CASE NO. 17-50840

IN THE UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII,

Plaintiff-Appellant,

v.

WHOLE FOODS MARKET, INCORPORATED; JOHN P. MACKEY, GLENDA JANE FLANAGAN; WALTER E. ROBB; A. C. GALLO; DAVID LANNON; KENNETH J. MEYER

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DITRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS – AUSTIN DIVISION
CASE NO. 1:15-cv-00681-LY
The Honorable Lee Yeakel

BRIEF OF DEFENDANTS-APPELLEES

GREENBERG TRAURIG, LLP

300 WEST 6TH STREET
SUITE 2050
AUSTIN, TEXAS 78701
TEL: (512) 320-7200
FAX: (512) 320-7210

Counsel for Defendants-Appellees

Employees' Retirement System of the State of Hawaii v. Whole Foods Market, Incorporated, et al.
Case No. 17-50840

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

1. PARTIES:

Plaintiff-Appellant:

Investors who purchased Whole Foods' common stock between July 31, 2013 and July 29, 2015, including Lead Plaintiff Employees' Retirement System of the State of Hawaii

Defendants-Appellees:

Whole Foods Market, Inc., is an indirect wholly-owned subsidiary of Amazon.com,Inc.

John P. Mackey, CEO of Whole Foods Market, Inc.

Walter E. Robb, III, ex-CEO of Whole Foods Market, Inc.

Glenda Jane Flanagan, ex-Chief Financial Officer of Whole Foods Market, Inc.

A. C. Gallo, President and Chief Operating Officer of Whole Foods Market, Inc.

David Lannon, Executive Vice-President of Operations of Whole Foods Market Services, Inc.

Kenneth J. Meyer, Executive Vice-President of Operations of Whole Foods Market Services, Inc.

2. ATTORNEYS:

For Plaintiff-Appellant:

Shawn A. Williams
Susan K. Alexander
Andrew S. Love
John H. George
ROBBINS GELLER RUDMAN & DOWD LLP
Post Montgomery Center
One Montgomery Street, Suite 1800
San Francisco, CA 94104
Phone: 415-288-4545
Fax: 415-288-4534

Danielle S. Myers
Susannah R. Conn
ROBBINS GELLER RUDMAN & DOWD LLP
655 West Broadway, Suite 1900
San Diego, CA 92101
Phone: 619-231-1058
Fax: 619-231-7423

Joe Kendall
Jamie J. McKey
KENDALL LAW GROUP, PLLC
3232 McKinney Ave., Ste. 700
Dallas, TX 75204
Telephone: 214-744-3000
Fax: 214-744-3015

Warren Price, III
PRICE OKAMOTO HIMENO LUM
728 Ocean View Center
707 Richards Street
Honolulu, HI 96813
Telephone: 808-538-1113
Fax: 808-533-0549

For Defendants-Appellees:

Gregory J. Casas
Jesse W. Wainwright
Justin Bernstein
GREENBERG TRAURIG, L.L.P.
300 West 6th Street, Suite 2050
Austin, TX 78701
Telephone: 512-320-7200
Fax: 512-320-7210

Jason S. Lewis
GREENBERG TRAURIG, L.L.P.
2200 Ross Avenue, Suite 5200
Dallas, Texas 75201
Telephone: 214-665-3600
Fax: 214-665-3601

Dated: January 19, 2018

/s/ Gregory J. Casas
Gregory J. Casas
Attorney of Record for Defendants-Appellees

STATEMENT REGARDING ORAL ARGUMENT

This appeal involves straightforward legal issues regarding proper pleading standards under the Private Securities litigation Reform Act ("PSLRA"), 15 USC 78(j). Plaintiff twice failed to plead falsity, scienter, and loss causation with particularity, as required by Rule 9 of the Federal Rules of Civil Procedure and the PSLRA, and further failed to plead a proper cause of action under Section 20(a), which would provide for derivative liability only if a Section 10(b) claim existed. After applying well-settled pleading standards as set forth by the Supreme Court and the Fifth Circuit, the District Court properly dismissed Plaintiff's claims with prejudice. Accordingly, the District Court's decision below can, and should, be affirmed without oral argument.

TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

STATEMENT OF THE ISSUES

a. The District Court was correct in ruling that Plaintiff did not properly plead falsity because Whole Foods did not state unearned revenue in violation of GAAP and because Defendants' statements regarding transparency and price competitiveness were merely aspirational and not false or misleading.

b. The District Court applied the correct legal standard in holding that Plaintiff did not sufficiently plead scienter as to the company or the individual Defendants, even in light of the Global Litigation Counsel's knowledge of both the California and New York City investigations.

c. The District Court was correct in ruling that Plaintiff did not sufficiently plead loss causation because the Defendants' discussion during an analysts call of the impact of the New York City Department of Consumer Affairs investigation on revenue was not the same as disclosing a fraudulent practice, especially given that the Department of Consumer Affairs ultimately stated that it found no evidence of systemic conduct.

d. The District Court properly dismissed Plaintiff's §20(a) claim because a Section 20(a) claim is a derivative claim, and the lack of any

underlying Section 10(b) claim necessarily meant that Section 20(a) was not violated. Plaintiff's improper pleading of falsity, scienter and loss causation could not overcome this result.

STATEMENT OF THE CASE

A. The District Court's Orders.

1. Ruling on Defendants' First Motion to Dismiss

Plaintiff's claims essentially arise out of a press release issued by the New York City Department of Consumer Affairs (the "NYC DCA") regarding incorrectly weighed and priced pre-packaged food. As part of its Amended Complaint, Plaintiff set forth a number of statements that formed the basis of its claims. The District Court grouped the statements into three categories:

> (1) aspirational statements about Whole Foods' commitment to transparency and quality, (2) statements about Whole Foods' price competitiveness and value initiatives, and (3) Whole Foods' financial results.

ROA.921.

According to the District Court, statements that Whole Foods was committed to quality and transparency, and that Whole Foods sought "to be a deeply responsible company in the communities where [it does] business around the world, providing ethically sourced, high-quality products and transparent information to [its] customers" were not actionable because they were generalized, positive characterizations, inactionable puffery, and "the type of vague, loosely optimistic affirmation that courts have repeatedly found immaterial as a matter of

law." **ROA.923** *(*citing *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 870 (5th Cir. 2003); *Boca Raton Firefighters and Police Pension Fund v. Bahash*, 506 F. App'x 32, 37 (2d Cir. 2012) (statement about company's "dedication towards transparent and independent decision-making process" not material)).

As for the second category of statements about Whole Foods' price competitiveness, the District Court found that plaintiff had not properly alleged that any of the statements were actually false when made. As the Court held:

> In the present case, none of the statements identified by the Retirement System as misleading relate to weights and measures or labeling specifically, nor do they address the accuracy of Whole Foods' pricing more generally. *See Shaw Group,* 537 F.3d at 541 (omission of information about problems with business partner did not make announcement of venture misleading where announcement neither stated nor implied anything about history of relationship).

ROA.925. Moreover, ruled the Court, "[n]othing in the complaint suggests that statements regarding Whole Foods' attempts to reduce prices across the board in order to remain competitive with lower-cost supermarkets had anything to do with whether all of Whole Foods' products were *accurately* priced with respect to each product's net weight." ROA.926, ROA.1161 n.2.

The Court also noted that the fact that the NYC DCA investigation was occurring did not necessarily require disclosure. ROA.926 (citing *In re Dell Inc., Sec. Litig.*, 591 F. Supp. 2d 877, 911 n.4 (W.D. Tex. 2008) (no allegation of duty to disclose SEC investigation into accounting practices)) (additional citations

omitted). The Court then ruled that: "in the absence of allegations explaining how the California and New York investigations rendered specific statements made by Defendants materially misleading, the complaint does not suggest that Whole Foods defrauded investors by failing to disclose the existence of those investigations." ROA.926.

