IN THE

Supreme Court of the United States

THE LABORERS DISTRICT COUNCIL CONSTRUCTION INDUSTRY PENSION FUND, AND THE CEMENT MASONS LOCAL 526 COMBINED FUNDS, On Behalf of Themselves and All Others Similarly Situated,

Petitioners,

VS.

OMNICARE, INC.; JOEL F. GEMUNDER; DAVID W. FROESEL, JR.; CHERYL D. HODGES; EDWARD L. HUTTON; AND SANDRA E. LANEY

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Are claims under Securities Act §11, 15 U.S.C. §77k(a), for which proof of fraud or mistake is no element of *prima facie* liability, subject to Federal Rule of Civil Procedure 9(b)'s heightened pleading requirement, that a party alleging claims of fraud or mistake "must state with particularity the circumstances constituting fraud or mistake"?

2. May investors seeking relief under Securities Act §11, for which neither negligence nor fraud is an element of liability, be required to plead facts showing either fraud or negligence?

3. May the courts reverse the burden that Congress placed on certain defendants, of demonstrating due diligence as an affirmative defense, by requiring plaintiffs to plead facts rebutting it?

PARTIES

The parties before the United States Court of Appeals for the Sixth Circuit were:

The Laborers District Council Construction Industry Pension Fund, Lead Plaintiff-Appellant;

The Cement Masons Local 526 Combined Funds, Intervener-Appellant;

Alaska Electrical Pension Fund, Intervener Plaintiff-Appellant;

Indiana State District Council of Laborers and Hod Carriers, Plaintiff-Appellant;

Omnicare, Inc., Defendant-Appellee;

Joel F. Gemunder, Defendant-Appellee;

David W. Froesel, Jr., Defendant-Appellee;

Cheryl D. Hodges, Defendant-Appellee;

Edward L. Hutton, Defendant-Appellee; and

Sandra E. Levy, Defendant-Appellee.

CORPORATE DISCLOSURE STATEMENT

Neither the Laborers District Council Construction Industry Pension Fund nor the Cement Masons Local 526 Combined Funds has a parent corporation.

Neither Petitioner issues stock.

Neither Petitioner is owned or controlled by a publicly traded corporation.

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REPORTS OF THE OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit, with which it contemporaneously entered judgment, was published on October 21, 2009, and is reported as *Indiana State District Council of Laborers and Hod Carriers Pension and Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935 (6th Cir. 2009). The opinion is reproduced in the Appendix to this Petition ("Pet. App.") at 1a-21a.

The Sixth Circuit's opinion affirmed in part, and reversed in part, an October 12, 2007, decision of the United States District Court for the Eastern District of Kentucky, that had dismissed all claims, and which was reported as *Indiana*

State District Council of Laborers and Hod Carriers Pension and Welfare Fund v. Omnicare, Inc., 527 F. Supp. 2d 698 (E.D. Ky. 2007). The district court's opinion also is reproduced in the Appendix. Pet. App. at 24a-48a.

JURISDICTION

The Court of Appeals issued its judgment and opinion on October 21, 2009, Pet. App. at 1a, and denied a timely petition for rehearing on December 16, 2009, Pet. App. at 22a. On March 8, 2010, Associate Justice John Paul Stevens granted an application (No. 09A822), extending the time for filing this petition for *certiorari* to May 14, 2010. (*The Laborers District Council Construction Industry Pension Fund, et al., v. Omnicare, Inc.*, No. 09A822 (Stevens, J., Mar. 8, 2010)).

This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTES AND RULES INVOLVED

Federal Rules of Civil Procedure 8 and 9, and Securities Act of 1933 Sections 11 and 12, 15 U.S.C. §§77k, 77*l*, are set out verbatim in the Appendix. Pet. App. at 49a-62a.

STATEMENT OF THE CASE

In this securities action investors who acquired securities of Omnicare Incorporated have sought to assert claims on behalf of a class of similarly situated investors, both under Securities Exchange Act of 1934 ("Exchange Act" or "1934 Act") §10(b), 15 U.S.C. §78j(b), and under Securities Act of 1933 ("Securities Act" or "1933 Act") §11, 15 U.S.C. §77k. The operative first amended complaint seeks relief under Securities Act §11, on behalf of investors who purchased Omnicare securities issued pursuant to a defective registration statement for a $761-million December 2005 public offering, and also under §§10(b) and 20(a) of the Exchange Act, on behalf of all investors who had purchased Omnicare

securities between August 3, 2005, and July 27, 2006. Defendants are: Omnicare; its Chief Executive Officer Joel F. Gemunder; Chief Financial Officer David W. Froesel, Jr.; Secretary and Senior Vice President Cheryl Hodges; Chairman of the Board Edward L. Hutton; and Director Sandra E. Laney.

