No. _____

IN THE

Supreme Court of the United States

THE BLACKSTONE GROUP, L.P., STEPHEN A. SCHWARZMAN, MICHAEL A. PUGLISI, PETER J. PETERSON and HAMILTON E. JAMES,

Petitioners,

—v.—

MARTIN LITWIN, MAX POULTER, FRANCIS BRADY and LANDMEN PARTNERS, INC., Individually and on behalf of all others similarly situated,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether, in assessing the materiality of alleged omissions in a registration statement for an initial public offering, the court below, in conflict with the Third and Eighth Circuits, used an erroneous legal standard in (i) considering only whether the alleged omission related to a significant business segment of the issuer's business, ignoring the alleged omission's relationship to the issuer's business as a whole, thereby overriding the requirement of *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. ___, 131 S. Ct. 1309, 1321 (2011), that any omissions must "significantly" alter the total mix of investor information; (ii) discarding long-standing judicial and regulatory authority regarding the importance of quantitative analysis in making materiality determinations, including a rule of thumb that omissions affecting amounts less than 5% are likely immaterial; and (iii) impermissibly requiring issuers to flood investors with unnecessary and confusing detail, *id.* at 1318.

PARTIES TO THE PROCEEDING

Petitioners are The Blackstone Group, L.P., Stephen A. Schwarzman, Michael A. Puglisi, Peter J. Peterson and Hamilton E. James, defendants and appellees below.

Respondents are Martin Litwin, Max Poulter, Francis Brady and Landmen Partners, Inc., plaintiffs and appellants below, on behalf of themselves and all others similarly situated.

RULE 29.6 DISCLOSURE

The Blackstone Group L.P. ("Blackstone") has no parent corporation and no publicly held corporation owns ten percent (10%) or more of Blackstone's common units.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully seek a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The decision of the Court of Appeals is reported at 634 F.3d 706 and is reprinted in the Appendix to the Petition ("App.") at 1a-37a. The District Court's opinion is reported at 659 F. Supp. 2d 532 and is reprinted at App. 38a-65a.

JURISDICTIONAL STATEMENT

The Court of Appeals issued its decision on February 10, 2011, App. 1a, and denied a petition for rehearing and rehearing en banc on March 30, 2011. App. 66a-67a. The Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The pertinent text of Sections 11, 12 and 15 of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l* and 77o, and Item 303 of Regulation S-K, 17 C.F.R. § 229.303, are set forth in the appendix.

STATEMENT OF THE CASE

This is a putative class action alleging claims under Sections 11 and 12 of the Securities Act of 1933.[1] Respondents allege that the Registration Statement for Blackstone's June 2007 initial public offering (IPO) contained certain omissions.[2] The central issue here is whether the court below misapprehended the controlling legal standards in determining whether such omissions were material, thereby creating confusion and uncertainty in the capital markets.

The material facts are few and not in dispute.

1. Blackstone is structured as a partnership with publicly traded common units representing partnership interests. Its business is to manage investment funds and to provide financial advisory services. *See* App. 39a. As the District Court succinctly stated, Blackstone's investment management business "profitably invest[s] other peoples' money." App. 39a. As of May 1, 2007,

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[1] Respondents also assert claims under Section 15 of the Securities Act against the individual defendants. Both the Second Circuit and District Court noted that such claims are derivative of or necessarily dependent on Respondents' Section 11 and 12 claims, and thus rise or fall with these claims. App. 4a-5a n.1, 47a n.6.

[2] In addition to alleging omissions regarding two investments made by Blackstone private equity funds and regarding certain unspecified real estate investments made by Blackstone real estate funds, Respondents allege a single affirmative misstatement regarding the level of growth and liquidity of the United States real estate industry generally. App. 13a. This petition refers to alleged omissions because that is the gravamen of Respondents' complaint and because the presence of this alleged misstatement does not alter the materiality analysis.

Blackstone had $88.4 billion under management in a variety of hedge funds, corporate private equity funds, real estate funds, funds of hedge funds, mezzanine funds and closed-end mutual funds. App. 39a-40a. These funds are generally structured as limited partnerships that are capitalized by limited partner investors (such as university endowments and state and local government pension funds) and managed by Blackstone. App. 40a. Various funds have different strategies and target different assets for investment, but the private equity funds relevant here typically acquire equity interests in companies (which become known as portfolio companies) that the funds intend to resell at a later time for a profit, and return net proceeds of such investments to the funds' investors (limited partners). Each fund pays Blackstone a management fee equal to 1.5% of the value of assets under management, and, should the fund be profitable, a performance fee equal to 20% of the profits generated. App. 40a-41a. Performance fees may be "clawed-back" by limited partners if a fund subsequently performs poorly. App. 41a. In contrast to limited partners, which invest in the funds themselves, holders of Blackstone public common units (Respondents here) have a stake only in Blackstone itself as the investment manager and any management or performance fees it might earn. App. 41a.

2. Respondents allege Blackstone's Registration Statement for its IPO failed to disclose information regarding (i) two companies in which Blackstone-managed private equity funds had an equity interest, and (ii) unspecified real estate investments held by Blackstone-managed funds. App.

42a-45a. According to Respondents, these disclosures were mandated by Item 303 of Regulation S-K, "which requires an issuer such as Blackstone to '[d]escribe any known trends or uncertainties that have or that [it] reasonably expects will have a material favorable or unfavorable impact on new sales or revenues or income from continuing operations.'" App. 48a (quoting 17 C.F.R. § 229.303(a)(3)(ii)).

3. The District Court for the Southern District of New York (Baer, J.) had jurisdiction over this action pursuant to 15 U.S.C. § 77v and 28 U.S.C. §§ 1331 and 1337. Petitioners moved to dismiss Respondents' claims on the ground that the alleged omissions were immaterial. The District Court thoroughly analyzed the allegations under the materiality analysis set forth in the Securities and Exchange Commission's Staff Accounting Bulletin No. 99 ("SAB No. 99"). Regarding the two portfolio companies, *the District Court concluded that the alleged omissions related to only miniscule percentages of Blackstone's assets under management* and were both quantitatively and qualitatively immaterial. The court also concluded that Respondents' generalized allegations about the subprime residential real estate market failed to plausibly show, under *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 556 U.S. __, 129 S. Ct. 1937 (2009), that the alleged market troubles could have a foreseeable material effect on any real estate investments actually held by Blackstone funds.

4. The Second Circuit reversed. Contrary to the Third and Eighth Circuits, it declined to examine whether the alleged omissions regarding the two

portfolio companies were material to Blackstone's business as a whole, which is what plaintiff investors actually invested in. Nor did the court deny that the omissions affected less than 5% of Blackstone's assets under management, a figure that the staff of the Securities and Exchange Commission (SEC) has endorsed as the basis for an assumption of immateriality when beginning a materiality analysis. Instead, contrary to judicial and regulatory authority, the court relied upon a purely qualitative, segment-by-segment analysis. It said that the omissions were qualitatively material because they related to investments that were reported under business segments that played a "significant role" in Blackstone's business operations. App. at 29a-30a (Corporate Private Equity), 34a-35a (Real Estate). Simply put, the court reasoned that because the segment was significant in Blackstone's business, any omissions relating to investments reported within it could be material to Blackstone's business as a whole.

REASONS FOR GRANTING THE WRIT

1. Sections 11 and 12 of the Securities Act of 1933 prohibit material omissions in a registration statement and prospectus in connection with an IPO. The Court has made clear that the question of materiality must be assessed on a context-specific case-by-case basis, *e.g.*, *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. __, 131 S. Ct. 1309, 1321 (2011), and this Court plainly cannot police the application of law to fact in each case. Instead, the Court's resources are appropriately reserved for ensuring the clarity and soundness of the legal rules derived from the governing law. The rules

for decision invoked by the court below have no basis in the Act, conflict with decisions of this Court and the Third and Eighth Circuits, and eviscerate important SEC staff policy guidance regarding the importance of quantitative analysis in materiality determinations, all with the effect of creating considerable confusion in the capital markets.

2. (a) Ostensibly implementing the materiality requirement of Sections 11 and 12, the Second Circuit in fact undermined the Court's insistence in *Matrixx Initiatives*, 131 S. Ct. at 1321, that any omissions must be "*significant*[ ]" (emphasis in original) to be material by (i) holding, with no basis in the securities laws and in direct conflict with decisions of the Third and Eighth Circuits,[3] that the significance of any omissions should be assessed on a segment-by-segment basis of an issuer's business, rather than the issuer's business as a whole; (ii) discarding long-standing judicial and regulatory authority regarding the importance of quantitative analysis in making materiality determinations, including a rule of thumb that omissions affecting amounts less than 5% are likely immaterial;[4] (iii) rendering *Twombly* and *Iqbal* a nullity in the context of Section 11 and

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[3] *See In re Westinghouse Sec. Litig.*, 90 F.3d 696, 715 & n.16 (3d Cir. 1996) (Alito, J.); *Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 547 (8th Cir. 1997).

[4] Securities and Exchange Commission Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 12, 1999); *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 204 (2d Cir. 2009); *Higginbotham v. Baxter Int'l, Inc.*, 495 F.3d 753, 759 (7th Cir. 2007).

12 actions;[5] and (iv) contrary to *Matrixx Initiatives*, 131 S. Ct. at 1318, requiring issuers to flood investors with wholly unnecessary information.

(b) The Second Circuit's holding will cause considerable confusion and uncertainty both in the courts and for issuers seeking to determine what disclosures they are obligated to make. In *Matrixx Initiatives*, the Court, in the context of a Section 10(b) action under the Securities Exchange Act of 1934 and SEC Rule 10b-5, warned against formulaic reliance on statistical (quantitative) factors in determining materiality. Now, in the context of a claim under Sections 11 and 12 of the Securities Act of 1933 arising from an IPO, this Court's guidance is necessary as to the appropriate role of quantitative factors in determining whether omissions are "significant." This guidance is especially needed when the court below (i) created confusion and produced a circuit split with the Third and Eight Circuits by not evaluating the significance of the alleged omissions in the context of the issuer's business as a whole, and (ii) greatly intensified the impact of that confusion by effectively disregarding long-standing judicial and regulatory authority on quantitative materiality analysis. Although the court purported to acknowledge the 5% starting point for materiality analysis in form, in substance its holding means that there is *no* set of quantitative facts that could ever overcome the court's qualitative, segment-by-segment approach.

3. The legal issues raised by the petition are cleanly presented. The material facts are few and

[5] *Twombly*, 550 U.S. 544; *Iqbal*, 556 U.S. __, 129 S. Ct. 1937.

undisputed: *Purchasers of Blackstone common units in the IPO acquired interests in Blackstone's entire business, not in any of its individual business segments, in any of the funds that Blackstone manages or in any investments held by those funds*. The omissions alleged in the registration statement related only to two private equity investments and unspecified real estate investments made by Blackstone-managed funds (among the hundreds of such investments). No fraud or intentional deceit is alleged. Further factual development will not illuminate the relevant legal issues.[6]

4. Given the far reaching implications of the holding below, Petitioners submit that the Court's guidance is imperative. The smooth and efficient running of American capital markets is vital to the nation's economic health, and this is particularly true of the IPO market. The decision below creates confusion and uncertainty in that market. The importance of the holding below alone justifies review. *See Camreta v. Greene*, 563 U.S. __, 131 S. Ct. __, slip op. at 13 (May 26, 2011). But there is much more. The decision, as noted, conflicts with this Court's holding in *Matrixx Initia-*

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[6] The full importance of the Second Circuit's decision is even more apparent when the Court considers the structure of securities litigation. The Securities Act of 1933 imposes liability for material omissions in registration statements; Section 10(b) of the Exchange Act reinforces that liability. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-86 (1983). But there is an important difference: Section 10(b) actions require allegations of fraud-like conduct. *Id.* at 382. In contrast, no such conduct need be alleged under Sections 11 and 12 of the Securities Act. *Id.* Its regime approaches that of strict liability and on a potentially class-wide basis.

tives, decisions of the Third and Eighth Circuits, and an important SEC staff policy guideline. The result is confusion and uncertainty with respect to the applicable legal rules governing IPOs, as well as securities disclosures in other contexts. Capital markets do not thrive on such a state of affairs.

I. THE DECISION BELOW WILL CAUSE CONSIDERABLE CONFUSION AND UNCERTAINTY IN THE AMERICAN CAPITAL MARKETS

The importance of the Second Circuit's holding with respect to materiality, and the uncertainty and confusion that it will engender for issuers and investors, bears emphasis. The Second Circuit decision may require every public company to significantly increase its disclosure, both in the context of IPOs and other securities disclosures. Over the past decade, there have been an average of more than 100 IPOs per year.[7] In each one of

[7] Though this number reflects the continued importance of the American IPO market, it also reflects a dramatic reduction in IPOs in the United States when compared to the previous decade average of 500 IPOs each year. Jean Eaglesham, *U.S. Eyes New Stock Rules: Regulators Move Toward Relaxing Limits on Shareholders in Private Companies*, WALL ST. J., Apr. 8, 2011, at 1. This reflects a shift in the global IPO market away from the United States. *See* Stavros Peristiani, *Evaluating the Relative Strength of the U.S. Capital Markets*, Federal Reserve Bank of New York Current Issues in Economics and Finance, Vol. 13, No. 6, pp. 1-7, at 2 (July 2007) ("[R]ecent statistics point to a shrinking U.S. share of global IPOs."); Luigi Zingales, *Is the U.S. Capital Market Losing its Competitive Edge?* 1-43, at 5 (Eur. Corp. Governance Inst., Working Paper No. 192, 2007) (noting that the percentage of global IPOs listed in the United States decreased from 37% to 10% between 2000 and 2005). Even American companies are now increasingly opting to conduct

those, an issuer must comply with a variety of disclosure requirements, some of which are black-and-white and some of which involve the professional judgments of the issuer, its officers and directors, and their advisors. Among the most difficult disclosure requirements to satisfy are the open-ended requirements like Item 303 of Regulation S-K, which is at issue in this case. Basic principles of materiality are the only guide issuers have in evaluating whether information must or must not be disclosed subject to requirements like these. As *Matrixx Initiatives* demonstrates, the legal standards governing such determinations are of considerable importance to issuers, investors and capital markets; and this is especially so here because the importance of the Second Circuit's errors with respect to the materiality requirement is not limited to IPOs. The holding also will bear on the decisions issuers make in their regular periodic securities disclosure filings. Thousands of companies file, at minimum, quarterly and annual reports, each of which requires materiality assessments. The uncertainty and confusion introduced by the Second Circuit decision will leave the market with often inconsistent and significantly less useful disclosures, and discour-

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IPOs on foreign markets rather than in the United States. *See* Graham Bowley, *Fleeing to Foreign Shores*, N.Y. TIMES, June 8, 2011, at B1 (noting that 85 United States companies conducted IPOs outside the United States between 2000 and 2010 compared with two between 1991 and 1999). The shift of IPOs away from the United States to other markets mirrors an overall decrease of approximately 40% since 1997 of public companies listing in the United States. *Id.*; Aaron Lucchetti, *U.S. Falls Behind in Stock Listings*, WALL ST. J., May 26, 2011, at 1. The uncertainty engendered by the Second Circuit decision can only exacerbate this trend.

age issuers from listing their securities in the United States.

The court below adopted a new and erroneous legal standard for determining the materiality of alleged omissions in the registration statement for Blackstone's IPO. As a result, Blackstone faces potential liability for allegedly failing to disclose risks facing portfolio companies comprising slivers of its funds' investment portfolio. This is especially egregious since there are no allegations of fraud or other wrongdoing here. In a claim for securities fraud under the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, plaintiffs must allege and prove that defendants acted with scienter, a requirement that not only provides robust limits on defendants' ultimate liability but also serves as a screen at the pleading stage. In a Section 11 claim, by contrast, an issuer and its executives may face liability for even innocent misstatements, such as those alleged in this case. Section 11 approaches applying strict liability on issuers for misstatements or omissions, including failing to disclose information subject to SEC form disclosure requirements. Where issuers face strict liability for innocent misstatements, it is all the more important that the materiality standards applied by courts are clear. The Second Circuit, however, has thrown those standards into confusion.

