No. 18-20286

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

POLICE AND FIRE RETIREMENT SYSTEM OF THE CITY OF DETROIT; IAM NATIONAL PENSION FUND, Lead Plaintiff; CITY OF WARREN POLICE &FIRE RETIREMENT SYSTEM; and MING LIU,
Plaintiffs-Appellants,
vs.
PLAINS ALL AMERICAN PIPELINE, L.P.; GREGORY L. ARMSTRONG; AL SWANSON; CHRIS HERBOLD; RICHARD MCGEE; PAA FINANCE CORPORATION; PAA GP HOLDINGS LIMITED LIABILITY CORPORATION; BB&T SECURITIES, LIMITED LIABILITY CORPORATION; BBVA SECURITIES, INCORPORATED; BMO CAPITAL MARKETS CORPORATION; BNP PARIBAS SECURITIES CORPORATION; and CIBC WORLD MARKETS CORPORATION,
Defendants-Appellees.

[Caption continued on following page.]

Appeal from the United States District Court
for the Southern District of Texas
Civil Action No. 4:15-cv-02404
The Honorable Lee H. Rosenthal

APPELLANTS' REPLY BRIEF

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JACKSONVILLE POLICE AND FIRE PENSION FUND,
Plaintiff-Appellant,

vs.

PLAINS ALL AMERICAN PIPELINE, L.P.; PLAINS GP HOLDINGS L.P.; GREGORY L. ARMSTRONG; HARRY N. PEFANIS; VICTOR BURK; EVERARDO GOYANES; GARY L. PETERSEN; JOHN T. RAYMOND; BOBBY S. SHACKOULS; ROBERT V. SINNOTT; VICKY SUTIL; TAFT SYMONDS; CHRISTOPHER M. TEMPLE; BARCLAYS CAPITAL, INCORPORATED; GOLDMAN SACHS & COMPANY; JP MORGAN SECURITIES, L.L.C.; CITIGROUP GLOBAL MARKETS, INCORPORATED; MERRILL LYNCH PIERCE FENNER & SMITH, INCORPORATED; UBS SECURITIES, L.L.C.; and WELLS FARGO SECURITIES, LIMITED LIABILITY CORPORATION,
Defendants-Appellees.

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I. INTRODUCTION

On September 7, 2018, a jury found Plains All American Pipeline "guilty of the crime of knowingly discharging oil or reasonably should have known that its actions would cause a discharge of oil into the waters of the state, a felony, in violation of Government Code Section 8670.64(a)(3), as charged in Count 1 of the felony indictment." *Compare* Plains Defendants' Brief ("PDB") 52 n.38 *with* Reporter's Transcript of Proceedings ("Transcript") at 29, *The People of the State of California v. Plains All American Pipeline*, Case No. 1495091 (Cal. Super. Ct. Santa Barbara Cty. Sept. 7, 2018). According to the Santa Barbara District Attorney, "[a]fter a 4-month trial in the Santa Barbara County Superior Court, a jury found Plains … guilty for failing to properly maintain its dangerous, highly-pressurized pipeline, which led to the discharge of crude oil into the Pacific Ocean."[1]

The question on appeal is whether facts that supported a jury verdict of knowing or criminally negligent conduct beyond a reasonable doubt are sufficient to plead a claim for defendants' false statements throughout the Class Period under the strict liability provisions of the Securities Act and, by also pleading defendants' scienter, under the Exchange Act. When defendants' fact disputes are reserved for

[1] https://www.countyofsb.org/da/msm_county/documents/Plains9718.pdf.

summary judgment, as they must be, it is clear that the Complaint indeed states a claim. The district court's dismissal should be reversed.

For example, after identifying the "integrity management programs" that were required for "high consequence areas," such as the Santa Barbara Coast where Lines 901 and 903 operated, all defendants told investors: "We have also developed and implemented certain pipeline integrity measures that go beyond regulatory mandate." (ROA.3082¶192 (Statement 1)) To the contrary, presaging the criminal jury verdict, the federal Safety Administration determined that Plains' "pipeline integrity" did not even meet basic "federal standards" when it concluded the spill should not have occurred "if the pipeline's integrity had been maintained to federal standards." (ROA.3057¶141)

Similarly, all defendants told investors that Plains was "in substantial compliance with [the Safety Administration] and the 2002 and 2006 amendments" regulating high consequence areas, and that "none of the Plains Entities, directly or indirectly, has violated any environmental, safety, health or similar law or regulation applicable to its business." (ROA.3173-74¶378; ROA.3176-77¶386 (Statements 13 and 16)) The Safety Administration and now a criminal jury each found to the contrary. (ROA.3057¶141; Transcript at 29, *Plains*, Case No. 1495091 (Cal. Super. Ct. Santa Barbara Cty. Sept. 7, 2018))

CEO Armstrong specifically told investors that Plains used "state-of-the-art inspection tools and technologies" and ran safety assessments "more often than [was] required." (ROA3086-87¶¶205-206 (Statement 7)) Yet, the Safety Administration found that one of the three primary causes of the catastrophic spill was Plains' failure to detect and mitigate external corrosion, including the fact that the "stated accuracy" of the smart-pig anomaly-measurement tool was "not met for *any* of the [in-line inspection] surveys." (ROA.3058-59¶144; ROA.3091¶217 (emphasis added)) The consequences of Plains' concealed failures, according to the federal regulators, was "active external corrosion" on Line 901 and "anomalies" on both Lines 901 and 903 that had been "undercalled" for "the past 10 years." (ROA.3050-51¶123; ROA.3055¶137)

What the Underwriter Defendants now describe as a "corporate setback" (Underwriter Defendants' Brief ("UDB") 1), was actually the largest oil spill in California in 25 years—in a known environmentally-sensitive "high consequence" area. (ROA.3007-08¶5) To be clear, an oil spill is not securities fraud. The fraud alleged is that defendants misled investors about Plains' value by, *inter alia*, repeatedly falsely assuring the market it was managing safety issues "in substantial compliance with" and "beyond regulatory mandate." (ROA.3173-74¶378; ROA.3082¶192) The facts in the Complaint state a claim.

