No. 20-16603

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MATTHEW VEAL; XIANGHONG DING; and ZHENBIN CHEN
Plaintiffs-Appellants

v.

LENDINGCLUB CORPORATION; SCOTT SANBORN;
BRADLEY COLEMAN; and THOMAS W. CASEY
Defendants-Appellees

Appeal From The United States District Court
For The Northern District of California
San Jose Division
Case No. 5:18-cv-2599-BLF
The Honorable Beth L. Freeman

BRIEF OF APPELLANTS, XIANGHONG DING AND ZHENBIN CHEN

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JURISDICTIONAL STATEMENT

This is an appeal from the district court's (Freeman, Beth, L.) June 12, 2020 Order and July 27, 2020 Final Judgment, dismissing the Second Amended Complaint. 1-ER-002-030.[1] Under §27 of the Securities Exchange Act, 15 U.S.C. §78aa (2012) and 28 U.S.C. §1331 (2012), the district court had subject matter jurisdiction. Lead Plaintiffs XiangHong Ding ("Ding") and Zhenbin Chen ("Chen") ("Plaintiffs") timely filed their notice of appeal on August 19, 2020. 2-ER-271-73. Under 28 U.S.C. §1291, this Court has jurisdiction.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

A. Whether the district court erred in holding that Defendants were entitled to omit information whose absence rendered their disclosures misleading about governmental investigations affecting LendingClub ("LC" or the "Company"), specifically the U.S. Federal Trade Commission ("FTC") investigation.

B. Whether the district court erred in ruling that the Complaint failed to adequately plead falsity.

C. Whether the district court erred in holding that Defendants were most likely unaware of the false or misleading nature of the challenged statements, even though Defendants had self-identified the problems underlying those statements,

[1] "[]-ER-__" refers to Appellants' Excerpts of Record.

and despite the statements of knowledgeable former employees who confirmed that LC management knew that the issues raised by the FTC were likely to be viewed as deceptive.

D. Whether the district court erred in ruling that the Complaint failed to adequately plead scienter.

E. Whether the district court improperly failed to draw reasonable inferences in Plaintiffs' favor.

STATEMENT OF THE CASE

This case is a class action, alleging violations of the antifraud provisions of the Securities Exchange Act of 1934 ("Exchange Act").

A. Relevant Procedural History

On November 7, 2018, pursuant to the Private Securities Litigation Reform Act ("PSRLA"), 15 U.S.C. §78u-4, *et seq*., the district court appointed Ding and Chen as Lead Plaintiffs for the class. (Dkt. No. 57). On January 7, 2019, Plaintiffs filed an Amended Class Action Complaint. (Dkt. No. 63). On March 8, 2019, Defendants moved to dismiss that complaint. (Dkt. No. 67).[2] On November 4, 2019, the district court dismissed that complaint, without prejudice. (Dkt. No. 92).

[2] "Defendants" are LC, Scott Sanborn ("Sanborn"), Bradley Coleman ("Coleman"), and Thomas W. Casey ("Casey"). Defendants Sanborn, Coleman, and Casey are referred to collectively as the "Individual Defendants."

On December 19, 2019, Plaintiffs filed their Second Amended Complaint ("Complaint"). 2-ER-079 (Dkt. No. 93). On January 28, 2020, defendants moved to dismiss the Complaint (Dkt. No. 96). On June 12, 2020, the district court issued an order dismissing the Complaint with prejudice for failure adequately to plead falsity and scienter, 1-ER-002 (Dkt. No. 113), and subsequently, on July 27, 2020, entered a Judgment (Dkt. No. 118). The Opinion appears at *Veal v. LendingClub Corp.*, 423 F. Supp. 3d 785, 792 (N.D. Cal. 2019). On August 19, 2020, Plaintiffs timely filed a Notice of Appeal. 1-ER-271 (Dkt. No. 120).

B. Statement Of Facts

LC operates an online lending marketplace that "matches" borrowers and investors, offering various types of loan products for consumers and small businesses. 2-ER-079-144, ¶2. The overwhelming majority of LC's revenues – approximately 80% – comes from "origination fees," a fee deducted from the loan amount before it is provided to the borrower. *Id.*, ¶¶32-35. In its U.S. Securities and Exchange Commission ("SEC") filings, LC emphasizes the importance of origination fees to its financial well-being. *Id.*, ¶¶29-36.

In May 2016, LC admitted to violations of federal law with respect to legal compliance issues, engaged in undisclosed self-dealing, that senior executives and managers had deceived its loan investors regarding characteristics of certain loans, and admitted to material weaknesses in internal controls. *Id.*, ¶¶3, 37, 40-41. This

disclosure caused a material decline in LC's stock price. *Id.*, ¶39. Defendants announced that they were conducting an internal board review of the specific malfeasance disclosed in May 2016. *Id.*, ¶¶3, 42. On May 17, 2016, LC filed its 10-Q for the period ended March 31, 2016 ("1Q16 10-Q"), revealing that the DOJ had issued a subpoena related to the board review issues announced earlier that month, and that the SEC had also contacted them regarding the board review issues. *Id.*, ¶41.

At the same time – May 2016 – the FTC told LC that it was investigating deceitful conduct against borrowers concerning issues completely different from those being investigated by the DOJ and the SEC, including the Company's claim that it had "no hidden fees" when its origination fees were indeed hidden, and whether the Company violated the Gramm-Leach-Bliley Act ("GLBA"). *Id.*, ¶¶2, 6, 52. The Company admitted after the Class Period that it had "self-identified" the FTC's issues before being approached by the FTC in May 2016. *Id.*, ¶¶4, 7, 51, 66. The Company's own legal counsel and largest investor had told Defendants, prior to May 2016, that its assertion of "no hidden fees" could make it a target for law enforcement action. *Id.*, ¶¶9, 59.

