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Omnicare: The Other Securities Case to be Worried About

In the securities law arena, all eyes are currently focused on the Halliburton case,[1] and whether the U.S. Supreme Court will scrap or modify the "fraud on the market" presumption for reliance in connection with claims brought under the Securities Exchange Act of 1934.

However, the high court also recently agreed to hear a case involving an important issue for Section 11 claims brought under the Securities Act of 1933. In March 2014, the Supreme Court granted certiorari in the case of Omnicare Inc. v. Laborers District Council, which was recently decided by the U.S. Court of Appeals for the Sixth Circuit.

At issue in Omnicare is whether a plaintiff can adequately plead a claim under Section 11 for a misleading or false opinion in a registration statement simply by alleging that the opinion was false. Generally, Section 11 claims are based on strict liability: once it is proven that a registration statement contains a material misrepresentation or omission, liability strictly attaches notwithstanding whether the misrepresentation or omission was innocent (or negligent or reckless).

However, an interesting question arises as to when an opinion in a registration statement is considered false for purposes of Section 11. Certain federal appellate courts have held that an opinion can only be actionable under Section 11 where the plaintiff alleges that the opinion is both objectively false (it turned out to be wrong), as well as subjectively false (the speaker did not believe the opinion to be true at the time it was provided).

In Omnicare, the Sixth Circuit ruled differently, finding that so long as a plaintiff alleges that a registration statement contained a false opinion, the issuer can be held strictly liable for the opinion under Section 11 regardless of subjectivity. If the Supreme Court upholds this decision, it would in effect relax the standards required of Section 11 plaintiffs to assert a claim based on allegedly misleading opinions made by issuers of securities. Such a ruling could also lead to an increase in Section 11 filings under the Securities Act of 1933.

Background

Following the stock market crash of 1929, Congress enacted several statutes in an attempt to protect investors and restore investor confidence in the financial markets. Among these were the Securities Act of 1933 (the "1933 Act" or "Act").

Among other things, the Securities Act of 1933 governs an issuer's duty to provide accurate information in registration statements for newly issued securities. The aim of the statute is to ensure that investors are informed of "the facts concerning securities to be offered for sale" and to provide "protection against fraud and misrepresentation."[2]

Section 11 of the Act creates an express private right of action for when an investor purchases a security pursuant to a registration statement that was either materially misleading or omitted material information. The actionable misrepresentation or omission must be contained (or omitted) in either the registration statement or the prospectus for the offered security.

Investors who have standing to sue under the Act are those that purchased or acquired securities traceable to the registration statement. Typically, this will frequently involve an investor's purchase in the initial offering of a debt or equity security, although this is not always the case.

If the securities are already publicly traded and are not traceable to a registration statement, the investor will lack standing to pursue a claim under the 1933 Act (however, the investor could still potentially pursue a claim under the Securities Exchange Act of 1934).[3]

If a registration statement contains a misleading statement or material omission, then several different individuals or entities can be liable under Section 11(a) of the Act, in addition to the issuer. These include:

1. any signer of the registration statement;
2. any directors or partners of the issuing entity at the time of filing the registration statement;
3. any persons who, with his or her consent, is named in the registration as being or about to become a director or partner of the issuing entity;
4. any auditors or appraisers for the security; and
5. every underwriter for the security.[4]

One key difference between the 1933 Act and the Securities Exchange Act of 1934 is that the 1933 Act has easier pleading standards than the 1934 Act, presenting what the U.S. Supreme Court has called a "minimal burden."[5] In contrast to the Securities Exchange Act of 1934, the 1933 Act does not require that the plaintiff allege scienter, loss causation or reliance.[6] So long as the registration statement contains a material misrepresentation or omission, the defendants are strictly liable under the 1933 Act.[7]

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Clearly, under the current law, there is no doubt that if a registration statement contains a material misrepresentation or omission, then the defendants are strictly liable under the 1933 Act. Facts are either true or false, and if a plaintiff alleges that a fact within a registration statement is false, they will have generally met their pleading burden under Section 11.

However, an interesting question is presented when one considers opinions or beliefs that are expressed in such statements — what some courts have called "soft information." Can such "soft information" form the basis of the alleged misstatement?[8] Is an opinion "untrue" simply because the assessment at the time ("The company believes that it has complied with all applicable regulations") ended up being wrong? Or is an opinion "untrue" because the speaker did not subjectively believe it to be true at the time it was provided? The Supreme Court's acceptance of the Omnicare decision for review should resolve this question.