With regard to the third category of statements, the Court ruled that the allegations in the amended complaint regarding Whole Foods' financial statements did not allege any falsity or fraud with particularity. As the Court noted:

> The Retirement System does not assert that Whole Foods' sales, net income, or gross profit were factually different from what Whole Foods reported; rather, the complaint simply alleges that the company's statements of financial performance were false when made because they were "driven" by the sale of items that were inaccurately weighed—and thus, in some cases, ostensibly sold at higher prices than their actual weights warranted. Yet the complaint does not state with particularity how the sale of inaccurately weighed items contributed to the falsity of any specific financial results. *See Dawes v. Imperial Sugar Co.*, 975 F. Supp. 2d 666, 698 (S.D. Tex. 2013) (allegation that misrepresentation extended to company's reported margins was insufficient because plaintiff "did not allege what [the] impact [on margins] was").

ROA.927-928.

The Court then addressed Plaintiff's allegations regarding GAAP violations. According to the Court, Plaintiff's allegations, that because some prepackaged food items were mispriced and that therefore Whole Foods financial statements were improper, were merely conclusory. ROA.928-929. Plaintiff needed to, and

did not, specify which transactions or amounts were overstated. ROA.929. Absent specific pleadings that link the exact overstated prices to alleged violations of GAAP, the Court determined that Plaintiff had not met the particularity requirements under the PSLRA. ROA.928-929.

The Court also ruled that Plaintiff had not alleged sufficient facts to meet the scienter pleading requirements under the PSLRA with regard to each named Defendant. The Court noted:

> [The PSLRA] requires a plaintiff to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2)(A). At minimum, this requirement impels a plaintiff to plead particular facts creating a "cogent and compelling" inference that the defendant acted with an "intent to deceive, manipulate, or defraud or that severe recklessness in which the danger of misleading buyers or sellers is either known to the defendant or is so obvious that the defendant must have been aware of it." *R2 Invs. LDC v. Phillips*, 401 F.3d 638, 643 (5th Cir. 2005) (quoting *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004)).

ROA.931. Plaintiff made no attempt to allege specific facts with regard to each defendant. Plaintiff's attempt to rely on statements made after the New York City DCA's investigation, showing that in house counsel was now aware of the investigations, and implying that other senior officers of Whole Foods must have known, was not sufficient, in the Court's view, to find that Plaintiff had adequately alleged scienter. The Court ruled that Plaintiff had not alleged specific facts to meet the PLSRA pleading standards for scienter. ROA.931-935.

Similarly, because Plaintiff had failed to allege with particularity that any of the defendants who signed the SOX certifications knew of any fraud or knew that the financial and accounting information was incorrect, the Court found that Plaintiff failed to allege specific facts to establish scienter through SOX certification violations. ROA.934. "[C]onsidering [Sarbanes-Oxley] certifications as part of the scienter analysis is proper only 'if the person signing the certification had reason to know, or should have suspected, due to the presence of glaring accounting irregularities or other "red flags," that the financial statements contained material misstatements or omissions.'" *Id.* (citing *Dawes*, 975 F. Supp. 2d at 693 (quoting *Cent. Laborers' Pension Fund v. Integrated Elec. Serv. Inc.*, 497 F.3d 546, 555 (5th Cir. 2007))). Because Plaintiff had not established the presence of any red flags, Plaintiff's attempt to rely on the SOX certifications fell short of what the law required. *Id*.

The District Court also ruled that Plaintiff had not specifically alleged loss causation. ROA.1392-1394. Plaintiff failed to allege that any of the statements made by the Defendants corrected any fraud or prior misstatements. As a result, the defendants did not make any "corrective disclosures" that could be tied to the drop in the stock price. The Court, as a result, correctly ruled that Plaintiff had not pleaded loss causation properly. ROA.1392-1394.

With regard to Plaintiff's Section 20(a) claim, the Court noted that "[c]ontrol person liability is secondary only and cannot exist in the absence of a primary violation." ROA.1394. Because Plaintiff had not adequately alleged a Section 10(b) claim, the Court found no basis to establish a Section 20(a) claim.

In allowing Plaintiff the opportunity to replead, the Court noted that even if the Court were to assume that Whole Foods did have a widespread practice of overweighing prepacked foods, Plaintiff's complaint failed to allege that such a practice would make Defendants' liable for securities fraud. Otherwise, "every individual who purchased the stock of a company that was later discovered to have broken the law could theoretically sue for fraud." ROA.937. Though the Court stated that Plaintiff's had not met the heightened pleading standards of the PSLRA, the Court allowed Plaintiff an opportunity to replead because the district courts ordinarily allow a plaintiff at least one chance to replead. ROA.937-938.

2. Ruling on Defendants' Second Motion to Dismiss

Plaintiff then filed its Second Amended Complaint ("SAC"). The District Court ruled that Plaintiff had not alleged falsity with particularity, and did not satisfy the PSLRA's pleading requirements. ROA.1389-1394. The Court found that Plaintiff's repackaged allegations of false statements regarding transparency, price competition and financial reporting did not satisfy the Court's concerns set forth in its order on Defendants' first motion to dismiss. ROA.1389-1394.

Plaintiff did allege new facts arising out of two affidavits submitted by Whole Foods to establish federal jurisdiction under the Class Action Fairness Act of 2005, 28 U.S.C. § 1332(d) in a consumer case in the Southern District of New York arising out of the NYC DCA investigation.[1] The Court ruled that the Moll Affidavits could not be used to satisfy the pleading standards for falsity under the PSLRA. According to the Court:

> The Retirement System argues that the Moll affidavits establish that Whole Food's financial results were materially inflated and thereby not "earned." The affidavits determined sales based on a hypothesis alleged in the pleadings in the [consumer] case, and the calculations contained in the hypothesis do not qualify as a factual admission of unearned sales revenue. In addition, the Moll affidavits address data solely as to the amount of certain products sold by Whole Foods during a three-year period. The data analyzed is based on aggregate sales and inventory records not pertaining to the weight and pricing of prepackaged products. Thus, no inference of the extent of mislabeling can be drawn based on the new allegations that rely exclusively on the Moll affidavits.

ROA.1389-1390. The Court ruled that Plaintiff had failed to allege falsity with particularity.

With regard to scienter, the Court ruled that Plaintiff's new allegations that because the Whole Foods management team was a "tightknit team" and often vacationed together, each individual Defendant must have known what in-house

[1] These affidavits were signed by Jeffrey Moll, a senior data mining analyst with Whole Foods, and were submitted to show that the District Court in New York had jurisdiction over a consumer class action under the Class Action Fairness Act of 2005, 28 U.S.C. § 1332(d). In this brief these affidavits are referred to as the "Moll Affidavits."

counsel knew about the California and New York City investigations was not sufficient to plead scienter with particularity. Finding that the Retirement System's scienter arguments "conflated" knowledge with scienter, and that the plaintiff had alleged only purported knowledge, not intent to deceive, "the second amended complaint does not add any credible factual allegations to support the Retirement System's theory of a system-wide scheme that was known to each Individual Defendant, and it fails to allege any facts that would distinguish among the Individual Defendants to allege each one's role, intent, and knowledge." ROA.1391-1392 (citing *Rosenzweig.*, 332 F.3d at 866 (scienter requires "intent to deceive, manipulate, or defraud" or "severe recklessness")).

With regard to loss causation, the District Court ruled that because Plaintiff failed to allege that any disclosure by Defendants was false or misleading, nor did Plaintiff allege that any statements made during the July 29, 2015 analysts call "reveal any new information regarding additional undisclosed inaccuracies or misstatements following the DCA's press release. Therefore, the stock decline on July 30, 2015, does not make the existence of loss causation plausible in this case." ROA.1393. (citations omitted).