On August 9, 2016, in its quarterly report filed with the SEC on Form 10-Q for the period ended March 31, 2016 ("2Q16 10-Q"), the Company disclosed that the DOJ and SEC were investigating the board review issues. *Id.*, ¶42:

> On May 9, 2016, following the announcement of the board review described elsewhere in this filing, the Company received a grand jury subpoena from the U.S. Department of Justice (DOJ). The Company was also contacted by the SEC. The Company continues cooperating with the DOJ, SEC and any other governmental or regulatory authorities or agencies. No assurance can be given as to the timing or outcome of these matters. [*Id.*, ¶43.]

The 2Q16 10-Q never mentioned the ongoing FTC investigation. *Id.*, ¶46.

On November 9, 2016 in its 10-Q for the period ended September 30, 2016 ("3Q16 10-Q"), LC revealed an FTC investigation for the first time, linking it to the DOJ/SEC investigations, and to the board review, even disclosing the FTC investigation in the same sentence as the SEC investigation:

> On May 9, 2016, following the announcement of the board review described elsewhere in this filing, the Company received a grand jury subpoena from the U.S. Department of Justice (DOJ). The Company was also contacted by the SEC and Federal Trade Commission ("FTC"). The Company continues cooperating with the DOJ, SEC, FTC and any other governmental or regulatory authorities or agencies. No assurance can be given as to the timing or outcome of these matters. [*Id.*, ¶112.]

Throughout the Class Period, Defendants conflated the FTC investigation with the Company's prior wrongdoing relating to the Company having deceived investors/lenders, conduct the DOJ and SEC were investigating, with language similar or identical to that in the 3Q16 10-Q. *See id.*, ¶115 (February 14, 2017 earnings conference call); ¶122 (2016 10-K, filed on February 28, 2017 ("2016 10-K")); ¶129 (10-Q for the period ended March 31, 2017 ("1Q17 10-Q")); ¶138 (10-Q for the period ended June 30, 2017 ("2Q17 10-Q")); ¶143 (10-Q for the period ended

September 30, 2017 ("3Q17 10-Q")); ¶145 (February 20, 2018 earnings conference call); ¶153 (2017 10-K, filed on February 22, 2018 ("2017 10-K")). Having voluntarily disclosed the fact of the FTC investigation, Defendants never disclosed the actual issues the FTC was investigating were completely different from the board review issues the DOJ and SEC were investigating, and that they involved origination fees—the source most of LC's revenue. *See*, *e.g.*, *id.*, ¶¶5, 46, 50.

On April 25, 2018, the FTC announced in a press release that it had filed a Complaint against LC alleging that it had falsely promised consumers that their loans contained "no hidden fees," as well as other deceptive conduct in violation of FTC rules and regulations and the GLBA, including unauthorized withdrawals and false promises of loans. *Id.*, ¶¶157-59. On this news, shares of LC fell over 15%, from $3.26 to $2.77 per share. *Id.*, ¶161. The FTC filing was the first time the market learned that the FTC investigation concerned deceiving borrowers and origination fees comprising approximately 80% of the Company's revenues. *Id.*, ¶¶6, 160. On May 5, 2018, Defendants themselves finally told investors in their Quarterly Report that the FTC Complaint did not relate to the board review. *Id.*, ¶50. During a May 8, 2018 earnings conference call, in response to an analyst's specific question, Defendant Sanborn admitted that the FTC investigation and FTC Complaint were unrelated to the board review, and that LC had "self-identified" the issues the FTC investigated before the FTC ever notified the Company. *Id.*, ¶51.

Throughout the Class Period, the Individual Defendants signed multiple Sarbanes-Oxley ("SOX") Certifications in the Company's annual and quarterly reports (10-Qs and 10-Ks) attesting that the documents did not "contain any untrue statement of fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report." ¶¶ 97, 111, 117, 126, 135, 140, 148.

SUMMARY OF THE ARGUMENT

Defendants were not compelled, but instead *chose*, of their own volition, to speak to investors about ongoing investigations. Defendants further chose to link the Department of Justice ("DOJ") and SEC to the issues LC investigated in its "board review" relating to a scandal involving the Company deceiving investor/lenders, and were, therefore, duty-bound to disclose that the issues ***the FTC in particular*** was investigating were wholly distinct and unrelated to the board review and the DOJ and SEC investigations. From the start of the Class Period, the FTC was investigating allegations of systemic wrongdoing involving "origination fees"—which comprised ***over 80% of LC's revenues***. The failure to disclose that the FTC investigation involved unrelated potential wrongdoing in the wake of disclosing it in connection with the board review, is actionably misleading. Moreover, given the purposeful and misleading manner by which

Defendants linked the subjects of the FTC investigation to the DOJ and SEC investigations, and their post-class period admission that they "self-identified" the FTC issues before the FTC approached them, the SAC adequately pleads a strong inference of scienter.

Plaintiffs' operative Complaint alleges, with requisite particularity, that once Defendants disclosed the existence of the FTC investigation, they were duty-bound to disclose that it was unrelated to the board review, but instead, involved potential violations relating to 80% of Company revenue, material information of which they were aware or which they severely recklessly disregarded. In August 2016, Defendants improperly omitted disclosing the FTC investigation altogether. When, in November 2016, they finally chose affirmatively to disclose the existence of the FTC investigation, they lumped it together with the DOJ and SEC investigations, relating all three investigations to the board review and the scandal that was already well-known to the market.

During the Class Period, investors were unaware that the FTC investigation involved wholly distinct, previously-undisclosed allegations of wrongdoing. Ninth Circuit precedent compels the conclusion that once Defendants disclosed the FTC investigation, they were duty-bound to disclose all material information necessary to make their disclosure not misleading. They did not. The Complaint pleads with requisite particularity both falsity and scienter.

The district court erred in turning a fundamental principle governing the disposition of Rule 12(b)(6) motions, *i.e.*, that all reasonable inferences be viewed in the light most favorable to Plaintiffs, on its head. In so doing, the district court forthrightly refused to construe Defendants' spoken and written paragraphs according to their plain meaning, accepted inferences directly at odds with the well-pled facts in Plaintiffs' Complaint, and otherwise disregarded Ninth Circuit precedent in order to grant Defendants' motion to dismiss. Accordingly, this Court should reverse.