The district court appointed the Laborers District Council Construction Industry Pension Fund to act as Lead Plaintiff for the putative class under procedures implemented by the Private Securities Litigation Reform Act of 1995 ("PSLRA"), as codified at 15 U.S.C. §§77z-1(a), 78u-4(a). The Cement Masons Local 526 Combined Funds was added as an additional plaintiff with standing to assert claims under Securities Act §11, because it had acquired 790 shares of Omnicare stock in Omnicare's $761-million December 2005 registered public offering at over $59 a share, suffering significant losses as the stock subsequently declined in value. [R52, FAC ¶33]; *cf. Hevesi v. Citigroup, Inc.*, 366 F.3d 70, 82-83 (2d Cir. 2004) (noting that additional plaintiffs may be added under such circumstances).

The claims asserted on behalf of investors under Securities Act of 1933 §11, on the one hand, and under Securities Exchange Act of 1934 §10(b), on the other, have significantly different elements.

Claims under §11 may be advanced only on behalf of investors who acquired registered securities issued under a registration statement that "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading," 15 U.S.C. §77k(a), while §10(b) is a catch-all provision covering "any manipulative or deceptive device or contrivance" proscribed by Securities and Exchange Commission Rule 10b-5. *See* 15 U.S.C. §78j(b); 17 C.F.R. §240.10b-5; *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).

Claims under §10(b) require a plaintiff to plead and prove facts demonstrating that the defendants' violation proximately caused the plaintiffs' loss, *see Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), while under §11(e) damages are set by statute as the difference between the price paid for a registered security (not to exceed the offering price) and either its value on the date of suit or the price at which it was sold—subject to an affirmative defense "if the defendant proves that any portion or all of such damages represents other than the depreciation in the value of such security resulting from" the registration statement's misleading statements or omissions. 15 U.S.C. §77k(e); *see In re Constar Int'l Sec. Litig*, 585 F.3d 774, 785 (3d Cir. 2009).

In addition, the defendants' fraudulent intent or "scienter is an element of a violation of §10(b) and Rule 10b-5, regardless of the identity of the plaintiff or the nature of the relief sought."[1] Yet scienter is no element of a claim for relief under §11. If a security's registration statement either omitted required information, or was in any material respect false or misleading, then anyone acquiring the registered security "may, either at law or in equity, in any court of competent jurisdiction, sue," not just the security's issuer, but "every person who signed the registration statement," and "every person who was a director" of the issuer, without regard to their culpability or fault. 15 U.S.C. §77k(a).

Section 11 imposes *strict liability* on the issuer of registered securities, while affording certain others involved in the offering process the opportunity of proving an affir-

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[1] *Aaron v. SEC*, 446 U.S. 680, 691 (1980); *see Merck & Co. v. Reynolds*, ___ U.S. ___, No. 08-905, slip. op. at 12-14 (U.S. Apr. 27, 2010); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007); *Basic Inc. v. Levinson*, 485 U.S. 224, 240 n.18 (1988); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976) ("*Hochfelder*").

mative defense of "due diligence," that he or she, after diligent investigation, reasonably believed that the registration statement was both accurate and complete. *See Huddleston*, 459 U.S. at 382; *Hochfelder*, 425 U.S. at 208. "If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case." *Huddleston*, 459 U.S. at 382. "Liability against the issuer of a security is virtually absolute, even for innocent misstatements." *Huddleston*, 459 U.S. at 382; *see Hochfelder*, 425 U.S. at 208 ("the issuer of the securities is held absolutely liable"). Others involved in the offering are liable unless they can demonstrate their own good faith and due diligence – as an affirmative defense.[2]

The information "required to be stated" in a registration statement naturally includes financial statements prepared in accordance with Generally Accepted Accounting Principles or "GAAP." *See United States v. Arthur Young & Co.*, 465 U.S. 805, 810-11 & nn.5, 7 (1984). "Financial statements filed with the [Securities and Exchange] Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading and inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided." 17 C.F.R. §210.4-01(a)(1). Deviations from GAAP do not, however, as a general matter, amount to fraud.[3]

Thus, by its terms, §11 imposes on the registered secu-

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[2] *See Huddleston*, 459 U.S. at 382; *Hochfelder*, 425 U.S. at 708; *see also In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 259 (3d Cir. 2006); *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1251 (10th Cir. 1997); *Kronfeld v. TWA*, 832 F.2d 726, 730 n.8 (2d Cir. 1987).