The Supreme Court's Grant of Certiorari in Omnicare

On March 3, 2014, the Supreme Court granted certiorari in Omnicare Inc. v. Laborers District Council to decide the following question:
For the purposes of a Section 11 claim, may a plaintiff plead that a statement of opinion was "untrue" merely by alleging that the opinion itself was objectively wrong as the Sixth Circuit concluded, or must the plaintiff also allege that the statement was subjectively false — requiring allegations that the speaker's actual opinion was different from the one expressed — as the Second, Third and Ninth Circuits have held.

The circuit split arose out of the Sixth Circuit's decision in Indiana State District Council of Laborers v. Omnicare Inc., 719 F.3d 498 (6th Cir. 2013). In Omnicare, the plaintiffs consisted of union pension funds who were investors in a December 2005 offering of 12.8 million shares of common stock offered by Omnicare, the nation's largest provider of pharmaceutical services to long-term care facilities for the elderly in the U.S. and Canada.

As part of the offering, Omnicare issued a Dec. 15, 2005, registration statement with the U.S. Securities and Exchange Commission attesting that the company was in "legal compliance" with all laws and regulations. For example, the registration statement provided that Omnicare's contracts with pharmaceutical companies were "legally and economically valid arrangements that bring value to the health care system and patients that we serve."[9]

However, the plaintiffs alleged in the third amended complaint that Omnicare had been engaged in various illegal activities, including kickback agreements with pharmaceutical firms and the making of false claims through Medicare and Medicaid. Thus, the primary allegation in the third amended complaint was that Omnicare's registration statement of "legal compliance" was materially false and misleading in violation of Section 11 because it led investors to believe that the firm was complying with the law.

In February 2012, the district court dismissed the third amended complaint with prejudice, finding that plaintiffs' Section 11 claims failed to allege that the defendants knew their statements were untrue at the time they were made.[10]

On appeal, the Sixth Circuit reversed, holding that the plaintiffs adequately pled a claim for relief under Section 11 of the Securities Act. The Sixth Circuit recognized that in the context of a Section 10(b) claim under the Securities Exchange Act of 1934, a plaintiff must plead and prove that the defendant knew that the statement at issue was false when it was made. However, the Sixth Circuit held that no such knowledge state is required under the 1933 Act.

In arriving at this decision, the Sixth Circuit honed in on the strict liability nature of Section 11 claims, noting that "[n]o matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim."[11]

The falsity of the registration statement enabled the plaintiffs to plead a viable Section 11 claim and survive a motion to dismiss because it contained an opinion of "legal compliance" that was not true. As such, the Sixth Circuit reversed the dismissal of the plaintiffs' legal compliance claims and remanded the case back to the district court.

Objectively False v. Subjectively False: A Circuit Split

The Sixth Circuit's holding in Omnicare is at odds with the holdings of several other federal circuit courts of appeal, a point acknowledged by both the Sixth Circuit itself and several media commentators.[12] In fact, Omnicare may be in conflict with an earlier Sixth Circuit decision.[13]

Not surprisingly, the defendants' petition for Supreme Court review also made much of the circuit split in trying to convince the Supreme Court to accept the case. The split arises out of the different conclusions reached by the Ninth Circuit in Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156 (9th Cir. 2009), and the Second Circuit in Fait v. Regions Financial Corp., 655 F.3d 105 (2d Cir. 2011).

In Fait, the Second Circuit held that for a plaintiff to plead a Section 11 violation based on an opinion or belief, liability will attach "only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."[14] Under this reasoning, the Second Circuit held that the plaintiffs had not adequately alleged actionable misstatements regarding the defendant's "opinion" of its goodwill because the plaintiffs did not allege that the defendants disbelieved their statements regarding goodwill at the time they were made.

In Rubke, the Ninth Circuit similarly held that opinions on the fairness of a transaction could only be actionable un-

der Section 11 "if the complaint alleges with particularity that the statements were both objectively and subjectively false or misleading."[15] The Third Circuit also appears to be in agreement with the Second and Ninth Circuits.[16]

Much of the disagreement between the Sixth Circuit and the Second, Third and Ninth Circuits stems from their differing interpretations of the Supreme Court's opinion in Virginia Bankshares v. Sandberg, 501 U.S. 1083 (1991).