The Court again dismissed the Section 20(a) claim due to Plaintiff's failure to adequately allege a violation of Section 10(b). ROA.1394.

Because Plaintiff had tried twice and failed to set forth sufficient allegations to satisfy the PSLRA and Rule 9, and because the Court found that a third attempt would not lead to a different result, the Court dismissed Plaintiff's claims with prejudice. ROA.1394-1395. That decision should be upheld.

SUMMARY OF DEFENDANTS' ARGUMENT

Plaintiff's pleadings wholly rely on the unsupported assumption that Whole Foods engaged in systemic and pervasive overpricing based on alleged violations of weights and measures regulations in California and in NYC. ROA.947-948 (SAC ¶¶ 21, 22, 24; App. Ex. A.) Plaintiff's allegations are not typical of a securities class action—they arise not from any disclosure by Whole Foods, but from the NYC DCA's headline-grabbing press release (the "DCA Release") about a pending investigation in which its inspectors conducted only a "snapshot" "sampling" of certain products at nine Whole Foods stores in NYC. To bolster its conclusory claim of systemic and widespread overpricing, Plaintiff cites to a stipulation entered into the previous fiscal year by Whole Foods in southern California concerning stores under separate management from those in NYC. In that stipulation too there was no admission of liability; it expressly provided that nothing in the complaint or stipulation, and no conduct to carry out its relevant provisions, "shall be deemed, considered or construed as any type of admission or concession by Defendants . . . of any fault, omission or wrongdoing." ROA.1032.

Nevertheless, Plaintiff assumes widespread tare weight violations that somehow materially inflated Whole Foods' financial results for three years of operations.

Plaintiff must allege particularized facts "capable of establishing" the falsity of Whole Foods' statements. *Stockman v. Flotek Indus., Inc.*, 2010 WL 3785586, at *15 (S.D. Tex. Sept. 29, 2010); *accord Dawes*, 975 F. Supp. 2d at 698 (explaining that plaintiffs must "allege[] facts sufficient to support an inference that the defendants made material misrepresentations or omissions."). To meet this burden, Plaintiff must demonstrate that identified statements were known to be inaccurate when made. *In re Lululemon Sec. Litig.*, 14 F. Supp. 3d 553, 571-72 (S.D.N.Y. 2014) (plaintiffs must plausibly allege *contemporaneous* falsity, *i.e.* a "failure to be truthful"), *aff'd* 604 F. App'x 62 (2d Cir. 2015).

Plaintiff's pleadings fall short of this threshold. Plaintiff's inference of systemic misconduct (*i.e.* "pervasive overpricing," "routine overcharging," (*see e.g.*, ROA.946, 960, 963-964, 967, 970, 975-978, 983-985, 995; SAC ¶¶ 21, 56, 60, 65, 68, 76, 81, 92, 94, 109) is based on the unreasonable assumption that allegations of wrongdoing in the California and the DCA investigations were (1) true, (2) related, and (3) system wide. But these allegations have been consistently denied by Whole Foods, never proven, and are not related to one another. The NYC DCA acknowledged it had no evidence of (i) fraud, (ii) knowledge by the Executives, or (iii) systemic problems across Whole Foods' stores. ROA.693-702.

Plaintiff's assumption that those unsubstantiated allegations were true and pervasive is not plausible and is fatal to its pleading.

Plaintiff's mischaracterized representations as to the Moll affidavits, submitted in a different case for purposes of establishing subject matter jurisdiction, does not plausibly support allegations that Whole Foods' financial statements violated GAAP. Moreover, Whole Foods did not restate any of its earnings as a result of either the California or the NYC DCA investigations. Further, Plaintiff has not alleged with particularity which transactions at issue were incorrect and how those transactions resulted in inaccurate financial statements. Plaintiff's broad, conclusory statements do not satisfy the pleading standards.

Plaintiff's reliance on Defendants' statements regarding price transparency, quality, and values also cannot support a claim of falsity under the PSLRA. These statements are inactionable puffery and, most tellingly, Plaintiff is unable to state that any of the individual defendants was not telling the truth when he or she made those remarks.

Plaintiff has not properly pled allegations of scienter among the individual Defendants. Plaintiff admittedly relies on group pleading, which is insufficient, but then justifies its improper pleading based on a claim that the individual defendants were a tightknit group who often vacationed together. Therefore, Plaintiff improperly surmises, the individual Defendants must have had knowledge

of the California and NYC DCA investigations. Two problems exist with this assertion. First, Plaintiff cannot rely on the fact that the individual defendants were "tightknit" and vacationed together in order to establish scienter. Second, even if Plaintiff is entitled to assume knowledge based on this theory, Plaintiff has not alleged intent to deceive or defraud, or even recklessness. To the contrary, the record reflects no systemic conduct and full disclosure.

Plaintiff also has not properly alleged loss causation. Plaintiff relies upon the temporal relationship between the analysts call and the decrease in share price to assume loss causation exists. But Plaintiff fails to address the actual statements made during the call. Those statements did not include any admission of wrongdoing, disclosure of restated earnings, or provide any information that had not already been released and discussed weeks prior to the call. Rather, the individual defendants simply stated that the publicity related to the NYC DCA's press release had impacted Whole Foods' brand, which was a risk factor set forth in Whole Foods' SEC filings on a continuing basis. Acknowledging the occurrence of a known and disclosed risk factor does not establish loss causation.

Finally, with regard to Plaintiff's Section 20(a) claim, Plaintiff's attempt to breathe life into this admittedly derivative claim by referring back to its pleadings, which Plaintiff assumes are sufficient to withstand scrutiny, is insufficient. Plaintiff's Section 20(a) claim should be dismissed.

ARGUMENT

I. LEGAL STANDARD.

The elements of a private securities-fraud claim based on Section l0(b) and Rule 10b-5 are (1) a material misrepresentation or omission; (2) scienter-a wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation—"a causal connection between the material misrepresentation and the loss." *Owens v. Jastrow*, 789 F.3d 529, 535 (5th Cir. 2015) (quoting *Lormand v. U S. Unwired, Inc.*, 565 F.3d 228, 238-39 (5th Cir. 2009)).

"Securities fraud claims brought by private litigants are also subject to the pleading requirements imposed by the [Reform Act]." *Owens*, 789 F.3d at 535. "At a minimum, the [Reform Act] pleading standard incorporates the 'who, what, when, where, and how' requirements" of Federal Rule of Civil Procedure 9(b). *Id.* (quoting *ABC Arbitrage Plaintiffs Grp. v. Tchuruk*, 291 F.3d 336, 349-50 (5th Cir. 2002)). This means that "a plaintiff pleading a false or misleading statement or omission as the basis for a section 10(b) and Rule 10b-5 securities-fraud claim must, to avoid dismissal pursuant to Rule 9(b) and [the Reform Act]," identify the allegedly misleading statement with particularity, explain why the statement was misleading, identify the speaker, state when and where the statement was made, and plead with particularity what the person making the misrepresentation obtained

thereby. *Goldstein v. MCI WorldCom*, 340 F.3d 238, 245 (5th Cir. 2003). Additionally, to adequately plead the element of scienter, "the [Reform Act] requires a plaintiff to 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."' *Owens*, 789 F.3d at 535 (quoting 15 U.S.C. § 78u-4(b)(2)). In the Fifth Circuit, "[t]he required state of mind [for scienter] is an intent to deceive, manipulate, or defraud or severe recklessness." *Lormand*, 565 F.3d at 251 (quoting *Ind. Elec. Workers' Pension Trust Fund IBEW v. Shaw Grp., Inc.*, 537 F.3d 527, 533 (5th Cir. 2008)).