The Second Circuit's new legal standard does not require evaluation of the materiality of alleged omissions as to the business operations of a securities registrant as a whole, but rather with reference to an individual business segment, if a particular business segment is alleged to play a

"significant role" in a registrant's business. This materiality standard invoked by the court below is contrary to the securities laws, including the very regulation allegedly setting forth Blackstone's disclosure obligation, Regulation S-K Item 303; it also is in direct conflict with the decisions of other courts of appeal. *Westinghouse*, 90 F.3d at 715 & n.16; *Parnes*, 122 F.3d at 547.

The Second Circuit's new materiality standard displaces any quantitative analysis, which is a highly relevant factor in a materiality inquiry, and eviscerates the 5% rule of thumb endorsed by courts and the staff of the SEC as a starting point for a materiality analysis. Under the Second Circuit's standard, an alleged omission as to one of Blackstone's business segments that would be immaterial if the business segment were a standalone company is nonetheless material as to Blackstone itself. Not only is this illogical, but it also overrides the requirement of *Matrixx Initiatives* that omissions must "*significantly* alter the 'total mix' " of investor information, and instead applies an impermissible bright-line rule. 131 S. Ct. at 1321 (emphasis in original). Moreover, the decision rejects this Court's cases that warn against requiring issuers to flood investors with unnecessary detail, of which *Matrixx Initiatives* is only the most recent. *See, e.g. TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976).

The standard for materiality applied by courts plays an important role in ensuring that securities issuers are not subject to liability for insignificant omissions. This is especially important in the context of Section 11 and 12 claims such as those here, where plaintiffs do not need to allege that

defendants acted with scienter or committed any conscious wrongdoing. The confusion created by the Second Circuit's decision will put issuers in an impossible position when making securities disclosures, with the ultimate effect of harming investors. The court below itself recognized that "the District Court and Blackstone raise the legitimate concern that plaintiffs' view of materiality would require companies like Blackstone to 'issue compilations of prospectuses for the scores of portfolio companies and real estate assets in which its private equity and real estate funds have any interest, . . . [which] would . . . obfuscate[ ] truly material information in a flood of unnecessary detail, a result that the securities laws forbid.' " App. 35a. But the court below offers no solution to the problem its decision creates. Faced with the standard for materiality set forth in the Second Circuit decision, an issuer must either overwhelm investors with minute details about the company, thereby obscuring significant information, or risk a lawsuit like the one Blackstone now faces. That result is harmful to reasonable investors who depend on receiving only important information that may affect their investment in the issuer as a whole. *TSC Indus.*, 426 U.S. at 449.

II. THE DECISION BELOW APPLIES THE WRONG MATERIALITY STANDARD

Under the Court's precedent, information is material (and omission of such information is actionable) only when "a *reasonable* investor would have viewed the nondisclosed information 'as having *significantly* altered the 'total mix' of information made available.' " *Matrixx Initiatives*, 131 S. Ct. at 1321 (quoting *Basic, Inc. v. Levinson*,

485 U.S. 224, 232 (1988); *TSC Indus.*, 426 U.S. at 449). In *Basic*, the Court held that where, as here, "contingent or speculative information or events" are at issue, "materiality 'will depend at any given time upon a *balancing of both the indicated probability* that the event will occur and the *anticipated magnitude* of the event in light of the totality of the company activity.'" *Basic*, 485 U.S. at 238 (emphasis added). *Matrixx Initiatives* reaffirmed this probability/magnitude analysis, although the facts of that decision required consideration only of the probability factor, because the anticipated magnitude of the contingent event was indisputably large. *See* 131 S. Ct. at 1323 ("Importantly, Zicam Cold Remedy allegedly accounted for 70 percent of Matrixx's sales.").

This case squarely concerns the importance of the magnitude prong of the *Basic* analysis: *whatever the probability of the alleged risks facing FGIC and Freescale*, the two portfolio investments that are the subject of the complaint, the *anticipated magnitude of such risks is tiny*. The worst possible risks facing FGIC and Freescale can render Blackstone's investment in these companies worthless, but have only a miniscule effect on Blackstone as a whole in light of the totality of Blackstone's operations. This point cannot be stressed enough. Yet, the Second Circuit squarely rejects consideration of "the anticipated magnitude of the event in light of the totality of the company activity" by looking at the alleged significance of the omissions to individual business segments of Blackstone rather than Blackstone as a whole.

Matrixx Initiatives recognizes the vital importance of a correct and clear understanding of the materiality requirement in the securities laws. The court below throws that standard into a state of confusion by holding that an issuer must disclose "any potentially adverse trends concerning a segment that constitute[s] nearly a quarter" of the issuer's business. App. at 34a-35a. Read literally, the decision entirely dispenses with a materiality requirement when an issuer reports several large segments for accounting purposes, as the Second Circuit adopts a standard that turns on the significance of the business segment, rather than on the non-disclosed information. Even reading the decision more narrowly, however, to construe materiality to mean any information significant to a large business segment rather than to the issuer as a whole, this segment-by-segment standard has no basis in the securities laws and is in conflict with the decisions of other circuits. Moreover, such a standard eviscerates any quantitative analysis of materiality, including the 5% rule of thumb endorsed by courts and the staff of the SEC.

A. The Second Circuit's Use Of A Segment-By-Segment Materiality Analysis Has No Basis In The Securities Laws And Is In Conflict With The Decisions Of Other Circuits

Approaching materiality from the perspective of individual business segments is inconsistent with the role materiality in fact plays in the securities laws. Material information is information that an investor would consider important in making a decision about whether or not to invest in the securities at issue. For this reason, the relevant

inquiry is whether information is material to the entity issuing such securities, not whether information is material only to a subdivision of the issuer. The Second Circuit decision replaces a logical one-step materiality inquiry evaluating the materiality of the omission to the issuer with an artificial two-step inquiry: (i) is the fact material to a subdivision of the issuer; and (ii) does that subdivision play a significant role in the issuer's business?

This approach must be rejected for several reasons.

(i) A segment-by-segment materiality analysis is contrary to Item 303 of Regulation S-K, which is the alleged source of Blackstone's disclosure obligation. App. 21a. As the SEC's interpretive release regarding Item 303 clarifies, "A disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on *the registrant's* financial condition or results of operation."[8] In fact, Item 303 requires disclosure of segment information only "[w]here in the registrant's judgment a discussion of segment information or of other subdivisions of the registrant's business would be appropriate to an understanding of such business." 17 C.F.R. § 229.303(a).

(ii) The Second Circuit's application of a segment-by-segment materiality analysis is also in direct conflict with the decisions of other courts of

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[8] Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 43 SEC Docket 1330 (May 18, 1989) (emphasis added).

appeal. In *Parnes*, 122 F.3d at 544, plaintiffs alleged that defendants overstated accounts receivable by $6.8 million. To take this amount "in context," the Eighth Circuit compared this overstatement to defendant's total assets, not accounts receivable or some other slice of the company, and found that a 2% overstatement was immaterial. In *Westinghouse*, then-Judge Alito of the Third Circuit considered the size of alleged omissions in the context of the defendant's entire enterprise, and dismissed allegations arising from omissions regarding the defendant's loan portfolio involving, at most, 1.2% of the defendant's total assets. 90 F.3d at 714-15, 715 n.16.

(iii) Finally, while the Second Circuit purports to derive its segment-by-segment analysis from a qualitative factor listed in the SEC's SAB No. 99, that guidance is in fact directly at odds with the materiality standard adopted by the Second Circuit. As discussed more fully below, SAB No. 99 urges the consideration of both quantitative and qualitative factors in evaluating the materiality of a misstatement. One of these qualitative factors is "whether the misstatement concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability." Quite clearly, however, this qualitative factor is *not* an open-ended invitation to transform an analysis of the materiality of misstatements from the issuer as a whole to an analysis of the materiality of misstatements to particular business segments, as the Second Circuit decision suggests. Rather, SAB No. 99 urges that when evaluating this qualitative factor, not only must the issuer and its financial statements be considered "as a whole," but the

size of the misstatement also must continue to factor into the analysis:

> [I]n assessing materiality of a misstatement to the financial statements taken as a whole, registrants and their auditors should consider not only the size of the misstatement but also the significance of the segment information to the financial statements taken as a whole.

64 Fed. Reg. 45,150, 45,152 (Aug. 12, 1999).

The stated purpose of this qualitative factor is also at odds with the Second Circuit's decision. SAB No. 99 states that the purpose of this factor is to capture misstatements and omissions that are significant to small but important business segments: "A misstatement of the revenue and operating profit of a relatively small segment that is represented by management to be important to the future profitability of the entity is more likely to be material to investors." *Id.* The purpose is *not*, as the Second Circuit held, to overemphasize minor omissions relating to an issuer's largest business segments.

The consequences of the Second Circuit's mistaken legal analysis are strikingly illustrated by this very case. FGIC, one of the two portfolio companies mentioned in the complaint, represented only 0.4% of Blackstone's total assets under management, and only approximately 1% of the Corporate Private Equity segment's assets under management. Yet the Second Circuit found omissions related solely to FGIC to be material to Blackstone because the Corporate Private Equity segment plays a "significant role" in Blackstone's business. Although stating elsewhere that "not

every portfolio company or real estate asset in which Blackstone invests will be deemed material," App. 36a, the court offers no distinction between FGIC and the scores of other companies and real estate assets in which Blackstone private equity and real estate funds invest, the vast majority of which are larger than FGIC.

Moreover, the Second Circuit's decision leads to an inherently illogical result. If Blackstone's Corporate Private Equity segment were a standalone firm, FGIC would represent 1% of its assets under management, well below the 5% threshold for presumptive immateriality (as discussed more fully below). One can therefore assume that FGIC would not be material if the Corporate Private Equity segment were a standalone firm, but under the Second Circuit decision, FGIC is material within the larger Blackstone organization. This is inherently illogical, and renders the materiality element of Section 11 claims a nullity.

At bottom, the Second Circuit's holding must rely on an impermissible bright-line rule that any alleged omissions related to a "significant" business segment are per se material. As the Court has repeatedly and recently held, bright-line rules are inappropriate to materiality analyses. A bright-line rule that certain omissions *are* material is just as inappropriate as a bright-line rule that certain omissions *are not* material, like the rule rejected in *Matrixx Initiatives*. In *Matrixx Initiatives* the Court considered a rule that adverse event reports that do not rise to the level of statistical significance are never material. 131 S. Ct. at 1318. Noting the long-standing precedent that "[a]ny approach that designates a single fact or

occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive," the Court resoundingly rejected the proposed bright-line rule. *Id.* at 1318-19 (quoting *Basic*, 485 U.S. at 236).

Ultimately, the Second Circuit decision expands disclosure requirements well beyond the materiality standard set forth by this Court in *TSC Industries* and *Basic*. The court found that both the Corporate Private Equity and Real Estate segments played "significant role[s]" in Blackstone's business. As discussed above, this conclusion with respect to Blackstone's Real Estate segment was based solely on the size of the segment. App. 34a-35a. But companies frequently report operating results of several large segments of a relative size comparable to Blackstone's Corporate Private Equity and Real Estate segments. Under the decision, all such issuers would face the segment-by-segment analysis applied to Blackstone here, because the size of these segments alone satisfies the "significant role" requirement. This would render Section 11's limitation of liability to *material* misstatements or omissions a nullity, not just with respect to Blackstone but for thousands of other companies that report results in several large segments.

B. The Second Circuit Materiality Standard Renders Any Quantitative Analysis Of Materiality A Nullity

Before adopting its erroneous segment-by-segment materiality analysis, the Second Circuit agreed with the District Court that the alleged

omissions were quantitatively immaterial, as Blackstone funds' investments in each portfolio company, FGIC and Freescale, fell below the 5% threshold that the staff of the SEC and various courts of appeal have endorsed as a starting point for a materiality analysis. App. at 27a.[9] In SAB No. 99 the staff of the SEC urged consideration of both quantitative and qualitative factors in assessing materiality, and noted that "[t]he use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that—without considering all relevant circumstances—a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material." 64 Fed. Reg. 45,150, 45,151 (Aug. 12, 1999); *see also JP Morgan*, 553 F.3d at 197 ("SAB No. 99 suggests a percentage threshold below which the amount is presumptively immaterial."); *Higginbotham*, 495 F.3d at 759 ("[S]ecurities lawyers often use a 5% change as a rule-of-thumb approach to what is 'material.' ").

However, in the guise of applying one of the qualitative factors listed in SEC staff guidance, the Second Circuit decision renders any quantitative analysis a nullity and eviscerates any 5% rule of thumb. If, for example, a plaintiff could allege an omission relating to 5% of a business

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[9] Specifically, FGIC represented 0.4% and Freescale allegedly represented 3.6% of Blackstone's assets under management at the time of the IPO. App. at 52a-53a. The Second Circuit decision implicitly found the same regarding the alleged real estate investments that were the subject of the Complaint. App. at 12a n.6 (finding that up to 3.4% of Blackstone's assets under management might consist of residential real estate assets).

segment that in turn comprised a quarter of an issuer, that omission would be material under the Second Circuit decision even though the omission would relate to only 1.25% of the company as a whole. If an even smaller business segment were found to play a "significant role" in an issuer's business, such as one comprising 10% of an issuer, an omission relating to 5% of that segment would be material even though it relates to only 0.5% of the company as a whole. By allowing the denominator of the quantitative analysis to be so easily manipulated, the Second Circuit decision renders this analysis meaningless. As a result, the Second Circuit was able to find that risks related to FGIC could be material to Blackstone, even though a quantitative analysis demonstrates that the greatest possible effect of these risks coming to fruition would be miniscule with respect to Blackstone's entire company.[10] Because the Second Circuit's flawed segment-by-segment materiality analysis renders any quantitative considerations a nullity, there is no set of facts that would have convinced the Second Circuit that the omissions here were immaterial.

Discarding any quantitative analysis is all the more inappropriate here because the only alleged effect on Blackstone from losses on its investments was purely economic. Respondents allege that when investments by Blackstone funds in

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[10] As noted above, in *Basic* the Court has set forth a probability/magnitude test where alleged omissions are of "contingent or speculative information or events." 485 U.S. at 238. *Matrixx Initiatives* reaffirmed this probability/magnitude analysis. 131 S. Ct. at 1323. In conflict with these decisions, the Second Circuit decision rejects any consideration of the magnitude of the risks alleged.

portfolio companies or real estate assets increase in value, Blackstone earns performance fees, and that losses on these investments cause Blackstone to earn reduced fees or to return previously earned fees. In other words, a risk that may cause a portfolio company or real estate asset to lose value matters to Blackstone only in so far as such reduction in value causes the performance fees earned by Blackstone to change. Because this is the only alleged effect that a risk facing FGIC may ever have on Blackstone itself, whether information about FGIC is material to Blackstone investors depends primarily on the size of FGIC relative to Blackstone's investment portfolio as a whole. Blackstone's position as an investment manager is not much different from a person with investments in scores of stocks in a brokerage account. Such a person would care much more about information about a company in which twenty percent of her portfolio is invested than another company in which she has less than half of one percent of her portfolio invested.

C. The Second Circuit Explicitly Applies An Erroneous Pleading Standard And Turns The *Twombly* Plausibility Standard Into A Possibility Test

As the Sixth Circuit recently noted in *Frank v. Dana Corp.*, No. 09–4233, 2011 WL 2020717, at *5 (6th Cir. May 25, 2011), *Matrixx Initiatives* confirms again that the allegations of a complaint must be viewed as a whole. In the context of Sections 11 and 12 actions, no other rule is possible if the demands of *Twombly* and *Iqbal* are to have meaning. These decisions recognize that defending

unwarranted lawsuits impose unjustifiable burdens and expense on both defendants and the courts. To avoid such costs, these decisions demand that the face of the complaint itself allege a *plausible* basis for liability. *Twombly*, 550 U.S. at 557-60; *Iqbal*, 129 S. Ct. at 1949-50. On its face, this complaint alleges no *plausible* basis for a conclusion that the alleged omissions were material to petitioner's business as a whole—which is what investors invested in. The court below concluded otherwise only because it filtered the allegations through a set of erroneous legal standards, which were infected with an erroneous understanding of the relevant pleading standards.

