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EXPERT ANALYSIS

A Matter of Opinion: Pleading False Statements Under Section 11

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When company management announces that last year's earnings exceeded the previous year's, it is describing a set of measurable facts that either corresponds to reality or does not. When management says it believes those results stem from the company's emphasis on strict quality control, it is expressing an opinion that may or may not reflect reality. If it turns out that the rise in last year's earnings was not due to quality control, and that by some standard the company's quality control is not "strict," in what sense is management's honestly made statement false or misleading?

Later this year, the U.S. Supreme Court will address whether an allegedly false statement of opinion or belief in a securities registration statement is actionable if the speaker genuinely believed what was stated. In *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund*,[1] the court granted *certiorari* to resolve a split between the 6th Circuit and the 2nd, 3rd and 9th circuits. The court will decide whether plaintiffs asserting claims under Section 11 of the Securities Act of 1933[2] must allege that purportedly false statements of opinion in a registration statement were *both* contrary to fact *and* disbelieved when made.

Although perhaps not as significant for the securities litigation bar and public companies as the court's much-anticipated decision on the continuing viability of the fraud-on-the-market presumption,[3] the court's decision in *Omnicare* will be far-reaching. The result will affect the course of Section 11 litigation, as well as the willingness of issuers, underwriters and auditors to volunteer their opinions in connection with a public offering.

Put simply, the fundamental issue in *Omnicare* is the difference under Section 11, if any, between expressions of opinion or belief and statements of objectively verifiable fact. The 6th Circuit held that because Section 11 is a "strict liability" provision, it has no requirement to prove *scienter* (or intent to deceive). This means a plaintiff can state a claim based on an allegedly untrue statement of opinion or belief — even if it was honestly held — if the statement was, or turned out to be, contrary to fact.[4]

The 2nd, 3rd and 9th circuits, however, have held that expressions of opinion or belief are not actionable unless, in addition to alleging that the statements are objectively wrong, plaintiffs aver that the speakers did not actually believe the statements when made.[5]

All four circuits cite the Supreme Court's decision in *Virginia Bankshares v. Sandberg*[6] but draw different conclusions from the court's reasoning. In *Virginia Bankshares* the court said "directors' statements of reasons or belief … are factual in two senses: as statements that the directors do act for the reasons given or hold the belief stated and as statements about the subject matter of the reason or belief expressed."[7]

Accord or contradiction of the stated belief with the reality regarding the subject matter of the belief can be ascertained by "[p]rovable facts" in many, though not all, instances.[8] According to the court, a statement of belief can also be materially false or misleading if it is "a misstatement of the psychological fact of the speaker's belief in what he says"[9] or, in other words, if the speaker "did not hold the beliefs or opinions expressed."[10]

In the Section 11 case the Supreme Court will consider, the plaintiffs seek to represent a class of investors in Omnicare Inc., a provider of pharmaceutical services to residents of long-term-care facilities in the U.S. and Canada.[11] The plaintiffs allege that the registration statement issued in connection with the company's December 2005 public stock offering was false and misleading.

The statement said, among other things, that the company's "contracts with drug companies were '*legally and economically valid* arrangements.'" The plaintiffs allege that this, and other statements regarding compliance with the law, were untrue, in violation of Section 11.[12] The complaint does not allege, however, that the defendants disbelieved what was said in the registration statement at the time it was filed.

The District Court granted the Omnicare defendants' motion to dismiss the plaintiffs' Section 11 claim on the ground that statements regarding beliefs about a company's compliance with law are generally considered "soft," non-actionable information. Furthermore, the plaintiffs failed to plead a "sufficient factual basis" to support an inference that the defendants knew the claims in the registration statement were false when made.[13]

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The court cited the 6th Circuit's earlier decision dismissing the plaintiffs' claim under Section 10(b) of the Securities Exchange Act of 1934,[14] based on similar public statements about Omnicare's compliance with the law. The claim was dismissed on the ground that those statements were not actionable because the plaintiffs did not adequately allege "that defendants actually knew that the 'legal compliance' statements were false when made."[15]

The court likewise said such statements of opinion could not be material misstatements under Section 11 unless facts supported an inference that the defendants believed the company was *not* in compliance with the law when they made the statement.

