently investment-specific standard. Had the court instead applied a materiality standard tailored more closely to the interests of equity investors, the true impact on the plaintiffs would have been clear, and the court could have properly assessed the materiality of the nondisclosure at issue.

The "[v]ariations in the formulation of a general test of materiality"<sup>43</sup> recognized by the *TSC Industries* Court have continued even af-

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<sup>37</sup> *Hutchison*, 647 F.3d at 488–89 & n.5. The court justified its decision to use CBRE's "entire investment portfolio" as the relevant basis for comparison because doing so was "consistent with the quantitative approach in *JP Morgan*." *Id.* at 488. The Second Circuit in that case rejected the plaintiff shareholders' Rule 10b-5 claim alleging the materiality of a mischaracterization of \$2 billion of assets — only 0.3% and 4.9% of JP Morgan's total assets and common equity, respectively. *JP Morgan*, 553 F.3d at 204 (citing J.P. Morgan Chase & Co., Annual Report (Form 10-K), at 62 (Mar. 20, 2001)).

<sup>38</sup> The qualitative prong of the materiality test is devoted to "considerations that may well render material a quantitatively small misstatement." SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. at 45,152.

<sup>39</sup> *Hutchison*, 647 F.3d at 489–90.

<sup>40</sup> *Id.* at 488, 490 (quoting *Litwin v. Blackstone Grp., L.P.*, 634 F.3d 706, 720 (2d Cir.), *cert. denied*, 132 S. Ct. 242 (2011)); *cf. Blackstone*, 634 F.3d at 719–20 (holding that a quantitatively small omission in Blackstone's entire portfolio was qualitatively material where it comprised 9.4% of the "flagship" Corporate Private Equity business segment).

<sup>41</sup> *Hutchison*, 647 F.3d at 491.

<sup>42</sup> Specifically, the court could arguably have found that CBRE's mezzanine lending business — its second-largest segment, which contained particularly risky loans and represented 17% of assets — was of "distinct interest to investors." *Id.* at 488. Moreover, the Second Circuit's standard analyzing misstatements relative to specific business segments is itself contested. *See* Petition for Writ of Certiorari at 16–17, *Blackstone*, 132 S. Ct. 242 (No. 11-15) (noting a circuit split on the application of this test).

<sup>43</sup> *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976).

ter that landmark decision was handed down.<sup>44</sup> For example, the Financial Accounting Standards Board (FASB) describes information as material if “omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity.”<sup>45</sup> In Regulation C under the Securities Act, the SEC defines material facts as “those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.”<sup>46</sup> And even the *TSC Industries* Court used varying definitions within the same opinion, declaring, in addition to its “total mix” formulation, that a fact is material “if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”<sup>47</sup>

These different formulations of the materiality requirement reflect varying degrees of sensitivity to cases’ factual contexts.<sup>48</sup> However, none of these formulations gives weight to the ranking of the plaintiff investor’s security within the issuer’s capital structure — arguably the most important contextual detail of all, since it determines the investor’s legal claim to some portion of the issuer’s income or assets.<sup>49</sup> A secured creditor to a firm, for instance, may be primarily focused on the value of the collateral securing his loan rather than the value of the assets of the firm as a whole. A general unsecured creditor, by contrast, is likely to be more focused on the value of the firm’s unencumbered assets or on the operating profit the firm can generate to cover its interest payments. And an investor in common equity is likely to care less about the value of a firm’s entire asset portfolio or operating profit — measures of corporate resources available to more senior providers of capital — than about the firm’s equity value or net income — residual measures of resources available to equity holders after other investors’ senior claims have been satisfied.<sup>50</sup> From this perspective, materiality definitions that focus on “a reasonable inves-

<sup>44</sup> See Sauer, *supra* note 3, at 320–23.

<sup>45</sup> FIN. ACCOUNTING STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS NO. 8 ¶ QC11 (2010), available at [http://www.fasb.org/cs/ContentServer?pagename=FASB%2Fdocument\\_C%2FdocumentPage&cid=1176157498129](http://www.fasb.org/cs/ContentServer?pagename=FASB%2Fdocument_C%2FdocumentPage&cid=1176157498129).

<sup>46</sup> 17 C.F.R. § 230.405 (2011).

<sup>47</sup> *TSC Indus.*, 426 U.S. at 449. *TSC Industries* arose in the context of a proxy solicitation pursuant to Rule 14a-9 under the Exchange Act. *Id.* at 440–43; 17 C.F.R. § 240.14a-9 (2011).

<sup>48</sup> For instance, while the FASB definition is generally applicable, the *TSC Industries* definition is more narrowly suited for cases in the shareholder voting context.

<sup>49</sup> For background on the types and implications of different securities within a firm’s capital structure, see RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 418–93 (10th ed. 2011).