The PSLRA requires that "the complaint shall, with respect to each act and omission alleged to violate this chapter, state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (emphasis added). It is not enough to set out "facts from which, if true, a reasonable person *could* infer that the defendant acted with the required intent" to deceive, for that gauge "does not capture the stricter demand Congress sought to convey in [the PSLRA]." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007) (emphasis added). Plaintiff's inference of fraud must not only be cogent, but also must be "at least as compelling as any opposing inference of nonfraudulent intent." *Id.* In determining whether this standard has been met, the court must consider "not only the inferences urged by the plaintiff . . . but also competing inferences rationally drawn from the facts

alleged." *Id.* Scienter can only be shown if the Plaintiff pleads, with particularity, and not by group pleading, that each defendant acted with intent or with severe recklessness. *Southland*, 365 F.3d at 365-66.

With regard to scienter, the Fifth Circuit has rejected the "group pleading" approach to scienter. *Shaw Grp.*, 537 F.3d. at 533. This means that "[i]t is insufficient to impute to each defendant a kind of collective knowledge of all the corporation's officers and employees acquired in their employment." *Carlton v. Cannon*, 184 F. Supp. 3d 428, 459 (S.D. Tex. 2016) (amended for unrelated reasons on denial of reconsideration) (citing *Flaherty & Crumrine Preferred Income Fund, Inc. v. TXU Corp.*, 565 F.3d 200, 208 (5th Cir. 2009)). Rather, "plaintiffs pleading fraud claims against individuals under § 10(b) and Rule l0b-5 [must] distinguish among the defendants and allege each one's role, intent, and knowledge." *Id.* The court, in turn, must "look to the state of mind of the individual corporate official who allegedly made, approved, or issued [each] statement at issue, or who furnished information or language to include in the statement." *Id.* In other words, "allegations claimed to show scienter on each defendant's part must be analyzed individually to determine whether the complaint sufficiently pleads scienter as to that defendant." *Id.*

A court assessing the sufficiency of scienter allegations must ‘‘take into account plausible inferences opposing as well as supporting a strong inference of

scienter." *Owens*, 789 F.3d at 536 (quoting *Shaw Grp.*, 537 F.3d at 533). A complaint will survive only if the inference of scienter is "at least as compelling as any opposing inference of nonfraudulent intent." *Id.*

To plead loss causation, "the plaintiff must allege that when the 'relevant truth' about the fraud began to leak out or otherwise make its way into the marketplace, it caused the price of the stock to depreciate and, thereby, proximately caused the plaintiffs economic harm." *Pub. Emps. Ret. Sys. of Miss. v. Amedisys, Inc.*, 769 F.3d 313, 320 (5th Cir. 2014) (quoting *Lormand*, 565 F.3d at 255).

II. PLAINTIFF HAS FAILED TO PLEAD FALSITY WITH PARTICULARITY UNDER THE PSLRA.

A. Plaintiff's Allegations of Violations of GAAP Are Insufficient.

Plaintiff's bare allegations of violations of GAAP are insufficient to establish falsity. ROA.999-1007 (SAC ¶¶ 124-138); *Shaw Grp.*, 537 F.3d at 534 n.3. Plaintiff may not rely on a "general allegation that the practices at issue resulted in a false report of company earnings." *See Gross v. Summa Four, Inc.*, 93 F.3d 987, 996 (1st Cir. 1996), *superseded by statute on other grounds as recognized in Greebel v. FTP Software Inc.*, 194 F.3d 185, 197 (1st Cir. 1999); *see City of Phila. v. Fleming Cos.*, 264 F.3d 1245, 1258 (10th Cir. 2001) ("allegations of GAAP violations or accounting irregularities" only state a claim of scienter where "coupled with evidence that the violations or irregularities were the result of

. . . fraudulent intent to mislead investors"). To support an inference of scienter, a GAAP violation "must extend in nature and magnitude beyond merely the materiality threshold . . . [to] be so grievous as to suggest 'no audit at all.'" *In re Dell*, 591 F. Supp. 2d at 904 (internal citation omitted); *see also Shaw Grp.*, 537 F.3d at 534 n.3.; *Shushany v. Allwaste, Inc.*, 992 F.2d 517, 522 (5th Cir. 1993) (holding that allegations of GAAP violation were insufficient under Rule 9(b) where plaintiff failed to specify adjustments made, how adjustments were improper in terms of reasonable accounting practices, how they were incorporated into company's financial statements, and whether they were material in light of company's overall financial position).

Plaintiff's pleadings fail to meet this standard. Nowhere does Plaintiff allege any facts or the amount of any supposed GAAP revenue recognition rule violation. ROA.999-1007 (SAC ¶¶ 124-138.) *See Konkol v. Diebold, Inc.* 590 F.3d 390, 400 (6th Cir. 2009) (abrogated on other grounds) (finding no inference where plaintiff failed to specify amount of revenue overstated; defendant was "multi-billion dollar company and . . . the amount of improperly recognized revenue would have to be significant in order to support a finding of scienter"). Moreover, Plaintiff's pleadings fail to allege any facts that show Whole Foods or any executive signing its filings intended to mislead investors. The revenue Whole

Foods recognized was realized, and Whole Foods financial reports have not been restated.

Similarly untenable is Plaintiff's argument that Whole Foods misstated its earnings *vis-à-vis* weights and measures violations. Whole Foods earned revenue upon payment at the cash register. This is not a sham transaction case. Plaintiff alleges that Whole Foods' products were weighed (therefore priced) incorrectly, not that Whole Foods sold fictitious products, or round-tripped products. *In re Suprema Specialties, Inc. Securities Litigation*, is entirely off-point. *See* 438 F.3d 256, 265 (3d Cir. 2006) ("round-trip sales scheme" in which defendant sold "fictitious products" to "entities posing as suppliers" and they sold them back resulted in misstated accounts). Nor does Whole Foods offer to refund any customer who purchased a misweighed product (ROA.1337) make the transaction a sham or the revenues unearned. Such a position would render any company that offered a refund for a defective product susceptible to a suit for securities fraud.

Plaintiff conclusorily alleges that throughout the putative class period Whole Foods overstated its revenue in violation of GAAP. But, to state a claim of financial statement fraud, Plaintiff must "identify specific transactions in which there was improper revenue recognition and the materiality of such transactions and must identify any resulting restatements." *In re Alamosa Holdings, Inc.*, 382 F. Supp. 2d 832, 853 (N.D. Tex. 2005). What Plaintiff does here, merely pleading

"unwarranted inferences with no factual predicate or the required particularity as to the calculated amounts," is insufficient. *Id.* at 854; *accord Dawes*, 975 F. Supp. 2d at 698. Plaintiff's "unsupported allegations that the numbers should have been different does not state a claim, especially when [the defendant] has never been required to restate its financial statements." *Alamosa*, 382 F. Supp. 2d at 854.

B. Plaintiff Mischaracterizes the Moll Affidavits, Which Do Not Support Any Allegation of Falsity.

Contrary to Plaintiff's unsupported conclusions, the Moll Affidavits neither admit nor support a strong inference of financial statement fraud by Whole Foods. Mr. Moll, a WFM data analyst, submitted two affidavits in a consumer class action, *Joseph Bassolino v. Whole Foods Market Group, Inc.*, 15 Civ. 6046 (PAE), in the United States District Court for the Southern District of New York, for the discrete purpose of demonstrating that "if" liability were assumed, and all damages alleged were taken as true (*i.e.* if *all* products sold within 80 types of pre-packaged product categories *were actually mislabeled*), damages could exceed the $5 million threshold for removing the case to federal court under the Class Action Fairness Act of 2005, 28 U.S.C. § 1332(d) ("CAFA").