ARGUMENT

A. Standard of Review

This Court reviews *de novo* a decision granting a motion to dismiss for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6). *Grigsby v. BofI Holding, Inc.*, 979 F.3d 1198 (9th Cir. 2020).

B. The Complaint Adequately Alleges Falsity

1. The Complaint Adequately Alleges that Defendants' Disclosure of the FTC Investigation Was Misleading

The Court will accept all well-pleaded factual allegations as true, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007), drawing all reasonable inferences in the light most favorable to Plaintiffs. *In re Extreme Networks, Inc. Sec. Litig.*, No. 15-cv-4883-BLF, 2018 WL 1411129, at *8 (N.D. Cal. Mar. 21, 2018). A complaint must merely "raise a reasonable expectation that

discovery will reveal evidence" to prove the claim." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 545 (2007).

Regardless of any specific duty to disclose, the Exchange Act is clear that when Defendants spoke to investors about governmental investigations, and specifically the FTC investigation, "they had a duty to speak truthfully about material issues and not mislead investors when making representations to investors." *See* 17 C.F.R. § 240.10b-5(b); *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44-45 (2011). For this reason, the district court erred in finding that Defendants were not required to disclose the FTC investigation in August 2016, because the district court failed to look beyond a specifically-enumerated duty to disclose the FTC investigation, and not to Defendants' duty to speak truthfully. *See* 1-ER-013.

In stark contrast to the district court, the Ninth Circuit has made clear that a registrant's disclosing some information but withholding related, material, adverse information is actionable. *See Schueneman v. Arena Pharm., Inc*., 840 F.3d 698, 705-06 (9th Cir. 2016) (while "companies can control what they have to disclose under [the securities laws] by controlling what they say to the market[,] . . . once defendants cho[o]se to tout positive information to the market, they [are] bound to do so in a manner that wouldn't mislead investors") (internal citations and quotations omitted); *see also Khoja v. Orexigen Therapeutics, Inc.*, 899 F.3d 988,

1010 (9th Cir. 2018) (reversing dismissal, finding that defendants' disclosures regarding positive results of their drug study were true, but defendants still had a duty to disclose that the results were likely unreliable); *Berson v. Applied Signal Tech.,* Inc., 527 F.3d 982, 987 (9th Cir. 2008) (reversing the lower court's dismissal of the case, holding that "once defendants chose to tout the company's backlog, they were bound to do so in a manner that wouldn't mislead investors as to what that backlog consisted of").[3]

Defendants may not have had to speak about the FTC investigation, but once they chose to disclose it, they were duty bound not to mislead. Defendants violated that duty.

In LC's 2Q16 10-Q, Defendants described the board review issues at great length. 2-ER-090-97, ¶¶42-43. Defendants' failure to disclose the FTC investigation at that time misled investors to believe that the only material active

[3] In *Arena Pharm.*, for example, the defendants claimed that they were confident the FDA would approve their drug in part because animal studies showed that the drug was not carcinogenic. In fact, in one study rats receiving the drug had developed cancer. 840 F.3d at 700. When the FDA later revealed the facts about the rat study, investors were "completely blindsided" and Arena's stock price plunged. *Id.* at 703. Reversing the lower court's dismissal, the Ninth Circuit held that the complaint adequately alleged falsity and scienter because "Defendants intentionally withheld information material to the market's assessment of whether and when the FDA would likely approve lorcaserin." Id. at 709. In reversing, the Ninth Circuit was unmoved by the FDA's having ultimately approved the drug, viewing the alleged violations ex ante and finding that the adverse information the defendants withheld disabled investors from understanding the real risk of FDA approval or denial of the drug.

investigations were the DOJ's and the SEC's, relating to the Company's illegal conduct underlying the board review. The Complaint pleads not only that Defendants learned of the FTC investigation months earlier, in May 2016, 2-ER-081, ¶4, but that even before May, Defendants had self-identified all of the issues the FTC later investigated. 2-ER-100, ¶51. Having chosen to disclose material investigations, Defendants were required to reveal that the FTC was investigating deceitful conduct wholly unrelated to the other investigations, but rather, origination fees constituting over 80% of LC's revenue.

In LC's 3Q16 10-Q, Defendants disclosed the FTC investigation, but affirmatively linked it to the board review issues the DOJ and the SEC were investigating. 2-ER-098, 122, ¶¶46, 112. Ninth Circuit precedent compels a conclusion that, having chosen to speak about the FTC investigation, Defendants were duty-bound to not mislead. To paraphrase *Dataproducts*, 976 F.2d at 503, a jury could find that LC's failure to disclose the wholly distinct issues in the FTC investigation had a misleading effect on the market price of LC's stock.[4] Indeed,

[4] *See also Karinski v. Stamps.com, Inc.*, No. CV 19-1828-MWF (SKx), 2020 WL 281716, at *11-12 (C.D. Cal. Jan. 17, 2020) (company's statement about strong relationship with USPS misleading because defendants failed to reveal that USPS opposed its practices); *Vignola v. FAT Brands, Inc.*, No. CV 18-7469 PSG (PLAx), 2019 WL 6888051, at *10 (C.D. Cal. Dec. 17, 2019) (revelation of some bankruptcies materially misleading and not puffery because defendants omitted disclosure of delisting and another bankruptcy); *Baker v. SeaWorld Entm't, Inc.*, No. 14cv2129-MMA (AGS), 2019 WL 6118448, at *43-44 (S.D. Cal. Nov. 6, 2019) (once SeaWorld publicly discussed factors affecting attendance, it had a

the FTC's disclosure at the end of the Class Period, revealing to the market that its investigation had nothing to do with the issues investigated by the DOJ and SEC, involved wholly unrelated fraud involving origination fees, caused a swift, immediate plummet of the stock by 15%. 2-ER-080-081; 141-144; ¶¶6, 157-60.[5]

2. The Complaint Adequately Alleges that Defendants' Purported Risk Disclosures were False

Risk warnings are actionable as material omissions when the warning speaks to "entirely… as-yet-unrealized risks and contingencies" and fails to alert "the reader that some of these risks may already have come to fruition." *Berson*, 527 F.3d at 986; *see also Siracusano v. Matrixx Initiatives, Inc*., 585 F.3d 1167, 1181 (9th Cir. 2009) ("By choosing to speak about the [topic] Defendants assumed a duty to disclose material information" about it), aff'd, 563 U.S. 27 (2011).