The 6th Circuit reversed, saying its earlier ruling in *Omnicare I*, regarding allegedly false statements of opinion about legal compliance, was limited to dismissal of the plaintiffs' Section 10(b) claim. This required allegations of *scienter* and did not apply to "strict liability" claims under Section 11, where the speakers' state of mind is irrelevant.[16]

The 6th Circuit acknowledged that this decision placed it squarely in opposition to the 2nd and 9th circuits' holdings[17] in *Fait v. Regions Financial Corp.* and *Rubke v. Capital Bancorp Ltd.* Both the 2nd and 9th circuits held that a statement of opinion is actionable under Section 11 "only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."[18]

In reaching its conclusion, the 6th Circuit disavowed the 2nd and the 9th circuits' reading of *Virginia Bankshares*, which, it said, led those courts "to extend this Section 14(a) case into a Section 11 context."[19] The opinion in *Virginia Bankshares* "reserved the question whether *scienter* was necessary for liability generally under Section 14(a)."[20]

Given that the *Omnicare* jury found the speakers "did not hold the beliefs or opinions expressed,"[21] the 6th Circuit read the Supreme Court's opinion as tying this to a *scienter* requirement missing from Section 11.[22] The 6th Circuit also dismissed Justice Antonin Scalia's "musings regarding mens rea" as dicta that should not be extended to Section 11 cases.[23]

The 6th Circuit denied a rehearing and a rehearing *en banc*, the defendants petitioned for a writ, and the Supreme Court granted *certiorari* March 3, 2014.

The rule the Supreme Court eventually adopts in *Omnicare* will be important for issuers, officers, directors, underwriters and auditors named as defendants in Securities Act cases. If the court follows the 6th Circuit's approach, it may be harder to end Section 11 litigation at the pleading stage. This would result in extensive discovery, greater legal costs and more time

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lost to management, which would consequently mean more pressure on defendants to settle, regardless of the merits of the case.

In addition, if corporate executives and their advisers face potential liability for expressing honestly held beliefs that later turn out not to be in perfect accord with the facts, they may be less willing to offer even the most solid opinions — or any opinions at all — about their company and its prospects, to the detriment of investors. Such exposure to liability by hindsight is counter to the thrust of the commonsense pleading requirements implemented by courts since passage of the Private Securities Litigation Reform Act of 1995.[24]

On the other hand, the 6th Circuit's concern about adding a *scienter* element to a private right of action under Section 11 is legitimate. There is no question that Section 11 is a strict liability provision, obviating the need to plead and prove that defendants consciously intended to mislead or defraud investors (or were reckless in their disregard of investors' rights to rely on corporate pronouncements). Imposing a requirement to plead *scienter* on Section 11 claims would fundamentally alter the statute and its intended purpose and effect.

The Supreme Court's opinion in *Virginia Bankshares*, however, points to a third option already recognized by the 2nd, 3rd and 9th circuits, and implicitly acknowledged by the 6th Circuit as well in the *Omnicare* case. The *Virginia Bankshares* opinion distinguishes between *scienter* as an element of a claim and the requirements of pleading falsity when the alleged misstatement discloses the speaker's subjective belief rather than an objectively verifiable fact. In that circumstance, a statement of opinion or belief can be false in two senses: if it is wrong about the subject matter of the statement, or if the speaker does not actually believe the statement.

Both the 2nd and 9th circuits held that a statement of opinion is actionable under Section 11 "only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."

Just as the 6th Circuit's requirement that Section 11 claims sounding in fraud be pleaded with Rule 9(b) particularity does not require pleading *scienter*,[25] requiring Section 11 claimants to plead that the statement was both objectively and subjectively false does not impose a *scienter* requirement on the right of action.

Whether the Supreme Court will follow the path it laid out in *Virginia Bankshares* in deciding the *Omnicare* case is of serious concern to investors and corporations alike. Requiring the same standard for pleading false statements of opinion or belief in private actions under the Securities Act and the Exchange Act, regardless of differing *scienter* requirements, is logically consistent. It would also enhance certainty for all actors in the capital markets.

NOTES

[1] *Omnicare Inc. et al. v. Laborers Dist. Council Constr. Indus. Pension Fund et al.,* No. 13-435, *cert. granted* (U.S. Mar. 3, 2014). Neither the author nor any attorney at White & Williams represents a party in this litigation or is in any way involved in the case. The opinions expressed in this article are the author's only and do not represent the views of White & Williams or its clients.

