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PERSPECTIVE

Federal case over an honest opinion?

By William Sullivan and John Durrant

Scenario 1: A pharmaceutical company issues stock, saying in the registration statement that it believes it can expect continued growth in the sales of a key drug. After the offering, sales of the key drug plummet. The stock drops in value.

Scenario 2: In making a secondary offering of stock, an originator of residential mortgages says that it adamantly opposes discrimination in lending practices. The mortgage originator is sued for discriminatory lending practices, and after several unfavorable rulings at class certification and summary judgment, the bank enters into a global settlement of $1 billion, a materially negative change in the company's finances. The stock drops in value.

Scenario 3: An automobile manufacturer represents in a registration statement that its strategic plan involves selling its cars in all 50 U.S. states. Various states then enact legislation to prohibit such sales because the manufacturer does not sell its cars through dealer networks but sells them directly. The stock drops in value.

Each of the above scenarios involves an issuer making a statement of opinion or belief (not fact) that turns out to be mistaken. In each case, the mistake could mean either: (i) The issuer made statements knowing they were not true; or (ii) the issuer made such statements in good faith, not knowing they would turn out to be mistaken.

On March 3, the U.S. Supreme Court agreed to hear *Indiana State District Council of Laborers v. Omnicare Inc.,* No. 13-435. That case will decide whether a plaintiff can state a claim under federal securities laws regarding a statement of opinion or belief without alleging both objective falsity (i.e., the statements were factually incorrect) and subjective falsity (i.e., they did not believe the statements were true). The court will thereby decide whether an honest statement of opinion or belief is actionable just because it turns out to be mistaken.

An appeal from the 6th U.S. Circuit Court of Appeals, Omnicare arises from a motion to dismiss claims under Section 11 of the Securities Act of 1933. Section 11 provides a civil remedy for material misstatements or omissions in registration statements. Unlike Sections 10(b) and 14(a) of the Securities Exchange Act of 1934, pleading and proving a claim under Section 11 does not generally require any showing of scienter — i.e., intent to defraud, reckless disregard for the truth, or knowledge of falsity. Section 11 also typically requires no pleading or proof reliance. Accordingly, a plaintiff can establish a claim by showing a materially false statement in the offering documents and resulting causation of damage.

In addition to issuers, others can be held liable under Section 11, including officers, directors, accountants and underwriters who help prepare a registration containing false statements. These defendants enjoy due diligence defenses. In effect, this makes defendants other than issuers subject to Section 11 liability only if they fail to prove an absence of negligence. Issuers, however, are often said — perhaps inexactly — to have "strict liability."

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This all may sound simple, but it can be difficult to determine whether statements are actually false. In *Omnicare*, the Supreme Court will address the circumstances under which a defendant can be held liable for statements of opinion or belief.

Omnicare is in the business of distributing pharmaceuticals to long-term care facilities. The plaintiffs have alleged that Omnicare falsely claimed in its registration statement that its arrangements with drug companies were "legally and economically valid" even though Omnicare engaged in a pattern of allegedly illegal conduct in relation to the drug companies, including alleged illegal kickbacks. The plaintiffs did not allege that Omnicare's officers or directors knew the arrangements were not "legally and economically valid."

Prior to the 6th Circuit's decision in *Omnicare*, the 2nd, 3rd and 9th Circuits all concluded that state of mind is relevant in assessing such claims. These circuits each have required a showing not only that such statements turned out to be mistaken, but also that the party making the statement actually did not believe it to be true *at the time* it made the statements. Notably, in making these holdings, these courts have included this requirement quite apart from the "scienter" requirements that are necessary elements of securities fraud cases.

This doctrine has been adapted from *Virginia Bankshares v. Sandberg,* 501 U.S. 1083 (1991), a Supreme Court case that allowed opinion-based claims under Section 14(a) of the '34 Act. In that case, the court examined the extent to which "statements of reasons, opinions or beliefs" can amount to misstatements, noting that "a statement of belief may be open to objection only ... as a misstatement of the psychological fact of the speaker's belief in what he says." The case did not hinge on the scienter requirement of the '34 Act. Rather, it analyzed the requirement of an "untrue statement of material fact" or "an omission to state a material fact" — a requirement found in both securities fraud cases under the '34 Act and misstatement cases under the '33 Act.

Virginia Bankshares stands for the self-evident proposition that statements of opinion are different from statements of fact. The court concluded that statements of opinion are only actionable if a defendant falsely claims to hold an opinion and the opinion is materially misleading. In this way, the court required pleading and proof of both subjective and objective falsity. The 2nd, 3rd and 9th Circuits found this reasoning applicable in the Section 11 context, because Section 11 of the '33 Act — like Sections 10(b) and 14(a) of the '34 Act — requires a materially false statement or omission.

In its May 23, 2013, *Omnicare* decision, the 6th Circuit broke with these other circuits. The 6th Circuit stated that "Section 11 ... provides for strict liability when a registration statement contain[s] an untrue statement of a material fact." It relied on the broad statements in *Huddleston v. Herman & MacLean*, 459 U.S. 375, 381-82 (1983), to the effect that "liability against the issuer of security is virtually absolute, even for innocent misstatements." The 6th Circuit concluded that Section 11 is a strict liability statute, even in regards to statements of opinion and belief. "No matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim." In this way, believing that *Virginia Bankshares* is confined to the '34 Act, the 6th Circuit refused "to extend" it to Section 11.

While plaintiffs have long encouraged courts to disregard any arguments that Section 11 claims require any pleading or proof of state of mind because it's a "strict liability" statute, the 6th Circuit was the first circuit court to actually endorse this view. Defendants have long argued and courts have long accepted that pleading and proving a claim requires more than merely showing that the statement of opinion or belief turned out to be wrong. Such a standard would seem even more severe that "strict liability," punishing defendants for misguided beliefs or insufficient clairvoyance. Fear of liability may encourage issuers to avoid making any statements of opinion or belief, even where it may help investors.

For this reason, 6th Circuit's decision seems to depart from not only prior case law, but also from reason. Opinions and statements of belief are not true or false like objective statements of fact. That is less a proposition of law than one of common sense. And it makes absolutely no sense to have an issuer indemnify shareholders when the issuer's honestly held opinions and beliefs turn out to be wrong.

While it is impossible to predict what the court will do, most observers seem to expect that the Supreme Court will reverse, applying V*irginia Bankshares* and barring claims arising from non-factual statements, absent a showing that such statements were not actually held by the parties making the statements.

It will be interesting to see if the Supreme Court passes at all on how statement of opinion and belief should be evaluated for defendants other than issuers, officers, and directors. Auditors and underwriters are often added as additional, deep-pocketed defendants in Section 11 cases. Such parties have due diligence obligations regarding an offering. But even the best due diligence may not reveal whether an issuer's opinions and belief are honestly held. Such defendants arguably should have even broader protections against liability for an issuer's non-factual statements.

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