The Moll Affidavits considered "all pre-packaged meat, dairy and baked goods products sold at every Whole Foods store in New York State for a three year period." ROA.1060. Defendants pointed out in their papers below the errors in Plaintiff's "extrapolation" of inflated revenue from the Moll Affidavits, where

those Affidavits could not identify how many packages within the broad "meat, dairy and baked goods" product categories were actually mislabeled, if any, how many of those errors accrued in consumers' favor, or the extent of the alleged over or underpricing (*i.e.* whether $.10 or $1.00, etc.). ROA.1168-1169. Rather than making any admission, the Moll Affidavits assumed the grossly overbroad claims alleged and set forth sales based on that hypothesis; this is simply how the amount in controversy is determined.

In order for the Moll Affidavits to comport with the allegations in the consumer class complaint, Moll's analysis assumes hundreds of products and tens of thousands of packages. As Moll himself explained, "[w]here the DCA information as to the packages it inspected did not indicate a particular product with sufficient specificity, our analysis included the category of that product (*e.g.* cheese)." ROA.1045 at ¶ 4. The limited tests run by the DCA are no basis to conclude that every product within the over $85 million in "cheese" purchased in NYC over a 3 year period was mislabeled, or that such mislabeling favored Whole Foods rather than the consumer in each instance. And even if the *Bassolino* allegations had been true, Whole Foods' financial statements still would not have been false.

Though the Court may take judicial notice of the Moll Affidavits, the hypothetical calculations contained therein are not "factual admissions" that the

Court must accept as true.[2] To draw Plaintiff's inference one must presuppose that the allegations in the *Bassolino* complaint—that all meat, dairy and baked good packages were mislabeled—are in fact true. The Moll Affidavits do not assume the truth of those allegations for purposes of the merits, only for addressing the jurisdictional issues; therefore, Plaintiff's reliance on those documents to establish those allegations as truth on the merits here is an unsupportable bootstrap.

Plaintiff's argument also fails because the data analyzed were aggregate sales and inventory records, not data pertaining to the weight and pricing of prepackaged products. Moll had no way of determining whether any particular item sold had actually been misweighed or mispriced, nor did he opine on revenue received or income earned, and his affidavits do not suggest the contrary. They concern sales data of particular types of products and are silent as to the essential issue of pricing. There simply was no judicial admission and consequently there is no basis to infer financial statement falsity.

[2] Plaintiff argues that the trial court rejected admissions sworn to in the Moll Affidavits. Appellant's Brief at 35-37. What the trial court did was properly identify the statements in the Moll Affidavits as merely assumptions underlying amount-in-controversy calculations for purposes of establishing jurisdiction under the Class Action Fairness Act of 2005. Estimating what damages might be if all allegations were true, all units of a product with one allegedly mispriced unit were mispriced, and all mispricing was in Whole Foods' favor is not the same as admitting those hypothetical assumptions, nor is it a basis to establish falsity under the PSLRA.

C. Defendants' Aspirational Comments Regarding Transparency, Price Quality and Core Values Are Inactionable.

Plaintiff ignores controlling case law establishing that puffery and other aspirational statements "about a company's competitive strengths," corporate culture, and integrity are inactionable. *Rosenzweig.*, 332 F.3d at 869. Whether the allegedly false statements are characterized as puffery, opinion, or aspirational statements, they are not an actionable basis for securities fraud. ROA.671-672 (citing cases); *see also In re JP Morgan Chase Sec. Litig.*, No. 02-1282, 2007 WL 950132, at *4, *12 (S.D.N.Y. Mar. 29, 2007), *aff'd sub nom. ECA Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase*, 553 F.3d 187 (2d Cir. 2009) (statements regarding "integrity" are "precisely the type of puffery that this and other circuits have consistently held to be inactionable") (internal quotation marks omitted). Investors do not rely on such statements as "[Whole Foods] has the highest standards in the industry;" "we have great prices, and we're proud to show you," "we seek to be a deeply responsible company . . . providing . . . transparent information to our customers." *See In re Plains All Am. Pipeline, L.P. Sec. Litig.*, 245 F. Supp.3d 870, 891, 902 (S.D. Tex. 2017) (aspirational statements are mere corporation cheerleading that a reasonable investor would not rely on).

In *City of Monroe Employees Retirement System v. Bridgestone Corp.*, 399 F.3d 651 (6th Cir. 2005), relied on by Plaintiff, the court held that similar statements of corporate optimism are not a basis for securities fraud. It found that

although Firestone tires were alleged to have undisclosed defects that caused 41 fatalities, the company's statements that it sold "the best tires in the world," that its products demonstrated "global consistent quality," earning high regard from automakers for "strength" in product quality," and that it had "full confidence" in its "premium quality" tires, were inactionable puffery. *Id.* at 671-72. These statements, "best characterized as loosely optimistic statements insufficiently specific," were immaterial as a matter of law. *Id.* at 671. None of the statements identified by Plaintiff are tethered to weights and measures or any other specific operational activity.

Plaintiff repeatedly alleges that Whole Foods' statements of its commitment to transparency, accountability, and value are false because there was, Plaintiff assumes, pervasive overpricing. But statements about a company's aspirations, values, standards, strengths and future prospects, or general expressions of optimism, cannot support a securities fraud claim—they contain "no *concrete* factual or material misrepresentation." *Southland*, 365 F.3d at 372 (citation omitted); *Rosenzweig*, 332 F.3d at 869 ("generalized, positive statements about [a] company's competitive strengths, experienced management, and future prospects are not actionable because they are immaterial"). Similarly, statements regarding corporate culture and integrity are inactionable. *See In re Fleming Cos. Inc. Sec. & Derivative Litig.*, 2004 WL 5278716, at *26 (E.D. Tex. June 16, 2004) (holding

that the statement that company instituted a "culture of thrift," despite executives' alleged personal use of corporate jets, inactionable); *see also Footbridge Ltd. v. Countrywide Home Loans, Inc.*, 2010 WL 3790810, at *24 (S.D.N.Y. Sept. 28, 2010) (rejecting as puffery statement that company had "maintain[ed] a very strong internal control environment . . . [O]ur culture is also characterized by a very high degree of ethics and integrity in everything we do.").

Plaintiff's repeated allegations that Whole Foods' statements of its goals, including transparency, value and accountability, are "false" or "misleading" (*see* ROA.943, 946-947, 963-965, 967-969, 973-974, 977-980, 982-983, 992, 1007-1008 at SAC ¶¶ 10, 19, 21, 58-60, 64-65, 71, 74, 77-78, 81-82, 89-91, 104, 140) must be ignored. *First*, these statements are true. They represent Whole Foods' beliefs and aspirations, and Plaintiff has not pointed to any fact that speaks otherwise. *Second*, they are not concrete or material statements of fact, and therefore cannot constitute actionable "misrepresentations." *See Southland*, 365 F.3d at 372. Statements about "competitive" pricing initiatives or price "integrity" (ROA.943-946, 948, 958-959, 965-966, 969-970, 974-978, 981 at SAC ¶¶ 10, 13, 16, 19, 23, 53, 62, 66, 74, 76, 78, 86) are similarly inactionable as statements of corporate goals or strengths. *See*, *e.g. In re Software Pub. Sec. Litig.*, 1994 WL 261365, at *8 (N.D. Cal. Feb. 2, 1994) ("Statements that the company 'is now

positioned to effectively compete' are the type of statements that this court has repeatedly found inactionable.")[3]

Statements of belief or optimism with regard to Whole Foods' financial condition are similarly not actionable. *See* ROA.965-966, 969-970, 974-975 at SAC ¶¶ 62, 66, 73-74. Investors and analysts rely on concrete facts in determining the value of a security, *see Rosenzweig*, 332 F.3d at 869, not on "corporate 'cheerleading'" and other "vague expressions of optimism." *In re Franklin Bank Corp. Sec. Lit.*, 782 F. Supp. 2d 364, 381 (S.D. Tex. 2011) (citation omitted). Whole Foods' statements of expectation as to financial trends and sales momentum, or how various initiatives would play out "over the long term," (*see* ROA.969-970, 983 at SAC ¶¶ 66, 90) are inactionable expressions of corporate optimism. Indeed, "as long as public statements are reasonably consistent with reasonably available data, corporate officials need not present an overly gloomy or cautious picture of the company's current performance." *Abrams v. Baker Hughes Inc.*, 292 F.3d 424, 433 (5th Cir. 2002).