[3] *See, e.g., DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 390 (9th Cir. 2002) ("'the mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter'") (citation omitted); *ECA & Local 134 IBEW*

rities' issuer strict liability for accounting violations in connection with a securities offering, without regard to whether the violations were deliberate, negligent, or even innocent.

In this case, Petitioners alleged that Omnicare and its top executives violated §10(b) with a string of false and misleading statements, on a variety of subjects, through a class period running from August 3, 2005, through July 27, 2006.

During that period, Petitioners alleged Omnicare also filed a registration statement containing financial statements prepared in violation of GAAP, for a December 2005 securities offering, in which Petitioner Cement Masons Local 526 Combined Funds acquired 790 shares of Omnicare common stock at $59.72 per share, which stock subsequently lost much of its value. [R52, FAC ¶33].

Plaintiffs believed that by alleging that Omnicare's registration statement included financial results reported in violation of GAAP, they had adequately stated a §11 claim.

The district court, however, dismissed the case in its entirety, on the ground that Petitioners failed to plead with the particularity required to state fraud-based

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Joint Pension Trust v. J.P. Morgan Chase Co., 553 F.3d 187, 200 (2d Cir. 2009) ("'GAAP violations or accounting irregularities, standing alone, are insufficient to state a securities fraud claim. . . . Only where such allegations are coupled with evidence of corresponding fraudulent intent might they be sufficient.'") (citation omitted); *In re Ceridian Corp. Sec. Litig.*, 542 F.3d 240, 246 (8th Cir. 2008) ("an amalgam of unrelated GAAP violations, without more, does not give rise to a strong inference of scienter" as "the opposing inference of nonfraudulent intent – that these were mistakes by accounting personnel undetected because of faulty accounting controls – is simply more compelling"); *Indiana Electrical Workers Pension Fund IBEW v. Shaw Group, Inc.*, 537 F.3d 527, 534 & n.3 (5th Cir. 2008) (collecting cases).

claims under Exchange Act §10(b). Pet. App. at 33a-46a. Although neither loss causation nor scienter is an element of *prima facie* liability under Securities Act §11,[4] the district court in a footnote dismissed plaintiffs' strict-liability §11 claims because plaintiffs had not particularized facts demonstrating the loss-causation element necessary to state a *prima facie* case for fraud under Exchange Act §10(b): "The Section 11 claim, which also sounds in fraud and is based on the alleged accounting violations, fails on the same grounds." Pet. App. at 38a.

The Court of Appeals affirmed in part and reversed in part. It affirmed the district court's dismissal of fraud-based §10(b) claims, holding in particular that plaintiffs had not adequately pleaded loss-causation with respect to Omnicare's accounting violations. Pet. App. at 11a-15a. Yet because loss causation "is not an element of a §11 claim, but an affirmative defense to it," the Sixth Circuit held that "the district court erred in dismissing this claim on that ground." Pet. App. at 20a.

The Court of Appeals then noted that the "[d]efendants also urge us to affirm on a different ground: that the §11 claims fail to allege the underlying GAAP violations with the specificity required by Rule 9(b)," Pet. App. at 20a, which requires that "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. P. 9(b). The Sixth Circuit declared: "We agree with Defendants that, since the GAAP violations sound in fraud, Rule 9(b) must apply." Pet. App. at 20a-21a. It left "the application of Rule 9(b) standards to the district court on remand," but only after rejecting the Eighth Circuit's holding from *In re*

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[4] *See* 15 U.S.C. §77k(a); *Huddleston*, 459 U.S. at 381-82; *Hochfelder*, 425 U.S. at 208-10.

NationsMart Corp. Sec. Litig., 130 F.3d 309, 315 (8th Cir. 1997), "that 'Rule 9(b) does not apply to claims under §11 of the Securities Act, because proof of fraud or mistake is not a prerequisite to establishing liability under §11.'" Pet. App. at 21a (citing and quoting *NationsMart*, 130 F.3d at 315).

With this petition, Petitioners respectfully ask that this Court grant review in order to resolve the resulting conflict among the Circuits on an important point of law, as to which the Petitioners submit most courts addressing the issue – including the Sixth Circuit – have struck a course fundamentally at odds with this Court's precedent and Congressional intent.

