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Report from Washington

Supreme Court Considers Pleading Requirements for Section 11 Claims Based on Statements of Opinion

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The Supreme Court heard oral arguments this week in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, No. 13-435, a case in which the Court will determine whether a plaintiff in a private suit against an issuer under § 11 of the Securities Act of 1933, 15 U.S.C. § 77k, may plead that a statement of opinion was "untrue" merely by alleging that the opinion was objectively wrong, or whether the plaintiff must also allege that the statement was subjectively false, requiring allegations that the speaker's actual opinion was different from the one expressed.

Section 11 provides a private right of action for any investor who purchases a security pursuant to a registration statement which "contained an untrue statement of a material fact or omitted to state a material fact . . . necessary to make the statements therein not misleading." 15 U.S.C. § 77k. Section 11 further provides for strict liability and limited affirmative defenses. In *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991), the Supreme Court addressed the question of liability for statements of opinion in the context of a different but related provision, § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n, holding that statements of opinion are actionable under § 14(a) and that plaintiffs must establish proof of objective falsity, in addition to knowledge of falsity, in order to recover under § 14(a). However, because § 14(a), unlike § 11, has been interpreted by lower courts as requiring a showing of scienter for recovery, it is unsettled whether the logic of *Virginia Bankshares* is directly applicable to § 11.

The Second, Third, and Ninth Circuits have interpreted *Virginia Bankshares* to require plaintiffs pursuing recovery under § 11 to allege both that the statement of opinion was objectively false and that the speaker's actual opinion was different from the one expressed, or so-called "subjective falsity." *See Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357 (3d Cir. 1993); *Rubke v. Capital Bancorp Ltd.*, 551 F.3d 1156 (9th Cir. 2009). In the *Omnicare* matter, however, the Sixth

Circuit held that a plaintiff may plead that a statement of opinion was "untrue" merely by alleging that the opinion was objectively wrong. *Indiana State District Council of Laborers and Hod Carriers Pension and Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013) ["*Omnicare II*"]. The Court's decision this term in *Omnicare* should resolve this split and offer guidance as to the correct pleading standard for § 11 claims.

Background

In *Virginia Bankshares*, the Supreme Court considered "the actionability *per se* of statements of reasons, opinion, or belief" under § 14(a) of the Securities Exchange Act of 1934. 501 U.S. at 1090. As implemented by Rule 14a-9, this section prohibits the solicitation of proxies by means of statements that are "false or misleading with respect to any material fact." 17 C.F.R. 240.14a-9(a). The Supreme Court held that statements of reasons, opinions, or beliefs can be actionable under § 14(a) as statements that are false as to a material fact. 501 U.S. at 1095. The Court reserved the question as to whether scienter was a necessary element for a § 14(a) private cause of action, assuming that the jury verdict finding the defendants liable in that case represented a determination by the jury that the directors did not subjectively believe the opinion included in the proxy statement. *Id.* at 1090 n.5. With this assumption in mind, the Court held that a statement of opinion, disbelieved by its maker, is actionable under § 14(a) only if it is also demonstrably false. *Id.* at 1095-96.

Omnicare involves the application of § 11 of the Securities Act of 1933 to the type of statement of opinion that was addressed in *Virginia Bankshares*. Petitioners are Omnicare, Inc., the country's largest provider of pharmacy-related services for the elderly and other residents of long-term care facilities, and individuals who were officers or directors of Omnicare at the relevant time. Respondents are investors who purchased shares of Omnicare stock in Omnicare's December 2005 public stock offering. In the registration statement filed in connection with that offering, Omnicare expressed its belief that it was in compliance with applicable laws, stating "[w]e believe our contract arrangements with other healthcare providers, our pharmaceutical suppliers and our pharmacy practices are in compliance with applicable federal and state laws" and that "our contracts with pharmaceutical manufacturers are legally and economically valid arrangements that bring value to the healthcare system and the patients that we serve." *Omnicare II*, 719 F.3d at 500; Petitioners' Merits Br. 4.

The instant litigation began in 2006, when a lawsuit was filed in the Eastern District of Kentucky on behalf of a putative class of investors in Omnicare stock. Following a series of interim rulings by the Sixth Circuit and remands to the district court, the operative version of

the complaint, which was amended on a number of occasions, asserted only a § 11 claim with respect to the above-mentioned statements regarding compliance with the law expressed in Omnicare's December 2005 registration statement. Respondents alleged that Omnicare's statements about legal compliance were false or misleading at the time they were made because Omnicare was engaged in practices that were illegal. Respondents particularly allege that a number of contractual arrangements amounted to illegal kickbacks, as well as that Omnicare filed false Medicare, Medicaid, and state reimbursement claims. Omnicare has settled separate *qui tam* lawsuits alleging such conduct, but has not admitted liability or wrongdoing as part of any settlement.