Plaintiff also argues that Defendants "concealed" the California and New York investigations.[4] [Appellant's Brief at p. 31]. Plaintiff has no support for this

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[3] As an aside, Plaintiff repeatedly uses adjectives, such as "rampant," "numerous," or "gross violation" presumably in an attempt to dress up conclusory allegations that otherwise do not pass muster under applicable pleading standards. Such rhetoric misstates the record and should not be considered.

[4] Defendants note that the settlement amounts are not material. As explained in the District Court, the $500,000 payment to settle the NYC DCA investigation over $15 billion in

allegation. To begin with, Defendants were under no obligation to disclose a mere investigation. *Dawes*, 975 F.Supp. 2d at 701. Second, Defendants did disclose the investigation, once settled or once otherwise made public, through letters to customers and videos. *See* ROA.706, ROA.708-709. Plaintiff's arguments regarding "concealment" are unsupported by the record and should be disregarded as mere argumentative rhetoric.

In light of the foregoing, Plaintiff has failed to plead falsity.

III. THE DISTRICT COURT CORRECTLY RULED THAT PLAINTIFF HAS FAILED TO PLEAD SCIENTER WITH PARTICULARITY AS TO EITHER WHOLE FOODS OR THE INDIVIDUAL DEFENDANTS.

Plaintiff has failed to raise a strong inference of scienter. Plaintiff claims (1) Whole Foods knew about the possibility of violations in California in 2013 or 2014; (2) John Hempfling, Whole Foods' Global Litigation Counsel, signed the SA and the CO; (3) Mackey, Robb and Flanagan signed Whole Foods' SEC filings and SOX certifications; and (4) Robb and Mackey "admitted" to "misconduct" by stating that the company "made some mistakes." ROA.1343-1349. None of these allegations allow a strong inference of scienter.[5]

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revenue, and the $800,000 payment in California over $14 billion in revenue and gross profits of $5 billion (ROA.664) are neither quantitatively nor qualitatively material.

[5] Plaintiff, in its opening brief, argues that Whole Foods settled the California claims one week after the complaint was filed. Plaintiff disingenuously misrepresents the timing involved in the California investigation. As recognized in the record, California began its investigation in 2012, and after years of investigations and negotiations, Whole Foods finally agreed to settle the claims against it in 2015. ROA.690. The initiation of the suit and the settlement followed as a matter of course.

Scienter cannot be established by hindsight. Plaintiff must "allege specific facts relating . . . to each Defendant-speaker sufficient to give rise to a strong inference that the speaker knew his statement was false when it was made." *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 917 (S.D. Tex. 2001). Thus, *contemporaneous* events must be alleged to create an inference that is "cogent and at least as compelling as any opposing inference of nonfraudulent intent." *See Tellabs, Inc.*, 551 U.S. at 314.

In-house counsel's *ex post* knowledge of the investigations—even assuming the individual Defendants shared that knowledge, which the consent order disclaimed—does not create an inference that any Individual Defendant spoke with scienter at the time of the alleged statements.[6] ROA.1344. An inquiry into scienter "focuses on the state of mind of the corporate officials who make, issue, or approve the statement rather than the 'collective knowledge of all the corporation's officers and employees.'" *Local 731 I.B. of T. Excavators & Pavers Pension Trust Fund v. Diodes, Inc.*, 810 F.3d 951, 957 (5th Cir. 2016) (citation omitted). In-house counsel's knowledge does not allow an inference of scienter by the individual Defendants (expressly disclaimed in the consent order). ROA.695-696 at ¶ 18.

[6] As addressed *supra* at n. 2. Plaintiff's claim that in-house counsel was a senior member of leadership (Appellant's Brief at 42) is a conclusory assumption that cannot support Plaintiff's arguments regarding scienter. Plaintiff's cite to *City of Monroe*, 399 F.3d 651, which involved an Executive Vice President, is inapposite. Accordingly, any attempt to impute knowledge to the leadership team based on in-house counsel's title and alleged position in the leadership ranks should be disregarded.

Nor does mere knowledge of a regulatory complaint allow for a "strong inference" of "intent to deceive, manipulate, or defraud" or "severe recklessness." *Rosenzweig*, 332 F.3d at 866. Knowledge that allegations have been made is not equivalent to knowledge that they are true. *See Curry v. Yelp Inc.*, No. 14-03547, 2015 WL 1849037, at *12 (N.D. Cal. Apr. 21, 2015) (*aff'd Curry v. Yelp Inc.*, 875 F.3d 1219 (9th Cir. Nov. 21, 2017).[7] This also holds true for Whole Foods' agreement to audit and monitor weights and measures into the future. Any reliance on such events to create scienter depends on the impermissible theory that "the fact that something turned out badly must mean defendant knew earlier that it would turn out badly." *Lormand*, 565 F.3d at 254.

In-house counsel's or Whole Foods' executive's, knowledge of the investigations is irrelevant. Knowledge of an investigation is not knowledge that the conduct at issue has actually occurred. There are simply no allegations allowing an inference that Hempfling or any executive knew of systematic overpricing by Whole Foods or had any duty to disclose "uncharged, unadjudicated wrongdoing or mismanagement." *Ciresi v. Citicorp*, 782 F. Supp. 819, 823 (S.D.N.Y. 1991).

[7] Whole Foods was under no duty to disclose the weights and measures investigations. *See Dawes*, 975 F. Supp. 2d at 701 (no duty to disclose company's use of co-packing and inference of material misrepresentation not plausible where omitted co-packing fees were less than 1% of sales).

Plaintiff's reliance on the allegations in those investigations as evidence sufficient to support its claims is misplaced.[8] With respect to California, the Settlement Agreement disavows any finding of wrongdoing (ROA.552 at ¶ 16), and the underlying complaint did not even *allege* intentional conduct. ROA.536-537. Whole Foods' settlement of that lawsuit does not support any inference of securities fraud. *See Samson v. Apollo Res., Inc.*, 242 F.3d 629, 639-40 (5th Cir. 2011) (refusing "to disregard the express stipulation and agreement of the parties and to now infer an admission of liability" by defendant where the prior settlement stated it was not "an admission of any liability or waiver of any defenses").

The DCA also made explicit that it had not found evidence of "systematic or intentional misconduct." ROA.695 at ¶ 17. Courts will not infer wrongful conduct from an agreement that expressly denies it; such a policy would give defendants "little incentive to settle cases." *Reynolds v. Roberts*, 202 F.3d 1303, 1315 (11th Cir. 2000) (refusing to infer wrongful conduct from a consent decree that did not admit liability). *Pfizer Shareholder Derivative Litigation*, 722 F. Supp. 2d 453 (S.D.N.Y. 2010) (Opp. 16), in which the court inferred scienter from plaintiff's admission to illegal off-label promotion of drugs, is vastly different. *Id.* at 457. In

[8] Plaintiff also references a handful of citations in Albany, NY. References to these citations, without more, provides no additional support for Plaintiff's allegations of scienter. Plaintiff assumes and concludes that these citations are part of systemic conduct, a claim which has been debunked and admitted not to exist by the very agency that originally made the allegation. To the extent that the citations in Albany do reflect weights and measures errors, Plaintiff has set forth no plausible allegations that transform these errors into anything larger or nefarious.