In Virginia Bankshares, the Supreme Court held that in the context of a claim asserted under Section 14(a) of the Securities Exchange Act of 1934 (which regulates the solicitation of shareholder votes in proxy statements), a statement of opinion or belief could not be actionable — even if the speaker did not believe it to be true — unless the opinion itself was false or misleading.[17] As a result, later appellate courts have interpreted Virginia Bankshares as requiring that statements of opinion must be both objectively false and subjectively false before any liability can attach.[18]

There are, of course, similarities between a registration statement (regulated by Section 11 of the 1933 Act) and a proxy statement (regulated by Section 14(a) of the 1934 Act). For example, at the very least they are both written representations to the public.

However, both courts and commentators have noted that the regulations appear in two different acts, which is sometimes used as a means to distinguish how opinions should be treated under the 1933 Act — a strict liability statute — versus the 1934 Act, which is a statute that requires the pleading of a certain mental state.

In Omnicare, the Sixth Circuit did just that: it criticized the Second and Ninth Circuits for "read[ing] more into Virginia Bankshares than the language of the opinion allows" and for having "stretched to extend" a Section 14(a) case into the context of a Section 11 claim, which is by its very nature a strict liability statute.[19]

Potential Implications

The fundamental issue in Omnicare is whether Section 11 claims based on opinions or beliefs are going to remain truly "strict liability" under the 1933 Act. Supporting the Sixth Circuit's opinion is the plain language of Section 11, which makes no mention of scienter or any state-of-mind requirement.[20]

U.S. Supreme Court precedent is also arguably supportive of the Sixth Circuit's position, such as its decision in Herman v. MacLean & Huddleston, 459 U.S. 375, 382 (1983), where it held that "[l]iability against the issuer of a security is virtually absolute, even for innocent misstatements." Under the Sixth Circuit's reasoning, once a false statement or opinion makes its way into a registration statement, liability attaches absolutely without regard for the defendant's state of mind.

On the other hand, the Second, Third and Ninth Circuits have an argument that under Virginia Bankshares, an opinion or belief can only be "untrue" where the speaker does not have a belief in it. This makes logical sense. There is a reasonable argument that the opinion, "I think the light was green when the car entered the intersection," can only be untrue if the speaker does not, in fact, believe that the light was green. This is so because the statement is phrased by way of an opinion. In the context of Section 11 claims, the Second Circuit appears to believe that an opinion cannot be false from a logical standpoint unless the holder of the opinion did not believe it to be true.[21]

Should the Supreme Court ultimately follow the approach of the Second and Ninth Circuits, a critical question arises as to what will be the necessary standard to sufficiently allege a false opinion claim under Section 11. Applying the Second and Ninth's current approach, if the complaint does not outright allege that the speaker did not believe the opinion at the time it was made, it risks dismissal for failure to allege subjective falsity. Thus far, courts have seemed unwilling to interpret allegations that the defendant "should have known" that its opinion was false as an allegation that the defendant did indeed disbelieve the opinion provided.

For example, in Fait, the Second Court grappled with whether the defendants' evaluation of goodwill constituted the submission of a false opinion. The plaintiffs in Fait attempted to rely on adverse market conditions in the mortgage market to support their allegation that the defendants should have reached a different conclusion regarding their valuation of goodwill.[22]

The Second Circuit rejected this, noting that the plaintiffs failed to allege that the defendants disbelieved their opinions of goodwill at the time they were made.[23] On that basis, the Second Circuit affirmed dismissal of the complaint for failure to allege subjective falsity.

Similarly, in Rubke, the plaintiffs alleged that the fairness opinion submitted by the defendants' advisers stating that a transaction was "financially fair" was false.[24] For support, the plaintiffs alleged that they provided an alternative fairness opinion to the defendants that contradicted the opinions made by the defendants' experts. The Ninth Circuit held that these allegations were insufficient to allege subjective falsity because the plaintiffs failed to allege that the defendants ever read the alternative opinion or failed to believe their own opinion.[25]

What can be taken from these two cases is that, if the Supreme Court ultimately requires that Section 11 plaintiffs allege both objective and subjective falsity for opinion-based claims, an allegation of subjective falsity is going to have to be made directly.

Put differently, an allegation that the defendants "should have known" that their opinion was false is likely to be insufficient. Instead, Section 11 plaintiffs are going to need to allege that the provider of the opinion truly did not believe the opinion at the time it was made.

Section 11 plaintiffs may try to plead subjective falsity simply by alleging that the defendants did not believe their opinion at the time it was made. However, whether such an allegation will be considered sufficient under Supreme Court precedent is a different question.