II. ARGUMENT

The Private Securities Litigation Reform Act ("PSLRA") heightened the pleading standard for securities claims—but it remains a pleading standard. This Court still "accept[s] all factual allegations in the complaint as true" and "draw[s] all reasonable inferences in the plaintiff's favor." *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 232 (5th Cir. 2009).

Falsity does not have an increased persuasiveness requirement—only a particularity requirement. The Complaint must allege the "who, what, when, where, and how" of each statement alleged to be false. *Owens v. Jastrow*, 789 F.3d 529, 535 (5th Cir. 2015). That detail is provided for each alleged false statement in the Complaint.

Scienter is also amply pled with facts that support a strong and cogent inference of scienter that is "at least as strong as any opposing inference." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322-23, 326 (2007). "[A] tie favors the plaintiff." *Lormand*, 565 F.3d at 254. Here, fact allegations that supported the conclusions of the relevant federal regulator and a jury's conviction also support an extremely strong and cogent inference of scienter.

Given the volume of fact disputes raised in both answering briefs, it would be easy to mistake this appeal for one at summary judgment. It is not. Fact challenges

have no place in this Court's analysis—facts alleged are accepted "as true" and inferences are drawn "in the plaintiff's favor" for both falsity and scienter. *Id.* at 232. Only after viewing the Complaint allegations in that light does this Court weigh the scienter allegations alone for "plausible inferences opposing as well as supporting a strong inference of scienter." *Id.* at 239. For clarity of analysis, plaintiffs separate this brief into the issues that are relevant to this Court's decision and those that are irrelevant obfuscation.

A. Relevant issues on appeal: falsity and scienter

Reversal of the district court's dismissal of plaintiffs' Securities Act claims against all defendants is required based solely on the falsity of Statements 1-4 and 13-16. (*See* complete numbered list of alleged false statements at ROA.3261-72) Even assuming the district court were correct in finding the Securities Act claims "sound in fraud" (ROA.3651-52), that only means falsity must be pled with particularity: the "who, what, when, where, and how" of each statement alleged to be false. *Owens*, 789 F.3d at 535. Defendants' "virtually absolute" liability for the Securities Act claims does not require any allegation of scienter or reliance. *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 495 (5th Cir. 2005); *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, __ U.S. __, 135 S. Ct. 1318, 1331 n.11 (2015) (§11 establishes liability "regardless of the issuer's state of mind"). As detailed in

Appellants' Opening Brief ("AOB") 34-41 and below, falsity is alleged with particularity.

Reversal of the district court's dismissal of the Exchange Act claims against Plains and Individual Defendants is also required based on all falsity allegations, including Statements 5-12, and the strong allegations of scienter. Again, falsity is alleged with particularity. (*See* AOB 17-18, 28, 34-37, 40-41) Moreover, the Complaint pleads a strong and cogent inference of scienter. For example, the federal Safety Administration found that, only two weeks before the spill, Plains itself had identified four areas on Line 901 with pipe anomalies requiring "immediate investigation and remediation" under relevant regulations and Plains' own "integrity management plan" (ROA.3050¶122)—and yet Plains did nothing. The facts alleged in the Complaint, detailing the Plains and Individual Defendants' knowledge and severe recklessness over years, supported a jury verdict against Plains on a felony charge of "knowingly engaging in or causing the discharge or spill of oil into the waters of the state." Transcript at 27, *Plains,* Case No. 1495091 (Cal. Super. Ct. Santa Barbara Cty. Aug. 28, 2018). Those facts, when considered cumulatively, amply plead scienter.

1. All defendants are strictly liable under the Securities Act for the particularly alleged false statements

Falsity of Statements 1-4 and 13-16 is well-pled. Alleged false Statement 1 (ROA.3082¶192) is representative.

- **Who**: All defendants.
- **What**: "The DOT regulations include requirements for the establishment of pipeline integrity management programs and for protection of 'high consequence areas' where a pipeline leak or rupture could produce significant adverse consequences. We have also developed and implemented certain pipeline integrity measures that go beyond regulatory mandate."
- **When and Where**: Plains' Annual reports on February 27, 2013, February 28, 2018, and February 25, 2015; Plains Holdings' Annual reports on March 12, 2014 and February 25, 2015; IPO Offering Materials; incorporated by reference in 10-Q Reports and Offering Materials.
- **How**: False because Plains' "pipeline integrity" did not even meet basic "federal standards," as the federal Safety Administration determined when it concluded that "if the pipeline's integrity had been maintained to federal standards," the spill should not have occurred. (ROA.3057¶141)

That particularity satisfies the PSLRA and this Court's requirements for pleading falsity. *Owens*, 789 F.3d at 535. The same level of particularity is alleged for Statements 2-4 and 13-16. (AOB 34-41; ROA.3082-83¶¶192-195; ROA3089-90¶214)