Pfizer, company subsidiaries paid hundreds of millions in fines and penalties and pled guilty to criminal charges; the settlement at issue amounted to $2.3 billion to settle civil *and criminal* charges. *Id.* at 455-57. The two settlements here are far removed from such a case.[9]

Plaintiff's cite to *Lormand.*, 565 F.3d at 254 n.17, and its statement that the Court, "flips scienter jurisprudence on its head" is unpersuasive and hyperbolic.[10] To begin with, the District Court refers to the "cogent and compelling," standard cited in *Lormand*, and then finds that Plaintiff has not met this standard. That is not flipping scienter jurisprudence on its head. Second, Plaintiff is trying to make the leap that because it has pled direct knowledge, then this inference is sufficient. But, as the District Court ruled, Plaintiff has not alleged direct knowledge with particularity. At most, Plaintiff relies on cursory group pleading. To the extent

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[9] Plaintiff ignores the terms of the Consent Order from the NYC DCA because those terms are anathema to Plaintiff's case. The Consent Order specifically states no evidence of systemic conduct. Plaintiff's repeated claim that there was systemic conduct, especially in New York, is simply not plausible in light of the plain language of the Consent Order. Plaintiff's repetition of this phrase does not change the fact that such allegations are conclusory and belied by public documents relied upon by Plaintiff.

[10] Plaintiff caricatures the District Court's reasoning regarding scienter. For example, Plaintiff writes: "the district court held that knowledge without motive was not sufficient to plead scienter." Appellant's Brief at iv; *id.* at 46 ("Requiring Allegations of Motive"); *id.* at 6 (similar). However, the trial court acknowledged that "a complaint may establish a strong inference of scienter without motive allegations." ROA.933. The District Court explained that scienter requires intent or severe recklessness, not merely knowledge, and that motive is one factor in the assessment of whether intent or recklessness was plausibly alleged. ROA.931-933. This is consistent with Fifth Circuit precedent and the basic psychological point that it is less plausible that a person without a motive to intentionally deceive would do so. More generally, Plaintiff's focus on whether motive or intent is required glosses over the other reasons for the trial court's scienter holding. One of those reasons was that Plaintiff failed to allege defendant-specific facts regarding each defendant's knowledge. ROA.931-932.

Plaintiff attempts pleading direct knowledge, the attempt fails. For example, Plaintiff cites to Gallo's comments during the analyst call. But the District Court ruled that even this statement was not enough. ROA.934-935. Third, in *Lormand*, the defendants admitted to knowledge of multiple material misrepresentations that they chose to hide, and the plaintiffs there attached e-mails evidencing those defendants' knowledge. But here, Plaintiff sets forth no credible or plausible allegations to establish that the Defendants knew of any systemic conduct, but were hiding it—to the contrary, the record and Plaintiff's allegations show that Defendants were open to the public and investors about the unintentional errors that led to improper pricing.

Plaintiff cursorily refers to Whole Foods' SOX certifications, signed by the individual Defendants to bolster its allegations of scienter. But, Plaintiff's conclusion that the SOX certifications were false, without more, "is not indicative of scienter." *Shaw Grp., Inc.*, 537 F.3d at 545. There is no allegation that anyone signing Whole Foods' SOX certifications contemporaneously had reason to know, "due to the presence of glaring accounting irregularities or other 'red flags,'" that its financial statements contained material misstatements or pervasive internal control weaknesses. *Id.*

Plaintiff points to no plausible "red flags" in the record to support its reliance on Whole Foods' SOX certifications. At most, Plaintiff regurgitates

conclusory and debunked allegations with regard to the California and NYC DCA investigations, and Defendants' admission of pricing mistakes. Plaintiff has set forth no plausible allegations however, that these events were intentional or part of a larger scheme. Moreover, with regard to any statements made by the individual Defendants, Plaintiff sets forth no plausible allegations that anything said was actually untrue. Plaintiff's allegations do not rise to the level of "red flags," and do not support a claim of severe recklessness. Absent any plausible support, Plaintiff's references to these certifications does nothing to help Plaintiff plead scienter.

The allegation that the individual Defendants are a closely knit team and regularly consult with each other (ROA.957 at SAC ¶ 49) is based on a statement from a newspaper article on leadership styles that is entirely unrelated to the claims in this action. ROA.1251. To ask the Court to attribute knowledge of alleged system-wide weights and measures problems to the individual Defendants based on such an article strains reason and is not plausible.[11] Such allegations cannot "enlighten *each defendant* as to his or her particular part in the alleged fraud." *Southland*, 365 F.3d at 365. In any event, the article further states that "there's no regularly scheduled gathering of the management team," that "there is no ultimate authority" at Whole Foods, but that "individuals might exert influence in certain

[11] Indeed, Plaintiff's entire argument on page 45 of Appellant's Brief overreaches to the point that it strains credulity.

areas" such as operations, finance, or strategy, for example. ROA.1253. This article is much too thin a reed to support an inference of joint knowledge and joint action as to the matters alleged in the pleadings.[12]

At best, Plaintiff's scienter arguments remain an attempt to establish scienter through group pleading, which is not recognized in the Fifth Circuit. *Shaw Group*, 537 F.3d at 533. Plaintiff has not alleged with particularity the state of mind of each individual to determine whether the Plaintiff has alleged scienter as to that Defendant. *Carlton*, 184 F.Supp. 3d at 459. Accordingly, the District Court's ruling that Plaintiff had not adequately alleged scienter should be affirmed.

IV. THE DISTRICT COURT CORRECTLY RULED THAT PLAINTIFF DID NOT ADEQUATELY ALLEGE FACTS ESTABLISHING LOSS CAUSATION.

Plaintiff argues that "investors and customers alike responded sharply when the wrongdoing was disclosed." This is not true. Whole Foods' stock did not significantly drop in reaction to (a) the June 24, 2014 California settlement announcement; (b) the June 26, 2015 letter to customers following the California settlement; (c) the June 24, 2015 DCA Release; or (d) the June 29, 2015 video message to customers. And Plaintiff does not allege any such drops.

Whole Foods' stock price only dropped when Whole Foods acknowledged on an investment call *a month after the DCA Release was issued*, and a year after

[12] Corporate management's general awareness of the daily workings of the company is not enough to establish scienter. *Yelp, Inc.*, 875 F.3d at 1227. A plaintiff must also point to specific information conveyed to management. *Id.*

disclosure of the California settlement, that the media's reaction to the inflammatory press release was causing consumer sales to decline. ROA.992-993 at SAC ¶¶ 104-107. By July 29, 2015, the weights and measures issues had long been part of the "total mix" of information and investors had not reacted. *Amedisys*, 769 F.3d at 323.

The earnings call, therefore, did not disclose a prior false statement, as is required for loss causation. *Yelp*, 875 F.3d 1219. As in *Yelp*, which Plaintiff cannot distinguish, "the mere announcement of an investigation was insufficient to establish loss causation because it does not reveal fraudulent practices to the market." *Id.* at *4 (internal quotation marks omitted); *see also In re Almost Family, Inc. Sec. Litig.*, No. 10-520, 2012 WL 443461, at *13 (W.D. Ky. Feb. 10, 2012) ("disclosure" of SEC investigation not corrective). Here, as in *Yelp*, the DCA release contained allegations, not results. The DCA did not find "any evidence" of systemic misconduct and the investigation concluded without factual findings. ROA.695. Accordingly, the discussion of the negative publicity related to the DCA release was not a corrective disclosure.

To establish that a "corrective disclosure" caused a decline in stock price, a pleading must allege that the market "reacted negatively to a corrective disclosure, ***which revealed the falsity*** of [defendant's] previous representations." *Catogas v. Cyberonics, Inc.*, 292 F. App'x 311, 314 (5th Cir. 2008) (emphasis added). A

corrective disclosure must include a "revelation of prior fraud or misrepresentation." *In re Dell*, 591 F. Supp. 2d at 909-10; *Dawes*, 975 F. Supp. 2d at 709 ("[T]o establish loss causation, the disclosed information must reflect part of 'the relevant truth'—the truth obscured by the fraudulent statements." (citation omitted). A plaintiff must "connect the alleged misrepresentations with correlative corrective disclosures during the Class Period." *MacGruder*, 2009 WL 854656, at *15.