Specifically, under the Supreme Court's decisions in Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007) and Ashcroft v. Iqbal, 556 U.S. 662 (2009), a complaint filed in federal court must contain sufficient factual allegations to state a plausible claim. Further, under Rule 11 of the Federal Rules of Civil Procedure, an attorney must only make a factual contention in a complaint where the attorney has "evidentiary support" of the contention or is likely to have "evidentiary support after a reasonable opportunity for further investigation or discovery."[26]

Thus, both the pleading requirements of Twombly and Iqbal, coupled with an attorney's ethical obligations under Rule 11, may put pressure on plaintiffs attorneys to conduct a substantial investigation of the facts before making an allegation of subjective falsity.

Ultimately, the Supreme Court will settle this debate when it decides whether subjective falsity is an element of a Section 11 claim based on opinion. If the Supreme Court were to uphold the Sixth Circuit's reasoning in Omnicare, the implications will be very important to financial markets, for several reasons.

- First, it will make it easier for Section 11 plaintiffs to adequately plead a claim for violations of Section 11 in connection with opinions. Smart plaintiffs attorneys would be wise to seek out any opinions, beliefs or other "soft information" within a registration statement or incorporated documents and base its Section 11 case around these.
- Second, a relaxed pleading standard will likely lead to more Section 11 claims being filed against corporate defendants, directors and officers, and possibly their underwriters and auditors.
- Third, if the Supreme Court were to allow the imposition of Section 11 liability simply for the objective component of an opinion, then companies, directors and officers, and even auditors and underwriters may be more hesitant to offer any opinion at all for fear of liability. Such a result would frustrate the goals of the securities regulatory framework, which is one that promotes full disclosure of all material information and should encompass how a company or its management "feels" or what they "believe" about certain developments (which shareholders also want to know).

It is not surprising that the Omnicare defendants' petition for review to the Supreme Court discussed many of these potentially negative consequences in depth. Unfortunately, we will have to wait until the Supreme Court reconvenes for the 2014-2015 term before learning its decision. ■

[1] Halliburton Co. v. Erica P. John Fund Inc., Docket No. 13-317.
[2] S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933).
[3] See In re: Century Aluminum Sec. Litig., 729 F.3d 1104, 1106-07 (9th Cir. 2013).
[4] See 15 U.S.C. § 77k(a).
[5] Herman v. MacLean & Huddleston, 459 U.S. 375, 382 (1983).
[6] Hutchison v. Deutsche Bank Securities Inc., 647 F.3d 479, 484 (2d Cir. 2011).
[7] Id. (noting that issuers are subject to "absolute liability" under the 1933 Act).
[8] See, e.g., In re Ames Department Stores Inc. Stock Litig., 991 F.2d 953, 964 n. 4 (2d Cir. 1993).
[9] Ind. State District Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare Inc., 719 F.3d 498, 501 (6th Cir. 2013) (emphasis in original).
[10] See Ind. State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare Inc., 2012 WL 462551 (E.D. Ky. Feb. 13, 2012).
[11] Id. at 505.
[12] See, e.g., Omnicare, 719 F.3d at 506 ("[W]e decline to follow the Second and Ninth Circuits as a result."); Alison Frankel, The 6th Circuit splits with 2nd and 9th, lowers bar for securities claims, Reuters, May 24, 2013.
[13] See Drew D. Dropkin, Important Conflict Being Overlooked in Omnicare Case, Law360 (March 6, 2014).
[14] Fait, 655 F.3d at 110.
[15] Rubke, 551 F.3d at 1162.
[16] See In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 368 (3d Cir. 1993) ("[S]uch statements of 'soft information' may be actionable misrepresentations if the speaker does not genuinely and reasonably believe them.").
[17] Id. at 1095-96.
[18] See, e.g., Fait, 655 F.3d at 110.
[19] Omnicare, 719 F.3d at 506.
[20] See 15 U.S.C. § 77k.
[21] See Fait, 655 F.3d at 112 ("This approach makes logical sense. Requiring plaintiffs to allege a speaker's disbelief in, and the falsity of, the opinions or beliefs expressed ensures that their allegations concern the factual components of those statements.").
[22] Fait, 655 F.3d at 112.
[23] Id.
[24] Rubke, 551 F.3d at 1161-62.
[25] Id. at 1162.
[26] FED. R. CIV. P. 11.

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