For example, falsity is also alleged with particularity for all defendants' statements that "none of the Plains Entities, directly or indirectly, has violated any

environmental, safety, health or similar law or regulation applicable to its business." (ROA.3176-77¶386 (Statement 16)) In truth, throughout the Class Period, Lines 901 and 903 were operating in violation of an extensive list of safety regulations. (ROA.3047-60¶¶119-146) As the district court acknowledged, "the plaintiffs have alleged specific reports and notices of regulatory violations." (ROA.3646) As one example, Plains actually had dig reports for 41 excavations for Line 901 completed by October 3, 2013—and they showed that Plains' in-line "smart-pig" inspections were inaccurate 42% of the time. (ROA.3090¶¶215-216) Plains had compiled that information in its "Unity Plot" (ROA.3096¶230)—but did not share it with its "smart-pig" vendor in violation of 49 C.F.R. §195.452. (ROA.3096¶230; ROA.3108¶248)

Because Plains violated that "regulation applicable to its business"—failing to calibrate the "smart-pigs" by giving its vendors the results documented in the "Unity Plot"—the corrosion anomaly that caused Line 901's rupture was erroneously sized at metal loss of 47% when the actual metal loss was 89%. (ROA.3093¶224) The Safety Administration expressly found the "stated accuracy" of the smart-pig anomaly-measurement tool was "not met for any of the [in-line inspection] surveys" and Plains' failure to detect and mitigate the corrosion was the second of three causes of the oil spill. (ROA.3058-59¶¶142, 144; ROA.3091¶217)

Indeed, reviewing Class Period conditions, the Safety Administration concluded that "it does not appear that Plains has an effective corrosion control program" on Line 903. (ROA.3056-57¶139) In other words, Plains did not comply with the laws and regulations requiring Plains to implement an "integrity management program" to "ensure pipeline safety in 'high consequence areas.'" (ROA.3035-36¶92)

Falsity is alleged—which is sufficient for the Securities Act claims and, therefore, requires reversal. Since defendants cannot dispute that the false statements are alleged with particularity, they resort to unconvincing assertions about materiality, literal truth, and context. None is persuasive.

a. The materiality of defendants' false statements related to this catastrophic oil spill is more than amply pled

In light of the catastrophic oil spill caused by Plains' failure to maintain the safety of Plains' pipelines and its failure to comply with applicable laws and regulations (which all defendants concealed), it is genuinely remarkable that defendants persist in asserting fact-bound materiality arguments. Defendants ask this Court to decide—at the pleading stage—that reasonable investors would not have wanted to know that one of Plains' oldest pipelines (ROA.3079-80¶187), operating in the "high consequence area" of Santa Barbara's coastline (ROA.3008¶6), had "active external corrosion" and "anomalies" that had been "undercalled" for "the past 10

years" (ROA.3050-51¶123; ROA.3055-56¶137)—and that Plains had concealed the data necessary to calibrate its measuring tools so that the pipeline had at least one area with "actual metal loss [of] 89%." (ROA.3093¶224)

Defendants now seek to compare the size of the rupture itself with Plains' overall pipeline (PDB1)—as though their alleged false statements were not expressly addressing pipelines in "high consequence areas" and as though Lines 901 and 903 were not alleged to comprise "9-10% of Plains' interstate crude oil pipelines in HCAs, and 15-18% of those affecting commercially navigable water and sensitive ecological resources." (ROA.3035-36¶92) The materiality of defendants' statements relates to their "high consequence area" pipelines—not to the one particular spot that ruptured before Plains was ordered to shut the pipelines down.

Defendants' assertions that their statements were not expressly addressing "high consequence areas" are contrary to the Complaint allegations. In Statement 1, all defendants specifically referenced the "requirements … for protection of 'high consequence areas'" and then told investors, "[w]e have also developed and implemented certain pipeline integrity measures that go beyond regulatory mandate." (ROA.3082¶192) Similarly, in Statement 13, all defendants told investors Plains was "in substantial compliance" with the specific regulations—"2002 and 2006

amendments"—that regulated high consequence areas. (ROA.3173-74¶378 (Statement 13))

Moreover, the absolute nature of all defendants' Statement 16 undermines defendants' materiality assertions. They assured investors that "none of the Plains Entities, directly or indirectly, has violated any environmental, safety, health or similar law or regulation applicable to its business." (ROA.3176-77¶386 (Statement 16)) Reasonable investors would have wanted to know the truth: that Plains was "knowingly engaging in or causing the discharge or spill of oil into the waters of the state." Transcript at 27, *Plains*, Case No. 1495091 (Cal. Super. Ct. Santa Barbara Cty. Aug. 28, 2018).

Out of options, defendants reach for language in the Underwriter Agreements to recycle a "Material Adverse Effect" assertion that was flatly rejected by the district court. As the district court recognized, "[t]he Santa Barbara spill and its consequences—both financial and legal—are easily within the 'material adverse effect' that the statement addresses." (ROA.2958) Despite defendants' continued insistence to the contrary (PDB33-34; UDB15 n.5), the obviously "Materially Adverse Effect" was much more than the legal fees Plains got away with. The Underwriter Agreements themselves define "Materially Adverse Effect" as including both "financial" and "other" consequences (ROA.3331)—and Plains' Annual Reports

described "material adverse effect" as including "property damage and environmental damage." (ROA.3484) Here, the "Material Adverse Effect" included the largest oil spill in California in 25 years (ROA.3007¶5) and Plains' felony conviction. Transcript at 29, *Plains*, Case No. 1495091 (Cal. Super. Ct. Santa Barbara Cty. Sept. 7, 2018). Materiality is amply pled.

b. Literal truth is not the test for securities fraud—materially misleading statements are actionable

The "disclosure required by the securities laws is measured not by literal truth, but by the ability of the statements to accurately inform rather than mislead prospective buyers." *Lormand*, 565 F.3d at 248. Yet, defendants resort to assertions of literal truth to avoid liability—at the pleading stage—for statements that were plainly materially misleading.