Twombly and *Iqbal* require that a complaint show plausible—not merely possible—grounds that a plaintiff is entitled to relief. *Twombly*, 550 U.S. at 556. "[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged—but it has not 'show[n]'—'that the pleader is entitled to relief.' " *Iqbal*, 129 S.Ct. at 1950 (citing Fed. R. Civ. P. 8(a)(2)). Here, it is undisputed that Respondents are only "entitled to relief" if the omissions they allege are material. There is therefore no basis for applying a lower pleading standard to the materiality element of Section 11 and 12 claims, particularly because such claims approach strict liability for material misstatements or omissions. Yet that is exactly what the Second Circuit did:

> In this case . . . plaintiffs need only satisfy the basic notice pleading requirements of Rule 8. So long as plaintiffs plausibly allege that Blackstone omitted material

> information that it was required to disclose or made material misstatements in its offering documents, they meet the relatively minimal burden of stating a claim pursuant to Sections 11 and 12(a)(2), under which, should plaintiffs' claims be substantiated, Blackstone's liability as an issuer is absolute. *Where the principal issue is materiality, an inherently fact-specific finding, the burden on plaintiffs to state a claim is even lower.*

App. 25a (emphasis added). By stating that the standard for pleading materiality of alleged misstatements or omissions is "even lower" than that set forth by Federal Rule of Civil Procedure 8, the Second Circuit decision is explicitly in conflict with *Twombly* and *Iqbal*. Although the court cited *Twombly* and *Iqbal*, it quite clearly did not follow them. The Second Circuit does not define what this lower pleading standard is, but the resulting materiality analysis in its decision makes clear that the Second Circuit effectively turned the *Twombly*/*Iqbal* plausibility standard into no more than a possibility test, one which would require a defendant to demonstrate that it would be impossible to find alleged misstatements or omissions material. This is the very holding that *Twombly* and *Iqbal* reject.

D. The Second Circuit Decision Requires Disclosure Of A Flood Of Unnecessary Information, Which Is Expressly Forbidden By This Court's Controlling Precedent

By finding any omissions relating to investments in Blackstone's Corporate Private Equity and Real Estate segments material, the Second Circuit decision may effectively require Blackstone and a host of public companies like it to disclose minute details about their major business segments, and inundate investors with so much information that truly important information is obscured. In so doing, the Second Circuit decision disregards the long line of cases warning against flooding investors with unnecessary detail. *See, e.g.*, *TSC Indus.*, 426 U.S. at 448.

Recognizing the danger of excessively detailed disclosure, the court offers only illusory protections: "as in all bases for liability under Sections 11 and 12(a)(2), the omitted information must be material." App. 35a-36a. But this simply illuminates the problem with the court's low materiality standard. The materiality requirement plays an important gatekeeping function in regulating the scope of disclosure requirements. The Second Circuit's decision significantly contracts the reasonable limits that the materiality requirement is designed to place on an issuer's disclosure obligations. *See TSC Indus.*, 426 U.S. at 448 ("[I]f the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause

it simply to bury the shareholders in an avalanche of trivial information."); *Matrixx*, 131 S. Ct. at 1318 ("We were 'careful not to set too low a standard of materiality,' for fear that management would ' "bury the shareholders in an avalanche of trivial information." ' "). Though the court below professes that "not every portfolio company or real estate asset in which Blackstone invests will be deemed material," App. 36a, this cannot be reconciled with its holding regarding, for example, FGIC, which represented 0.4% of assets under management. The court offers nothing to distinguish FGIC from the scores of other investments that are also reported within the Corporate Private Equity segment, or the hundreds of investments reported within the Real Estate segment.[11]

[11] The Second Circuit decision also suggests that protection arises from the fact that omissions are actionable only where disclosure is required, such as by a regulatory requirement like Item 303. App. 36a. But as a clever plaintiff can cast any omission from a registration statement as a "trend, event, or uncertainty" under the Second Circuit's holding, the suggestion that Item 303 provides protection to issuers is no comfort at all.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 2011

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2010

Argued: August 25, 2010
Decided: February 10, 2011

Docket No. 09-4426-cv

MARTIN LITWIN, MAX POULTER, FRANCIS BRADY, and LANDMEN PARTNERS, INC., Individually and on behalf of all others similarly situated,

Plaintiffs-Appellants,

—v.—

THE BLACKSTONE GROUP, L.P., STEPHEN A. SCHWARZMAN, MICHAEL A. PUGLISI, PETER J. PETERSON, and HAMILTON E. JAMES,

*Defendants-Appellees.**

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* The Clerk of the Court is directed to amend the official caption as set forth above.

Before:

MINER, CABRANES, and STRAUB,
Circuit Judges.

Plaintiffs Appellants appeal from a judgment of the United States District Court for the Southern District of New York (Harold Baer, Jr., *Judge*), entered on September 25, 2009, dismissing plaintiffs' putative securities class action complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim. We conclude that the District Court erred in dismissing plaintiffs' complaint because plaintiffs plausibly allege that material information was omitted from, or misstated in, defendants' initial public offering registration statement and prospectus in violation of Sections 11 and 12(a)(2) of the Securities Act of 1933. VACATED AND REMANDED.

DAVID A.P. BROWER, Brower Piven, PC, New York, NY (Caitlin M. Moyna, Brower Piven, PC, and Samuel H. Rudman, David A. Rosenfeld, and Mark M. Millkey, Robbins Geller Rudman & Dowd LLP, Melville, NY, *on the brief*), *for Plaintiff-Appellants*.

BRUCE D. ANGIOLILLO, Simpson Thacher & Bartlett LLP (Jonathan K. Youngwood, *on the brief*), New York, NY, *for Defendants-Appellees*.

STRAUB, *Circuit Judge*:

Plaintiffs-Appellants appeal from a judgment of the United States District Court for the Southern District of New York (Harold Baer, Jr., *Judge*), entered on September 25, 2009, dismissing plaintiffs' putative securities class action complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim. *See Landmen Partners Inc. v. Blackstone Group, L.P.*, 659 F. Supp. 2d 532 (S.D.N.Y. 2009). We conclude that the District Court erred in dismissing plaintiffs' complaint because plaintiffs plausibly allege that material information was omitted from, or misstated in, defendants' initial public offering registration statement and prospectus in violation of Sections 11 and 12(a)(2) of the Securities Act of 1933. Accordingly, we vacate the District Court's judgment and remand for further proceedings.

BACKGROUND

Because this is an appeal from a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the following facts, which we assume to be true, are drawn from plaintiffs' Consolidated Amended Class Action Complaint as filed on October 27, 2008. *See Slayton v. Am. Express Co.*, 604 F.3d 758, 766 (2d Cir. 2010). Where relevant, however, we include information from Securities and Exchange Commission ("SEC") filings by the Blackstone Group, L.P. ("Blackstone") to which plaintiffs refer in their complaint, particularly the Form S-1 Registration Statement ("Registration Statement") and Prospectus filed by Blackstone in connection with its June 21, 2007 initial public

offering ("IPO"). *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007) ("[C]ourts must consider the complaint in its entirety, as well as other sources . . . , in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice."); *see also ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 (2d Cir. 2007) ("[W]e may consider . . . legally required public disclosure documents filed with the SEC, and documents possessed by or known to the plaintiff and upon which it relied in bringing the suit.").

Lead plaintiffs Martin Litwin, Max Poulter, and Francis Brady, appointed by the District Court on September 15, 2008, bring this putative securities class action on behalf of themselves and all others who purchased the common units of Blackstone at the time of its IPO. Plaintiffs seek remedies under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77k, 77l(a)(2), 77o, for alleged material omissions from, and misstatements in, Blackstone's Registration Statement and Prospectus.[1] Defendants are Black-

[1] Defendants correctly point out that plaintiffs did not refer to their control-person liability claims under Section 15 of the Securities Act, which were dismissed by the District Court, in their opening brief on appeal. Typically, we consider challenges to district court rulings not raised on appeal to be abandoned. *See, e.g.*, *Major League Baseball Props. Inc. v. Salvino, Inc.*, 542 F.3d 290, 294 (2d Cir. 2008); *Hobbs v. County of Westchester*, 397 F.3d 133, 147 (2d Cir. 2005), *cert. denied*, 546 U.S. 815 (2005); *see also* Fed. R. App. P. 28(a)(9). However, in this case, the District Court did not make a particular ruling on plaintiffs' Section 15 claims. Rather, the District Court mentioned the Section 15 claims only once, noting that they were "derivative" of plaintiffs'

stone and Blackstone executives Stephen A. Schwarzman, Michael A. Puglisi, Peter J. Peterson, and Hamilton E. James (collectively referred to herein as "Blackstone").

Blackstone is "a leading global alternative asset manager and provider of financial advisory services" and "one of the largest independent alternative asset managers in the world," with total assets under management of approximately $88.4 billion as of May 1, 2007. Blackstone is divided into four business segments: (1) Corporate Private Equity, which comprises its management of corporate private equity funds; (2) Real Estate, which comprises its management of general real estate funds and internationally focused real estate funds; (3) Marketable Alternative Asset Management, which comprises its management of hedge funds, mezzanine funds, senior debt vehicles, proprietary hedge funds, and publicly traded closed-end mutual funds; and (4) Financial Advisory, which comprises a variety of advisory services. The Corporate Private Equity segment constitutes approximately 37.4% of Blackstone's total assets under management ($33.1 billion of $88.4 billion), and the Real Estate segment constitutes approx-

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Section 11 claims. *Landmen Partners*, 659 F. Supp. 2d at 539 n.6. The District Court then addressed plaintiffs' Section 11 and 12(a)(2) claims on the merits, and, finding them lacking, dismissed all of plaintiffs' claims. *Id.* at 547. Because plaintiffs' Section 15 claims are necessarily dependent on their Section 11 and 12(a)(2) claims, *see* 15 U.S.C. § 77o; *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 358 (2d Cir. 2010), and were treated as such by the District Court, we decline to find that plaintiffs abandoned their Section 15 claims by failing to specifically refer to the claims in their opening brief.

imately 22.6% of Blackstone's assets under management ($20 billion of $88.4 billion). According to Blackstone, "[b]oth the corporate private equity fund and the two real estate opportunity funds (taken together) . . . are among the largest funds ever raised in their respective sectors." Blackstone further represents to prospective investors that its "long-term leadership in private equity has imbued the Blackstone brand with value that enhances all of [its] different businesses and facilitates [its] ability to expand into complementary new businesses."

In preparation for its 2007 IPO, Blackstone reorganized its corporate structure. Prior to the IPO, Blackstone's business was operated through a large number of separately owned predecessor entities. On March 12, 2007, just prior to the launch of the IPO, Blackstone was formed as a Delaware limited partnership and eventually became the sole general partner of five newly formed holding partnerships into which the majority of the operating predecessor entities were contributed. Blackstone receives a substantial portion of its revenues from two sources: (1) a 1.5% management fee on its total assets under management and (2) performance fees of 20% of the profits generated from the capital it invests on behalf of its limited partners. Under certain circumstances, when investments perform poorly, Blackstone may be subject to a "claw-back" of already paid performance fees, in other words, the required return of fees which it had already collected.

On March 22, 2007, Blackstone filed its Form S-1 Registration Statement with the SEC for the IPO. Blackstone filed several amendments to its

Registration Statement, and the Prospectus, which formed part of the Registration Statement, finally became effective on June 21, 2007. At this time, 153 million common units of Blackstone were sold to the public, raising more than $4.5 billion. The individual defendants and other Blackstone insiders received nearly all of the net proceeds from the IPO.

Plaintiffs principally allege that, at the time of the IPO, and unbeknownst to non-insider purchasers of Blackstone common units, two of Blackstone's portfolio companies as well as its real estate fund investments were experiencing problems. Blackstone allegedly knew of, and reasonably expected, these problems to subject it to a claw-back of performance fees and reduced performance fees, thereby materially affecting its future revenues.

FGIC Corporation

In 2003, a consortium of investors that included Blackstone purchased an 88% interest in FGIC Corp. ("FGIC"), a monoline financial guarantor, from General Electric Co. for $1.86 billion. FGIC is the parent company of Financial Guaranty, which primarily provides insurance for bonds. Although municipal bond insurance traditionally constituted the majority of Financial Guaranty's business, in the years leading up to Blackstone's IPO it began writing "insurance" on collateralized debt obligations ("CDOs"),[2] including CDOs

[2] "CDOs are diversified collections of bonds that are divided into various risk groups and then sold to investors as securities." *Slayton v. Am. Express Co.*, 460 F.3d 215, 219 n.3 (2d Cir. 2006).

backed by sub-prime mortgages to higher-risk borrowers. Financial Guaranty also began writing "insurance" on residential mortgage-backed securities ("RMBSs")[3] linked to non-prime and sub-prime mortgages. This "insurance" on RMBSs and CDOs was in the form of credit default swaps ("CDSs").[4]

By the summer of 2007, FGIC, as a result of Financial Guaranty's underwriting practices, was exposed to billions of dollars in non-prime mortgages, with its total CDS exposure close to $13 billion. From mid-2004 through mid-2007, factors including rising interest rates, the adjustment of interest rates on sub-prime mortgages, and a sub-

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[3] RMBSs are "a type of asset-backed security—that is, a security whose value is derived from a specified pool of underlying assets. Typically, an entity (such as a bank) will buy up a large number of mortgages from other banks, assemble those mortgages into pools, securitize the pools (i.e., split them into shares that can be sold off), and then sell them, usually as bonds, to banks or other investors." *Gearren v. McGraw-Hill Cos.*, 690 F. Supp. 2d 254, 258 n.2 (S.D.N.Y. 2010).

[4] CDSs "are contracts that provide protection against the credit risk of a particular company. The seller of a CDS agrees to pay the buyer a specific sum of money, called the notional amount, if a credit event, such as bankruptcy, occurs in the referenced company. . . . In exchange for this risk protection from the CDS seller, the CDS buyer agrees to make periodic premium payments during the course of the contract. The CDS buyer can use the CDS to provide protection, like insurance, against the possibility that the debt instruments the buyer holds will seriously deteriorate in value because of a credit event in the referenced company." *SEC v. Rorech*, 720 F. Supp. 2d 367, 370–71 (S.D.N.Y. 2010); *see also Aon Fin. Prods., Inc. v. Societe Generale*, 476 F.3d 90, 92 n.1 (2d Cir. 2007).

stantial slowing of property-value appreciation (and in some markets, property-value depreciation) caused many borrowers to be unable to refinance their existing loans when they could not meet their payment obligations. As a result, beginning in 2005, there was a significant increase in mortgage-default rates, particularly for sub-prime mortgage loans. By early 2007, before the IPO, some of the top mortgage lenders with sub-prime mortgage exposure began revealing large losses and warned of future market losses. All of these symptoms, plaintiffs allege, provided a strong indication that the problems plaguing sub-prime lenders would generate substantial losses for FGIC on the CDSs it issued to its counterparties. This likelihood was allegedly exacerbated because, in many instances, FGIC's CDS-counterparties were able to demand accelerated payments from FGIC even before a default event occurred on the underlying referenced assets.

Blackstone's 23% equity interest in FGIC was worth approximately $331 million at the time of the IPO. Plaintiffs allege that, due to this significant interest, Blackstone was required to disclose the then-known trends, events, or uncertainties related to FGIC's business that were reasonably likely to cause Blackstone's financial information not to be indicative of future operating results. Following the IPO, in a March 10, 2008 press release, Blackstone announced its full-year and fourth-quarter 2007 earnings. The company's Corporate Private Equity segment reported 2007 revenues of $821.3 million, down 18% from 2006 revenues. "Most significantly, Blackstone reduced

the value of its portfolio investment in [FGIC], . . . which accounted for $122.2 million, or 69%, of the decline in revenues for the year." Blackstone reported that its "Corporate Private Equity fourth quarter revenues of ($15.4) million were negative, as compared with revenues of $533.8 million for the fourth quarter of 2006," a change "driven primarily by decreases in the value of Blackstone's portfolio investment in [FGIC] . . . and lower net appreciation of portfolio investments in other sectors as compared with the prior year."