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duty to be complete and disclose the impact of a critical documentary on attendance); *Deora v. NantHealth, Inc.*, No. CV 17-01825 TJH (MRWx), 2018 WL 4743494, at *3 (C.D. Cal. Mar. 27, 2018) (once defendant spoke about its relationship to a university, it was required to disclose adverse information regarding that relationship); *Shenwick v. Twitter, Inc.,* 282 F. Supp. 3d 1115, 1140 (N.D. Cal. 2017) (once Twitter spoke positively about user engagement, referencing monthly average user growth, it was duty-bound to disclose that the daily average user trend was negative); *In re Juno Therapeutics, Inc.*, No. C16-1069RSM, 2017 WL 2574009, at *5 (W.D. Wash. June 14, 2017) (once defendants discussed positively partial immunotherapy study results, they were duty-bound to disclose that a patient had died).

[5] This decline evidences the materiality of the substance of the FTC investigation as opposed to the fact of the investigation itself. *Greenberg v. Cooper Cos.*, No. 11-CV-05697 YGR, 2013 WL 100206, at *11 (N.D. Cal. Jan. 7, 2013); *Westley v. Oclaro, Inc.*, 897 F. Supp. 2d 902, 914 (N.D. Cal. 2012).

The Complaint alleges the falsity of multiple risk warnings, *see* 2-ER-113-144, ¶¶92, 100, 102, 104, 106, 122, 124, 127, 136, 141, 155, for failure to disclose the FTC investigation into deceitful conduct with borrowers, including its origination fees and violations of the GLBA, which was wholly unrelated to the DOJ and SEC investigations. When LC disclosed the theoretical risk of violating the FTC Act and the GLBA, but failed to disclose that they were aware, at that moment, that the FTC had been investigating the Company for just such violations since May 2016, and that the FTC investigation was unrelated to the board review issues, Defendants lied to investors. The risk had materialized in material part, and Defendants were duty-bound to inform investors. *See e.g.*, *Flynn v. Sientra, Inc.*, No. CV 15-07548 SJO (RAOx), 2016 WL 3360676, at *10–11 (C.D. Cal. June 9, 2016) (finding falsity and scienter even though defendants warned generally about risks of product contamination in production facilities).

Despite Defendants' boilerplate risk warnings, they "knew or recklessly disregarded" that the risk had specifically materialized. *Compare* 2-ER-125, ¶122 (in which Defendants warned of the risk of incurring "significant … expenses" related to "inquiries," a risk that had materialized because Defendants knew but did not disclose that the FTC was investigating issues unrelated to the board review) *with Maz Partners LP v. First Choice Healthcare Solutions, Inc.*, No. 6:19-cv-619-Orl-40LRH, 2020 WL 1072582, at *6 (M.D. Fla. Feb. 14, 2020) (risk warning

stating that stock price may experience "wide fluctuations" due to "factors unconnected to the Company's performance" materially misleading where defendants failed to disclose that they were actively manipulating the stock's price). *See also Matrixx*, 585 F.3d at 1181 (holding that a warning that the compan might incur legal costs inadequate when the company had already been sued). Hence, the Complaint adequately pleads the falsity of the risk warnings.

3. The Complaint Adequately Alleges that the Sarbanes-Oxley ("SOX") Certifications were False

Defendants violated SOX, presenting a materially inaccurate picture of the Company's operations while certifying that the Class Period reports neither contained "untrue statements of a material fact nor omitted to state material facts necessary to make the statement made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report," and that the Company's filings presented fairly, "in all material respects, the financial condition and results of operations of the Company." *See*, *e.g.*, 2-ER-123, ¶117. These statements are actionable because Defendants were aware that each filing's statements about investigations were misleading for failing to disclose that the FTC was investigating origination fees and GLBA violations and that the FTC investigation was wholly distinct from the board review and the DOJ and SEC investigations. 2-ER-100, ¶51. *See Roberti v. OSI Sys., Inc.*, No. CV 13-9174-MWF VBKX, 2015 WL 1985562, at *10–11 (C.D. Cal. Feb. 27, 2015)

(false certification adequately alleged when falsity of certification arises from same basic facts as other misrepresentations); *Maz Partners LP*, 2020 WL 1072582, at *4-5 (SOX certifications actionably misleading where defendants omitted revelation of a stock manipulation scheme).

4. The District Court Improperly Drew Inferences Against Plaintiffs on Key Factual Issues

On a Rule 12(b)(6) motion to dismiss, courts must take all allegations of material fact as true and construe then in the light most favorable to the Plaintiffs. *Extreme Networks*, 2018 WL 1411129, at *8. Dismissal is inappropriate unless the complaint "fails to state a claim to relief that is plausible on its face." *Arena Pharm., Inc.*, 840 F.3d at 704 (citations and internal quotations omitted). Nevertheless, The district court repeatedly substituted its own judgment for the Complaint's allegations and failed to draw reasonable inferences in Plaintiffs' favor. These errors were central to its decision to dismiss the suit.

a) The District Court Erred in Ignoring Basic Principles of Paragraph Construction

In dismissing the Complaint, the district court ignored basic conventions of paragraph construction to improperly convert what should be inferences in Plaintiffs' favor to inferences *against* Plaintiffs. One basic rule of paragraph

construction enunciated by Strunk & White exhorts writers to, "[a]s a rule, begin each paragraph with a topic sentence; end it in conformity with the beginning."[6]

Likewise, the Purdue University Writing lab instructs that:

> ***Every paragraph should include a topic sentence that identifies the main idea of the paragraph. A topic sentence also states the point the writer wishes to make about that subject. Generally, the topic sentence appears at the beginning of the paragraph. It is often the paragraph's very first sentence***. A paragraph's topic sentence must be general enough to express the paragraph's overall subject. But it should be specific enough that the reader can understand the paragraph's main subject and point.[7] (Emphasis added.)