For example, Plains' Annual Reports and offering materials assured investors about Plains' "commitment" to "investment in any necessary equipment, systems, processes, or other resources" and touted Plains' "internal review process in which we examine the condition and operating history of our pipelines and gathering assets to determine if any of our assets warrant additional investment or replacement." (ROA.3082-83¶¶193-194 (Statements 2 and 3)) Plains' SEC filings claimed Plains complied with regulatory requirements for "more frequent inspections, correction of

identified anomalies and other measures, to ensure pipeline safety in 'high consequence areas.'" (ROA.3083¶195 (Statement 4))

Yet, Plains did not even meet the *minimum* "process" requirement of providing its smart-pig vendors with actual data to calibrate Plains' equipment for accurate in-line inspections. (ROA.3093¶224; ROA.3058-59¶¶142, 144; ROA.3091¶217) Plains did collect the data and organize it into a "Unity Plot" (ROA.3096¶230)—but then effectively put it into a drawer rather than use it to actually "determine if any of [its] assets warrant additional investment or replacement." (*Compare* ROA.3082-83¶194 (Statements 3))

The statements are not even literally true. Plains did not invest in necessary equipment or processes for evaluating the safety of its pipelines. To do that, Plains would have needed to comply with applicable regulations and share the actual data with its vendors. It did not. The statements are false—and, even if generously read as "literally true," they are certainly actionable as materially misleading statements. *Lormand*, 565 F.3d at 248. Defendants' assertion that this case is about "the efficacy of its processes" (PDB6) is part of their narrative that must await trial.

c. The relevant context during the Class Period was Plains' focus on rehabilitating its terrible reputation and the crucial location of Lines 901 and 903

An important part of the context alleged in the Complaint is that, before and throughout the Class Period, Plains had the worst safety record of any pipeline operator in the United States. (ROA.3065¶151) The Complaint alleges Plains was determined to rehabilitate its public image as a safe and responsible pipeline operator—and that CEO Armstrong led the effort. (ROA.3037¶96; ROA.3039¶100) That context supports a reasonable inference that the Plains/Individual Defendants were motivated to tell the market that safety issues were being well-handled.

The other crucial context is that Lines 901 and 903 operated in "high consequence areas" in Santa Barbara—"the one" "place in the world you would not want to have a release," according to CEO Armstrong. (ROA.3008¶6; ROA.3044¶112) Those "high consequence areas" had additional regulatory requirements for increased attention, care, maintenance, and the implementation of "integrity management programs, including more frequent inspections, correction of identified anomalies and other measures to ensure pipeline safety in 'high consequence areas.'" (ROA.3035-36¶92) That context supports the reasonable inference that all defendants paid special attention to, and investors were most

concerned about, Lines 901 and 903—as well as other pipelines in high consequence areas.

Now in litigation, however, defendants assert that the location of false Statements 15 and 16—in underwriting agreements—is the only important context to consider. (PDB7; UDB12-13) Even if that were plausible, the location in SEC-required public documents is not a context that makes defendants' false statements less actionable. "[R]epresentations and warranties in underwriting agreements" are "required" to be included in registration statements (15 U.S.C. §77aa)—and §11 of the Securities Act establishes liability for "any part" of those statements that is materially false or omits a material fact. 15 U.S.C. §77k(a). "Section 11 liability continues to extend to exhibits." 52 Fed. Reg. 21252-01, 21256.

The Underwriter Defendants actually explain why investors would find these statements particularly material: "The contractual representations and warranties in an underwriting agreement also serve an important due diligence function, which ensures the integrity of the offering … for public investors." (UDB16) Of course, the Underwriter Defendants' litigation sentence adds that the agreement also ensures the offering's integrity for the underwriters—appearing to overlook that the underwriters were paid $141 million in fees for ensuring the truthfulness and accuracy of the statements contained in or incorporated by reference into the offering materials

(ROA.3020-28¶¶45-81; ROA.3209-10¶462) and that the Plains/Individual Defendants would be liable in any event.

Continuing to attempt to portray themselves as unwitting bystanders rather than "securities professionals" who "occup[y] a vital position in an offering" (SEC Release No. 26100 (Sept. 22, 1988)), the Underwriter Defendants assert that "Courts have recognized that when underwriters obtain contractual representations and warranties enforceable against an issuer, this is part of the diligence process." (UDB16) The Underwriter Defendants appear to be asserting a fact-bound affirmative defense that is unavailable to them at this stage. Indeed, the claim is unlikely to succeed at any stage since "part" of the process is a far cry from sufficient—especially when the Underwriters are making representations to "ensure[] the integrity of the offering" for the investing public. (*Id.*)