Freescale

Freescale Semiconductor, Inc. ("Freescale"), is a semiconductor designer and manufacturer. In 2006, Blackstone invested $3.1 billion in Freescale, the single largest investment by a Blackstone corporate private equity fund since 2004. The Freescale investment accounted for 9.4% of the Corporate Private Equity segment's assets under management and 3.5% of Blackstone's total assets under management.[5]

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[5] There is some ambiguity in the record as to exactly how much of the $3.1 billion was invested directly by Blackstone-sponsored funds. The Registration Statement includes a footnote that states, with respect to all portfolio companies, that the amount of equity invested "includes equity invested by limited partner co-investors and additional equity invested by limited partners of our corporate private equity funds outside of our corporate private equity funds." However, the Registration Statement's chart indicating the amount of equity invested in various corporate private equity fund portfolio companies does not describe the investment amount in any more detail. Moreover, although Blackstone states in its brief that plaintiffs "use an erroneous $3.1

Shortly before the IPO, in March 2007, Freescale lost an exclusive agreement to manufacture wireless 3G chipsets for its largest customer, Motorola, Inc. ("Motorola"). The loss of this exclusive agreement followed two years of manufacturing and production problems for Freescale. On April 25, 2007, Freescale's management held an analysts' call, on which it stated that "revenue[s] in our wireless business were negatively impacted by a sales decline due to weak demand in our largest customer Motorola. . . . During the last several weeks of the quarter, our main wireless customer began to reduce their orders." Plaintiffs allege that "[t]hese adverse facts[ ] had a material adverse effect on Freescale's business and, concomitantly, the material corporate private equity fund controlled by Blackstone." Plaintiffs argue that Blackstone was required to disclose this material adverse development in its Registration Statement.

Real Estate Investments

As noted above, Blackstone's Real Estate segment constitutes 22.6% of its total assets under management. Although the parties seem to agree

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billion figure," and further asserts that Blackstone's investment was "*a fraction* of the total [$3.1 billion] equity invest[ment]," nowhere does Blackstone specify the precise amount invested by Blackstone-sponsored funds and the record does not support any amount other than $3.1 billion. Accordingly, because this is a motion to dismiss, we draw the reasonable inference in favor of plaintiffs that Blackstone's equity investment in Freescale was the full $3.1 billion. *See Elec. Trading Group, LLC v. Banc of Am. Sec. LLC*, 588 F.3d 128, 133 (2d Cir. 2009), *cert. denied*, 130 S. Ct. 3276 (2010).

that the majority of Blackstone's real estate investments were non-residential in nature, the Registration Statement provides that its "real estate opportunity funds have made a significant number of investments in lodging, major urban office buildings, residential properties, distribution and warehousing centers and a variety of real estate operating companies." Moreover, Blackstone concedes that its real estate funds maintained at least one "modest-sized residential real estate investment." There is no indication in the record, however, of the exact dollar amount of Blackstone's residential real estate investment(s), and thus it is not possible to discern the exact percentage of the Real Estate segment's assets under management attributable to residential properties.[6]

As detailed above with respect to FGIC, several factors were causing the real estate and mortgage securities markets to deteriorate by the time of the IPO, including the adverse effects of a series of negative developments in the credit markets. Thus, plaintiffs allege, it was foreseeable that Blackstone would have performance fees clawed back in connection with its real estate invest-

[6] The Registration Statement does disclose that "over 85% of the investments of [Blackstone's] real estate opportunity funds are in office building and hotel assets," *i.e.*, commercial real estate. It is unclear, however, whether that means that the remaining 15% of Blackstone real estate investments are in residential real estate, which would amount to a $3 billion investment. Such an investment, in addition to being 15% of the assets under management in the Real Estate segment, would be 3.4% of Blackstone's total assets under management.

ments and that Blackstone would not generate additional performance fees on those investments.

In addition to Blackstone's alleged material omission of information related to the downward trend in the real estate market and its likely impact on Blackstone's real estate investments, plaintiffs allege that the Registration Statement included the following affirmative material misstatement:

> The real estate industry is also experiencing historically high levels of growth and liquidity driven by the strength of the U.S. economy . . . and the availability of financing for acquiring real estate assets. . . . The strong investor demand for real estate assets is due to a number of factors, including persistent, reasonable levels of interest rates . . . and the ability of lenders to repackage their loans into securitizations, thereby diversifying and limiting their risk. These factors have combined to significantly increase the capital committed to real estate funds from a variety of institutional investors.

GAAP and Risk Disclosure Allegations

Plaintiffs' complaint includes additional allegations that are related to, and in many ways overlap with, the allegations detailed above. First, they allege that Blackstone's unaudited financial statements for the three-month periods ending March 31, 2007, and March 31, 2006, respectively, which were included in the Registration Statement, violated generally accepted accounting prin-

ciples ("GAAP") and materially overstated the values of Blackstone's real estate investments and its investment in FGIC. Plaintiffs also allege that Blackstone's disclosure of certain risk factors was too general and failed to inform investors adequately of the then-existing specific risks related to the real estate and credit markets.

Procedural History and District Court Opinion

The initial complaint was filed in the District Court by Landmen Partners, Inc., on April 15, 2008. On September 15, 2008, the District Court appointed Martin Litwin, Max Poulter, and Francis Brady as lead plaintiffs, and on October 27, 2008, the lead plaintiffs filed the operative, Consolidated Amended Class Action Complaint. Blackstone filed a motion to dismiss the complaint on December 4, 2008, and, following oral argument, the District Court granted the motion, with prejudice, in an opinion dated September 22, 2009. *See Landmen Partners Inc. v. Blackstone Group, L.P.*, 659 F. Supp. 2d 532 (S.D.N.Y. 2009).

The District Court's opinion primarily focused on the materiality of the alleged omissions and misstatements concerning FGIC, Freescale, and Blackstone's real estate investments. First, the District Court analyzed the relative scale or quantitative materiality of the alleged FGIC and Freescale omissions. After noting our (and the SEC's) acceptance of a 5% threshold as an appropriate "starting place" or "preliminary assumption" of immateriality, the District Court noted that "Blackstone's $331 million investment in FGIC represented a mere 0.4% of Blackstone's [total] assets under management at the time of

the IPO."[7] *Id.* at 541 (citing *ECA & Local 134 IBEW Joint Pension Trust v. JP Morgan Chase Co.*, 553 F.3d 187, 204 (2d Cir. 2009)). The District Court then addressed plaintiffs' argument that the materiality of the omissions is best illustrated by the effect the eventual $122.2 million drop in value of Blackstone's FGIC investment had on Blackstone's 2007 annual revenues. *Id.* The District Court found that while the decline in FGIC's investment value may have been significant relative to the Corporate Private Equity segment's annual revenues, it was quantitatively immaterial as compared with Blackstone's $3.12 billion in total revenues for 2007.[8] *Id.*

The District Court next looked at the quantitative materiality of the Freescale omissions, again comparing Blackstone's investment to its total assets under management. The court stated that "the $3.1 billion investment in Freescale represented 3.6% of the total $88.4 billion the Company had under management at the time of the IPO." *Id.* The District Court did not mention that the investment in Freescale accounted for 9.4% of the Corporate Private Equity segment's $33.1 billion of assets under management. The District Court found it significant that the complaint did not (and likely could not) allege that Freescale's loss

[7] The investment accounted for approximately 1% of the Corporate Private Equity segment's assets under management.

[8] The District Court incorrectly stated that the "$122 million write down for FGIC was a mere 0.4% of Blackstone's $3.12 billion in annual revenue." *Landmen Partners*, 659 F. Supp. 2d at 541. In fact, $122 million is nearly 4% of $3.12 billion.

of its exclusive supplier relationship with Motorola would cause Blackstone's investment in Freescale to lose 100% of its value. *Id.* at 542.

The District Court then pointed to the structure of the Blackstone enterprise as further support for the immateriality of the alleged omissions. According to the District Court, because the performance of individual portfolio companies only affects Blackstone's revenues after investment gains or losses are aggregated at the fund level, the poor performance of one investment may be offset by the strong performance of another. *Id.* Accordingly, "there is no way to make a principled distinction between the negative information that Plaintiff[s] claim[ ] was wrongfully omitted from the Registration Statement and information . . . about every other portfolio company." *Id.* The District Court found that requiring disclosure of information about particular portfolio companies or investments would risk "obfuscat[ing] truly material information in a flood of unnecessary detail, a result that the securities laws forbid." *Id.*

Next, recognizing that a quantitative analysis is not dispositive of materiality, the District Court found that only one of the qualitative factors that we, or the SEC, often consider were present in this case. Specifically, the court found that: (1) none of the omissions concealed unlawful transactions or conduct; (2) the alleged omissions did not relate to a significant aspect of Blackstone's operations; (3) there was no significant market reaction to the public disclosure of the alleged omissions; (4) the alleged omissions did not hide a failure to meet analysts' expectations; (5) the alleged omissions did not change a loss into income or vice versa;

and (6) the alleged omissions did not affect Blackstone's compliance with loan covenants or other contractual requirements. The District Court noted that the one qualitative factor it found present in this case—that the alleged omissions had the effect of increasing Blackstone's management's compensation—was not enough, by itself, to make the omissions material. *Id.* at 543–44. Accordingly, the District Court held that the alleged omissions concerning FGIC and Freescale were immaterial as a matter of law. *Id.* at 544.

The District Court then separately analyzed the alleged omissions and misstatements regarding Blackstone's real estate investments. The District Court first noted that the complaint failed to "identify a single real estate investment or allege a single fact capable of linking the problems in the subprime residential mortgage market in late 2006 and early 2007 and the roughly contemporaneous decline in home prices (which are well-documented by the [complaint]) to Blackstone's real estate investments, 85% of which were in commercial and hotel properties." *Id.* According to the District Court, without further factual enhancement as to how the troubles in the residential mortgage markets could have a foreseeable material effect on Blackstone's real estate investments, plaintiffs' allegations fell short of the plausibility standard set forth in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007). In addition, the District Court found that plaintiffs had failed to allege any facts that, if true, would render false those statements alleged to be affirmative misrepresentations. The District Court further found that insofar as plaintiffs alleged that Blackstone

was required to disclose general market conditions, such omissions are not actionable because Sections 11 and 12(a)(2) do not require disclosure of publicly available information: "The omission of generally known macro-economic conditions is not material because such matters are already part of the 'total mix' of information available to investors." *Landmen Partners*, 659 F. Supp. 2d at 545. Finally, the District Court noted that the complaint contained no allegations that Blackstone knew that market conditions "were reasonably likely to have a material effect on *its* portfolio of real estate investments," *id.* at 545, and stated that "generalized allegations that problems brewing in the market at large made it 'foreseeable' that a particular set of unidentified investments would sour are insufficient to 'nudge[ ] [the] claims across the line from conceivable to plausible,'" *id.* at 546 (alterations in original) (quoting *Twombly*, 550 U.S. at 570). The District Court's opinion concluded with a brief analysis of the GAAP allegations. The District Court found that because those allegations were largely derivative of plaintiffs' other allegations, they were insufficient to state a claim for essentially the same reasons that the primary allegations failed. Accordingly, the District Court granted Blackstone's motion to dismiss and dismissed plaintiffs' claims with prejudice. Judgment was entered in favor of Blackstone on September 25, 2009. Plaintiffs filed a timely notice of appeal on October 23, 2009.

DISCUSSION

Standard of Review

"We review de novo the dismissal of a complaint under Rule 12(b)(6), accepting all factual allegations as true and drawing all reasonable inferences in favor of the plaintiff." *ECA & Local 134*, 553 F.3d at 196. "To survive a motion to dismiss, a complaint must plead enough facts to state a claim to relief that is plausible on its face." *Id.* (internal quotation marks omitted). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. __, 129 S. Ct. 1937, 1949 (2009).

Notably, plaintiffs' complaint explicitly does not allege fraud; rather, it alleges that Blackstone acted negligently in preparing its Registration Statement and Prospectus. *See Rombach v. Chang*, 355 F.3d 164, 171 (2d Cir. 2004) ("Fraud is not an element or a requisite to a claim under Section 11 or Section 12(a)(2) . . . . [A] plaintiff need allege no more than negligence to proceed under Section 11 and Section 12(a)(2) . . . ."). Moreover, Blackstone does not argue on appeal that plaintiffs' claims are premised on allegations of fraud. Accordingly, as pleaded, plaintiffs' claims are not subject to the heightened pleading standard of Federal Rule of Civil Procedure 9(b). *See id.* (holding that Rule 9(b)'s heightened pleading standard applies to claims under Section 11 and Section 12(a)(2) only "insofar as the claims are premised on allegations of fraud"). Stated differently, this is an ordinary notice pleading case, subject only to

the "short and plain statement" requirements of Federal Rule of Civil Procedure 8(a).

Sections 11 and 12(a)(2) of the Securities Act

Section 11 of the Securities Act imposes liability on issuers and other signatories of a registration statement that, upon becoming effective, "contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). Section 12(a)(2) imposes liability under similar circumstances on issuers or sellers of securities by means of a prospectus. *See id.* § 77l(a)(2). So long as a plaintiff establishes one of the three bases for liability under these provisions—(1) a material misrepresentation; (2) a material omission in contravention of an affirmative legal disclosure obligation; or (3) a material omission of information that is necessary to prevent existing disclosures from being misleading, *see In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 360 (2d Cir. 2010)—then, in a Section 11 case, "the general rule [is] that an issuer's liability . . . is absolute." *In re Initial Pub. Offering Sec. Litig.*, 483 F.3d 70, 73 n.1 (2d Cir. 2007); *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 381–82 (1983) ("[Section 11] was designed to assure compliance with the disclosure provisions of the [Securities] Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering. . . . Although limited in scope, Section 11 places a relatively minimal burden on a plaintiff." (footnote omitted)). The primary issue before us is the second basis for liability; that is, whether

Blackstone's Registration Statement and Prospectus omitted material information that Blackstone was legally required to disclose.[9]

Required Disclosures Under Item 303 of Regulation S-K

Plaintiffs principally contend that Item 303 of SEC Regulation S-K, 17 C.F.R. § 229.303(a)(3)(ii), provides the basis for Blackstone's disclosure obligation. Pursuant to Subsection (a)(3)(ii) of Item 303, a registrant must "[d]escribe any known trends or uncertainties . . . that the registrant reasonably expects will have a material . . . unfavorable impact on . . . revenues or income from continuing operations." Instruction 3 to paragraph 303(a) provides that "[t]he discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition." 17 C.F.R. § 229.303(a) instruction 3. The SEC's interpretive release regarding Item 303 clarifies that the Regulation imposes a disclosure duty "where a trend, demand, commitment, event or uncertainty is both [1] presently known to management and [2] reasonably likely to have material effects on the registrant's financial condition or results of operations." Management's Discussion and Analysis of Financial Condition and Results of Operations,

[9] There is, of course, the additional issue of the alleged material misstatements related to Blackstone's affirmative disclosures about the strength of the real estate market at the time of the IPO. We will address those alleged misstatements below.

Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 43 SEC Docket 1330 (May 18, 1989) [hereinafter MD&A].

Although the District Court opinion and the parties on appeal primarily focus on the materiality of Blackstone's alleged omissions, Blackstone does urge that plaintiffs' complaint fails to adequately allege that Blackstone was required by Item 303 to disclose trends in the real estate market for the purpose of Sections 11 and 12(a)(2). We disagree. Plaintiffs allege that the downward trend in the real estate market was already known and existing at the time of the IPO, and that the trend or uncertainty in the market was reasonably likely to have a material impact on Blackstone's financial condition. Therefore, plaintiffs have adequately pleaded a presently existing trend, event, or uncertainty, and the sole remaining issue is whether the effect of the "known" information was "reasonably likely" to be material for the purpose of Item 303 and, in turn, for the purpose of Sections 11 and 12(a)(2).

Legal Standard of Materiality

Materiality is an "inherently fact-specific finding," *Basic Inc. v. Levinson*, 485 U.S. 224, 236 (1988), that is satisfied when a plaintiff alleges "a statement or omission that a reasonable investor would have considered significant in making investment decisions," *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 161–62 (2d Cir. 2000) (citing *Basic*, 485 U.S. at 231).[10] "[T]here must be a sub-

[10] Although *Ganino* addresses materiality in the context of claims brought pursuant to Section 10(b) of the Secu-

stantial 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." *Id.* at 162 (alteration in original) (internal quotation marks omitted). However, "it is not necessary to assert that the investor would have acted differently if an accurate disclosure was made." *Id.* Rather, when a district court is presented with a Rule 12(b)(6) motion, "'a complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.'" *Id.* (quoting *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985)); *see also TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976) (noting that even at the summary judgment stage, the "determination [of materiality] requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact").

