

Second Circuit Holds that Falsity of Estimates of Goodwill and Loan Loss Reserves For Purposes of Sections 11 and 12(a)(2) of the Securities Act of 1933 Hinges on the Speakers' Subjective Belief in the Estimates' Accuracy

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In *Fait v. Regions Financial Corp.*, No. 10-2311-cv, 2011 WL 3667784 (2d Cir. Aug. 23, 2011), the [United States Court of Appeals for the Second Circuit](#) affirmed the dismissal of claims under [Section 11](#) and [Section 12\(a\)\(2\)](#) of the Securities Act of 1933 (“1933 Act”), 15 U.S.C. §§ 77k, 77l(a)(2), alleging that statements concerning goodwill and loan loss reserves contained in a prospectus and registration statement were false and misleading. The Court held that such statements were “opinions” which can be false or misleading only if defendants did not genuinely believe the opinions at the times they were made. This decision is notable because it recognizes squarely that estimates of goodwill and loan loss reserves are inherently subjective and thus constitute “opinions” rather than statements of fact.

Plaintiff Alfred Fait (“Fait”) brought a purported class action on behalf of purchasers of stock issued by Regions Financial Corporation (“Regions”) in an April 2008 securities offering. Plaintiffs alleged that the registration statement and prospectus issued in connection with the offering contained false statements regarding goodwill and loan loss reserves. Specifically, plaintiffs alleged that Regions failed to write down the \$6.2 billion of reported goodwill attributed to its 2006 acquisition of AmSouth Bancorporation (“AmSouth”), despite evidence that serious problems existed in AmSouth’s loan

portfolio. Plaintiffs also alleged that Regions' loan loss reserves from the first quarter of 2007 through the first three quarters of 2008 were materially inadequate and did not reflect the high risk of loss inherent in its mortgage loan portfolio. Plaintiffs alleged that defendants violated Section 11 of the 1933 Act, which imposes liability on issuers and other signatories of 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," and Section 12(a)(2) of the 1933 Act, which imposes liability under similar circumstances with respect to prospectuses.

The [United States District Court for the Southern District of New York](#) dismissed the complaint, holding that measurements of goodwill and loan loss reserves are matters of judgment and opinion as there are no objective standards of value to measure these items. *See Fait v. Regions Fin. Corp.*, 712 F. Supp. 2d 117 (S.D.N.Y. 2010). It went on to find that an opinion is actionable under Section 11 or 12 only if the complaint alleges that the speaker did not truly hold the opinion at the time it was issued. The court dismissed plaintiffs' complaint because *Fait* did not allege that the defendants made statements they believed to be false.

The Second Circuit affirmed. It agreed with the district court that estimates of goodwill and loan loss reserves are inherently subjective and should be considered statements of opinion. Citing [Virginia Bankshares v. Sandberg](#), 501 U.S. 1083, 1095 (1991), the Court held that such statements of opinion are actionable if (a) the statements are false or misleading with respect to the underlying subject matter they address *and* (b) the statements misstate the opinions or beliefs actually held by the parties who issued the statements. Thus, to state a claim, plaintiffs must allege not only the falsity of the opinion (*i.e.*, that it turned out to be wrong), but also that the speaker did not genuinely believe the opinion expressed. Because plaintiffs failed to allege that the Regions did not genuinely believe in the accuracy of the goodwill estimates and loan loss reserves at issue at the times they were reported, the Court agreed that plaintiffs failed to state a claim under Sections 11 and 12(a)(2).

This decision is noteworthy because it clearly categorizes estimates of goodwill and loan loss reserves as opinions, not statements of fact. This is important because claims under Sections 11 and 12(a)(2), unlike claims under [Section 10\(b\) of the Securities Exchange Act of 1934](#), 15 U.S.C. § 78j(b), and [Rule 10b-5](#), 17 C.F.R. § 240.10b-5, do not necessarily require proof that the false or misleading statements were made by the speaker with subjective intent to mislead. By categorizing estimates of goodwill and loan loss reserves as opinions rather than statements of fact, this decision places the additional burden on plaintiffs to prove the speaker's state of mind in a Section 11 and 12(a)(2) claim.

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