Finally, all defendants isolate particular phrases in the Underwriter Agreements to attempt to exonerate themselves. (UDB11-12) But, they overlook that the Registration Statement expressly provided that "the underwriters' obligation to purchase Class A shares depends on the satisfaction of the conditions contained in the underwriting agreement," including that "the representations and warranties made by us [Plains Defendants] to the underwriters are true." (ROA.3496-97) So, while the Plains Defendants wanly assert that no "reasonable investor" would think its words

really meant what they said (PDB34-35) and all defendants continue to argue that the SEC-required public document was somehow private, a reasonable investor would certainly understand that the representations and warranties were "true." (ROA.3496-97)

Two courts to address the issue have found statements in underwriting agreements filed with the SEC to be actionable. *In re Galena Biopharma, Inc. Sec. Litig.*, 117 F. Supp. 3d 1145, 1179 (D. Or. 2015); *In re NovaStar Fin. Sec. Litig.*, 2005 WL 1279033, at *5 (W.D. Mo. May 12, 2005). The Underwriter Defendants here attempt to distinguish both cases because they involved claims under the Exchange Act rather than the Securities Act (UDB20 n.6)—overlooking that Exchange Act claims are even more challenging to plead as, unlike Securities Act claims, they do involve a required element of reliance as well as scienter. Thus, the reasoning applies with even greater force to Securities Act claims: "[a]lthough the Underwriting Agreement contains a clause stating that the warranties and representations were made only to the underwriter, at this stage it is a plausible inference that a reasonable investor would believe that the statements and representations made to the underwriter were truthful and could be relied upon." *Galena*, 117 F. Supp. 3d at 1179.

d. The Underwriter Defendants are liable for all false statements and omissions in the Registration Statement and its exhibits—with or without their signatures

The Underwriter Defendants are also flatly incorrect in stating that "unexecuted drafts of the underwriting agreements … cannot serve as the basis of a securities claim in any event." (UDB7 n.4, 27-28) The law is directly contrary: "[U]nderwriter liability under section 11 is not affected by the omission of underwriters' names from the registration statement; anyone with the status of an underwriter is potentially liable under section 11 whether or not named in the registration statement." 52 Fed. Reg. 21256.

Liability extends to exhibits. *Id.* Here, each of the relevant registration statements contained "Exhibit 1.1 Form of Underwriting Agreement" (ROA.1267-351; ROA.3214-16), repeating unqualified statements about Plains' legal and regulatory compliance. (ROA.3176-77¶386 (Statements 15 and 16)). Further, the underwriting agreements were incorporated by reference into each prospectus and prospectus supplement for the offerings. (ROA.3214-16) The agreements were signed by the Plains Defendants and by defendant McGee. (ROA.3177¶387) And, the Underwriter Defendants are liable "whether or not named." 52 Fed. Reg. 21256.

The Underwriter Defendants' extensive timing assertions are also inaccurate. (*See* UDB22-27) "[T]here is 'no doubt that [investors] may assert Section 11 claims

on the basis of statements included in the Final Prospectus, even for those Certificates [investors] committed to purchase before those documents were filed.'" *Fed. Hous. Fin. Agency v. Nomura Holding Am., Inc.*, 68 F. Supp. 3d 499, 506 (S.D.N.Y. 2014) (citation omitted), *aff'd sub nom. Fed. Hous. Fin. Agency for Fed. Nat'l Mortg. Ass'n v. Nomura Holding Am., Inc.*, 873 F.3d 85 (2d Cir. 2017), *cert. denied*, 138 S. Ct. 2679 (2018). Exhibits such as the Underwriter Agreements "are not required to be filed in executed form at the time of effectiveness." 52 Fed. Reg. 21255.

Here, the offerings were issued pursuant to shelf registration statements, meaning the same registration statements applied to each offering. Plains' Registration Statement explained the "Underwriting Agreement" will "be filed as an exhibit to a report pursuant to Section 13(a) or 15(d) of the Exchange Act or in a post-effective amendment to this registration statement." (ROA.3500) Putting the same concept in other words, Plains Holding's Registration Statement explained the "Underwriting Agreement" was "[t]o be filed as an Exhibit to a Current Report on Form 8-K or a post-effective amendment to this registration statement." (ROA.3503) The Underwriter Defendants' assertion that the "later-filed Forms 8-K … come squarely within the cited exclusionary clause of Rule 159(a)" (UDB27 n.8) is completely unsupported.

The *Ho v. Duoyuan Global Water, Inc.*, 887 F. Supp. 2d 547, 569 (S.D.N.Y. 2012) decision cited by the Underwriter Defendants actually involves a conclusion that new information "published in 2011, cannot demonstrate, for purposes of §11, that the representation [about facts] made in the registration statement was false in the 2006–2009 time periods when the IPO and SPO were conducted." *Id.* That analysis has no bearing on the essentially contemporaneous filings that were expressly incorporated in the offering documents here.

As the *Nomura* court explained, "Defendants cannot take advantage of the 2005 reforms meant to ease burdens on issuers and underwriters like defendants—here the authority to file a prospectus supplement following the sale of a security—to escape liability under Section 11 for material misrepresentations or omissions in those supplements." 68 F. Supp. 3d at 506-07. Moreover, like the *Nomura* defendants, the Underwriter Defendants here "appear to be shoehorning an improper reliance argument into an argument as to materiality" (*id.* at 506) when reliance is not an element of a §11 claim. *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 872 (5th Cir. 2003).

2. The Plains and Individual Defendants are also liable under the Exchange Act for false statements pled with a strong and cogent inference of their severe recklessness

All of the statements particularly alleged as false under the Securities Act are also actionable under the Exchange Act. Defendants' additional statements alleged as false under the Exchange Act were also pled with particularity. Again, falsity does not have an increased persuasiveness requirement—only a particularity requirement. *Lormand*, 565 F.3d at 232. Further, the standard for false statements under the Exchange Act is also not literal truth; materially misleading statements are actionable. *Id.* at 248.