[2] 15 U.S.C. § 77k.

[3] *Halliburton Co. et al. v. Erica P. John Fund Inc.,* No. 13-317, oral argument held (U.S. Mar. 5, 2014).

[4] *Ind. State Dist. Council of Laborers et al. v. Omnicare Inc. et al.,* 719 F.3d 498, 503 (6th Cir. 2013) ("Omnicare II").

[5] *See Fait v. Regions Fin. 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).

[6] 501 U.S. 1083, 111 S. Ct. 2749 (1991) (construing Section 14(a) of the Securities Exchange Act of 1934).

[7] *Id.* at 1092.

[8] *Id.* at 1093.

[9] *Id.* at 1095.

[10] *Id.* at 1090.

[11] This case was first filed in February 2006 and has a long procedural history. Details of that history and the factual background can be found in an earlier 6th Circuit decision and the District Court opinion that led to that first appeal. *See Ind. State Dist. Council of Laborers et al. v. Omnicare Inc. et al.,* 583 F.3d 935, 945 (6th Cir. 2009) ("*Omnicare I*"), and *Ind. State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare Inc.,* 527 F. Supp. 2d 698 (E.D. Ky. 2007).

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[12] *Omnicare II*, 719 F.3d at 501 (emphasis in original). The plaintiffs supported their allegation that the statements about legal compliance were false with averments that the company was later the subject of government investigations. *Id.* at 508.

[13] *Ind. State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund et al. v. Omnicare Inc. et al.,* Civ. A. No. 2006-26 (WOB), 2012 WL 462551 at *4 & *5 (E.D. Ky. Feb. 13, 2012).

[14] 15 U.S.C. § 78j.

[15] *Omnicare I*, 583 F.3d at 947.

[16] *Omnicare II*, 719 F.3d at 505 ("Section 10(b) and Rule 10b-5 require a plaintiff to prove *scienter*, Section 11 is a strict liability statute. ... No matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim.").

[17] *Id.* at 506.

[18] *Fait*, 655 F.3d at 110 (citing *Virginia Bankshares,* 501 U.S. 1083, 1095-96, 111 S. Ct. 2749). Accord *Rubke*, 551 F.3d at 1162 (allegedly misleading fairness opinions "can give rise to a claim under section 11 only if the complaint alleges with particularity that the statements were both objectively and subjectively false or misleading").

[19] *Omnicare II*, 719 F.3d at 506.

[20] *Virginia Bankshares*, 501 U.S. at 1090 n.5.

[21] *Omnicare II*, 719 F.3d at 506 (quoting *Virginia Bankshares,* 501 U.S. at 1090, 111 S. Ct. 2749).

[22] In contrast, the 3rd Circuit found a logical connection between Section 14(a) and Section 11 claims. In *Trump* the 4th Circuit affirmed the lower court's dismissal of complaints brought under the 1933 act and the 1934 act, holding that cautionary language rendered the alleged misrepresentations and omissions immaterial as a matter of law. *Trump,* 7 F.3d at 364. The court said expressions of opinion "may be actionable misrepresentations if the speaker does not genuinely and reasonably believe them." *Id.* at 368. The court supported the application of the bespeaks caution doctrine to the Section 11 and the Section 10(b) claims before it with *Virginia Bankshares*' analysis of statements of opinion under Section 14(a). *Id.* at 372 & n.14 (consideration of Section 14(a) claims "instructive" in considering Section 11 claims "which [also] involve corporate communications in the sale of securities," citing *Basic Inc. v. Levinson*, 485 U.S. 224, 232, 108 S. Ct. 978, 983 (1988), for "adopting the materiality standard under Section 14 for Section 10").

[23] *Omnicare II*, 719 F.3d at 507 (quoting *Virginia Bankshares*, 501 U.S. at 1108-09, 111 S. Ct. 2749 (Scalia, J., concurring) ("As I understand the court's opinion, the statement 'In the opinion of the directors, this is a high value for the shares' would produce liability if in fact it was not a high value and the directors knew that. It would not produce liability if in fact it was not a high value but the directors honestly believed otherwise.").

[24] Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified at 15 U.S.C. §§ 77, 78).

[25] *Omnicare II*, 719 F.3d at 502.

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