REASONS FOR GRANTING THE WRIT

With the decision below, the Sixth Circuit has joined several other circuits in holding that investors' strict-liability claims under Securities Act §11, which in this case are based on allegations that Omnicare's registration statement contained financial reports that violated GAAP, somehow "sound in fraud," making them subject to dismissal under Rule 9(b)'s requirement that claims of fraud or mistake be pleaded with particularity. Pet. App. at 20a-21a.

The Sixth Circuit's opinion below acknowledges that this holding conflicts with the Eighth Circuit's contrary holding in *NationsMart*, 130 F.3d at 315, that "'Rule 9(b) does not apply to claims under §11 of the Securities Act, because proof of fraud or mistake is not a prerequisite to establishing liability under §11.'" *See* Pet. App. at 21a. (quoting and citing *NationsMart* with a "*But see*" flag). The conflict with *NationsMart*, on a point relating to pleading standards for federal securities claims, itself presents an important question warranting this Court's attention.

But the conflict runs far deeper – for the rule of *NationsMart* is compelled by this Court's holdings that §11 imposes *strict liability* on securities issuers, "even for innocent misstatements," *Huddleston*, 459 U.S. at 382; *see Hochfelder*, 425 U.S. at 208 ("the issuer of the securities is held absolutely liable"), and that others involved in the offering are liable unless they can demonstrate their own good faith and due diligence *as an affirmative defense*. *See* 15 U.S.C. §77k(b)(3); *Huddleston*, 459 U.S. at 382; *Hochfelder*, 425 U.S. at 208. Those defendants "bear the burden of demonstrating due diligence." *Huddleston*, 459 U.S. at 382.

By requiring plaintiffs to plead fraud with particularity in order to state a §11 claim, the decision below imposes on investors a burden that Congress flatly rejected when it chose to impose strict liability – without regard to proof of fraud – on the issuer, and to require that other defendants prove the absence of both negligence and fraud to carry an affirmative defense. The decision below thus conflicts both with congressional intent and with this Court's repeated holdings that §11 claimants are *not* required to plead or prove either fraud or negligence in order to pursue relief under §11. *See Huddleston*, 459 U.S. at 382; *Hochfelder*, 425 U.S. at 208.

By reversing the burden of pleading on what Congress intended to be an affirmative defense, moreover, the Sixth Circuit also conflicts with this Court's decisions holding that plaintiffs cannot be required to anticipate, or to plead facts in avoidance of, potential affirmative defenses. *See, e.g.*, *Crawford-El v. Britton*, 523 U.S. 574, 595 (1998) (noting that the Court has repeatedly "refused to change the Federal Rules governing pleading by requiring the plaintiff to anticipate" an affirmative defense); *Gomez v. Toledo*, 446 U.S. 635, 640 (1980) (finding "no basis for

imposing on the plaintiff an obligation to anticipate such a defense by stating in his complaint" any facts in avoidance of it); *Vance v. Terrazas*, 444 U.S. 252, 269 n.11 (1980) (burdens regarding affirmative defenses do not shift even where the complaint's allegations improperly anticipate an affirmative defense).

The case thus is one that warrants this Court's review.

I. THE CASE PRESENTS A CLEAR AND WELL-DEVELOPED CONFLICT AMONG THE CIRCUITS ON AN IMPORTANT POINT OF LAW

This case principally involved allegations of fraud for which plaintiffs asserted claims under Securities Exchange Act of 1934 §10(b), 15 U.S.C. §78j(b), that are unquestionably subject to Rule 9(b)'s requirement that "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed. R. Civ. P. 9(b). To state §10(b) claims also requires particularizing facts raising "a strong inference" of fraudulent intent.[5] Yet plaintiffs *also* sought relief under §11 of the Securities Act, which requires no proof of fraud or mistake, but only a showing that the registration statement for securities they acquired (1) contained an untrue statement of material fact; (2) omitted to state a material fact required to be stated

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[5] 15 U.S.C. §78u-4(b)(2) (requiring §10(b) claimants to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind"); *see Tellabs*, 551 U.S. at 314; *see also Merck & Co.*, slip op. at 13 ("facts showing scienter are among those that 'constitut[e] the violation'").