As examples of additional statements actionable under the Exchange Act, CEO Armstrong told investors that Plains "regularly assess[ed] pipeline integrity using state-of-the-art inspection tools and technologies" and used "the best tools that are available." (ROA.3086-87¶¶205-206 (Statements 7 and 8)) Specifically referencing "[s]mart pigs," Armstrong, Pefanis, and Swanson told investors Plains "improve[d] our data interpretation to make sure that we are trying to prevent things from happening, not diagnose what did happen." (*Id.*) Plains also told the market it "perform[ed] scheduled maintenance on all of our pipeline systems and ma[d]e repairs and replacements when necessary or appropriate." (ROA.3085-86¶202(Statement 5))

Those statements were both literally false and materially misleading. The Safety Administration concluded Plains' measuring tool had "undercalled" pipeline anomalies "over the past 10 years"—and the "stated accuracy" of the smart-pig anomaly-measurement tool was "not met for any of the [in-line inspection] surveys." (ROA.3055-56¶137; ROA.3058-59¶144; ROA.3091¶217) The federal regulators also concluded Plains' failure to accurately calibrate the "smart pigs" was a central cause of the rupture. (ROA.3058-59¶144; ROA.3091¶217) Specifically, it concluded the corrosion anomaly that caused Line 901's rupture on May 19, 2015 was erroneously sized at metal loss of 47% when the actual metal loss was 89%. (ROA.3093¶224)

The problem was not "efficacy." (*See* PDB6) Plains' maintenance *procedure* precluded accurately measuring the corrosion and timely performing necessary repairs and replacements—failures that caused the tragic oil spill. Falsity is alleged.

The Exchange Act claims are also amply supported by allegations of a strong and cogent inference of scienter "*at least as* compelling as any opposing inference one could draw from the facts alleged." *Lormand*, 565 F.3d at 255 (emphasis in original). This Court holds that scienter is well pled with allegations that a company "directed [an employee] to investigate what plaintiffs allege [is the factual basis for the fraud]" and then "persisted" in failing to use that information "after receiving the report." *Barrie v. Intervoice-Brite, Inc.*, 397 F.3d 249, 264 (5th Cir. 2005). Here, Plains

internally compiled the data from 41 excavations for Line 901 completed by October 3, 2013 into a "Unity Plot"—and then refused to share it with the "smart-pig" vendor. (ROA.3090¶¶215-216; ROA.3092-93¶¶220-224) That compilation of data—and "persistence" in proceeding without it—is strong indicia of scienter. *Id.*; *Cent. Laborers' Pension Fund v. Integrated Elec. Servs. Inc.*, 497 F.3d 546, 551 (5th Cir. 2007).

Further, the federal regulator expressly stated that the factual basis for its final conclusions about the spill's cause came from Plains' own 2013 inspections 18 months earlier. (ROA.3053-54¶132) Specifically, the regulator had earlier warned Plains—in March of 2009—that its "data integration process must be modified to require the application of tool uncertainty to [in-line inspection] results." (ROA.3094-95¶227) In December 2013, the federal regulator had also warned Plains about its central control room, which was likely violating regulations for timely detecting and responding to rupture issues. (ROA.3150¶324, quoting 49 C.F.R. §195.446(h)) Thus, the issue is not "all dig reports for all pipelines" as the Plains/Individual Defendants suggest. (PDB45) In light of the earlier warnings, the available information, and the fact that Lines 901 and 903 made up 9-10% of Plains' pipelines in "high consequence areas" (ROA.3035-36¶92), it is "reasonable to assume, given the importance of [an aspect of a company's business] to the company, that [defendants] would have

familiarized [themselves] with the [relevant facts]." *Plotkin v. IP Axess Inc.*, 407 F.3d 690, 700 (5th Cir. 2005).

Plains is also responsible for the knowledge of its senior officers, Gorman, Valenzuela, and Nerbonne, because they each "furnish[ed] information or language for inclusion" in Plains' alleged false statements. *Southland Sec. Corp. v. INSpire Ins. Sols., Inc.*, 365 F.3d 353, 366 (5th Cir. 2004). "A corporation cannot act or have a mental state by itself, and thus, under the common law, 'the acts and mental states of its agents and employees will be imputed to the corporation where such natural persons acted on behalf of the corporation.'" *United States ex rel. Vavra v. Kellogg Brown & Root, Inc.*, 848 F.3d 366, 372 (5th Cir. 2017) (citation omitted).

While defendants deny, without support, that the Complaint alleges those three individuals furnished information for Plains' Class Period statements (PDB8, 42), the Complaint alleges Gorman, Valenzuela, and Nerbonne each received direct information from the federal regulators contradicting Plains' Class Period statements in areas for which they had primary authority. (*See* AOB 61, discussing ROA.3037-38¶98; ROA.3047-49¶119; ROA.3067-68¶159; ROA.3071¶166; ROA.3094-95¶227; ROA.3150¶324; ROA.3153-54¶333)

For example, Nerbonne, Plains' senior officer in charge of the "integrity management program," received the March 2009 notice requiring Plains to modify its

data integration process for tool accuracy (ROA.3094-95¶227)—and was the senior person responsible for the very facts from Plains' own 2013 inspection on which the regulator based its final conclusions about the failures of that program. (ROA.3047-49¶119; ROA.3053-54¶132) Gorman and Valenzuela were required to review that information to sign the PIPES Act certifications. (ROA.3095¶228; ROA.3097¶233)