Finally, the late Supreme Court Justice Antonin Scalia and the esteemed American lexicographer Bryan Garner concurred with the above authorities regarding the importance of paragraph topic sentences:

> **USE PARAGRAPHS INTELLIGENTLY; SIGNPOST YOUR ARGUMENTS**
>
> Section headings are not the only means of mapping your argument. Within each captioned section, paragraph breaks perform the same function. ***The first sentences of paragraphs (your fifth-grade teacher called them "topic sentences") are as important as captioned section headings in guiding your readers through your brief—telling them what next thought is about to be discussed***. Paragraph breaks should not occur randomly, inserted simply because the last paragraph was getting too long. They should occur when you are moving on to

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[6] https://faculty.washington.edu/heagerty/Courses/b572/public/StrunkWhite.pdf

[7] https://owl.purdue.edu/engagement/ged_preparation/part_1_lessons_1_4/index.html

> a new subpoint and wish to signal a change of topic.[8] (Emphasis added.)

The topic sentence of all of Defendants' disclosures from November 2016 onwards reads as follows: "On May 9, 2016, following the announcement of the board review described elsewhere in this filing, the Company received a grand jury subpoena from the U.S. Department of Justice (DOJ)." 2-ER-97, 122, ¶¶43, 112. The topic of this paragraph is ***the board review***, and the DOJ (and other) investigations stemming from it. One has to ignore the plainest way to read the paragraph in order to conclude that mentioning the FTC investigation in this paragraph did not create the affirmative impression that the FTC investigation was related to the board review issues, as the district court did here. 1-ER-012. The district court did the opposite of what Circuit precedent requires, *i.e.*, grant Plaintiffs all reasonable inferences in their favor, in order to conclude that origination fees are *not* one of the self-identified issues, a reading again ignores the fundamental principles of paragraph construction. The district court's total disregard the most plausible inference from the above-quoted disclosure merits reversal now.

[8] https://www.abajournal.com/magazine/article/making_your_case

b) The District Court Improperly Inferred that the Individual Defendants were not Adequately Alleged

In its order dismissing the Complaint, the district court found that Plaintiffs' falsity allegations lacked substantiation that each of the Individual Defendants knew what Plaintiffs say they knew. 1-ER-012 However, none of the materials considered by the district court in connection with Defendants' motion to dismiss permits the inference that Individual Defendants did ***not*** know what Plaintiffs say they knew.

As a threshold matter, Defendant Sanborn is properly alleged as a speaker who held himself out to investors and analysts as possessing knowledge about LC's "self identified" issues. 2-ER-100, ¶51. Further, Defendant Sanborn admitted that "the company" was the entity that self-identified the FTC issues. *Id.* The district court's reading of Defendant Sanborn's reference to "the company" as *excluding* the CEO and CFO of that same Company, *i.e.*, LC, stands in direct opposition to the benefit-of-the-doubt that Plaintiffs were entitled to receive at the pleading stage.

The district court erred, therefore, refusing to grant to Plaintiffs all reasonable, plausible inferences, requiring reversal.

c) The District Court Withheld Required Inferences on The Remaining Falsity Issues

With respect to Defendants' compliance-related misrepresentations, the

district court deprived Plaintiffs of the favorable inferences which they were due. Regarding Defendants' purported "risk warnings," in particular, the district court uncritically accepted Defendants' claim that the subject "risks that had *not* yet materialized," without anything other than Defendants' say-so, and over the Complaint's well-pled allegations. 1-ER-013-014.

In response to Plaintiffs' allegations that costs from legal inquiries were going to be materially higher because of the separate investigation whose nature defendants hid from investors, the district court instead held, nonsensically, that no relationship could be inferred between an entirely separate and highly-damaging investigation and the costs themselves. 1-ER-015-016. The district court's citation to *Extreme Networks*, the factual predicate of which is entirely unrelated to this action, underscores the district court's lack of any meaningful basis for rejecting these allegations.

Finally, the Court entirely disregarded that even if some of Defendants' GLBA violations had been cured before these statements concerning those violations were made, liability for those practices was still a possibility, and the FTC was investigating that very issue *at the time the statements at issue were made*. 1-ER-010-020. As with the other errors discussed above, the district court failed to accept the Complaint's factually-supported allegations as true, a requirement at the pleading stage.

C. The Complaint Adequately Alleges Defendants' Scienter

1. Standard of Review

"Falsity and scienter in private securities fraud cases are generally strongly inferred from the same set of facts and the two requirements may be combined into a unitary inquiry under the PSLRA." *In re Daou Sys., Inc.*, 411 F.3d 1006, 1015 (9th Cir. 2005) (citations and internal quotation omitted). Knowledge or deliberate recklessness satisfies the scienter element of a Rule 10b-5 claim. *Reese v. Malone*, 747 F.3d 557, 569 (9th Cir. 2014).