<sup>50</sup> Moreover, to the extent that a firm employs a high degree of financial leverage, omissions or impairments that are relatively minor in the context of a firm’s overall assets or operating profit could be much larger relative to a firm’s equity or net income. For additional background on the evaluation of financial leverage, see *id.* at 216–21.

to . . . determining whether to purchase the *security registered*<sup>51</sup> usefully suggest that the materiality inquiry necessarily depends on the type of security a plaintiff investor owns.<sup>52</sup>

The *Hutchison* panel, by contrast, did not consider what metrics would matter most to the plaintiff shareholders for materiality purposes; it simply followed an earlier Second Circuit panel in “compar[ing] the value of the troubled investment to the value of the defendant’s entire investment portfolio.”<sup>53</sup> Because CBRE’s capital structure was 70% debt, the \$51.5 million of allegedly impaired assets, which represented only 4.9% of total asset value, amounted to 17.8% of CBRE’s \$290 million pre-IPO equity book value and 11.6% of CBRE’s \$445.1 million post-IPO market capitalization. The impairments had a similarly substantial impact on CBRE’s income statement: the \$7.8 million impairment charge, \$30.4 million total impairment loss, and \$51.5 million Triton loan principal amount comprised 56.9%, 221.9%, and 375.9%, respectively, of CBRE’s 2006 net income, and 69.0%, 269.0%, and 455.8%, respectively, of its 2007 net loss. It is difficult to imagine that adjustments of these magnitudes would not have meaningfully altered the total mix of information for a reasonable equity investor. At the very least, the size of these omissions relative to equity-specific metrics seriously undermines the idea that they would have been “so obviously [un]important to an investor, that reasonable minds [could not] differ on the question of materiality.”<sup>54</sup>

An investment-specific materiality inquiry is well within the capacity of the courts. One might worry that nonspecialist judges could find it too complex to determine which financial metrics would matter most to investors in different securities. However, applying such a test would likely be no more complex than the current procedure, in which courts balance complex quantitative and qualitative factors without specifying the type of investor whose perspective they are adopting. A similar concern is that different investors in the same types of securities might consider different types of information material.<sup>55</sup> But this

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<sup>51</sup> 17 C.F.R. § 230.405 (emphasis added).

<sup>52</sup> Cf. Sauer, *supra* note 3, at 321 (describing how judges and juries applying the standard must “imagine themselves as investors in the security at issue . . . [and] contemplat[e] how the alleged misstatement or omission would have affected their decision to buy, sell, or hold the security”).

<sup>53</sup> *Hutchison*, 647 F.3d at 487 (citing ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 204 (2d Cir. 2009)).

<sup>54</sup> *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976) (quoting *Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124, 1129 (4th Cir. 1970)) (internal quotation marks omitted).

<sup>55</sup> See Sauer, *supra* note 3, at 321 (noting that even different investors in the same security might focus on different financial measures of firm performance). There is a similar debate about the appropriate degree of subjectivity in other “reasonable person” standards — for example, in tort law. See, e.g., RICHARD A. EPSTEIN, *CASES AND MATERIALS ON TORTS* 179–80 (9th ed. 2008); Warren A. Seavey, *Negligence — Subjective or Objective?*, 41 HARV. L. REV. 1 (1927).

concern is subordinate to the fundamental presumption that owners of different types of securities will primarily focus on the types of claims on firm resources to which they are contractually entitled.

Nor would such an investment-specific materiality inquiry burden courts with too much litigation. At first blush, applying an investment-specific quantitative materiality standard could appear to increase litigation by allowing shareholders to bypass motions to dismiss more easily,<sup>56</sup> a result that could reduce the attractiveness of U.S. capital markets to potential issuers<sup>57</sup> or induce potential issuers to “bury the shareholders in an avalanche of trivial information,” as the *TSC Industries* Court feared.<sup>58</sup> But tailoring the materiality inquiry to the type of plaintiff investors is not necessarily plaintiff-friendly. The level of the quantitative materiality threshold (the 5% rule of thumb) is conceptually distinct from the metric to which that threshold is applied (e.g., total assets versus equity); indeed, it is possible to support a higher SEC threshold for quantitative materiality (say, 10% or 15%) while simultaneously supporting its investment-specific application.

*Hutchison* demonstrates that when courts apply materiality standards that do not address plaintiffs’ investment-specific perspectives, they undermine the purposes of the federal securities laws. Congress enacted the securities laws “to protect investors who were considering putting capital into the country’s financial markets from abuses by company insiders and market professionals . . . by encouraging full disclosure and deterring fraud.”<sup>59</sup> Similarly, it enshrined private rights of action by investors because these investors are, in many cases, best situated to pursue their own interests when they believe that a registrant did not fulfill its obligations under the securities laws.<sup>60</sup> To the extent that inapposite materiality standards — such as the Second Circuit’s “total assets” standard for CBRE stockholders — prevent plaintiffs from enforcing private rights of action, these standards undermine the broader statutory and regulatory scheme enacted to promote confidence in U.S. capital markets. Accordingly, courts should take care to use materiality standards that are relevant to the owners of the particular types of security at issue.

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<sup>56</sup> Specifically, shareholders could more easily bypass motions to dismiss because a firm’s equity value and net income are typically lower than its total asset value and operating income, thus establishing smaller bases for applying the quantitative materiality threshold.

<sup>57</sup> See, e.g., Hal S. Scott, *What is the United States Doing About the Competitiveness of Its Capital Markets?*, 22 J. INT’L BANKING L. & REG. 487, 488–89 (2007).

<sup>58</sup> *TSC Indus.*, 426 U.S. at 448.

<sup>59</sup> STEVEN J. CHOI & A.C. PRITCHARD, *SECURITIES REGULATION* 1 (2d ed. 2008).

<sup>60</sup> Cf. *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (noting that the Supreme Court has repeatedly emphasized that “private actions provide ‘a most effective weapon in the enforcement’ of the securities laws and are ‘a necessary supplement to [SEC] action’” (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964))).