"[W]e have consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation." *Ganino*, 228 F.3d at 162; *see also ECA & Local 134 IBEW Joint Pension Trust v. JP Morgan Chase Co.*, 553 F.3d 187, 204 (2d Cir. 2009) ("While *Ganino* held that bright-line numerical tests for materiality are

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rities Exchange Act of 1934, the test for materiality is the same when claims are brought pursuant to Sections 11 and 12(a)(2) of the Securities Act. *See Rombach*, 355 F.3d at 178 n.11.

inappropriate, it did not exclude analysis based on, or even emphasis of, quantitative considerations.”). In both *Ganino* and *ECA & Local 134*, we cited with approval SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (1999) [hereinafter SAB No. 99], which provides relevant guidance regarding the proper assessment of materiality. *See ECA & Local 134*, 553 F.3d at 197–98; *Ganino*, 228 F.3d at 163–64.

As the SEC stated,

> [t]he use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that . . . a deviation of less than the specified percentage with respect to a particular item . . . is unlikely to be material. . . . But quantifying, in percentage terms, the magnitude of a misstatement . . . cannot appropriately be used as a substitute for a full analysis of all relevant considerations.

SAB No. 99, 64 Fed. Reg. at 45,151; *see also ECA & Local 134*, 553 F.3d at 204 (noting that a “five percent numerical threshold is a good *starting place* for assessing . . . materiality” (emphasis added)). Accordingly, a court must consider “both ‘quantitative’ and ‘qualitative’ factors in assessing an item’s materiality,” SAB No. 99, 64 Fed. Reg. at 45,151, and that consideration should be undertaken in an integrative manner. *See Ganino*, 228 F.3d at 163; *see also In re Kidder Peabody Sec. Litig.*, 10 F. Supp. 2d 398, 410–11 (S.D.N.Y. 1998); SAB No. 99, 64 Fed. Reg. at 45,152 (“Qualitative

factors may cause misstatements of quantitatively small amounts to be material . . . .").

In this case, the District Court confronted a Rule 12(b)(6) motion, a motion for which plaintiffs need only satisfy the basic notice pleading requirements of Rule 8. So long as plaintiffs plausibly allege that Blackstone omitted material information that it was required to disclose or made material misstatements in its offering documents, they meet the relatively minimal burden of stating a claim pursuant to Sections 11 and 12(a)(2), under which, should plaintiffs' claims be substantiated, Blackstone's liability as an issuer is absolute. Where the principal issue is materiality, an inherently fact-specific finding, the burden on plaintiffs to state a claim is even lower. Accordingly, we cannot agree with the District Court at this preliminary stage of litigation that the alleged omissions and misstatements "are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Ganino*, 228 F.3d at 162 (internal quotation marks omitted).

Materiality of Omissions Related to FGIC and Freescale

As to the materiality of the omissions related to FGIC and Freescale, Blackstone first argues that the relevant information was public knowledge, and thus could not be material because it was already part of the "total mix" of information available to investors. Specifically, Blackstone contends that, as the complaint itself alleges based on citations to news articles and analysts' calls, the shift in FGIC's strategy toward a less

conservative approach to bond insurance and Freescale's loss of its exclusive contract with Motorola were facts publicly known at the time of the IPO.

It is true that, as a general matter, the "'total mix' of information may . . . include information already in the public domain and facts known or reasonably available to [potential investors]." *United Paperworkers Int'l Union v. Int'l Paper Co.*, 985 F.2d 1190, 1199 (2d Cir. 1993) (internal quotation marks omitted); *see also Garber v. Legg Mason, Inc.*, 537 F. Supp. 2d 597, 612 (S.D.N.Y. 2008) (holding that defendants had no duty under the securities laws to disclose the publicly reported departure of an asset manager), *aff'd*, 347 F. App'x 665 (2d Cir. 2009) (summary order). But case law does not support the sweeping proposition that an issuer of securities is never required to disclose publicly available information. *See, e.g.*, *Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 213, 215 (5th Cir. 2004) (holding that the "definition of 'material' under Section 11 is not strictly limited to information that is firm-specific and non-public" and noting that "the SEC requires an issuer to disclose certain 'trends' that could affect its business, and in appropriate circumstances this requirement may extend to certain trends that are not firm-specific or are publicly available"); *United Paperworkers*, 985 F.2d at 1199 (stating that "the mere presence in the media of sporadic news reports . . . should not be considered to be part of the total mix of information that would clarify or place in proper context the company's representations in its proxy materials"); *see also Kronfeld v. Trans World Airlines, Inc.*, 832

F.2d 726, 736 (2d Cir. 1987) ("There are serious limitations on a corporation's ability to charge its stockholders with knowledge of information omitted from a document such as a . . . prospectus on the basis that the information is public knowledge and otherwise available to them."), *cert. denied*, 485 U.S. 1007 (1988).

In this case, the key information that plaintiffs assert should have been disclosed is whether, and to what extent, the particular known trend, event, or uncertainty might have been reasonably expected to materially affect Blackstone's investments. And this potential future *impact* was certainly not public knowledge, particularly in the case of FGIC, which was not even mentioned in Blackstone's Registration Statement and thus cannot be considered part of the "total mix" of information already available to investors. Again, the focus of plaintiffs' claims is the required disclosures under Item 303—plaintiffs are not seeking the disclosure of the mere fact of Blackstone's investment in FGIC, of the downward trend in the real estate market, or of Freescale's loss of its exclusive contract with Motorola. Rather, plaintiffs claim that Blackstone was required to disclose the manner in which those then-known trends, events, or uncertainties might reasonably be expected to materially impact Blackstone's future revenues.

While it is true that Blackstone's investments in FGIC and Freescale fall below the presumptive 5% threshold of materiality, we find that the District Court erred in its analysis of certain qualitative factors related to materiality. First, the District Court and Blackstone place too much emphasis on

Blackstone's structure and on the fact that a loss in one portfolio company might be offset by a gain in another portfolio company. Blackstone is not permitted, in assessing materiality, to aggregate negative and positive effects on its performance fees in order to avoid disclosure of a particular material negative event. *Cf.* SAB No. 99, Fed. Reg. at 45,153 (noting in the context of aggregating and netting multiple misstatements that "[r]egistrants and their auditors first should consider whether each misstatement is material, irrespective of its effect when combined with other misstatements"). Were we to hold otherwise, we would effectively sanction misstatements in a registration statement or prospectus related to particular portfolio companies so long as the net effect on the revenues of a public private equity firm like Blackstone was immaterial. The question, of course, is not whether a loss in a particular investment's value will merely affect revenues, because even after aggregation of gains and losses at the fund level, it will almost certainly have some effect. The relevant question under Item 303 is whether Blackstone reasonably expects the impact to be material. We see no principled basis for holding that an historically "private" equity company that has chosen to go public is somehow subject to a different standard under the securities disclosure laws and regulations than a traditional public company with numerous subsidiaries. *See* Mohsen Manesh, *Legal Asymmetry and the End of Corporate Law*, 34 Del. J. Corp. L. 465, 482 (2009) (noting that Blackstone, as a publicly listed entity, is "substantively indistinguishable from [its] publicly traded corporate counterparts"). In a case of

pure omissions, to the extent that the securities laws require information to be disclosed and the information in question is material in the eyes of a reasonable investor, Blackstone must disclose the information. Blackstone's structure is no defense on a motion to dismiss.[11]

Second, the District Court erred in finding that the alleged omissions did not relate to a significant aspect of Blackstone's operations. In discussing "considerations that may well render material a quantitatively small misstatement," SAB No. 99 provides that "materiality . . . may turn on where [the misstatement] appears in the financial statements:" "[S]ituations may arise . . . where the auditor will conclude that a matter relating to segment information is qualitatively material even though, in his or her judgment, it is quantitatively immaterial to the financial statements taken as a whole." SAB No. 99, 64 Fed. Reg. at 45,152. SAB No. 99 also provides that one factor affecting qualitative materiality is whether the misstatement or omission relates to a segment that plays a "significant role" in the registrant's business. *Id.* In this case, Blackstone makes clear in its offering documents that Corporate Private Equity is its flagship segment, playing a significant role in the company's history, operations, and value. Blackstone states that its Corporate Private Equity fund is "among the largest . . . ever raised," and that its "long-term leadership in pri-

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[11] Blackstone would certainly be free to argue before a jury that its structure renders the omissions related to FGIC and Freescale immaterial. We simply hold that Blackstone's structure does not permit a finding of immateriality as a matter of law.

vate equity has imbued the Blackstone brand with value that enhances all of [its] different businesses and facilitates [its] ability to expand into complementary new businesses." Because Blackstone's Corporate Private Equity segment plays such an important role in Blackstone's business and provides value to all of its other asset management and financial advisory services, a reasonable investor would almost certainly want to know information related to that segment that Blackstone reasonably expects will have a material adverse effect on its future revenues. Therefore, the alleged misstatements and omissions relating to FGIC and Freescale were plausibly material.

Furthermore, with respect to Freescale in particular, Blackstone's investment in the company accounted for 9.4% of the Corporate Private Equity segment's assets under management, and the investment was nearly three times larger than the next largest investment in that segment as reported in Blackstone's Prospectus. Even where a misstatement or omission may be quantitatively small compared to a registrant's firm-wide financial results, its significance to a particularly important segment of a registrant's business tends to show its materiality. *See In re Kidder Peabody*, 10 F. Supp. 2d at 410–11 (noting that while amount of "false profits may have been minor compared to GE's earnings as a whole, they were quite significant to" a subsidiary's profits, which, "in turn, represented a significant portion of GE's balance sheet"). Viewed in that light, we cannot hold that the alleged loss of Freescale's exclusive contract with its largest customer and the concomi-

tant potential negative impact on one of the largest investments in Blackstone's Corporate Private Equity segment was immaterial.

Finally, the District Court failed to consider another relevant qualitative factor—that the omissions "mask[ ] a change in earnings or other trends." SAB No. 99, 64 Fed. Reg. at 45,152. Such a possibility is precisely what the required disclosures under Item 303 aim to avoid. Here, Blackstone omitted information related to FGIC and Freescale that plaintiffs allege was reasonably likely to have a material effect on the revenues of Blackstone's Corporate Private Equity segment and, in turn, on Blackstone as a whole. Blackstone's failure to disclose that information masked a reasonably likely change in earnings, as well as the trend, event, or uncertainty that was likely to cause such a change.

All of these qualitative factors, together with the District Court's correct observation that the alleged omissions "doubtless had 'the effect of increasing management's compensation,'" *see* SAB No. 99, 64 Fed. Reg. at 45,152, show that the alleged omissions were material. Accordingly, we hold that plaintiffs have adequately pleaded that Blackstone omitted material information related to FGIC and Freescale that it was required to disclose under Item 303 of Regulation S-K.

Materiality of Omissions and Misstatements Related to Real Estate Investments

We also find that the District Court erred in its analysis of the alleged omissions and misstatements related to Blackstone's real estate investments. First, the District Court's opinion implies

that to state a plausible claim, plaintiffs' complaint had to identify specific real estate investments made or assets held by Blackstone funds that might have been at risk as a result of the then-known trends in the real estate industry. *See Landmen Partners Inc. v. Blackstone Group, L.P.*, 659 F. Supp. 2d 532, 545–46 (S.D.N.Y. 2009). This expectation, however, misses the very core of plaintiffs' allegations, namely, that Blackstone omitted material information that it had a duty to report. In other words, plaintiffs' precise, actionable allegation is that Blackstone failed to disclose material details of its real estate investments, and specifically that it failed to disclose the manner in which those unidentified, particular investments might be materially affected by the then-existing downward trend in housing prices, the increasing default rates for sub-prime mortgage loans, and the pending problems for complex mortgage securities. That is all Item 303 requires in order to trigger a disclosure obligation: a known trend that Blackstone reasonably expected would materially affect its investments and revenues. Plaintiffs allege that they were unaware of, but legally entitled to disclosure of, the very information that the District Court held had to be specified in plaintiffs' complaint.

Moreover, there are two problems with the District Court's finding that plaintiffs' claims fail because they cannot establish any "link[ ]" between the declining residential real estate market and Blackstone's heavy investments in commercial real estate. *See id.* at 544. First, the offering documents indicate, and Blackstone admits, that Blackstone has at least one modest-sized residential real estate investment, and,

drawing all reasonable inferences in plaintiffs' favor, its residential real estate holdings might constitute as much as $3 billion and 15% of the Real Estate segment's assets under management. *See supra* n.6. This alone is enough on a Rule 12(b)(6) motion to establish a plausible link between the alleged trend in the residential real estate market and Blackstone's real estate investments. Second, even if the overwhelming majority of Blackstone's real estate investments are commercial in nature, it is certainly plausible for plaintiffs to allege that a collapse in the residential real estate market, and, more importantly, in the market for complex securitizations of residential mortgages, might reasonably be expected to adversely affect commercial real estate investments. Blackstone's own disclosures in its Registration Statement make this link clear, given that it admits that "the ability of lenders to repackage their [residential] loans into securitizations" is one factor contributing to the "significant[ ] increase [in] the capital committed to [predominantly commercial] real estate funds."

Finally, the District Court erred when it stated that "Plaintiff[s] fail[ ] to allege any *facts* . . . that if true, would render false the few statements alleged to be affirmative misrepresentations." *Landmen Partners*, 659 F. Supp. 2d at 544. To the contrary, plaintiffs provide significant factual detail about the general deterioration of the real estate market and specific facts that, drawing all reasonable inferences in plaintiffs' favor, directly contradict statements made by Blackstone in its Registration Statement. First, the chart in plaintiffs' complaint illustrating the seasonally adjusted price change in the U.S. housing market

contradicts Blackstone's representation that the "real estate industry [was]. . . experiencing historically high levels of growth," because the chart shows that the rate of price appreciation began to decline significantly beginning in late 2005. In addition, Blackstone's representation that "strong investor demand for real estate assets is due [in part] to . . . persistent, reasonable levels of interest rates" is refuted by plaintiffs' allegations that "[a]s key short-term and the prime rates rose [beginning in June 2004], other interest rates rose as well, including those for most residential mortgage loans" and that "[t]his rise in interest rates made it more difficult for borrowers to meet their payment obligations." Also, Blackstone's statement that "lenders [were able] to repackage their loans into securitizations, thereby diversifying and limiting their risk," is at least impliedly refuted by plaintiffs' detailed allegations as to how the increasing sub-prime mortgage loan defaults were going to impact negatively the existing and future uses of, and value associated with, CDOs, RMBSs, and CDSs.

Absent these errors, the materiality of the alleged omitted and misstated information related to Blackstone's real estate investments becomes clear. First, Blackstone's real estate segment played a "significant role," SAB No. 99, 64 Fed. Reg. at 45,152, in Blackstone's business. While Blackstone's real estate segment may not be as prominent to the company's traditional identity as its Corporate Private Equity segment, Blackstone's real estate segment nevertheless constituted 22.6% of Blackstone's total assets under management. A reasonable Blackstone investor

may well have wanted to know of any potentially adverse trends concerning a segment that constituted nearly a quarter of Blackstone's total assets under management. Second, the alleged misstatements and omissions regarding real estate were qualitatively material because they masked a potential change in earnings or other trends. Finally, the alleged misstatements and omissions, if proven, had "the effect of increasing management's compensation," *id.* For all these reasons, we conclude that the District Court erred in dismissing plaintiffs' allegations relating to Blackstone's real estate investments. Plaintiffs plausibly allege that Blackstone omitted material information that it was required to disclose and that it made material misstatements in its IPO offering documents.