The market's reaction to news of a government investigation or other adverse publicity is not equivalent to its reaction to disclosure of past fraudulent conduct. In the former case, the market reaction reflects uncertainty as to the investigation's ultimate results. *See Yelp*, 2015 WL 7454137, at *10-11 (distinguishing stock market speculation "about whether fraud has occurred" resulting from an investigation's announcement from a revelation of "fraudulent practice to the market"). Thus, an announcement of an investigation is not a corrective disclosure—regardless of whether it leads to a drop in stock price—as any decline is attributable to market speculation about whether a fraud has occurred, rather than disclosure of a fraudulent practice. This market speculation "cannot form the basis for a viable loss causation theory." *Id.*

Moreover, Whole Foods cautioned that its forward-looking statements "involve risks and uncertainties that may cause our actual results to be materially

different . . . and could adversely affect our business" including "risks and uncertainties that we currently deem immaterial." ROA.714-776. These risks, specifically referred to by Plaintiff and numerous analysts in assessing the stock price decline (ROA.988-993 at SAC ¶¶ 98, 100-102, 105, 107), included that "*[a]dverse publicity may reduce our brand value and negatively impact our business.*" ROA.726, 787. Whole Foods warned that "***even isolated incidents can erode trust and confidence, particularly if they result in adverse publicity, governmental investigations*** or litigation." ROA.726, 787. *(emphasis added).*) Whole Foods further disclosed, *"*[o]ur stock price may be volatile and adversely affected by general market factors, including fluctuations in our quarterly results of operations," and that *"*variations in our sales and earnings results and any failure to meet market expectations . . . . may be impacted by . . . publicity regarding us.*"* ROA.726, 788.

The July 29, 2015 earnings guidance, which recognized the adverse publicity created by the "national news" coverage of the allegations in the DCA Release (ROA.678), caused the July 30 stock drop.[13] That timely disclosure is

[13] Plaintiff asserts that "[t]he allegation of defendants' admission that this was 'national news' appears nowhere in either of the court's two opinions." Appellant's Brief at 5. In fact, the District Court's orders explain that a Whole Foods representative "acknowledged during a conference call with investors that . . . [the] New York City weights and measures audit received ***national media attention***." ROA.918 (emphasis added) (brackets in original). The order also noted that a story about alleged overpricing appeared in the New York Times, which is national news. ROA.917. The District Court thus took into account the national attention paid to

precisely within Whole Foods' risk warnings and is not actionable. The July 29 call did not "reveal" misconduct, but acknowledged that customer relations needed mending. All that happened here is the risk warning attendant to adverse publicity occurred.

In light of the foregoing, the District Court's ruling that Plaintiff had not properly alleged loss causation should be affirmed.

V. THE DISTRICT COURT CORRECTLY DISMISSED PLAINTIFF'S SECTION 20(a) CLAIM.

To state a control person claim under § 20(a) of the Exchange Act, a plaintiff must show: (1) a primary violation by a controlled person; *and* (2) direct or indirect control of the primary violator by the defendant. *In re ArthroCare Corp. Sec. Litig.*, 726 F. Supp. 2d 696, 729 (W.D. Tex. 2010). Here, Plaintiff fails both prongs. *First*, as demonstrated above, Plaintiff failed to plead a primary violation. *See Shaw Grp.*, 537 F.3d at 545 (stating that control person liability "cannot exist in the absence of a primary violation." (citation omitted). *Second*, even if Plaintiff has pled a violation, Plaintiff failed to plead facts sufficient to establish actual control over the wrongdoer and the transactions in question. *Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496, 509 (5th Cir. 1990).

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overpricing allegations; the allegation that something was in the news was simply insufficient to carry Plaintiff's burdens.

Officer or director status alone does not constitute control. *Id.* at 509; *In re Dynegy, Inc. Sec. Litig.*, 339 F. Supp. 2d 804, 913 (S.D. Tex. 2004). The plaintiff must plead facts showing that each individual defendant "induced or participated in" the primary violation, or "had the requisite power to direct" corporate policy." *Dennis*, 918 F.2d at 509-510; *In re BP P.L.C. Sec. Litig*, 922 F. Supp. 2d 600, 640 (S.D. Tex. 2013) ("[A]llegations [that] establish that [an officer] was high in the organization, but not that he *controlled* anyone or anything relevant to any actionable misrepresentation," are insufficient).

Here, by improper group pleading, Plaintiff conclusorily alleges that "the Individual Defendants participated in conference calls with investors . . . and were provided with copies of the Company's reports, Press Releases, public filings and other statements" and "[b]ecause of their positions [they] directly participated in the Company's management . . . and operations and . . . controlled the contents of Whole Foods' quarterly reports and other public filings." ROA.1015 at SAC ¶ 171.

That allegation, however, begs the threshold question—did each individual Defendant have knowledge. Plainly none of the individual Defendants were weighing products at any of Whole Foods' locations. Plaintiff does not allege with particularity—and the CO in fact denies—that any individual Defendant had notice of the supposed "practices" underlying the DCA investigation. ROA.695-696 at ¶ 18. There are no specific allegations of participation in any alleged fraud, or that

any of the individual Defendants had "the ability to control" the "specific transaction or activity" conclusorily alleged as the primary violation—a system-wide failure to properly weigh packaged food.

The District Court's ruling that Plaintiff's Section 20(a) claim should be dismissed is correct, and should be affirmed.

CONCLUSION

Plaintiff has not alleged falsity, scienter, or loss causation with particularity as required by Rule 9 of the Federal Rules of Civil Procedure or the PSLRA. In addition, because Plaintiff has not properly alleged claims of a violation of Section 10(b), Plaintiff's derivative claim under Section 20(a) must also fail. Accordingly, Defendants ask this Court to uphold the District Court's Order dismissing Plaintiff's claims with prejudice.

Dated the 19th day of January 2018.

GREENBERG TRAURIG, LLP

By: */s/ Gregory J. Casas*

Gregory J. Casas
Texas State Bar No. 00787213
300 West 6th Street, Suite 2050
Austin, Texas 78701
E-mail: casasg@gtlaw.com
Telephone: 512-320-7200
Facsimile: 512-320-7210

Attorneys for Defendants-Appellees Whole Foods Market, Incorporated, John P. Mackey, Glenda Jane Flanagan, Walter E. Robb, III, A.C. Gallo, David Lannon, and Kenneth J. Meyer

OF COUNSEL:

GREENBERG TRAURIG, LLP

Jason S. Lewis
Texas State Bar No. 24007551
2200 Ross Avenue, Suite 5200
Dallas, Texas 75201
E-mail: lewisjs@gtlaw.com
Telephone: 214-665-3600
Fax: 214-665-3601

Jesse W. Wainwright
Texas State Bar No. 00000049
Justin Bernstein
Texas State Bar No. 24105462
300 West 6th Street, Suite 2050
Austin, Texas 78701
E-mail: wainwrightd@gtlaw.com
E-mail: bernsteinju@gtlaw.com
Telephone: 512-320-7200
Facsimile: 512-320-7210

Attorneys for Defendants-Appellees

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

I certify that this brief complies with the type-volume limitation set forth in Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure. This brief uses Times New Roman 14-point typeface and contains 9,675 words.

/s/ Gregory J. Casas
Gregory J. Casas

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing brief was electronically filed with the Court and that counsel of record, who are deemed to have consented to electronic service in the above-referenced case, are being served this 19th day of January, 2018, with a copy of the above-document via the Court's CM/ECF System.

/s/ Gregory J. Casas
Gregory J. Casas