The district court dismissed the complaint for failure to state a claim, following the lead of the Second, Third, and Ninth Circuits in holding that subjective falsity is required for a § 11 claim based on a statement of opinion, which was not pleaded here by respondents. The Sixth Circuit reversed in part, affirmed in part, and remanded; most relevantly, it reversed the district court's dismissal of the § 11 claim premised on the statement of legal compliance in Omnicare's registration statement. While recognizing its disagreement with the other circuits that have addressed the question, the Sixth Circuit distinguished *Virginia Bankshares*, focusing on the fact that, under Sixth Circuit precedent, § 14(a) claims require proof of scienter, while § 11 is universally acknowledged to be a strict liability provision. The Sixth Circuit held that it was inappropriate for the district court to require respondents to plead subjective knowledge to make out a § 11 claim, and that a § 11 plaintiff need only plead objective falsity. *Id.* at 506.

On March 3, 2014, the Court granted Omnicare's petition for writ of certiorari. Omnicare's petition argued that the Sixth Circuit's decision contradicts the precedent of *Virginia Bankshares* and other circuit court decisions, which Omnicare asserts require both objective and subjective falsity before § 11 liability may attach for a statement of opinion. On June 12, 2014, the United States filed a brief as amicus curiae, asserting its interest in the interpretation of the securities laws, particularly given the potential impact of this litigation on SEC enforcement actions. On October 2, 2014, the Supreme Court granted the Solicitor General's motion for leave to participate in oral argument as amicus curiae, allotting 10 minutes to the United States, to be subtracted from respondents' time for argument.

Summary of the Argument

At oral argument, counsel for Omnicare stressed that under their reading of the *Virginia Bankshares* precedent, the only fact that is communicated by a statement of opinion is the fact that the speaker in fact holds that opinion. When asked by the Chief Justice if putting

"Why isn't it . . . implicit that when somebody -- when an issuer puts something in a registration statement, that the issuer has acted with diligence in making that statement?"

— Justice Ginsburg

"we believe" before an otherwise factual statement, such as "we believe that we have 3.5 million units of inventory," would inoculate the statement from liability absent subjective disbelief, counsel replied "probably," which was greeted with incredulity by the Chief Justice. Justices Breyer and Ginsburg queried whether, given the formal context of a registration statement, the kind of statements at issue in this case carried an implication that the speaker had at least made an investigation into the subject matter of the opinion. Justice Breyer offered the analogy of a scientist who stated that in his opinion a set of bones belonged to one species of dinosaur and not another; would a listener not reasonably believe, based on that statement, that the scientist had at least examined the bones? Omnicare's counsel maintained that the lack of a basis for an opinion amounted only to circumstantial evidence that the speaker did not actually hold the opinion, but could not independently be considered a false statement of fact. When asked by Justice Alito which person's subjective belief would be examined in the context of a registration statement issued by a corporate entity, Omnicare's counsel replied that existing case law for similar questions in the context of the securities laws could be a guide, such as in the context of § 10(b) claims.

Justice Kagan picked up on a latent issue of pure textual statutory interpretation in this case. The language of § 11 makes actionable a registration statement which "contained an untrue statement of a material fact or omitted to state a material fact . . . necessary to make the statements therein not misleading." 15 U.S.C. § 77k. Justice Kagan laid out a hypothetical situation in which an issuer's honestly held opinion was that its activities were lawful, but the issuer also knew "that the Government seems to disagree, that your competitors seem to disagree, and that most of the lawyers seem to disagree." She asked why failing to include these facts alongside the legal compliance opinion would not be an omission of a material fact necessary to make the statement of opinion not misleading. Counsel for Omnicare argued that the statutory language is most naturally read to mean that "statements" in the latter part of the above-quoted statutory language refers back to "statement of a material fact" only. Justice Kagan pointed out that the latter language does not say "statements of material fact," just "statements," and so it would seem that material facts necessary to make any statements of opinion not misleading must not be omitted under the language of the statute; however, no other justice picked up on this line of argument. Counsel for Omnicare later used his reserved time to emphasize the policy consequences of respondents' reasoning, including the need for predictability in the strict liability context of registration statements and the possibility that uncertainty in this area could lead issuers to avoid including any statements of opinion in registration statements, leading to less information being communicated to investors. Counsel also reminded the Court that it "has recognized in the securities context, obtaining resolution of these claims on a dispositive motion is often, as a

practical matter, the only way in which defendants can avoid liability because of the pressures of settlement in cases of this variety."