Because they were the senior officers in charge of the "integrity management program" (Nerbonne), safety and regulatory compliance (Valenzuela), and operations (Gorman), and because of Plains' internal reporting requirements (ROA.3068-69¶¶160-163), the reasonable inference is that they furnished the information for Plains' statements on those topics. Indeed, Plains' Class Period statements assured investors of as much. (*Id.*) For example, directly addressing Plains' regulatory compliance responsibilities, Plains told investors its audit committee "[o]btain[ed] reports from management … with respect to compliance by each of [the Plains Holdings and Plains entities]" and "[d]iscuss[ed] with the General Counsel [McGee] legal matters that may (a) have a material impact on [Plains Holdings' or Plains'] financial statements or (b) result in material non-compliance by [the Plains entities] with legal or regulatory requirements." (ROA.3068-69¶162) Because of Plains' horrific safety record (ROA.3065¶151), process changes such as this reporting

requirement for safety and regulatory compliance information were precisely the types of reassurances investors sought from Plains.

Given Nerbonne's, Valenzuela's, and Gorman's leadership positions and Plains' internal reporting requirements, it would have been severely reckless for Plains to speak without consulting the senior information holders. *Omnicare*, 135 S. Ct. at 1331-32 (Even a statement of opinion requires "considering the foundation [the "reasonable person"] would expect an issuer to have before making the statement."). Accordingly, Nerbonne's, Valenzuela's, and Gorman's scienter establishes Plains' scienter for its false statements about legal compliance, its "integrity management program," its "state-of-the-art" tools, and its response capabilities. *Fed. Deposit Ins. Corp. v. Lott*, 460 F.2d 82, 88 (5th Cir. 1972); *see* AOB 62-64.

Undeterred, the Plains/Individual Defendants continue to insist that the relevant data about failing Lines 901 and 903 was "granular" and they argue it is not reasonable to infer that Plains' top officers would have reviewed it. (PDB44, 49) They again overlook specific Complaint allegations to the contrary. The Complaint alleges Gorman and Valenzuela signed Plains' PIPES Act reports—and that, in order to complete those forms, they needed to review results of digs, in-line inspections, and related excavations for repairs in high consequence areas, including Line 901. (ROA.3095¶228; ROA.3097¶233)

The officers' scienter is also alleged. Plains' Class Period SEC reports affirmatively stated that CEO Armstrong, CFO Swanson, and "other appropriate officers" were each given all material information about Plains' pipelines and operations. (ROA.3066-68¶¶157-159) And Plains' own internal procedures required two of the four senior executive officers—Armstrong, Pefanis, Swanson, and McGee—to approve any material deviation from pipeline safety and environmental protection. (ROA.3074-75¶¶173-174) Choosing to compile data from actual digs into a "Unity Plot," but then withhold it from vendors who could use it to accurately calibrate the in-line measuring tools as required by regulation (49 C.F.R. §195.452), is precisely such a material deviation.

Despite what Armstrong, Swanson, and Pefanis knew, they each repeatedly referred investors to false statements on Plains' website statements, including that Plains "perform[ed] scheduled maintenance on all of our pipeline systems and ma[d]e repairs and replacements when necessary or appropriate," as well as stating a belief that "all of our pipelines have been constructed and are maintained in all material respects in accordance with applicable federal, state and local laws and regulations … and accepted industry practice." (ROA.3085-86¶202 (Statement 5); (ROA.3178¶388 (Statement 17)) Notwithstanding the Plains/Individual Defendants' concern that such a rule might interfere with false statements on corporate websites

(PDB43), this Court does hold that "specific factual allegations link[ing] the individual to the statement at issue" make a company's statement attributable to those individuals. *Southland*, 365 F.3d at 365. Here, Armstrong's, Swanson's, and Pefanis' repeated reference to statements on the website is just such specific factual linkage.

The strong inference of Armstrong's, Swanson's, and McGee's scienter is even further supported by (i) Plains' reporting requirements to its audit committee which directed regulatory compliance information to McGee and Armstrong (ROA.3068-69¶¶160-162); (ii) Armstrong's and Swanson's signatures on Sarbanes-Oxley certifications declaring they received all "material information" (ROA.3072¶167); and (iii) Plains' public statements that it had "an internal review process in which we examine the condition and operating history of our pipelines and gathering assets to determine if any of our assets warrant additional investment or replacement." (ROA.3070-71¶165)

Even further supporting all the officers' scienter, Plains' compensation system was structured so that money spent on safety and repairs meant smaller bonuses for officer defendants. (ROA.3075-79¶¶175-186) That financial motivation is corroborated by the federal regulator's finding that Plains had identified a need to upgrade Lines 901 and 903, but relegated those lines to a "low-to-medium" priority. (ROA.3059-60¶145) Cumulatively, those facts plead a strong inference of scienter,

"at least as compelling as any opposing inference one could draw from the facts alleged." *Spitzberg v. Houston Am. Energy Corp.*, 758 F.3d 676, 684 (5th Cir. 2014).