With regard to all of the alleged omissions and misrepresentations, the District Court and Blackstone raise the legitimate concern that plaintiffs' view of materiality would require companies like Blackstone to "issue compilations of prospectuses for the scores of portfolio companies and real estate assets in which its private equity and real estate funds have any interest." Although, as the District Court correctly noted, "[i]ncluding all such information would . . . obfuscate[ ] truly material information in a flood of unnecessary detail, a result that the securities laws forbid," *id.* at 542 (citing *I. Meyer Pincus & Assocs. v. Oppenheimer & Co.*, 936 F.2d 759, 762 (2d Cir. 1991)), we are not persuaded that such a concern is warranted in this case because of two protections from that result. First, as in all bases for liability under Sections 11 and 12(a)(2), the omitted information

must be material. Although materiality is undoubtedly a flexible concept due to its fact-specific nature, it is still capable of some defined boundaries. And needless to say, not every portfolio company or real estate asset in which Blackstone invests will be deemed material. Moreover, in the area of pure omissions, disclosure of the information must be required. Here, plaintiffs adequately plead that Item 303 of Regulation S-K requires Blackstone to disclose the omitted information, but without that regulatory requirement Blackstone would be under no obligation to disclose even material information. Thus, it is only when there is both materiality and a duty to disclose that a company may be held liable for omitting information from a registration statement or prospectus. These requirements provide sufficient protection against the opening-of-the-floodgates argument advanced by Blackstone and accepted by the District Court.

Additional Allegations and Denial of Leave to Amend

We conclude by briefly addressing two remaining issues presented by this appeal. First, as to plaintiffs' remaining allegations, we find, as did the District Court, that plaintiffs' GAAP allegations "are essentially derivative of those discussed above," *id.* at 546, although we, in turn, conclude that these allegations are sufficient to state a claim for largely the same reasons. In addition, although the District Court did not specifically address plaintiffs' risk disclosure allegations, we similarly conclude that these allegations are derivative of those already discussed and, accord-

ingly, those claims are also reinstated upon remand.

Second, we do not reach the issue whether the District Court exceeded its allowable discretion by dismissing plaintiffs' complaint without providing leave to amend. However, we note that where, as here, leave to amend is requested informally in a brief in opposition to a motion to dismiss, we have held that it is within the district "court's discretion to deny leave to amend implicitly by not addressing the request." *In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187, 220 (2d Cir. 2006).

CONCLUSION

In sum, we hold that the District Court erred in dismissing for failure to state a claim plaintiffs' complaint brought pursuant to Sections 11, 12(a)(2), and 15 of the Securities Act because (1) plaintiffs plausibly allege that Blackstone omitted from its Registration Statement and Prospectus material information related to its investments in FGIC and Freescale that Blackstone was required to disclose under Item 303 of Regulation S-K; (2) plaintiffs plausibly allege that Blackstone both omitted material information that it was required to disclose under Item 303 and made material misstatements in its offering documents related to its real estate investments; and (3) plaintiffs' remaining GAAP and risk disclosure allegations are derivative of their primary allegations, and therefore these secondary allegations are sufficient to state a claim. Accordingly, we vacate the District Court's judgment and remand for further proceedings.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 08-CV-3601 (HB)
September 22, 2009

LANDMEN PARTNERS INC., Individually and On Behalf of All Others Similarly Situated,

Plaintiff,

—v.—

THE BLACKSTONE GROUP, L.P., et al,

Defendants.

David Avi Rosenfeld, Samuel Howard Rudman, Coughlin Stoia Geller Rudman & Robbins, LLP, Melville, NY, Jack Gerald Fruchter, Abraham Fruchter & Twersky LLP, New York, NY, for Plaintiff.

Bruce Domenick Angiolillo, Jonathan K. Youngwood, Paul Jacob Sirkis, Simpson Thacher & Bartlett LLP, New York, NY, for Defendants.

OPINION & ORDER

HAROLD BAER, JR., District Judge.

Plaintiff Landman Partners Inc. ("Plaintiff") brings this putative securities class action on behalf of all purchasers of common "units" (*i.e.* limited partnership interests) in The Blackstone Group L.P. ("Blackstone" or the "Company"), pursuant or traceable to Blackstone's June 25, 2007 initial public offering (the "IPO" or the "Offering"). Consolidated Amended Class Action Complaint ("CAC") ¶¶ 2, 20. Plaintiff alleges that in connection with the IPO, Blackstone and certain of its executives (collectively, "Defendants") caused the Registration Statement and Prospectus issued in connection with the IPO (collectively, the "Offering Documents") to contain materially false and/or misleading statements in violation of Sections 11 and 12(a) of the Securities Act of 1933 (the "Act"), 15 U.S.C. §§ 77k and 77*l*. Defendants move to dismiss the CAC for failure to state a claim pursuant to Fed.R.Civ.P. 12(b)(6). For the reasons that follow, Defendants' motion is GRANTED.

I. FACTUAL BACKGROUND

A. Blackstone's Business

Blackstone is a self-described "leading global alternative asset manager and provider of financial advisory services"; at root, the Company's business is to profitably invest other peoples' money. CAC ¶ 2. As of May 1, 2007, Blackstone had $88.4 billion "under management" in a variety of hedge funds, corporate private equity funds,

funds of hedge funds, mezzanine funds, closed-end mutual funds.[1] CAC ¶ 27; Decl. of Jonathon K. Youngwood, dated December 4, 2008 ("Youngwood Decl."), Ex. A ("Reg.Stmt.") at 2. These various funds are generally structured as limited partnerships that are capitalized by limited-partner investors (such as institutional investors and pension funds) and managed by Blackstone, which, through subsidiary holding partnerships, serves as general partner.

Blackstone thus does not own directly either the various portfolio companies in which its corporate private equity funds invest or the real estate assets owned by its real estate funds.[2] Rather, Blackstone derives revenue from two principal sources: (1) it earns a "management fee" equal to 1.5% of the value of the assets under management; and (2) it earns a "performance fee" or "carried interest" equal to of 20% of the profits

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[1] Blackstone's business is organized into four segments: (1) corporate private equity, which focuses on management of the Company's private equity funds; (2) real estate, which is responsible for management of Blackstone's various real estate investment funds; (3) "marketable alternative asset management," which involves management of Blackstone's various hedge funds, mezzanine funds, and other "alternative" investment vehicles; and (4) the financial advisory group, which comprises the Company's advisory services business that provides, for example, merger and acquisition analysis and services to other companies. CAC ¶ 31; Reg. Stmt. at 2.

[2] Although Blackstone does invest some of its own funds in the various investments that it manages, as of May 1, 2007, such funds represented a mere 6% of the total assets under management. *See* Registration Statement at 158.

generated on the capital it invests for limited partners. CAC ¶ 33. Blackstone is subject, however, to having its performance fees "clawed-back." That is, the Company is obligated to return performance fees to investors if investments perform poorly. CAC ¶ 33. In contrast to those who invest in Blackstone's various funds, investors in Blackstone itself acquire a stake in Blackstone's investment management business, hoping that strong performance by the various investment funds will generate performance fees for the Company.

B. The IPO

On March 22, 2007, Blackstone filed with the SEC a Form S-1 Registration Statement ("Registration Statement") for the IPO, and thereafter filed certain amendments thereto. CAC ¶ 34. On June 21, 2007, the Prospectus became effective and 153 million of Blackstone's common units were sold to the public at $31 per unit, thereby raising more than $4.5 billion, much of which was used to purchase the ownership interests from Blackstone's then-existing owners (*i.e.* senior management including the individual named defendants). CAC ¶ 36; Registration Statement at 20-21. As of the date the initial complaint was filed in this action, on April 15, 2008, Blackstone common units traded between $17.00 and $17.50 per unit. Class Action Complaint ¶ 33. By the time the Consolidated Amended Complaint ("CAC") was filed on October 27, 2008, the units traded for approximately $7.75 per unit. CAC ¶ 8.

C. Alleged Misrepresentations and Omissions

The gravamen of Plaintiff's CAC is that the Registration Statement "misrepresented and failed to disclose that certain of the Company's portfolio companies were not performing well and were of declining value," such that there was a "real, palpable and almost certain risk that the Company would be subject to a claw-back of performance fees and reduced performance fees." CAC ¶¶ 7, 40. More specifically, the CAC alleges that had the Registration Statement not been negligently prepared, it would have disclosed adverse facts about the following three Blackstone investments.

1. *FGIC*

FGIC is in the business of insuring bonds issued by other entities; it is a monoline financial guarantor. CAC ¶ 41. According to the CAC, Blackstone "owns" a 23% equity stake in FGIC.[3] According to the CAC, between 2003 and 2007 FGIC moved away from its traditional and generally more conservative business of insuring municipal bonds towards the much riskier business of insuring collateralized debt obligations ("CDOs"), including CDO's backed by subprime mortgages and "synthetic" CDOs backed by credit default swaps, a

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[3] Blackstone avers that it does not "own" a 23% equity stake in FGIC, but rather that one of its private equity funds invested approximately $332 million to acquire an a 23% stake in the company in a transaction pursuant to which a consortium of investors acquired a collective 88% interest in FGIC from General Electric Capital Corporation. *See* Youngwood Decl. Ex. C. The PMI Group, Inc. Form 8-K, August 6, 2003.

form of insurance policy designed to protect the holder of a CDO against default. CAC ¶¶ 43-55. According to the CAC, as a consequence of its investment in FGIC, Blackstone had substantial exposure to the subprime mortgage market, which, as of the time of the IPO in March 2007, was clearly and demonstrably on the verge of collapse. CAC¶¶ 62-75. Plaintiff alleges that as a major investor in FGIC, Blackstone had a duty to disclose in the Offering Documents such "then-known trends, events, or uncertainties associated with FGIC" because they were "reasonably likely to cause the [sic] Blackstone's financial information not to be indicative of future operating results." CAC ¶ 77. The Registration Statement, however, did not mention Blackstone's investment in FGIC, and in March 2008, Blackstone wrote down that investment by $122 million. CAC ¶ 40.

2. *Freescale Semiconductor*

The Registration Statement did disclose to prospective purchasers of Blackstone units that one of the Company's corporate private equity funds had a substantial investment in Freescale, a designer and manufacturer of semiconductors.[4] However, Plaintiff alleges that the Registration Statement failed to mention that "[s]hortly before the IPO, Freescale lost an exclusive agreement to manufacture wireless 3G chipsets for its single

[4] The CAC acknowledges that the investment capital used by Blackstone's private equity funds "includes equity invested by Blackstone's limited partner co-investors," *i.e.* other people's money. CAC ¶ 78 n. 2. The Registration Statement confirms that the combined investment in Freescale was approximately $3.1 billion. Reg. Stmt. at 162.

largest customer, Motorola" after design defects and quality issues caused delays in the launch of a new cell phone. CAC ¶ 77-80. The CAC alleges that the loss of Freescale's exclusive arrangement with Motorola was disclosed by, *inter alia,* Motorola's CEO who on a March 21, 2007 conference call with securities analysts announced that it was terminating its relationship with Freescale as the exclusive supplier of its 3G chipset. CAC ¶ 83. Plaintiff alleges that the loss of the contract had a "material adverse affect on Freescale's business and, concomitantly, . . . [on the] corporate private equity fund controlled by Blackstone." CAC ¶ 85.

3. *Real Estate Investments*

Finally, the CAC alleges "that at the time of the IPO Blackstone had significant investments in real estate," and at that time "the market for real estate . . . [was] starting to deteriorate" and "was being adversely affected by a series of negative developments in the credit market." CAC ¶ 87. Consequently, according to the allegations in the CAC, "by the time of the IPO, it was foreseeable that the Company would have performance fees clawed-back in connection with real estate investments and would not generate additional performance fees on those investments." CAC ¶ 87. The CAC further alleges that certain statements in the Registration Statement about "high levels of growth" in the real estate industry and "strong investor demand for real estate assets" were materially inaccurate because at the time of the IPO, "the U.S. real estate market had passed its zenith

and was in the midst of a prolonged decline." CAC ¶ 88.

Plaintiff alleges that Blackstone failed to disclose material information about "currently known trends, events and uncertainties" pertaining to the foregoing three investments, which Plaintiff alleges were "reasonably likely to have material effects" on Blackstone's performance. CAC ¶ 89-90 (quoting Management's Discussion and Analysis of Financial Condition and Results of Operations, SEC Release No. 6835, May 18, 1989 (the "1989 Interpretative Release")). Plaintiff also alleges that the financial statements in the Registration Statement were materially inaccurate and violated GAAP, *see* CAC ¶¶ 94-118, and that the Registration Statement omitted required information about facts and circumstances that made investment in Blackstone units risky. CAC ¶¶ 119-125.

II. LEGAL STANDARD

The Supreme Court in *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007) and, more recently, *Ashcroft v. Iqbal,* ___ U.S. ___, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009), articulated the standards that apply to test the sufficiency of Plaintiff's CAC in the face of Blackstone's motion to dismiss pursuant to Rule 12(b)(6).[5] "To survive a motion to

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[5] Because Plaintiff's allegations sound in negligence, not fraud, Plaintiff's complaint is not subject to the more exacting pleading standard of Rule 9(b). *Rombach v. Chang,* 355 F.3d 164, 171 (2d Cir.2004). Although the "heightened pleading standard of Rule 9(b) applies to Section 11 claims insofar as the claims are premised on allegations of fraud,"

dismiss, 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,* ___ U.S. ___, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009) (quoting *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (citing *Twombly,* 550 U.S. at 556, 127 S.Ct. 1955). The Court must accept all factual allegations as true, but this requirement does not apply to "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements." *Id.* The court's determination of whether a complaint states a "plausible claim for relief" is a "context-specific inquiry" that requires application of "judicial experience and common sense." *Id.* Unless a plaintiff's well-pleaded allegations have "nudged [its] claims across the line from conceivable to plausible, [the plaintiff's] complaint must be dismissed." *Twombly,* 550 U.S.at 570, 127 S.Ct. 1955.

Id. at 171, and "[i]t is well established that in this context a 'boilerplate disclaimer is not enough to make out a claim for negligence,' " *Ladmen Partners, Inc. v. Globalstar, Inc.,* No. 07 Civ. 976(LAP), 2008 WL 4449280, *11 n. 10 (S.D.N.Y. Sep. 30, 2008) (quoting *In re Ultrafem, Inc. Secs. Litig.,* 91 F.Supp.2d 678, 691 (S.D.N.Y.2000)), Plaintiff's allegations in this case clearly sound in negligence and not fraud. Indeed, Blackstone does not argue to the contrary.