[6] 15 U.S.C. §77k(a) (imposing liability whenever "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading"); *see, e.g., Constar*, 585 F.3d at 782-83; *Suprema*, 438 F.3d at 269; *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194, 1204 (1st Cir. 1996).

therein; or (3) omitted to state a material fact necessary to make the statements therein not misleading.[6]

Because neither fraud nor mistake is an element of a §11(a) claim, *see Huddleston*, 459 U.S. at 382, and because Rule 9(b) by its terms applies *only* to averments of fraud or mistake, *see Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993), the Rule's requirement that claims for fraud be pleaded with particularity cannot sensibly apply to the Securities Act claims. For this Court has repeatedly held that heightened particularity cannot be required to state claims requiring no proof of fraud. *Jones v. Bock*, 549 U.S. 199, 212-13 (2007); *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 515 (2002); *Leatherman*, 507 U.S. at 168.[7]

The Eighth Circuit accordingly held in *NationsMart* that "a pleading standard which requires a party to plead particular facts to support a cause of action that does not include fraud or mistake as an element comports neither with Supreme Court precedent nor with the liberal system of 'notice pleading' embodied in the Federal Rules of Civil Procedure." *NationsMart*, 130 F.3d at 315. Simply put, "the specificity requirement of Rule 9(b) does not apply to claims brought under §11 of the Securities Act." *Id.* at 316.

Subsequent Eighth Circuit decisions are emphatic in holding that "[t]here is no scienter requirement for a

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[7] *See also Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 569 n.14 (2007) (noting that to apply a heightened pleading standard to non-fraud claims or to otherwise "broaden the scope of Federal Rule of Civil Procedure 9 . . . can only be accomplished "'by the process of amending the Federal Rules, and not by judicial interpretation'"") (quoting *Swierkiewicz*, 534 U.S. at 506); *Haas v. Quest Recovery Servs.*, 549 U.S. 1163, 1164 (2007) ("Under this Court's jurisprudence, however, federal courts ordinarily have no warrant to impose heightened pleading standards not prescribed by statute or rule.") (Ginsburg, J., concurring).

Section 11 claim," and that for this reason "the particularity requirements of Federal Rule of Civil Procedure 9(b) do not apply to Section 11 claims." *In re Acceptance Ins. Cos. Sec. Litig.*, 423 F.3d 899, 903 (8th Cir. 2005) (following both *Huddleston*, 459 U.S. at 375, 382, and *NationsMart*, 130 F.3d at 315).

In *Romine v. Acxiom Corp.*, 296 F.3d 701 (8th Cir. 2002), for example, the Eighth Circuit acknowledged conflict among the circuits: "A pleading issue that has divided federal courts is whether §11 claims are 'grounded in fraud,' and therefore must be alleged with the particularity required by Rule 9(b) . . . ." *Id.* at 705. But the court held firm to its holding in *NationsMart*, "that §11 claims do not require proof of fraud, and therefore the notice pleading requirements of Rule 8(a) apply, not the particularity requirements of Rule 9(b)." *Romine*, 296 F.3d at 705. The court observed that when Congress addressed pleading requirements for securities cases in the Private Securities Litigation Reform Act of 1995, it expressly authorized heightened requirements only for fraud-based Exchange Act claims: "The structure and legislative history of that Act persuade us that [Securities Exchange Act §21D(b), 15 U.S.C.] §78u-4 applies only to fraud actions brought under the Securities Exchange Act of 1934. *Compare* Pub. L. 104-67 §101(a), *with* §101(b), 109 Stat. 737-49; *see* 1995-2 U.S.C.C.A.N. 679, 705, 740." *Romine*, 296 F.3d at 704-05. "Accordingly, *NationsMart* remains a controlling precedent, and plaintiffs' complaint need only comply with the short and plain statement requirements of Rule 8(a)." *Id.*

Yet many other courts have held to the contrary – that some §11 claims "sound in fraud," or are "grounded in fraud," while others "sound in negligence," with those supposedly sounding in fraud because they are coupled

with a §10(b) claim properly made subject to Rule 9(b)'s heightened pleading requirement. *See NationsMart*, 130 F.3d at 315 (citing such cases and refusing to follow them). The Sixth Circuit's opinion in this case, for example, string-cites and follows seven decisions of other circuits applying Rule 9(b)'s requirement to strict-liability Securities Act claims.[8]

Several of those decisions acknowledge that they conflict with the Eighth Circuit's *NationsMart* decision. "Our sister circuits are split on this matter," noted the Eleventh Circuit in *Wagner*, 464 F.3d at 1277, as it rejected *NationsMart* to "hold that Rule 9(b) applies when the misrepresentation justifying relief under the Securities Act is also alleged to support a claim for fraud under the Exchange Act and Rule 10b-5."