Courts evaluate scienter allegations holistically, avoiding scrutinizing each allegation in isolation. *Tellabs*, 551 U.S. at 324. All reasonable inferences from the Complaint that are "at least as compelling as any opposing inference" must be drawn in Plaintiff's favor, *id.* at 322-23, and if competing inferences exist, "a tie goes to the Plaintiff," *Maiman v. Talbott*, No. SACV 09-0012 AG (ANx), 2010 WL 11421950, at *5 (C.D. Cal. Aug. 9, 2010). "The inference [of] . . . scienter need not be irrefutable, *i.e.*, of the 'smoking-gun' genre, or even the 'most plausible of competing inferences.'" *Tellabs, Inc.*, 551 U.S. at 324. Courts "need not close their eyes to circumstances that are probative of scienter viewed with a practical and common-sense perspective." *S. Ferry LP, No. 2 v. Killinger*, 542 F.3d 776, 784 (9th Cir. 2008).[9]

[9] LC's scienter can be imputed from the scienter of any of the three individual

2. The Complaint Adequately Alleges Scienter Because Defendants Knew or Recklessly Disregarded that Their Statements Concerning The FTC Investigation Were Misleading When Made

Scienter is adequately pleaded where a complaint alleges that defendants knew of specific information undermining their public statements. *Arena Pharm.*, 840 F.3d at 707. Making statements while knowing facts "suggesting the statements were inaccurate or misleadingly incomplete is classic evidence of scienter." *In re Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 1022 (S.D. Cal. 2005).

a. Defendants' Self-Identification of The FTC Issues Prior to The Beginning of the Class Period Evidences Their Scienter

From August 2016 until the filing of the FTC Action on April 25, 2018, Defendants disclosed in SEC filings, press releases, and earnings conference calls that they had engaged in fraud against investors, namely the board review issues. Throughout the Class Period, Defendants discussed this fraud, remedial steps, and improvements in internal controls. Defendants omitted mention of the existence of the FTC investigation in August 2016. When they revealed the FTC investigation in November 2016, they linked it to the board review issues, though the FTC was investigating wholly distinct fraud upon borrowers. LC shareholders had no idea

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defendants. *Roberti v. OSI Sys., Inc.*, No. CV 13-9174-MWF (VBKx), 2015 WL 1985562, at *13 (C.D. Cal. Feb. 27, 2015).

the FTC was investigating practices related to origination fees comprising 80% of its revenues. Defendants, though, knew all along, and Defendant Sanborn admitted that Defendants had been cooperating with the FTC since it began its investigation. *see* 2-ER-098, 136, 139, ¶¶46, 146, 153, and even had self-identified the FTC's issues with respect to origination fees prior to the FTC investigation, which began at the start of the Class Period.

In May 2016, the FTC communicated with Defendants that the Company's practices with borrowers were being investigated for possible violations of Section 4 of the FTC Act and the GLB Act, separate and distinct from its prior fraud on loan investors. Defendants knew that this investigation had nothing to do with LC's ongoing board review. However, instead of letting investors know the true thrust of the investigation, Defendants chose to first, omit the fact of any FTC investigation, in both the Company's August 8, 2016 press release and conference call where Defendant Sanborn specifically discussed the comprehensive review of "controls, compliance and governance" and the DOJ and SEC investigations. 2-ER-113-115, ¶¶92-96.

Then, in filing after filing after they disclosed an FTC investigation in November 2016, for two years, Defendants led the market to believe that the FTC investigation was directly linked to their prior fraud and the DOJ/SEC investigations thereto. Defendant Sanborn finally admitted after the Class to an

analyst who specifically asked whether the FTC investigation was about the board review or something new, that the FTC investigation was not related to the board review, stating that "the company" identified the issues before the FTC approached them, and that the company fixed those issues (which it did not, in any event). The Complaint, though, alleges otherwise. The plausible inference that Defendants knew what the FTC was investigating as of May 2016, *see* 2-ER-100, ¶51, must be credited. Admissions of actual knowledge of material adverse facts suffices adequately to plead a strong inference of fraudulent intent.[10]

Here, Sanborn admitted that the FTC communicated potential violations in May 2016, prior to the start of the Class Period. As such, Plaintiffs have properly pled the requisite scienter. *See Evanston Police Pension Fund v. McKesson Corp.*, 411 F. Supp. 3d 580, 601-02 (N.D. Cal. 2019) ("[F]alsity may itself be indicative of scienter where it is combined with allegations regarding a management's role in the company that are particular and suggest that the defendant had actual access to

[10] The facts in *Purple Mountain Tr. v. Wells Fargo & Co.*, No. 3:18-cv-03948-JD, 2020 WL 127614 (N.D. Cal. Jan. 10, 2020), are almost identical to the facts alleged herein, where the CEO and Company admitted after the fact that they knew about customer concerns before certain of their misstatements or omissions, causing Wells Fargo to discontinue the offending program—self-identification and self-mediation. *Id.* at *6. The Court denied the defendants' motion to dismiss, in part, ruling that the defendants' admission that they knew about and remediated problems in a program in advance of allegedly false statements sufficed to plead a strong inference of scienter with requisite particularity. *Id.*

the disputed information, and where the nature of the relevant fact is of such prominence that it would be absurd to suggest that management was without knowledge of the matter" (quoting *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1000 (9th Cir. 2009) (quotation marks omitted)). This standard can be satisfied by "specific admissions from top executives" about their "access to information within the company." *Id. See also Karinski*, 2020 WL 281716, at *11-12 (defendants' referenced conversations with a third party supports an inference that defendants were aware that the USPS was not happy with its business practices); *Vancouver Alumni Asset Holdings Inc. v. Daimler AG*, No. CV 16-02942 SJO (KSx), 2017 WL 2378369, at *16 (C.D. Cal. May 31, 2017) ("Falsity itself can be indicative of scienter when allegations as to falsity are combined with allegations regarding a management's role in the company that are particular and suggest that the defendant had actual access to the disputed information.") (internal quotations omitted). Here, Defendants' collective admissions evidencing their knowledge of the FTC investigation and its contents focus constitute scienter. See *In re CV Scis.s., Inc. Sec. Litig.*, No. 2:18-cv-01602-JAD-BNW, 2019 WL 6718086, at *5 (D. Nev. Dec. 10, 2019) ("defendants' knowledge of the rejections constitutes, at the very least, deliberate recklessness as to whether the subsequent statements would mislead investors. The defendants' knowledge of the rejections thus raises a strong inference of scienter on its own, and it is at least as strong as

any opposing inference that the defendants lacked the requisite state of mind").