III. DISCUSSION

A. Applicable Law

Plaintiffs' primary claims arise under Sections 11 and 12(a) of the Securities Act of 1933, which are "'designed to ensure compliance with the disclosure provisions of the Securities Act by imposing a stringent standard of liability on the parties who play a direct role in a registered [securities] offering.'"[6] *Ladmen Partners v. Globalstar,* 07 Civ. 976(LAP), 2008 WL 4449280 (S.D.N.Y. Sept. 30, 2008) (quoting *Herman & MacLean v. Huddleston,* 459 U.S. 375, 381-82, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983)). To state a claim, a plaintiff must allege that, as of its effective date, the offering document contained a material misstatement or omission. 15 U.S.C. § 77k(a). "Section 11 places a relatively minimal burden on a plaintiff, requiring simply that the plaintiff allege that he purchased the security and that the registration statement contains false or misleading statement concerning a material fact." *In re Initial Public Offering Secs. Litig.,* 358 F.Supp.2d 189, 205 (S.D.N.Y.2004) ("*In*

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[6] Whereas Section 11 applies to misstatements or omissions in a registration statement filed with the SEC, Section 12(a) applies to persons who sell securities pursuant to a prospectus that contains misstatements or omissions. 15 U.S.C. §§ 77k, 77*l*(a). However, "claims under Sections 11 and 12 are usually evaluated in tandem because if a plaintiff fails to plead a cognizable Section 11 claim, he or she will be unable to plead one under Section 12(a)." *Lin v. Interactive Brokers Group, Inc.,* 574 F.Supp.2d 408, 416 (S.D.N.Y.2008) (McMahon, J.). Plaintiff's claims under Section 15(a) against the individual defendants for "control person liability" are derivative of its Section 11 claims.

re IPO"). The veracity of a registration statement is determined by assessing the facts as they existed when the statement became effective. *Id.*

In this case, Plaintiff proceeds primarily under a theory of omission:[7] Plaintiff alleges that omissions of material fact (1) made affirmative statements in the Registration Statement false or misleading; and (2) violated Item 303 of SEC Regulation S-K ("Item 303"), which requires an issuer such as Blackstone to "[d]escribe any known trends or uncertainties that have or that [it] reasonably expects will have a material favorable or unfavorable impact on new sales or revenues or income from continuing operations." 17 C.F.R. 229.303(a)(3)(ii). Courts have held that Section 11 imposes liability on a registrant who omits to state fact required to be stated under Item 303. *In re IPO,* 358 F.Supp.2d at 211 ("An omission of fact 'required to be stated' under Item 303 will generally produce liability under Section 11.") A plaintiff must "'therefore plead facts indicating that the alleged known trends existed at the time of the purported misleading statements or omissions,'" that the trends were *known* to the registrant who fails to disclose them. *Garber v. Legg Mason, Inc.* 537 F.Supp.2d 597, 611 (S.D.N.Y.2008) (quoting *In re Turkcell Iletisim Hizmetler, A.S. Sec. Litig.,* 202 F.Supp.2d 8, 13 (S.D.N.Y.2001)). Allegations that derive from the requirements of Item 303, how-

[7] Plaintiff maintains that certain allegations in the CAC concerning the Registration Statement's discussion of the then-current state of the real estate market constitute affirmative misrepresentations. *See* CAC ¶ 125; Tr. of Oral Arg. at 27. The CAC's allegations pertaining to the Company's real estate investments are discussed *infra.*

ever, are still subject to the materiality requirement. That is, under Item 303 a known-trend is only required to be disclosed if the company reasonably expects that it will have a material impact on continuing operations. 17 C.F.R. 229.303(a).[8]

"The materiality of a misstatement depends on whether 'there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to act.'" *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.,* 553 F.3d 187, 197 (2d Cir.2009) ("*JP Morgan Chase* ") (citing *Basic Inc. v. Levinson,* 485 U.S. 224, 240, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988)) (internal quotation marks and alteration omitted). That is, for a misstatement or omission to be material, "'there must be a sub-

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[8] Although the Second Circuit has not squarely addressed the issue, in *Oran v. Stafford,* the Third Circuit stated that "[b]ecause the materiality standards for Rule 10b-5 and SK-303 differ significantly, the 'demonstration of a violation of the disclosure requirements of Item 303 does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5. Such a duty to disclose must be separately shown.'" 226 F.3d 275, 288 (3d Cir.2000) (Alito, J.) (quoting *Alfus v. Pyramid Tech. Corp.,* 764 F.Supp. 598, 608 (N.D.Cal.1991)). Consequently, the Third Circuit held that a violation of Item 303's "reporting requirements does not automatically give rise to a material omission under Rule 10b-5." The same holds true here because, as discussed below, "[t]he standard for assessing materiality under Section 10(b) and Rule 1 0b-5 is the same as under Sections 11 and 12(a)(2)." *Garber v. Legg Mason, Inc.,* 537 F.Supp.2d 597, 615 (S.D.N.Y.2008) (citing *I. Meyer Pincus & Assocs. v. Oppenheimer & Co.,* 936 F.2d 759, 761 (2d Cir.1991)). Consequently, the general requirement of materiality overlays the Plaintiff's allegations that Blackstone violated the disclosure requirements of Item 303.

stantial 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.'" *Levinson,* 485 U.S. at 240, 108 S.Ct. 978 (quoting *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976)).

To determine whether an allegedly misleading statement is material, a court must engage "in a fact-specific inquiry"—there is no bright line rule. *JP Morgan Chase,* 553 F.3d at 197. "Because materiality is a mixed question of law and fact, in the context of a Fed.R.Civ.P. 12(b)(6) motion, a complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Id.* (quoting *Ganino v. Citizens Utils. Co.,* 228 F.3d 154, 162 (2d Cir.2000)). This is not to say that a complaint can never be dismissed on materiality grounds at the motion to dismiss stage: indeed several courts have found relatively small misstatements or omissions to be immaterial as a matter of law. *See, e.g., JP Morgan Chase,* 553 F.3d at 204 (accounting treatment of 0.3% of bank's assets immaterial as a matter of law); *Garber,* 537 F.Supp.2d at 613-14 (omission of .4% of annual revenue immaterial and citing similar cases); *In re: Duke Energy Corp. Secs. Litig.,* 282 F.Supp.2d 158, 161 (S.D.N.Y.2003) (inflation of company's revenue by 0.3% immaterial as a matter of law); *In re Turkcell Iletisim,* 202 F.Supp.2d at 13 (failure to disclose 9% difference in operating income insufficient to establish lia-

bility under Section 11); *Parnes v. Gateway 2000, Inc.,* 122 F.3d 539, 546-47 (8th Cir.1997) (overstatement of assets by 2% immaterial as matter of law); *Glassman v. Computervision Corp.,* 90 F.3d 617, 633 n. 26 (1st Cir.1996) (omission of information regarding 3% to 9% of actual revenues immaterial as a matter of law).

In *JP Morgan Chase,* the Second Circuit reaffirmed that the inquiry entails both quantitative and qualitative inquiries, although there the Circuit considered the two inquiries *sequentially*. *JP Morgan Chase,* 553 F.3d at 204. *First,* the Circuit considered quantitative factors: that is, on a relative scale, how large are the alleged misstatements? *Id.* The Circuit cited the SEC's Staff Accounting Bulletin No. 99 ("SAB 99"), which provides that "[t]he use of a percentage as a numerical threshold, such as 5% may provide the basis for a preliminary assumption that . . . a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material." *Id.* (quoting SAB 99, 64 Fed.Reg. 45150, 45151 (1999)). The Circuit agreed with SAB 99 that "the five percent numerical threshold is a good starting point for assessing the materiality of the alleged misstatement."[9] *Id. Second,* the Circuit considered the qualitative factors which are "intended to allow for a finding of materiality if the quantitative size

[9] Under the facts of *JP Morgan Chase,* where the alleged misstatement concerned 0.3% of JP Morgan Chase's total assets, the Circuit found the misstatement "does not even come close" to the threshold. *JP Morgan Chase,* 553 F.3d at 204.

of the misstatement is small but the effect of the misstatement is large." *Id.* at 205.

B. Alleged Omissions Concerning the Portfolio Companies

Applying the foregoing analysis to the alleged misstatements and omissions concerning the portfolio companies FGIC and Freescale, it is apparent that the allegations satisfy neither the quantitative nor qualitative prongs of the test. It is important not to interpret my conclusion here as some sort of approval of the conduct by those responsible for the IPO, nor any indication as to how much, if any, knowledge (as alleged in the CAC) those who drafted the Offering Documents possessed. First, Blackstone's $331 million investment in FGIC represented a mere 0.4% of the Blackstone's assets under management at the time of the IPO, on par with the 0.3% of JP Morgan Chase's assets that the Circuit found "does not even come close" to the 5% threshold that serves as an appropriate "starting place." *JP Morgan Chase,* 553 F.3d at 204. When the amount of the write-down on the FGIC investment is considered—$122 million—the relative size of the alleged omission drops further. Plaintiffs rejoin that the drop in value of Blackstone's investment in FGIC accounted for 69% of the decline in revenue of Blackstone's corporate private equity group for the year 2007, which, at $881 million was down 18% over the prior year. But the corporate private equity group's $881 million in revenue constituted only 28% of Blackstone's $3.12 billion in total revenue for 2007. In *this* context, the quantitative immateriality of the $122 million

write down is plain: the $122 million write down for FGIC was a mere 0.4% of Blackstone's $3.12 billion in annual revenue.

Second, the $3.1 billion investment in Freescale represented a 3.6% of the total $88.4 billion the Company had under management at the time of the IPO, which falls below the 5% benchmark that the Second Circuit has stated is a good "starting point" for the quantitative inquiry into materiality. *JP Morgan Chase,* 553 F.3d at 204. Furthermore, the CAC does not allege that loss of the exclusive supplier relationship with Motorola would cause the Blackstone fund's investment in Freescale to lose 100% of its value.[10] Were this lawsuit about a registration statement issued in connection with the sale of shares in Freescale, loss of the exclusive supplier relationship with Motorola would almost certainly be material. *See*

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[10] Indeed, the CAC does not allege *any* drop in the value of the Blackstone corporate equity fund's investment in Freescale. Allegations of actual loss are not required because the veracity and materiality of the statements at issue here must be judged as of the effective date of the Registration Statement. *See Feiner v. SS & C Techs.,* 11 F.Supp.2d 204, 209 (D.Conn.1998); 15 U.S.C. § 77k(a). Nevertheless, it cannot be reasonably inferred from the facts alleged in the CAC that the value of Freescale could possibly have dropped to zero as a consequence of the loss of the exclusive relationship with Motorola. Indeed, the statements made by Freescale's management in an April 2007 conference call and quoted in the CAC confirm that Freescale "never expected" to provide 100% of Motorola's 3G chipsets. CAC ¶ 86 ("[w]e expect that going forward on 3G, they're going to have a multi vendor strategy which, for a company of their size, they had [ ] in 2 and 2.5G and there's no reason to think that all of a sudden they should change for 3G.")

e.g. In re Scholastic Corp. Sec. Litig., 252 F.3d 63, 70-74 (2d Cir.2001) (omission of sharp decline in sales and increase in returns of companies' best-selling product was material). But this case is not about sale of shares in Freescale, which was one of 43 companies in which Blackstone's corporate private equity segment had investments.

The immateriality of the alleged omissions concerning FGIC and Freescale derives not only from the relative size of Blackstone's investments in these companies, but also the *structure* of the Blackstone enterprise. The performance of the individual companies only affects Blackstone's revenues after investment gains or losses are aggregated at the fund level. *See* Reg. Stmt. at 1 ("[W]e receive a preferred allocation of income (a 'carried interest') or an incentive fee from an investment fund in the event that specified investment returns are achieved by the funds.") At the fund level, the poor performance of one investment may be offset by the strong performance of another: the fact that Blackstone's corporate private equity fund wrote down its investment in FGIC by $122 million but still saw revenues of $821 million proves this point. Purchasers of units in Blackstone at the IPO (the putative class here get the benefit of performance fees or the "carried interest" when an *entire fund* makes a profit and are potentially subject to the adverse consequences of claw-backs if the *entire fund* loses money). In this respect, there is no way to make a principled distinction between the negative information that Plaintiff claims was wrongfully omitted from the Registration Statement and information—whether positive or negative—about

every other portfolio company, let alone every investment made by Blackstone's many subsidiary funds. Including all such information would have obfuscated truly material information in a flood of unnecessary detail, a result that the securities laws forbid. *I. Meyer Pincus & Assocs. v. Oppenheimer & Co.,* 936 F.2d 759, 762 (2d Cir.1991) ("The federal securities laws require that disclosure in a prospectus must steer a middle course, [and not] submerg[e] a material fact in a flood of collateral data."); *Olkey v. Hyperion 1999 Term Trust, Inc.,* 98 F.3d 2, 5 (2d Cir.1996). In sum, the alleged omissions concerning FGIC and Freescale fall short of the quantitative threshold for materiality by virtue of both the size of the investments relative to Blackstone's total assets under management and the structure of Blackstone's investment management business.

This is not to the say that the size or structure of a company immunizes it from liability under the Securities Act. To the contrary, in this Court's view, preventing such a result is a critical purpose of the qualitative considerations that are "intended to allow for a finding of materiality if the quantitative size of the misstatement is small, but the effect of the misstatement is large." *JP Morgan Chase,* 553 F.3d at 205. But the alleged omissions concerning the portfolio companies fall short here as well. None of the qualitative considerations discussed by the Circuit in *JP Morgan Chase* or any of the others set forth in SAB 99 are implicated here. *Id.* at 204-05. First, the CAC contains no allegation that any of the alleged misstatements or omissions concealed unlawful transactions or conduct. Plaintiff contends that

the Registration Statement should have included a fuller exposition of the risks attendant to an investment in Blackstone and then-current trends and events, but not that any omission concealed something illegal.

Second, although the investment Freescale by Blackstone's corporate private equity group was substantial and the write down of its investment FGIC large as an absolute value, these entities were but two of 43 portfolio companies invested in by one of four business segments. For this reason, and as discussed above, the alleged omissions about FGIC and Freescale did not relate to a "significant aspect of [Blackstone's] operations" as a whole. *JP Morgan Chase,* 553 F.3d at 204.[11] The third qualitative factor considered by the Circuit is also absent, namely the market's reaction to the public disclosure of the alleged omission. *Id.* at 205. Here, Blackstone units traded at approximately $14.50 before disclosure of the alleged omission concerning FGIC in the March 10, 2008 press release, but traded at approximately $17.50

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[11] *JP Morgan Chase* concerned the defendant bank's ("JPMC") characterization of certain transactions with Enron. There, the Circuit stated, "[w]hile Plaintiffs allege that Enron is a "key client" of JPMC, it appears clear that JPMC's transactions were not a significant aspect of JPMC's operations, considering the fact that JPMC earned less than .1% of its revenues from Enron related transactions each year." *JP Morgan Chase,* 553 F.3d at 204-205. Put into the context of the allegations of this complaint, even if Blackstone's investment in FGIC dropped to zero, the $331 million investment loss would be approximately .1% of Blackstone's $3.12 billion in revenues for 2007.

when the initial complaint in this action was filed approximately one month later.[12]

Furthermore, the other "considerations that may well render material a qualitatively small misstatement" identified in SAB No. 99 are not implicated here. The CAC does not allege that the misstatements or omissions about the portfolio companies "hide[ ] a failure to meet analysts' consensus expectations for the enterprise," "change[d] a loss into income or vice versa," or affected Blackstone's "compliance with loan covenants or other contractual requirements." SAB No. 99, 64 Fed.Reg. 45150, 45152. Although Blackstone executives were some of the chief beneficiaries of the IPO so that alleged omissions in the Offering Documents doubtless had "the effect of increasing management's compensation," the alleged omissions pertaining to the portfolio companies are so quantitatively small that this qualitative concern identified in SAB No. 99 is not enough to, alone, make the omissions material. Accordingly, I conclude the alleged misstatements and omissions concerning FGIC and Freescale are immaterial as a matter of law.

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[12] The Court "'may take judicial notice of well-publicized stock prices without converting the motion to dismiss into a motion for summary judgment.'" *Miller v. Lazard, Ltd.,* 473 F.Supp.2d 571, 578 (S.D.N.Y.2007) (quoting *Ganino* 228 F.3d at 167 n. 8). Blackstone argues that the absence of a price decline makes clear that the lack of loss causation is apparent from the face of the CAC. Because I conclude that the CAC fails to state a claim for reasons other than the adequacy of its allegations of loss causation, I need not and expressly decline to address Blackstone's loss causation argument.

C. Alleged Misstatements and Omissions Concerning Real Estate Investments

The core of the Plaintiff's allegations with respect to the real estate investments is the following single paragraph of the CAC:

> At the time of the IPO, Blackstone had significant investments in real estate. As noted herein, by the time of the IPO, the market for real estate in several significant markets were [sic] starting to deteriorate. Further, at the time of the time of the IPO the real estate market was being adversely affected by a series of negative developments in the credit markets. Accordingly, by the time of the IPO, it was foreseeable that the Company would have performance fees clawed-back in connection with those real estate investments and would not generate additional performance fees on those investments.

CAC ¶ 87. On the basis of this factual allegation, Plaintiff contends that Blackstone's failure to specifically address the deteriorating real estate market constituted a material omission. The CAC also alleges that the Registration Statement affirmatively misrepresented that the "[t]he real estate industry is . . . experiencing historically high levels of growth and liquidity," when in fact the "real estate market had passed its zenith and was in the midst of a prolonged decline." CAC ¶¶ 87-8. Finally, Plaintiff alleges that the Registration Statement's risk disclosures pertaining to real estate investments were materially inaccu-

rate because the disclosed risks had already materialized. CAC ¶ 125.