Acknowledging that the Eighth Circuit "has categorically held that 'the particularity requirement of Rule 9(b) does not apply to claims under §11 of the Securities Act, because proof of fraud or mistake is not a prerequisite to establishing liability under §11,'" the Second Circuit resolved a split among its own district courts by rejecting the Eighth Circuit's approach. *Rombach*, 355 F.3d at 170-71 & n.6 (quoting and rejecting *NationsMart*, 130 F.3d at 314).

The First, Third, and Sixth Circuits all have acknowledged the conflict by citing the Eighth Circuit's

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[8] Pet. App. at 21a (citing *ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 68 (1st Cir. 2008); *Wagner v. First Horizon Pharm. Corp.*, 464 F.3d 1273, 1277 (11th Cir. 2006); *Cal. Pub. Employees' Ret. Sys. ("CalPERS") v. Chubb Corp.*, 394 F.3d 126, 160-63 (3d Cir. 2004); *Rombach v. Chang*, 355 F.3d 164, 170-71 (2d Cir. 2004); *Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, 238 F.3d 363, 368-69 (5th Cir. 2001); *In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1404-05 (9th Cir. 1996); *Sears v. Likens*, 912 F.2d 889, 892-93 (7th Cir. 1990)).

NationsMart decision with a *"But see"* signal.[9] And the rule that strict-liability §11 claims may sound in fraud, making them subject to dismissal under Rule 9(b) for failure to allege the elements and circumstances of fraud with particularity, has by now been adopted by the First,[10] Second,[11] Third,[12] Fourth,[13] Fifth,[14] Sixth,[15] Seventh,[16] Ninth,[17] and Eleventh[18] Circuits. These courts have, moreover, begun to apply their rule to other kinds of strict-liability or negligence claims, whenever plaintiffs allege alternative claims for intentional wrongdoing, or otherwise chance to suggest that a defendant's conduct might have been deliberate.[19]

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[9] *E.g.*, *Advest*, 512 F.3d at 68 (citing *NationsMart* as "*But see*"); *Cozzarelli v. Inspire Pharmaceuticals, Inc.*, 549 F.3d 618, 629 (4th Cir. 2008) (citing *NationsMart* as "*But see*"); *CalPERS*, 394 F.3d at 162 n.25 (citing *NationsMart* as "*But see*").

[10] *Advest*, 512 F.3d at 68; *Shaw*, 82 F.3d at 1223 ("if a plaintiff were to attempt to establish violations of Sections 11 and 12(2) as well as the anti-fraud provisions of the Exchange Act through allegations in a single complaint . . . the particularity requirements of Rule 9(b) would probably apply to the Sections 11, 12(2), and Rule 10b-5 claims alike").

[11] *Rombach*, 355 F.3d at 167, 170-71 (considering "whether the heightened pleading standard of Rule 9(b) of the Federal Rules of Civil Procedure applies to claims brought under Section 11 and Section 12(a)(2) of the Securities Act" and holding that "Rule 9(b) applies when the claim sounds in fraud").

[12] *Suprema*, 438 F.3d at 270 ("Plaintiffs urge us 'to do away with the "sounds in fraud" doctrine altogether,' but this panel is bound by prior precedential decisions of this court.") (citations omitted); *In re Digital Island Sec. Litig.*, 357 F.3d 322, 334-35 (3d Cir. 2004) ("Rule 9(b) applies to claims under Sections 11 and 12(2) of the Securities and Exchange Act of 1933, 15 U.S.C. §§77k, 77l, when those claims are grounded in fraud"); *CalPERS*, 394 F.3d at 160-63; *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 287 (3d Cir. 1992) ("The district court held that the §11 and §12(2) allegations in Count II 'sounded in fraud' and that Rule 9(b) applies. We agree.").

[13] *Cozzarelli*, 549 F.3d at 629 ("As almost every circuit court to examine the issue has held, Rule 9(b) applies to allegations under the Securities Act where those allegations sound in fraud.").

[14] *Melder v. Morris*, 27 F.3d 1097, 1100 n.6 (5th Cir. 1994) ("When 1933 Securities Act claims are grounded in fraud rather than negligence as they clearly are here, Rule 9(b) applies.").

[15] Pet. App. at 20a-21a.

[16] *Sears*, 912 F.2d at 892-93 (investors' 11 claims "fail[ed] to satisfy this 9(b) standard" because "their complaint [was] bereft of any detail concerning who was involved in each allegedly fraudulent activity, how the alleged fraud was perpetrated, or when the allegedly fraudulent statements were made").