b. Hiding The Focus Of The FTC Investigation For Two Years Evidences Defendants' Scienter

Scienter and falsity are often established by the same facts. A strong inference of scienter is supported by allegations showing a statement was false. *See*, *e.g.*, *Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001) ("Because falsity and scienter in private securities fraud cases are generally strongly inferred from the same set of facts, we have incorporated the dual pleading requirements of 15 U.S.C. §§ 78u-4(b)(1) and (b)(2) into a single inquiry"). As described in detail, Defendants' Class Period filings repeatedly linked the FTC investigation to the board review issues. *See*, *e.g.*, 2-ER-122, ¶112. Further, during a February 20, 2018 earnings conference call, in direct response to a question from an analyst, who asked "which cases have been settled" and about the magnitude of the remaining cases, Defendant Sanborn stated that the remaining cases were a "derivative lawsuit from this which is not against the company," and, again, lumped the FTC investigation in with the DOJ and SEC investigations. 2-ER-136, ¶146. These allegations support a strong inference of scienter. Defendants' repeated misleading linkage of the FTC investigation to the board review when they knew that the FTC was conducting a wholly separate investigation indicates an intent to mislead. The "most powerful evidence of scienter is the content and context of [a defendant's] statements themselves." *Institutional Inv'rs Grp. v.*

Avaya, Inc., 564 F.3d 242, 269 (3d Cir. 2009). "[W]hen a defendant . . . is specifically asked, directly and repeatedly," about issues materially impacting a company, statements made by defendant in the face of contradictory evidence support an inference of scienter. *Id.* at 270. *See also id.* at 269-270 (defendants' statements that were inconsistent with their discounting policy constitutes "the most powerful evidence of scienter [in] the context of [defendants'] statements").

c. Defendants' Admission that They Were Warned of Potential FTC Violations Evidences Their Scienter

The Complaint alleges that Defendants were aware that their risk disclosures with respect to compliance with FTC regulations were false. Defendants admitted in their answer to the FTC Complaint that one of the Company's largest investors warned Defendants that their loan fee structure "is not clear and conspicuous and could be subject to [deceptive practices]," and that investor's legal counsel warned the Company that LC's misleading ads could subject the Company to law enforcement action. 2-ER-083, ¶9.

Further, the Company's own internal compliance reviews flagged the deceptive nature of the Company's fees. *Id.*, ¶¶9, 58. Additionally, in the wake of their previous investor scandal, LC and its management touted their focus on compliance, as the Company could not afford any further reputational damage. ¶94. Defendants made multiple statements touting their laser-like focus on compliance, particularly following the Company's previous admission of deceptive

conduct toward its investors. During the August 8, 2016, Q2 2016 Earnings Call, Defendant Sanborn described the Company's "relentless focus on compliance, security and risk management," and further, that "we're retraining employees on code of conduct and ethics, and reinforcing the importance of a high compliance culture." *Id.*

These statements are indicative of Defendants' knowledge not only of the Company's regulatory requirements (including its obligations under GLBA, which are also detailed in the Company's risk disclosures), but also the importance that any such investigation by the FTC would be to investors. Although Plaintiffs need not plead a motive to satisfy the elements of a Section 10(b) claim, *see Matrixx*, 563 U.S. 27, 48 ("absence of a motive allegation, though relevant, is not dispositive") (citation omitted), these allegations "contribute to [the Court's] evaluation of whether a strong inference of scienter is supported by the entirety of the complaint." *Skechers U.S.A. Secs. Litig. v. Skechers U.S.A.*, Inc., 273 F. App'x 626, 630 (9th Cir. 2008). Here, Defendants were motivated to continue to mislead analysts who had predicated favorable coverage of LC on management's response to prior control failures. *See* 2-ER-070; *see also* 2-ER-089, 098, ¶¶38, 45.

Defendants' admissions of knowledge of the FTC investigation, therefore, give rise to a strong inference of scienter. *Purple Mt. Tr.,* 2020 WL 127614, at *6.

d. Confidential Witnesses Add to the Indicia of Scienter

The former employee allegations contribute to a strong inference of scienter. Defendants admitted that they were continually monitoring customer feedback, and the CWs confirmed that LC management knew that the issues raised by the FTC were likely to be viewed as deceptive, and that management knew of thousands of complaints received from borrowers. ¶¶ 32, 131. According to CW1 and CW2, both of whom had personal knowledge, Company management knew that support representatives were fielding a material number of customer complaints concerning the hidden nature of the fees, and regarding borrowers receiving less money than they had contracted. ¶¶67-69, 74. *City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Tr. v. RH, Inc.*, 302 F. Supp. 3d 1028 (N.D. Cal. 2018), is on point. There, the court found that plaintiffs had adequately alleged scienter concerning defendants' knowledge of inventory problems, based on statements of confidential witnesses concerning customer complaints of the inventory problems. *Id.* at 1045. *See e.g.*, 2-ER-097-100, ¶¶43-44, 46, 50.

Both CW1 and CW2 had personal knowledge of these practices and management's knowledge of the practices. CW1 was a loan support staff representative at LC's headquarters from 2016 to 2018, and had knowledge of LC's training policies and directives to support staff from senior management. *Id.* ¶43-44. CW2 was a senior credit specialist at LC's San Francisco office, and had regular meetings with the Company's Senior Vice President of Operations in

which CW2 and other loan support staff reported the material number of customer complaints regarding the Company's hidden fees. CW1 also stated that CW1's direct supervisors and LC management knew that customers were confused about LC's fees as a result of the Company's misleading statements. *Id.*, ¶45. In addition, Defendants affirmatively trained and managed their support representatives to ensure consumer confusion. *Id.*, ¶44.

