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Ninth Circuit Strengthens Pleading Standard in Section 11 Claims: In re Century Aluminum Co. Securities Litigation

BY SECURITIES LITIGATION AND ENFORCEMENT PRACTICE

On January 2, 2013, the Ninth Circuit provided additional support for an increasingly vigorous application of the *Twombly*/*Iqbal* pleading standard.[1] In *In re Century Aluminum Co. Securities Litigation*,[2] the Ninth Circuit applied the *Twombly*/*Iqbal* pleading standard to the tracing element of "aftermarket" purchasers in connection with a claim brought under Section 11 of the Securities Exchange Act of 1933.[3] The Ninth Circuit's decision marks the first time a circuit court has applied the *Twombly*/*Iqbal* standard to the tracing element, significantly heightening the level of factual specificity required in aftermarket purchasers' claims. The decision indicates an increasing willingness to dismiss claims that require a court to draw unreasonable inferences or accept speculative conclusions from allegations in a complaint.

Under Section 11, any person who buys a security issued under a materially false or misleading registration statement may bring a claim against the issuer of that security. A plaintiff has standing to sue provided he or she either (1) purchased shares in the offering made under the misleading registration statement, or (2) purchased shares in the aftermarket that are traceable back to the relevant offering. *Century Aluminum* involved the latter scenario.

The *Century Aluminum* plaintiffs alleged that the company's prospectus supplement, issued in connection with a secondary offering of 24.5 million shares, contained false and misleading information in violation of Section 11. The plaintiffs conceded that they had purchased shares in the aftermarket rather than directly in the secondary offering. The complaint did not set forth specific facts showing the securities were traceable to the allegedly misleading registration statement, but rather relied on a general allegation that plaintiffs had "purchased Century Aluminum common stock directly traceable to the Company's Secondary Offering."[4] The trial court dismissed the complaint, finding that the presence of 49 million shares in the market prior to the secondary offering made the plaintiffs' general allegations insufficient as a matter of law. On appeal, the Ninth Circuit affirmed, finding that the *Twombly*/*Iqbal* pleading standard required plaintiffs to make factual allegations "tending to exclude . . . the alternative explanation" that the plaintiffs' purchased shares came from the already existing pool.[5]

On review, the Ninth Circuit began by noting that when a company has issued shares under more than one registration statement, a plaintiff seeking to proceed under Section 11 must "prove that her shares were issued under the allegedly false or misleading registration statement, rather than some

other registration statement."[6] This standard requires plaintiffs who purchased in the aftermarket to trace the chain of title for their shares back to the secondary offering. As the court recognized, the tracing requirement is "often impossible" for aftermarket purchasers to meet.[7]

Turning to the *Twombly*/*Iqbal* pleading standard, the Ninth Circuit explained that a complaint's allegations, at a minimum, must suggest the claim has a plausible chance of success. Specifically, "the complaint must allege factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[8] This requires the exclusion of any "obvious alternative explanations."[9] In the case before it, the Ninth Circuit reasoned that the complaint was deficient because the plaintiffs' allegations were consistent with their shares not only having come from the secondary offering but also from the pool of previously issued shares.[10] To succeed, the court determined, the plaintiffs would have had to allege specific facts excluding the possibility that their purchased shares came from the already existing pool.

The Ninth Circuit also addressed allegations that shares purchased by one of the named plaintiffs, Peter Abrams, were traceable because Abrams had directed his broker to purchase shares from the secondary offering. The complaint alleged that Abrams's broker had purchased shares from Citigroup, which was in a joint venture with one of the underwriters of the secondary offering. Finding even these allegations insufficient, the court stated that Citigroup could have filled the order with shares from the secondary offering or from previously issued shares it was holding. Consistent with its determination as to the general allegations of tracing, the Ninth Circuit determined that allegations regarding Abrams's purchases were insufficient without fact-specific allegations excluding the latter possibility, "such as an allegation that Citigroup held *only* shares issued in the secondary offering."[11]