Counsel for respondents began by arguing that Congress designed § 11 to put the financial risk of falsity in a registration statement on the issuer, not on investors. Respondents' counsel was forced to spend a lot of his time clarifying the difference between the government's position—the reasonable basis test—and respondents' position, which is that § 11 provides for liability as long as a statement of opinion is objectively wrong, regardless of any subjective belief or basis for belief by the speaker. Respondents "endorse" the government's position, but also have a broader reading of the statute—a fact that was at times hard to convey, as Justices Breyer and Sotomayor especially seemed more comfortable with the government's narrower spectrum of liability. Counsel went so far as to say that on remand they were prepared to proceed to discovery and "show that a person would not reasonably conclude this activity was legal." Justice Alito seemed concerned about the application of a reasonable basis test, pushing counsel to present a more useful test for the justices to provide for the lower courts than an "open-ended" reasonableness test. Counsel responded that the common law has employed the reasonableness standard for "well over a hundred years," and that while this kind of inquiry is inherently fact-specific it is one the courts are equipped to handle.

The United States also participated in oral argument, arguing for a result that would favor the respondents in this context but trying to stake out a middle ground between the "two extreme positions" offered by the parties. Focusing on the requirement against omissions of material facts necessary to make statements in a registration statement not misleading, the government argued that in the context of a registration statement, a reader would assume that all statements of opinion were made at least with a reasonable basis for the opinion, and thus a failure to state that there was no basis or to state contravening facts would affect the weight the reader would place on the opinion. In an attempt to alleviate Justice Alito's concern about the application of the reasonable basis test, the government explained that it "mean[t] a basis that would be expected under the circumstances." Justice Alito argued that liability by hindsight could still arise under the government's test, at least in a practical sense, because it would be relatively easy for a plaintiff to plead "that the issuer did not make a reasonable investigation because if . . . they had done a reasonable investigation, they would have discovered that X wasn't true." The government responded that the heightened pleading standards for state of mind under *Twombly, Iqbal*, and Federal Rule of Civil Procedure 9(b) would present a sufficient barrier to plaintiffs, but Justice Alito was not convinced. Justice Breyer also expressed concern that the government's proposed test might

"[A]ll you're saying is reasonable, reasonable, reasonable. I -- I would like some more concrete guidance as to what is reasonable."

— Justice Alito

"The alternative, of course, is to issue registration statements that have statements in them of opinion, very detailed, very fact-based, and where people would think some work was being done, and, in fact, far less work has been done than anybody would think was plausible, and they just float right by without attack. Now, isn't the law designed to catch those things?"

— Justice Breyer

make it too easy for plaintiffs to get to the discovery stage, increasing the pressure on defendants to settle even when they might otherwise ultimately prevail.

Throughout the argument, Justices Alito and Kennedy expressed concern about the impact the Court's decision would have on the procedural outcome of the case. As counsel for Omnicare argued, "This is the rarer case in which none of the parties is defending the reasoning of the court of appeals below." Respondents argued that if the Court agrees with their argument, they should affirm the Sixth Circuit's opinion but correct the reasoning below in the Supreme Court's own opinion. The government argued that the Sixth Circuit's opinion was incorrect because it opened the door to liability by hindsight, and thus the Court should vacate and remand. Finally, petitioners clearly desire a reversal of the court below.

Implications

In deciding this case, the Court is expected to clarify whether subjective falsity must be pleaded to state a claim for relief under § 11 for an objectively false statement of opinion in a registration statement. Affirmance of the Sixth Circuit's ruling could substantially expand the potential liability of issuers who include honestly held opinions in registration statements, dis-incentivizing the inclusion of such opinions. Following the rule suggested by the United States could mitigate this increased liability to an extent, but could also lead to new complexities in litigation as courts struggle to determine whether there was a "reasonable basis" for the opinion at the time it was expressed. However, a ruling in favor of Omnicare could make it difficult for investors to successfully challenge any statement in a registration statement that is phrased as an opinion. No matter which way it rules, the Court's decision will have significant impacts on litigation under § 11 going forward.

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