[17] *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009) ("Although the heightened pleading requirements of the PSLRA do not apply to section 11 claims, plaintiffs are required to allege their claims with increased particularity under Federal Rule of Civil Procedure 9(b) if their complaint 'sounds in fraud.'") (citations omitted); *In re Daou Systems Sec. Litig.*, 411 F.3d 1006, 1028 (9th Cir. 2005) ("Thus, all of plaintiffs' claims, whether including an element of fraud or not, must satisfy the heightened pleading standard set out in Rule 9(b)."); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1133 (9th Cir. 2002) ("The alleged violations of the 1933 Act §§11 and 12(a)(2) similarly fail to state a cognizable claim. Although these provisions are not governed by the heightened pleading standards of the PSLRA, 15 U.S.C. §78u-4(b)(1) ('under this chapter'), they are subject to Federal Rule of Civil Procedure 9(b): 'The circumstances constituting fraud or mistake shall be stated with particularity.'") (citation omitted); *Stac*, 89 F.3d at 1404-05 ("We now clarify that the particularity requirements of Rule 9(b) apply to claims brought under Section 11 [of the 1933 Securities Act] when, as here, they are grounded in fraud.").

[18] *Wagner*, 464 F.3d at 1277 ("In line with the majority of circuits to address the matter, we hold that Rule 9(b) applies when the misrepresentation justifying relief under the Securities Act is also alleged to support a claim for fraud under the Exchange Act and Rule 10b-5.").

[19] *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1126 (9th Cir. 2009) (applying Rule 9(b) to dismiss state-law claims requiring no proof of fraud); *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1103-04 (9th Cir. 2003) (same).

The decisions thus present a clear and well-developed circuit split that calls for this Court's attention and resolution.

II. THE CASE PRESENTS A CLEAR CONFLICT WITH SUPREME COURT PRECEDENT AND CONGRESSIONAL INTENT

The conflict presented involves more than mere tension among the circuits, for only the Eighth Circuit's approach is true to this Court's precedents concerning pleading burdens and the elements of liability under §11. The rule adopted by the Sixth Circuit in the decision below conflicts with this Court's precedents and with congressional intent concerning both the elements of liability under the Securities Act, and the parties' relative burdens of pleading and proof.

The decisions holding that §11 claims may be subject to Rule 9(b)'s heightened pleading requirements are based on the assumption that §11 liability must be premised upon allegations of either fraud, on the one hand, or negligence, on the other. In *Rombach*, for example, the Second Circuit endorsed the view of the "several circuits [that] have distinguished between allegations of fraud and allegations of negligence, applying Rule 9(b) only to claims pleaded under Section 11 and Section 12(a)(2) that sound in fraud." *Rombach*, 355 F.3d at 170-71. "[W]hen §11 and §12[(a)](2) claims are grounded in fraud rather than negligence, Rule 9(b) applies," explained the Third Circuit in *Shapiro*, 964 F.2d at 288. And the Fifth Circuit held in *Melder*, 27 F.3d at 1100 n.6, that Rule 9(b) applies when "Securities Act claims are grounded in fraud rather than negligence."

The notion that §11 claims could be grounded in either negligence or in fraud, however, makes no sense – for "Congress created express liability regardless of the

defendant's fault." *Hochfelder*, 425 U.S. at 200. As this Court explained in *Huddleston*:

> If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case. Liability against the issuer of a security is virtually absolute, *even for innocent misstatements.* Other defendants bear the burden of demonstrating due diligence.

Huddleston, 459 U.S. at 382 (emphisis added); *see Hochfelder*, 425 U.S. at 208 ("the issuer of the securities is held absolutely liable"). Negligence comes into the picture, if at all, only with some defendants' efforts to carry their "burden of demonstrating due diligence." *Huddleston*, 459 U.S. at 382. "In effect, this is a negligence standard." *Hochfelder*, 425 U.S. at 208. But the presence or absence of negligence or fraud relates only to an affirmative defense, not to a foundation of liability on which a plaintiff's claims must be "grounded," or with respect to which the plaintiff may be required to plead.

By permitting some defendants to escape liability by proving that each, "after reasonable investigation," had reasonable grounds for believing that the registration statement was true and complete, 15 U.S.C. §77k(b)(3), the statute makes the absence of both fraud and negligence *an affirmative defense* – to be pleaded and proved by the defendants – rather than an element of the plaintiff's *prima facie* case, on which a plaintiff might be required to plead. *See Hochfelder*, 425 U.S. at 208; Fed. R. Civ. P. 8(c).