Despite those detailed and specific allegations, the Plains/Individual Defendants persist in arguing that the scienter allegations against the Officer defendants are simply "'positional scienter'"—because senior officers with knowledge, Valenzuela and Gorman, reported to them. (PDB47) First, defendants overlook *Plains'* liability for Valenzuela's and Gorman's scienter. *Kellogg Brown*, 848 F.3d at 372. Second, plaintiffs do not dispute that "positional scienter" alone has been held insufficient in this Circuit. But the abundant scienter allegations here, detailed above, go well beyond position. In addition to the many well-pled channels of communication to the Officer defendants about which Plains assured investors (ROA.3068-69¶¶160-163), Plains' own internal procedures specifically required that two of the four senior executive officers approve any material deviation regarding pipeline safety and environmental protection. (ROA.3074-75¶¶173-174)

Finally, defendants argue Hodgins' scienter is not well pled. The Plains/Individual Defendants' brief acknowledges allegations that Hodgins falsely testified before the California State legislative committee investigating the Line 901 spill that "[w]e had no indication at all to assume there was an issue" and failed to correct a false statement about the actual spill volume. (ROA.3087¶¶207-208

(Statement 9); ROA.3167-68¶¶362-364 (Statement 12)) Defendants further acknowledge the Complaint alleges Hodgins was Plains' director of safety and security and a member of the Spill Unified Command. (PDB39, citing ROA.3087¶208, ROA.3089-90¶214; ROA.3167-69¶¶362, 364, 366)

The Plains/Individual Defendants assert those are "the *sole* allegations concerning Hodgins" (PDB39 (emphasis in original)), overlooking a crucial allegation—that Plains sent Hodgins to testify before the California State Legislature. (ROA.3087¶207) Hodgins testified as Plains' agent and Plains is responsible for his testimony. *Kellogg Brown*, 848 F.3d at 372. Hodgins either had the available contradictory information, in which case his statements were knowingly false and his scienter is attributed to Plains, or Plains sent an agent to testify to the California State legislature without giving him the relevant information, which was at least severely reckless. Either way, Plains is liable for Hodgins' false statements. *Id.*

When those allegations are considered "holistically," rather than "scrutinize[d] … in isolation" (*Tellabs*, 551 U.S. at 326), scienter is well pled. The district court's dismissal should be reversed.

B. Defendants' fact challenges cannot be heard at the pleading stage and must await summary judgment or trial

Defendants' Answering Briefs are replete with fact challenges. As the Supreme Court and this Court have repeatedly held, those challenges cannot be resolved at the

pleading stage—even for scienter—and must await summary judgment or trial. *Tellabs*, 551 U.S. at 322; *Lormand*, 565 F.3d at 232.

For example, the Complaint alleges "Lines 901 and 903 comprised 9-10% of Plains' interstate crude oil pipelines in HCAs [high consequence areas], and 15-18% of those affecting commercially navigable water and sensitive ecological resources." (ROA.3035-36¶92) Yet, the Plains/Individual Defendants argue "Appellants wrongly assert" those fact allegations. (PDB17 & n.11; *see also* PDB30) Presumably in support of their remarkable materiality challenge, addressed above, the Plains/Individual Defendants resort to their own calculation of "aggregate mileage." (*Id.*) Their disputed calculation—and their materiality claim—must await a later stage of the proceedings.

Similarly, the Plains/Individual Defendants insist that Plains resolved the regulator's order that Plains' "data integration process must be modified." (PDB51-52) But the Complaint alleges "the validation process" for "incorporat[ing] the known … 'under-call' bias" was "never corrected." (ROA.3094-95¶227) The facts alleged in the Complaint—as opposed to argued in defendants' brief—are that "[f]our years later, during its 2013 inspections of Lines 901 and 903, [regulator] PHMSA again raised the concern to Plains that its integrity management procedures failed to

address how differences in anomalies as directly measured in the fields and as sized by [in-line inspection] tool would be handled." (*Id.*)

The Plains/Individual Defendants argue that "PHMSA did not communicate these 2013 results to Plains until after the Line 901 leak." (PDB31) But, as quoted above, the Complaint cites the regulator's report that it did "raise[] the concern to Plains … during its 2013 inspections." (ROA.3094-95¶227) The Complaint alleges that Plains "[s]till … did not correct the problem." (*Id.*)

Defendants' fact challenges cannot be considered at the pleading stage. They are no basis for affirming the district court's erroneous dismissal.

III. CONCLUSION

For the reasons set forth above and in the Opening Brief, the district court's dismissal of securities claims under §§11, 12(a)(2), and 15 of the Securities Act as well as §§10(b) and 20(a) of the Exchange Act should be reversed.

DATED: October 9, 2018

Respectfully submitted,

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RULE 32(g) CERTIFICATE

The undersigned counsel certified that APPELLANTS' REPLY BRIEF uses a proportionally spaced Times New Roman typeface, 14-point, and that the text of the brief comprises 6,500 words according to the word count provided by Microsoft Word 2010 word processing software.

s/Susan K. Alexander
SUSAN K. ALEXANDER

DECLARATION OF SERVICE

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and employed in the City and County of San Francisco, over the age of 18 years, and not a party to or interested party in the within action; that declarant's business address is Post Montgomery Center, One Montgomery Street, Suite 1800, San Francisco, California 94104.

2. I hereby certify that on October 9, 2018, I electronically filed the foregoing document: **APPELLANTS' REPLY BRIEF** with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit by using the appellate CM/ECF system.

3. Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

4. I further certify that some of the participants in the case are not registered CM/ECF users. I have served the foregoing document on the parties to the within action by email addressed as follows:

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I declare under penalty of perjury that the foregoing is true and correct. Executed on October 9, 2018, at San Francisco, California.

s/Tamara J. Love
TAMARA J. LOVE