These allegations fall short for several reasons. First, the CAC does not identify a single real estate investment or allege a single fact capable of linking the problems in the subprime residential mortgage market in late 2006 and early 2007 and the roughly contemporaneous decline in home prices (which are well-documented by the CAC) to Blackstone's real estate investments, 85% of which were in commercial and hotel properties. Reg. Stmt. at 50. Plaintiff alleges that Blackstone invested in real estate and the real estate market was starting to deteriorate. CAC ¶ 87. But "without further factual enhancement" as to *how* the troubles in the residential mortgage and housing markets could possibly (let alone plausibly) have a foreseeable material affect on Blackstone's real estate investments, such allegations "stop[ ] short of the line between possibility and plausibility." *Twombly,* 550 U.S. at 546, 127 S.Ct. 1955; *see also Hutchison v. CBRE Realty Finance, Inc.,* No. 07 Civ. 1599(SRU), 2009 WL 2342768, *9-10 (D.Conn. Jul. 29, 2009) ("It is not enough for the plaintiffs to allege that, at the time CBRE issued its offering statements, CBRE's financial health possibly could have been worsened by a Triton default.") Furthermore, Plaintiff fails to allege any *facts,* as distinct from conclusory statements such as that the "U.S. real estate market had passed its zenith," that if true, would render false the few statements alleged to be affirmative misrepresentations: namely, that "the real estate *industry* is [ ] experiencing historically high levels of growth," "that replacement costs of real property

assets have *continued* to escalate." CAC ¶ 88 (emphasis added).

Second, to the extent that Plaintiff alleges Blackstone should have disclosed the conditions of the market generally, such omissions are not actionable. "Sections 11 and 12(a)(2) do not require the disclosure of publicly available information." *In re Merrill Lynch & Co., Inc. Research Reports Securities Litigation,* 272 F.Supp.2d 243, 250 (S.D.N.Y.2003) (citing, *inter alia, Seibert v. Sperry Rand Corp.,* 586 F.2d 949, 952 (2d Cir.1978)) ("Although the underlying philosophy of federal securities regulations is that of full disclosure, there is no duty to disclose information to one who reasonably should already be aware of it.") The omission of generally known macro-economic conditions is not material because such matters are already part of the "total mix" of information available to investors. For example, in *In re: Donald Trump Casino Sec. Litig.,* 7 F.3d 357, 377 (3d Cir.1993), the Third Circuit held that an issuer's failure to alert investors to the implications of the "weakened economic conditions in the Northeast" was not actionable because "the reasonable investor should have known of the economic downturn in the Northeast at that time, [and thus] the inclusion of this information would not have substantively altered the total mix of information the prospectus provided to investors." Thus when the CAC alleges the omission of "adverse events and uncertainties associated with Blackstone's investments in . . . real estate" but points only to a real estate market "in the midst of a prolonged decline" the CAC points to nothing

that the reasonable investor would not already know.

Third and finally, Plaintiff's allegations fall short to the extent they allege that Blackstone knew things that others did not and that Item 303's requirement of disclosure of "known trends" renders the alleged omissions material.[13] The CAC contains no allegations that Blackstone knew that the conditions in the real estate and credit markets were reasonably likely to have a material effect on *its* portfolio of real estate investments.[14]

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[13] One of the principal deficiencies with the CAC's allegations pertaining to Blackstone's real estate investments is that one is forced to speculate as to what it is that Plaintiff contends should have been disclosed.

[14] The parties dispute whether Item 303 requires the pleader to allege that the undisclosed trends were in fact known by the registrant. At oral argument, Plaintiff argued that because the trends were "knowable" and Section 11 and 12(a) claims impose a negligence standard of liability, Plaintiff is only required to allege that "the information was knowable or that the defendants were negligent in not knowing it." Tr. 37-38. As it pertains to the general standard of *liability* under Sections 11 and 12(a), Plaintiff's argument finds support in the case law. Indeed, as was recently noted by the district court in *Hutchison v. CBRE Realty Finance, Inc.,* if a plaintiff adequately alleges material omissions from a securities offering statement, under Sections 11 and 12(a), "those claims are subject to a strict liability standard and issuers are held liable despite any otherwise available due diligence defense or lack of knowledge." *Hutchison v. CBRE Realty Finance, Inc.*, 638 F.Supp.2d 265, 274 (D.Conn.2009). But Section 11 only imposes strict liability on an issuer who fails to include information "required to be stated" in the registration statement. 15 U.S.C. § 77k(a). Here Plaintiff relies on the disclosure requirements of Item 303 to make a case for the *materiality* of the alleged omis-

It may well be that as sophisticated real estate investors Blackstone *should have known* that the problems in the real estate and credit markets were not limited to subprime residential mortgages, but this is not enough. *See e.g. Garber,* 537 F.Supp.2d at 611; n. 14, *supra.* Plaintiff does not allege that Blackstone knew of any trends that would materially affect *its* real estate investments

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sions (*i.e.* that they were "required to be stated"), but Plaintiff cannot bootstrap its way into a lower standard for materiality under Item 303 simply because it pursues claims under Sections 11 and 12(a). Both the language of Item 303 itself and the SEC releases and case law interpreting it are clear that Item 303 requires disclosure of "*known* trends." 17 C.F.R. § 229.303(a)(3)(ii) (imposing requirement for issuer to "[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 . . . revenues or income from continuing operations.") The 1989 Interpretive Release upon which Plaintiff relies states, that "[a] disclosure duty exists where a trend, demand, commitment, event or uncertainty is both *presently known to management* and reasonably likely to have material effects on the registrant's financial condition or results of operation." 1989 Interpretive Release, Fed. Sec. L. Rep. (CCH) ¶ 72,436, at 62,143, reprinted at ¶ 73,193, at 62,842 (emphasis added). The case law confirms this point. *See e.g., Garber,* 537 F.Supp.2d at 611; *In re Turkcell Iletisim Hizmetler, A.S. Sec. Litig.,* 202 F.Supp.2d 8, 13 (S.D.N.Y.2001) ("The complaint fails to allege that there [were] 'trends' or that they were 'known' as of the date the Prospectus became effective."); *J & R Marketing, SEP v. General Motors Corp.,* 549 F.3d 384, 387 (6th Cir.2008) ("We find that the named plaintiffs' [Section 11 and 12(a)] claims are without merit because the offering materials did not have material omissions because . . . Item 303 only imposes a duty to make forward-looking projections regarding known information, and plaintiffs pleaded only that the information was knowable").

and generalized allegations that problems brewing in the market at large made it "foreseeable" that a particular set of unidentified investments would sour are insufficient to "nudge[ ][the] claims across the line from conceivable to plausible." *Twombly,* 550 U.S.at 570, 127 S.Ct. 1955.

D. Alleged Inaccuracies in Financial Statements

Finally, the CAC alleges that the financial statements contained in the Registration Statement overstated the value of Blackstone's investment in FGIC and in the Company's various real estate funds.[15] These allegations are essentially

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[15] The CAC also alleges a more technical violation of generally accepted accounting principles ("GAAP"), "the standard metric by which courts determine whether accounting statements are false or misleading." *In re Countrywide Financial Corp. Sec. Litig.,* 588 F.Supp.2d 1132, 1175 (C.D.Cal.2008). Of course to be actionable, misleading statements must also be material. In addition to the fact that any overvaluing of Blackstone's investment in FGIC would not be material, Plaintiffs fail to adequately allege that Blackstone accounting treatment of FGIC violated GAAP. Plaintiff alleges that Blackstone was required to either account for FGIC under the "equity method" or make an "irrevocable" election to use the so-called "fair value option" pursuant to Statement of Financial Accounting Standards No. 159 ("SFAS No. 159"), but in fact Blackstone accounted for its investments under the "fair value method" without making the election. Plaintiff's allegation, thus, assumes that the *only* way Blackstone was permitted to account for its "equity method investments at their fair values" was pursuant to SFAS No. 159. However, the AICPA Audit and Accounting Guide, *Audits of Investment Companies* and EITF Issue No. 85-12, *Retention of Specialized Accounting for Investments in Consolidation,* each of which

derivative of those discussed above and are insufficient to state a claim for largely the same reasons. As discussed above, the alleged omissions about FGIC's exposure to the subprime mortgage market are immaterial as a matter of law. So too, then, are Plaintiff's allegations that Blackstone overvalued its investment in FGIC at the time of the Registration Statement. Similarly, Plaintiff's allegations that the financial statements overvalued Blackstone's real estate investments are premised on the conclusory allegation that the real estate market was in the "midst of the freefall" but they lack any factual connection to the real estate investments actually in the Company's portfolio.

IV. CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss the CAC for failure to state a claim is GRANTED. Because Plaintiff elected to stand on it pleading rather than to amend it in the face of Defendant's motion to dismiss as allowed by my Individual Practices, Plaintiff's claims are dismissed with prejudice. *Nwaokocha v. Sadowski,* 369 F.Supp.2d 362, 372 (E.D.N.Y.2005) ("A court . . . has discretion to dismiss with prejudice if it believes that amendment would be futile or would

were relied upon by Blackstone (and disclosed in the financial statements) permit accounting for subsidiary investments under the fair value method. Moreover, SFAS No. 159 was not in effect as of the date of the financial statements, and Blackstone affirmatively disclosed that it elected not to early adopt it but rather was "considering its effect." Reg. Stmt. at 87, F-42.

unnecessarily expend judicial resources."). The Clerk of the Court is instructed to close this case and any open motions and remove it from my docket.

SO ORDERED.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket Number: 09-4426-cv
Filed: March 30, 2011

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the City of New York, on the 30th day of March, two thousand eleven,

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MARTIN LITWIN, MAX POULTER,
FRANCIS BRADY, and LANDMEN PARTNERS, INC.,
Individually and on behalf of all
others similarly situated,

Plaintiffs-Appellants,

—v.—

THE BLACKSTONE GROUP, L.P.,
STEPHEN A. SCHWARTZMAN,
MICHAEL A. PUGLISI, PETER J. PETERSON,
and HAMILTON E. JAMES,

Defendants-Appellees.

ORDER

Appellees The Blackstone Group, L.P., Stephen A. Schwartzman, Michael A. Puglisi, Peter J. Peterson, and Hamilton E. James filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*. The panel that determined the appeal has considered the request for panel rehearing, and the active members of the Court have considered the request for rehearing *en banc*.

IT IS HEREBY ORDERED that the petition is denied.

For the Court:
Catherine O'Hagan Wolfe, Clerk

/s/ CATHERINE O'HAGAN WOLFE

[SEAL]

15 U.S.C. § 77k

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with

respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

* * *

15 U.S.C. § 77*l*

(a) In general

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraphs (2) and (14) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable, subject to subsection (b) of this section, to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

* * *

15 U.S.C. § 77o

(a) Controlling persons

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77 of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

* * *

17 C.F.R. § 229.303

(a) Full fiscal years. Discuss registrant's financial condition, changes in financial condition and results of operations. The discussion shall provide information as specified in paragraphs (a)(1) through (5) of this Item and also shall provide such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations. Discussions of liquidity and capital resources may be combined whenever the two topics are interrelated. Where in the registrant's judgment a discussion of segment information or of other subdivisions of the registrant's business would be appropriate to an understanding of such business, the discussion shall focus on each relevant, reportable segment or other subdivision of the business and on the registrant as a whole.

* * *

(3) Results of operations.

(i) Describe any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations and, in each case, indicate the extent to which income was so affected. In addition, describe any other significant components of revenues or expenses that, in the registrant's judgment, should be described in order to understand the registrant's results of operations.

(ii) Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.

(iii) To the extent that the financial statements disclose material increases in net sales or revenues, provide a narrative discussion of the extent to which such increases are attributable to increases in prices or to increases in the volume or amount of goods or services being sold or to the introduction of new products or services.

(iv) For the three most recent fiscal years of the registrant or for those fiscal years in which the registrant has been engaged in business, whichever period is shortest, discuss the impact of inflation and changing prices on the registrant's net sales and revenues and on income from continuing operations.

* * *

Instructions to paragraph 303(a):

1. The registrant's discussion and analysis shall be of the financial statements and other statistical data that the registrant believes will enhance a reader's understanding of its financial condition,

changes in financial condition and results of operations. Generally, the discussion shall cover the three-year period covered by the financial statements and shall use year-to-year comparisons or any other formats that in the registrant's judgment enhance a reader's understanding. However, where trend information is relevant, reference to the five-year selected financial data appearing pursuant to Item 301 of Regulation S–K (§ 229.301) may be necessary. A smaller reporting company's discussion shall cover the two-year period required in Article 8 of Regulation S–X and shall use year-to-year comparisons or any other formats that in the registrant's judgment enhance a reader's understanding.

2. The purpose of the discussion and analysis shall be to provide to investors and other users information relevant to an assessment of the financial condition and results of operations of the registrant as determined by evaluating the amounts and certainty of cash flows from operations and from outside sources.

3. The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (A) matters that would have an impact on future operations and have not had an impact in the past, and (B) matters that have had an impact on reported operations and are not expected to have an impact upon future operations.

4. Where the consolidated financial statements reveal material changes from year to year in one or more line items, the causes for the changes shall be described to the extent necessary to an understanding of the registrant's businesses as a whole; Provided, however, That if the causes for a change in one line item also relate to other line items, no repetition is required and a line-by-line analysis of the financial statements as a whole is not required or generally appropriate. Registrants need not recite the amounts of changes from year to year which are readily computable from the financial statements. The discussion shall not merely repeat numerical data contained in the consolidated financial statements.

5. The term "liquidity" as used in this Item refers to the ability of an enterprise to generate adequate amounts of cash to meet the enterprise's needs for cash. Except where it is otherwise clear from the discussion, the registrant shall indicate those balance sheet conditions or income or cash flow items which the registrant believes may be indicators of its liquidity condition. Liquidity generally shall be discussed on both a long-term and short-term basis. The issue of liquidity shall be discussed in the context of the registrant's own business or businesses. For example a discussion of working capital may be appropriate for certain manufacturing, industrial or related operations but might be inappropriate for a bank or public utility.

6. Where financial statements presented or incorporated by reference in the registration statement are required by § 210.4–08(e)(3) of Regula-

tion S–X [17 CFR part 210] to include disclosure of restrictions on the ability of both consolidated and unconsolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances, the discussion of liquidity shall include a discussion of the nature and extent of such restrictions and the impact such restrictions have had and are expected to have on the ability of the parent company to meet its cash obligations.

7. Any forward-looking information supplied is expressly covered by the safe harbor rule for projections. See Rule 175 under the Securities Act [17 CFR 230.175], Rule 3b–6 under the Exchange Act [17 CFR 240.3b–6] and Securities Act Release No. 6084 (June 25, 1979) (44 FR 38810).

8. Registrants are only required to discuss the effects of inflation and other changes in prices when considered material. This discussion may be made in whatever manner appears appropriate under the circumstances. All that is required is a brief textual presentation of management's views. No specific numerical financial data need be presented except as Rule 3–20(c) of Regulation S–X (§ 210.3–20(c) of this chapter) otherwise requires. However, registrants may elect to voluntarily disclose supplemental information on the effects of changing prices as provided for in Statement of Financial Accounting Standards No. 89, "Financial Reporting and Changing Prices" or through other supplemental disclosures. The Commission encourages experimentation with these disclosures in order to provide the most meaningful presentation of the impact of price changes on the registrant's financial statements.

9. Registrants that elect to disclose supple-mentary information on the effects of changing prices as specified by SFAS No. 89, "Financial Reporting and Changing Prices," may combine such explanations with the discussion and analysis required pursuant to this Item or may supply such information separately with appropriate cross reference.

10. All references to the registrant in the discussion and in this Item shall mean the registrant and its subsidiaries consolidated.

11. Foreign private registrants also shall discuss briefly any pertinent governmental economic, fiscal, monetary, or political policies or factors that have materially affected or could materially affect, directly or indirectly, their operations or investments by United States nationals.

12. If the registrant is a foreign private issuer, the discussion shall focus on the primary financial statements presented in the registration statement or report. There shall be a reference to the reconciliation to United States generally accepted accounting principles, and a discussion of any aspects of the difference between foreign and United States generally accepted accounting principles, not discussed in the reconciliation, that the registrant believes is necessary for an understanding of the financial statements as a whole.

13. The attention of bank holding companies is directed to the information called for in Guide 3 (§ 229.801(c) and § 229.802(c)).

14. The attention of property-casualty insurance companies is directed to the information called for in Guide 6 (§ 229.801(f)).

* * *