Congress deemed this allocation of burdens utterly critical to the scheme of liability it sought to implement. A House Report underscored the importance of imposing *prima facie* liability without any showing of fault on the defendants' part, even in cases involving actual fraud:

> Every lawyer knows that with all the facts in the control of the defendant it is practically impossible for a buyer to prove a state of knowledge or a failure to exercise due care on the part of defendant. Unless responsibility is to involve merely paper liability it is necessary to throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public's reliance.

H.R. Rep. No. 73-85, 73d Cong., 1st Sess., at 9 (1933). The decision below *reverses* the burden contemplated by Congress, by requiring investors to particularize the elements of fraud before they may proceed with their §11 claim.

In *Huddleston*, moreover, this Court held that the federal securities acts' remedies are cumulative, and that availability of relief under one provision does not preclude relief under another, with different elements. *Huddleston*, 459 U.S. at 380-87. The "sounds in fraud" precedents overturn this holding, by holding that merely alleging a fraud-based §10(b) claim somehow overrides the availability of a non-fraud strict-liability claim under §11. The First Circuit has said that strict-liability Securities Act claims become subsumed by fraud-based Exchange Act claims when the two are pleaded together "in a single complaint." *Shaw*, 82 F.3d at 1223. The Eleventh Circuit, holds that "Rule 9(b) applies when the misrepresentation justifying relief under the Securities Act is also alleged to support a claim under the Exchange Act and Rule 10b-5." *Wagner*, 464 F.3d at 1277. These holdings conflict with *Huddleston*, by merging two distinct claims.

By shifting to plaintiffs the burden of particularizing facts showing either fraud or negligence, moreover, the opinion conflicts with this Court's decisions holding that a complaint may not be dismissed because plaintiffs have failed to anticipate and adequately plead facts relating to an affirmative defense. *See Gomez*, 446 U.S. at 640;

Vance, 444 U.S. at 269 n.11. This Court has repeatedly "refused to change the Federal Rules governing pleading by requiring the plaintiff to anticipate" an affirmative defense. *Crawford-El*, 523 U.S. at 595. In *Gomez*, this Court found "no basis for imposing on the plaintiff an obligation to anticipate such a defense by stating in his complaint" any facts in avoidance of it. 446 U.S. at 640.

Nor do burdens regarding affirmative defenses shift to plaintiffs where a complaint's allegations improperly anticipate an affirmative defense. *Vance*, 444 U.S. at 269 n.11. In *Vance*, this Court held:

> Even where a plaintiff's complaint improperly contains allegations that seek to avoid or defeat a potential affirmative defense, "it is inappropriate for the court to shift the burden of proof on the anticipated defense to plaintiff as a 'sanction' for failing to follow the burden of pleading structure established by Rule 8 or by adopting the fiction that plaintiff's anticipation of the issue evidences his intention to 'assume' the burden of proving it."

444 U.S. at 269 n.11 (quoting 5 Charles Alan Wright & Arthur R. Miller, *Federal Practice and Procedure* §1276, at 327 (1969)).

Thus, even if plaintiffs anticipate an affirmative defense to §11 liability by in fact alleging fraud, that cannot shift to plaintiffs the burdens of pleading and proof on this aspect of the case. Investors cannot be required to plead fraud with particularity in order to pursue their §11 claim, or to prove fraud in order to recover. The burden of demonstrating the absence of both fraud and negligence should lie entirely with the defendants who hope to establish the statutory due-diligence defense.

In sum, this Court's controlling precedents hold that neither fraud nor mistake, nor even negligence, has anything to do with the *prima facie* case that investors must plead to

state a §11 claim. By requiring plaintiffs to plead fraud with particularity under Rule 9(b), the opinion below thus conflicts with this Court's decisions holding that fraud is no element of plaintiffs' *prima facie* case under §11. *See Huddleston*, 459 U.S. at 382; *Hochfelder*, 425 U.S. at 200, 208. By subjecting strict-liability claims to Rule 9(b), the decision below conflicts with this Court's decisions holding that courts cannot subject such claims to Rule 9(b)'s heightened pleading standard. *See Jones*, 549 U.S. at 213-13; *Swierkiewicz*, 534 U.S. at 515; *Bell Atl.*, 550 U.S. at 569 n.14. As the "sounds in fraud" precedents also upset the statutory balance crafted by Congress, this Court's immediate attention is warranted. A writ of certiorari should issue.

CONCLUSION

The decision below conflicts with the law of the Eighth Circuit and, even more fundamentally, with this Court's decisions. A writ of certiorari should issue so that this Court may resolve the conflict.

Respectfully submitted,

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