In re PMI Group. Inc. Sec. Litig., No. C 08-1405 SI, 2009 WL 3681669, at *3 (N.D. Cal. Nov. 2, 2009), is also on point. In that case, the court ruled scienter was adequately alleged where confidential witnesses stated that defendant company had been evaluating its credit risk and potential losses from mortgage defaults, and internal reports showed underwriters were performing below standards. Rather than disclose the problems, in conference calls during the Class Period defendants "repeatedly acknowledged that credit quality was critical to PMI's success and that they were directly involved with determining PMI risk management." *Id.* at *3. Similarly, here, management knew that representatives were materially misrepresenting the loan process and hidden fees, and instructed representatives not to read truth-in-lending disclosures to consumers. CW3 corroborated the statements of CW1 and CW2 that a material number of borrowers were calling to complain about hidden fees in LC's loans. ER-109-110; ¶¶75-79. According to CW3, who worked as both a member support representative and a

payment processing specialist at the Company's San Francisco office, roughly a quarter to a third of the calls taken every day from LC's member support team were from borrowers upset after receiving materially less proceeds than the amount of their loans, as a result of LC's deduction of hidden fees. *Id.* Further, CW3 stated that the Company tailored the training of member support personnel to deal with those specific complaints, id., demonstrating management's knowledge of the extensive customer confusion surrounding LC's fees.

Defendants knew or were reckless in both their risk disclosures and their statements linking the FTC investigation to the prior fraud, knowing that completely separate new potential FTC violations were occurring.

e. The Core Operations Doctrine Supports an Inference of Scienter

Scienter can be imputed to LC's key officers "based on the inference that [they] had knowledge of the 'core operations' of the company." *S. Ferry*, 542 F.3d at 781. The Ninth Circuit has held that core operation allegations can satisfy the PSLRA's scienter requirement in three ways: (a) "the allegations may be used in any form along with other allegations that, when read together, raise an inference of scienter that is 'cogent and compelling, thus strong in light of other explanations'"; (b) "such allegations may independently satisfy the PSLRA where they are particular and suggest that defendants had actual access to the disputed information"; and (c) "such allegations may conceivably satisfy the PSLRA

standard in a more bare form, without accompanying particularized allegations, in rare circumstances where the nature of the relevant fact is of such prominence that it would be 'absurd' to suggest that management was without knowledge of the matter." *Id.* at 785-86. *Evanston Police Pension Fund*, 411 F. Supp. 3d at 601-02 (the magnitude of the price-fixing conspiracy, its significance to McKesson's revenues, and the executive defendants' roles at the company, are sufficient to satisfy a "core operations" theory). The statements at issue here concern origination fees comprising approximately 80% of LC's revenue.

Defendants continually disclosed throughout the Class Period how important origination fees were to its financial and operational success. ER-086-087, ¶¶29-36. In addition, the CEO touted the Company's focus throughout the Class Period on compliance, and its cooperation with government authorities in its investigation of fraud. To suggest that Sanborn and LC's executives did not know what the FTC was investigating, origination fees comprising 80% of LC's revenue, is not only absurd, it is contradicted by Defendants' own admission. *See In re Obalon Therapeutics*, Inc., No. 3:18-cv-0352-AJB-WVG, 2019 WL 4729461, at *9 (S.D. Cal. Sept. 25, 2019) (core operations doctrine supports strong inference of scienter where defendants admitted working closely with audit committee and product at issue was most important to company); *Reese*, 747 F.3d 557, 576 (9th Cir. 2014) (absurd to suggest that executive overseeing operations after oil spill did not know

information contradicting statement that corrosion was occurring at a low rate), overruled on other grounds by *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech., Inc.*, 856 F.3d 605 (9th Cir. 2017).

The district court erred in holding that the core operations doctrine was inapplicable even though Plaintiffs' allegations involve origination fees comprising 80% of LC's revenue. 1-ER-025-026. Indeed, the district court accepted that origination fees were LC's core business, but disputed that an investigation centered on those same fees was sufficient to support the core operations inference. 1-ER-025. In fact, the district court's reasoning would invalidate *Reese* since "oil spills" were not BP's core product. The district court's rejection of directly on-point Ninth Circuit precedent warrants reversal.

f. The FTC Allegations Provide Additional Support for Scienter

The allegations in the FTC action add to the indicia of scienter, detailing LC's deceptive practices. 2-ER-141, ¶157. According to the FTC (based on, inter alia, its review of LC internal documents), LC's internal compliance reviews repeatedly cite the concealment of the up-front or origination fee as a significant problem for consumers. 2-ER-082; 103-04; ¶¶9, 58. One compliance review noted that the upfront fee was "not readily apparent." *Id.* "This omission," LC's compliance review cautioned, "could be perceived as deceptive as it is likely to mislead the consumer." *Id.*, ¶¶9, 58-59, 157. Similarly, one of LC's largest

investors warned Defendants that the up-front fee "is not clear and conspicuous" and could subject LC to an enforcement action. 2-ER-082, ¶9. That the FTC's allegations corroborate those of the former employees featured in the Complaint bolsters Plaintiffs' scienter allegations. *See, e.g., In re Flowers Foods, Inc. Sec. Litig.*, No. 7:16-CV-222 (WLS), 2018 WL 1558558, at *17-18 (M.D. Ga. Mar. 23, 2018) (pending lawsuits add to the indicia of scienter when they corroborate plaintiffs' other allegations).[11]

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that this Court reverse the district court's Judgment and remand with instructions to allow this case to proceed on all counts.

[11] Because the Complaint adequately pleads a primary violation under Section 10(b), it states a viable claim under Section 20(a).

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CERTIFICATE OF COMPLIANCE WITH NINTH CIRCUIT RULE 32-1

I certify that pursuant to Ninth Circuit Rule 32-1, this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B), as it contains 7,832 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman, 14-point font.

Dated: December 28, 2020

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CERTIFICATE OF SERVICE

I hereby certify that I caused the foregoing to be electronically filed with the Clerk of the Court for the United States of Appeals for the Ninth Circuit by using the appellate CM/ECF system on December 28, 2020, which will send notification of such filing to all parties and counsel registered for electronic filing of the submission.

Dated: December 28, 2020

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