The Ninth Circuit's determination that the *Twombly*/*Iqbal* pleading standard requires factually specific allegations of tracing squarely contradicts the decisions of a few district courts. In recent cases, the District of Maryland and the Southern District of New York have each applied the *Twombly*/*Iqbal* standard to aftermarket purchasers' Section 11 claims.[12] Both courts upheld complaints alleging only that plaintiffs purchased shares "pursuant and/or traceable to" the relevant registration statement(s), finding that such general allegations satisfy the *Twombly*/*Iqbal* standard.[13] However, both courts' determinations rested, in large part, on pre-*Twombly*/*Iqbal* case law and the lack of any authority requiring fact-specific allegations of tracing.[14] The Ninth Circuit's decision in *Century Aluminum* suggests a different outcome may result in these jurisdictions' future decisions.

Authority from other circuit courts suggests that they may follow the Ninth Circuit's reasoning and require factually specific allegations that purchased shares are traceable to the public offering at issue. For example, in a Section 11 case decided before the Supreme Court established the *Twombly*/*Iqbal* standard, the Fifth Circuit reasoned that aftermarket purchasers' allegations must show more than a "very high" statistical probability that their shares are traceable to the relevant offering.[15] Although the Fifth Circuit has yet to apply the *Twombly*/*Iqbal* standard to Section 11 claims, this early authority suggests that court may find *Century Aluminum* persuasive.

The *Century Aluminum* decision alters the Section 11 landscape by making it more difficult for aftermarket purchasers to successfully assert claims. The Ninth Circuit's statement, "that when a company has offered shares under more than one registration statement, aftermarket purchasers usually will *not* be able to trace their shares,"[16] effectively creates a rebuttable presumption against traceability. Thus, for plaintiffs' allegations to survive a motion to dismiss, they must rebut the Ninth Circuit's presumption with factually specific information – a difficult pre-discovery standard for any plaintiff to meet.

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[1] The *Twombly*/*Iqbal* pleading standard is the result of two cases which moved federal courts away from a system of pure notice pleading. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). *Bell Atlantic Corp. v. Twombly* determined that a complaint must be plausible in order to survive a motion to dismiss. 550 U.S. at 556-57. *Ashcroft v. Iqbal* determined that "plausibility" requires "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." 556 U.S. at 678.

[2] No. 11-15599, 2013 WL 11887 (9th Cir. Jan. 2, 2013).

[3] 15 U.S.C. § 77.

[4] *In re Century Aluminum*, 2013 WL 11887, at *2.

[5] *Id.* at *3.

[6] *Id.* at *1 (citing *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 n.4 (9th Cir. 1999)).

[7] *Id.* (quoting *Barnes v. Osofsky*, 373 F.2d 269, 271-72 (2d Cir. 1967)).

[8] *Id.* at *2 (citing *Iqbal*, 556 U.S. at 678).

[9] *Id.* at *3.

[10] *Id.*

[11] *Id.* (emphasis in original).

[12] *See In re Mun. Mortgage & Equity, LLC, Sec. & Deriv. Litig.*, 876 F. Supp. 2d 616 (D. Md. 2012); *In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 372-73 (S.D.N.Y. 2011).

[13] *In re Mun. Mortgage & Equity, LLC*, 876 F. Supp. 2d at 657; *see In re Wachovia Equity*, 753 F. Supp. 2d at 372-73 (upholding complaint alleging that "Plaintiffs purchased securities pursuant or traceable to Offering Materials that contained material misstatements and omissions of fact" (internal citations omitted)).

[14] *See In re Wachovia Equity*, 753 F. Supp. 2d at 373 ("Although the . . . Defendants assert that there is no set of facts under which Plaintiffs could trace the notes purchased to the Supplemental Offerings, they supply no binding authority for the proposition that anything more is required to plead a Section 11 claim." (internal citations omitted)).

[15] *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 496 (5th Cir. 2005); *see Cozzarelli v. Inspire Pharms. Inc.*, 549 F.3d 618, 628 (4th Cir. 2008) (stating that "we have serious doubts that plaintiffs even 'nudged [their Section 11] claims across the line from conceivable to plausible,'" but upholding dismissal of complaint based on rule 9(b) of the Federal Rules of Civil Procedure).

[16] *In re Century Aluminum*, 2013 WL 11887, at *2 (emphasis in original).